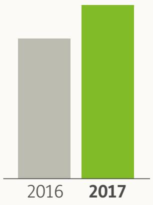
Annual Report and Accounts 2017

The experts in specialist lending

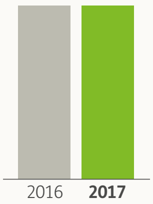
Highlights

Gross new lending
+14%
2017: £2.6bn
2016: £2.3bn

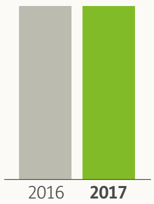
Net loan book
+23%
2017: £7.3bn
2016: £5.9bn



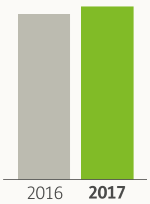
Net interest margin
Stable
2017: 316bps
2016: restated 316bps[2]



Cost to income ratio
Stable
2017: 27%
2016: 27%[2]

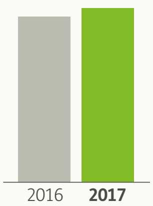


Profit before tax
+3%
2017: £167.7m
2016: £163.1m[1]



Underlying profit before tax
+21%
2017: £167.7m
2016: restated £138.2m[2]

Basic EPS
+3%
2017: 51.1p
2016: 49.4p



Underlying basic EPS
+23%
2017: 51.1p
2016: 41.7p

For more information and definitions, see Key performance indicators on page 26

1. In 2016, profit before tax included net gain from exceptional items of £24.9m.
2. Prior to 2017, OSB deducted coupons on equity Perpetual Subordinated Bonds ('PSBs') accounted for as dividends from underlying profit before and after tax, net interest margin and cost to income ratio. Following a review of market practice in advance of the Bank's AT1 issue in May 2017, OSB no longer deducts these coupons from the calculation of these key performance indicators. The comparatives have been restated accordingly. Interest payments on AT1 securities classified as dividends are treated in the same way.

Who we are

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

Full year dividend per share
+22%
2017: 12.8p
2016: 10.5p

Fully-loaded common equity Tier 1 ratio
Strengthened
2017: 13.7%
2016: 13.3%

Customer satisfaction (NPS)
+3
2017: +62
2016: +59

Our investor site gives you direct access to a wide range of information about OSB:

www.osb.co.uk

I am delighted to welcome you to OneSavings Bank's Annual Report for 2017.

As the new Chairman of the Board, I am delighted to introduce the Annual Report for 2017, which has been an exceptional year of earnings and loan book growth for OneSavings Bank.

In another year of regulatory and tax changes, our clear strategy to be a leading specialist lender continues to be successful. The shift towards professional landlords in the private rental sector plays to our strengths and will continue to provide a solid foundation for our Buy-to-Let business.

Additionally, we believe there to be opportunities in 2018 for the Bank to grow in additional residential and commercial market sub-sectors where we have established capabilities.

There has been significant change in our share register during 2017 and I welcome new investors. I am pleased with the positive reaction of the market and existing investors as the principal shareholder reduced its holding from c.50% to c.10% of share capital.

We continue to generate sustainable returns for investors and develop a healthy and strong business for all stakeholders.

David Weymouth
Non-Executive Chairman

Key reads

Chief Executive Officer's statement
Continued strong performance
Page 4

Market review
Page 8

Our business model
Page 10

At a glance

Our business

Buy-to-Let and SME lending

2017 Buy-to-Let/SME

Net loans and advances	Gross new lending	Average book LTV at 31 December
£5.6bn	**£2.4bn**	**69%**
2016: £4.1bn	2016: £1.9bn	2016: 69%

Buy-to-Let mortgages

We provide loans to limited companies and individuals, 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. Loans are staged, with monitoring surveyors signing off each stage of the development before funds are released.

Funding lines

We provide funding lines (loans) to non-bank finance companies secured against portfolios of financial assets, principally mortgages and leases.

For more information go to the Operating and financial review on page 22

Residential mortgage lending

2017 Residential mortgages

Net loans and advances	Gross new lending	Average book LTV at 31 December
£1.7bn	**£0.2bn**	**56%**
2016: £1.9bn	2016: £0.4bn	2016: 58%

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. We are also experts in shared ownership, lending to first-time buyers and key workers buying a property in conjunction with a housing association.

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.

Funding lines

We provide funding lines to non-bank lenders who operate in high yielding, specialist sub-segments such as residential bridge finance.

For more information go to the Operating and financial review on page 24

Retail savings

2017 balance by channel

Direct	Online	Branches
41%	36%	23%
2016: 37%	2016: 32%	2016: 31%

Online
We attract retail savings deposits via the internet.

Direct
The direct channel sources savings products via telephone and post.

High street branches
Our Kent Reliance branded network operates in the South East of England and offers a variety of fixed, notice, easy access and regular savings products, including ISAs.

For more information go to One fair place to save on page 16

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 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 (commenced trading in January 2014).

Prestige Finance

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

osbIndia

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

You can find more about us by visiting our website **www.osb.co.uk**

Chief Executive Officer's statement

Continued strong performance

Underlying earnings per share

51.1p

+23%

2016: 41.7p

Dividend per share

12.8p

+22%

2016: 10.5p

I am delighted to report another excellent year for OneSavings Bank ('OSB'). The Group's clear strategy and unique business model have proven robust as we successfully navigated significant regulatory and tax changes during the year. Underlying basic earnings per share grew by 23% to 51.1 pence with underlying pre-tax profit up by 21% to £167.7m. We finished the year with a strong balance sheet, a high quality secured asset portfolio and an excellent reputation for customer service. Our strategy continues to provide the platform for us to grow and develop our business.

The Group grew its loan book by 23% to £7.3bn in 2017, whilst maintaining its strong discipline on understanding and pricing for risk, and delivering a stable net interest margin ('NIM') of 3.16% for the year.

Balance sheet growth was achieved whilst delivering a best in class return on equity of 28% and a low cost to income ratio of 27%. Our Common Equity Tier 1 ('CET1') capital ratio increased to 13.7% from 13.3% in 2016, demonstrating the strength of our organic capital generation capability to support significant growth through profitability. I am very pleased that we further optimised our capital structure through the issuance of £60m of Additional Tier 1 securities ('AT1 securities') in May 2017.

The Board is recommending a final dividend of 9.3 pence per share. Together with the interim dividend of 3.5 pence this gives a total dividend per share for the year of 12.8 pence, in line with our stated dividend policy.

Best specialist lender
OneSavings Bank continued to grow its loan book through its specialist lending brands, with total organic origination up by 14% in 2017 to £2.6bn. Our core Buy-to-Let lending sub-segment grew by 39% to £5.0bn, with our target audience of professional landlords continuing to deliver strong application and completion volumes.

This performance has been achieved despite the overall Buy-to-Let market shrinking in response to tax and regulatory changes. These changes have reduced the attractiveness of the sector to amateur investors, whilst largely maintaining the interest of professional landlords, and have driven the reduction in gross advances from £40.6bn in 2016 to £35.8bn[1] in 2017. In this context, the Bank's performance demonstrates the sustainable strength of our proposition targeted at professional landlords, particularly our specialist, manual underwriting, and our deep relationships with mortgage intermediaries.

New Buy-to-Let mortgage origination increased during 2017, reflecting our specialism and expertise in lending to limited companies and large portfolio landlords. Professional/multi-property landlords accounted for 80% of completions for OSB by value during 2017, up from 75% in 2016.

We have also seen significant growth in the commercial side of our Buy-to-Let/SME segment. Organic origination grew to £176m, as we focused on innovation and building scale in our established InterBay Commercial business. In March, we successfully piloted an entry to the bespoke bridging market, again leveraging the Bank's strengths in asset risk assessment and manual underwriting.

We saw a reduction in originations in the residential segment in 2017. This contributed to the first charge gross loan book reducing to £1,241m from £1,322m in 2016, with new organic lending more than offset by redemptions in the back book and acquired mortgages in run-off. However, we see opportunities for growth in the residential market in 2018 and beyond.

I am pleased that our more cyclical commercial businesses continued to perform strongly. The Bank's Heritable Development Finance business provides development finance to smaller residential developers, with a preference for forging relationships with those active outside prime central London. The business continued to grow in 2017, in spite of new entrants to the market, as customers sought an experienced and pragmatic lender.

In addition, we have also grown the provision of secured funding lines to other lenders that operate in certain high yielding, specialist sub-segments, such as residential bridge finance and asset finance.

Whilst we continue to carefully consider inorganic acquisition opportunities, market pricing did not meet our high return targets during the year.

Our broker net promoter score ('NPS') recovered from the short-term negative NPS of -7 in the first half of the year, the result of a surge in Buy-to-Let volumes. For the second half of the year, our NPS was +25.

1. UK Finance, New and outstanding buy-to-let new mortgages, 2 Feb 2018.

We continue to deliver exceptional performance and reinforce our position as a leading specialist lender, supported by our stable, long-standing retail savings franchise and efficient, scalable back office function.

We made significant investment in our sales capability and continued to gain recognition from mortgage customers and intermediaries, winning multiple awards during the year. I am particularly pleased that OSB won the Mortgage Strategy Awards, Best Specialist Lender and The Mortgage Introducer Awards, Specialist Lender of the Year in 2017.

To encourage greater levels of retention amongst borrowers reaching the end of their initial product term, OSB offers a mortgage product transfer scheme ('Choices'). Under this programme, borrowers are encouraged to engage with their broker to receive advice and select from a bespoke product set. Since the implementation of the scheme in mid-2016, we have seen a consistently strong proportion of our borrowers choose a new product within three months of their initial product ending, at around 60% by December 2017. This is driven by success in switching borrowers who were otherwise remaining on standard variable rate ('SVR') and who, by definition, were therefore in the market for other lenders.

Sustainable funding model with award-winning savings
Our stable and award-winning retail funding franchise continues to support lending growth, with retail deposits up 12% to £6.7bn during the year. Over 27,000 new savings customers joined the Bank during 2017 and our successful programme of creating long-term savings relationships by offering market competitive rates to all customers, including those with maturing fixed rate bonds and ISAs, continued to deliver a very strong 90% retention rate. The strength and fairness of our retail savings proposition, coupled with excellent customer service and high retention rates, continues to allow the Bank to raise significant funds without needing to price at the very top of the best buy tables and provides a consistent and stable source of liquidity.

I am delighted that Kent Reliance has been recognised by Moneyfacts in 2017 as the Best Cash ISA Provider for the fifth year running. The Bank also received the ISA Provider of the Year Award from Consumer Moneyfacts for the second consecutive year. These awards are a testament to our savings proposition and to the outstanding customer service delivered by our staff.

Chief Executive Officer's statement continued

We continue to gain recognition among customers and intermediaries, winning multiple awards during the year.

The Bank remained predominantly retail funded during 2017, with a loan to deposit ratio for the year of 92%[2] delivering on our strategy to primarily fund our loan book using retail deposits. We continued to make judicious use of the Bank of England's Funding for Lending Scheme ('FLS') and the Term Funding Scheme ('TFS'), drawing down additional net funding of £624m in the year. The Bank completed its planned transition out of the FLS into the TFS by year end. As at 31 December 2017, TFS drawdowns stood at £1.25bn.

Leveraging our unique business model

As the Group has grown, costs and efficiency have remained a key focus for the business, resulting in a stable cost to income ratio of 27% (2016: 27%[3]) despite significant investment during the year. We continued to invest in our risk management and modelling capabilities in preparation for IFRS 9 and our planned internal ratings-based ('IRB') application. We also invested in technology to offer an automated solution to brokers to help the Bank meet the PRA's new specialist underwriting rules in an efficient way.

OSBIndia continues to undertake a range of primary processing services at a significantly lower cost than an equivalent UK-based operation and with very high quality levels. I am especially pleased that we achieved this whilst maintaining our focus on customers, borne out by an increase in customer NPS to an outstanding 62 (2016: 59).

We continue to differentiate ourselves from the competition by offering well-defined propositions in high margin, underserved markets, where we have the experience, as well as the internal and intermediary infrastructure, to successfully develop and service those markets.

Building our business for the future

The Group continued to exercise strong diligence over loan and customer assessment. The loan loss ratio fell to 7bps in the year to 31 December 2017 (2016: 16bps) mainly due to assumption updates that took place in 2016. We remain particularly pleased with the performance of the front book of mortgages. From more than 38,500 loans totalling £8.3bn of new organic originations since the Bank's creation in February 2011, we have only 137 cases of arrears over three months in duration, with an aggregate balance of £18.4m and an average loan to value ('LTV') of 63%, reflecting the continued strength of the Bank's underwriting and lending criteria.

2. Excluding the impact of TFS/FLS drawdowns. The unadjusted ratio was 109% as at 31 December 2017 (2016: 100%).
3. Prior to 2017, OSB deducted coupons on equity Perpetual Subordinated Bonds ('PSBs') accounted for as dividends from underlying profit before and after tax, net interest margin and cost to income ratio. Following a review of market practice in advance of the Bank's AT1 issue in May 2017, OSB no longer deducts these coupons from the calculation of these key performance indicators. The comparatives have been restated accordingly. Interest payments on AT1 securities classified as dividends are treated in the same way.

The weighted average LTV of the overall mortgage book remained low at 64% at the end of 2017, with an average LTV of 69% on new origination during the year.

In 2017 we saw the market adjusting to the new Buy-to-Let underwriting standards, including ensuring that lenders reflect the changes to personal tax on landlords within their affordability assessments. We have seen a clear trend for borrowers to seek to mitigate this by opting to borrow via a limited company during 2016 and 2017, with a continued increase in the proportion of purchase applications via limited companies for our main Buy-to-Let brand, Kent Reliance, to 69% in 2017. The Group has always specialised in lending to limited companies, and given market trends, this gives us a competitive advantage over those lenders without such a capability.

From 1 January 2017, The Prudential Regulation Authority ('PRA') required lenders to adopt more stringent affordability assessments. We have always assessed affordability for borrowers through our specialist underwriting model and applied stringent stress tests, so were well-placed to benefit from these changes. This can be seen in our weighted average interest coverage ratio ('ICR') for Buy-to-Let origination during 2017, which increased to 185%, demonstrating our cautious approach to the assessment of customer affordability.

Further market-wide measures to strengthen underwriting standards were implemented from October 2017. We already substantively met the regulatory requirements for assessment of landlords with four or more mortgaged properties, and sought to enhance this proposition through the use of technology, creating a simple and automated way of providing comprehensive portfolio information. This has been embedded within our underwriting process to create a strong proposition for brokers and borrowers alike.

These measures, and an expectation of further interest rate rises, also caused a shift in the demand amongst our professional landlords towards five-year fixed rate products which accounted for c.43% of our Buy-to-Let completions in 2017. Competition has increased in this area, and the market has not yet fully repriced following the Bank of England base rate rise in November 2017 or for subsequent widening of swap spreads, putting pressure on margins.

Outlook

Trading conditions in our core markets are positive and current application levels are strong. In line with UK Finance forecasts, the overall Buy-to-Let market is expected to contract further in 2018, however, we expect to continue to grow market share through the relevance of our proposition to professional landlords.

The Group's IFRS 9 models and first generation IRB models were delivered on schedule in late 2016 and we ran the models in parallel throughout 2017. We remain pleased with progress towards our IRB application and also welcomed the recalibration of risk weights in the final revisions to the Basel III reforms on standardised capital requirements published in December 2017. We believe that these new calibrations combined with the final IRB output floor will be beneficial to the Bank's capital requirements, however we remain cautious until the final rules are adopted.

The market sub-segments targeted by OSB, principally professional landlords, including limited companies, have remained strong despite the overall slowdown in the Buy-to-Let market in 2017. We remain confident in the underlying strength of the Private Rented Sector and believe that we are well-placed as the Buy-to-Let market continues to professionalise in response to tax and regulatory changes. We will continue to concentrate on what we have proven we do best: using our relationships, manual underwriting expertise and secured lending strategy to lend responsibly to our customers.

We see opportunities for growth in other segments of the lending market where we already have expertise and a platform to build from. In particular, we expect to grow commercial and bridge finance lending through our InterBay Commercial brand and see further opportunities to grow our residential lending franchise.

We will remain predominantly retail funded, aiming to fund our loan book through our Kent Reliance savings brand. In addition, we intend to invest in our online savings platform during 2018 to attract a broader customer base and grow SME and other lower cost deposits in future years. Our additional liquidity will continue to come from wholesale funding, and we intend to return to the securitisation market during 2018 following the closure of the TFS in February. We drew down an additional £250m in 2018 before the scheme closed, bringing the total balance to £1.5bn. Over time we will use these different funding sources to optimise our cost of funds.

The pipeline of regulatory change continues to grow, with GDPR and PSD 2 both going live in 2018 and work continuing on IRB and other smaller regulatory projects. We expect to expense c.£7m on regulatory projects in 2018, around double the total in 2017. In addition, we plan to continue to invest in our technology infrastructure, mortgage origination system and online savings platforms to support our future growth strategy and enable us to broaden our reach into adjacent markets, such as sub-segments of residential mortgages, where we see opportunities, particularly once we transition to IRB. All of these projects are expected to lead to a significant increase in operating costs in 2018. However, we expect to offset this in part, by delivering further efficiencies in the cost of running the Bank on a 'business as usual' basis, by continuing to focus on cost discipline and leveraging our unique operating platform in India.

We are now live with IFRS 9 after a successful parallel run throughout 2017. The day one impact of the implementation of IFRS 9 is an increase in the provisions of c.£4m, representing 9bps on the Bank's CET1 ratio as at 31 December 2017, on an end game basis, reflecting the strength of security underpinning our loan book.

Our achievements in 2017 are a testament to the management and staff of OSB and I would like to thank my colleagues for their hard work and commitment throughout the year.

We are a responsible lender and will continue to manage the business prudently.

Looking forward to 2018

Over the coming year, organic lending through the Buy-to-Let segment will remain the key driver of loan book growth, but we expect to grow our residential lending, and our commercial and bridge finance lending through our InterBay Commercial brand.

We expect to deliver net loan book growth in the mid teens in 2018 and NIM of c.3%, reflecting current asset pricing, in particular for five-year fixed loans and an expectation of a rising cost of retail funds after the end of TFS. We anticipate a cost to income ratio of c.30%, reflecting the significant increase in the cost of regulation and planned additional investment in the business.

We start 2018 with a fully loaded CET1 ratio of 13.7% and a proven organic capital generation capability through profitability. We anticipate maintaining a CET1 ratio at a minimum of 12% going forward. Our dividend policy remains a payout ratio of at least 25% of underlying profit after taxation attributable to ordinary shareholders.

Our primary growth strategy remains organic origination, but we continue to look at inorganic opportunities, including portfolio purchases, where they meet the Bank's return hurdles.

I believe that OneSavings Bank is well placed to take advantage of opportunities that arise and we remain capable of generating attractive returns for our shareholders.

Andy Golding
Chief Executive Officer
15 March 2018

Market review

Economic overview

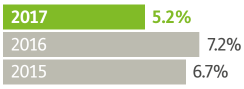
UK Buy-to-Let gross advances

£35.8bn

Source: UK Finance

UK house price inflation

5.2%



Source: ONS, Survey of mortgage lenders

1

The housing market

The housing market in 2017 continued to reflect the uncertainties that emerged in 2016 after the UK's vote to leave the EU. Transaction volumes remained at much the same levels as they have since 2014[1], reflecting ongoing challenges posed by affordability driven by low wage growth and higher house price inflation ('HPI')[2]. 2017 has seen HPI fall back, particularly in London, and it is possible that we may see a return to a moderate level of growth in transactions.

In February 2017, the government issued a long-awaited housing white paper. This reflected a shift in sentiment towards a more holistic approach to property tenure and away from an explicit focus on demand side initiatives that promoted home ownership. The political instability that followed the General Election has, however, left most of the proposed measures untouched. With the housing market remaining in the national spotlight, it is likely that the agenda set out in that white paper will re-emerge.

The mortgage market

According to UK Finance, gross mortgage lending reached £257bn in 2017[3], ahead of the expected figure of £248bn and 4.4% up on 2016, driven largely by an increase in remortgage activity. The larger house purchase market rose by 9% to £139bn.[4]

First time buyers continued to take advantage of Help to Buy, with overall first time buyer lending up by 11% to £59.2bn (2016: £53.5bn).[5] The effect of the Stamp Duty Land Tax ('SDLT') change for first time buyers that was announced in the Budget came too late to have any influence on the market in 2017; however, our view is that any impact will be minimal.

OneSavings Bank's lending markets:

2

UK Buy-to-Let/specialist SME market

The Private Rented Sector ('PRS') accounts for approximately 5.5 million households.[6] In the year to December 2017, it grew by 2.2%, a figure less than a third of that for the same period in 2014 and less than half of what it was in 2016.

This was, of course, a reaction to a series of regulatory and political interventions aimed at cooling the rate of market growth and improving levels of home ownership. In the year, new Buy-to-Let lending of £35.8bn was down 12% on 2016 (£40.6bn).[7] This is, however, within the context of a continuing shortage of housing supply and mortgage regulation that keeps house prices relatively high and mortgage finance beyond the reach of many, thus underpinning strong and sustained demand for rental property.

The PRA changes to affordability assessment and to underwriting standards for portfolio landlords have driven two significant shifts within the Buy-to-Let market. First, we have seen growth in the professional landlord community, at the expense of the amateur. Second, we have seen these professional landlords increasingly prioritise yield, resulting in an increase in Houses in Multiple Occupation ('HMO') and student let lending, coupled with geographic diversification away from the South East, where yields tend to be lower.

Furthermore, professional landlords continue to mitigate the impact of tax changes by borrowing through limited companies. OSB is a respected lender within the specialist Buy-to-Let sector with a strong reputation for limited company lending and that has been beneficial to date and is expected to continue to be so.

Commercial
The UK commercial property market saw investment demand continue to increase during 2017, driven by overseas investors, who accounted for 60% of the whole market, up from around 50% in 2016.[8] Uncertainty caused by Brexit continues to present risks, but there are strong underlying factors which mean the UK, and particularly London, remains attractive to investors. Demand has grown in all sectors except retail, with strong growth in offices, and particularly the industrial sector, which has benefited from the same types of shift – towards e-commerce – that has damaged the retail sector.

Research from JLL shows commercial property investment recorded double digit growth in 2017 to £60bn, although the share of that accounted for by properties over £200m is more than twice as high as 2016, and the proportion of smaller lot sizes has dropped.[9] However, yields in cities across Europe came under more pressure in 2017 compared to London and other regional UK cities, creating the possibility for more activity in the UK during 2018, albeit with growth returning to more 'normal', single digit levels.

The lending market is dominated by the high street banks. Opportunity exists for specialist lenders whose manual underwriting approach, and willingness to engage in a dialogue to ensure robust understanding of customer requirements, can provide a service differential.

Residential development
The UK has experienced a long-term upward trend in real house prices, creating affordability problems as demand for housing continues to outstrip both supply and real wage growth. Furthermore, turnover in the second-hand housing market is subdued.

The housing white paper published in February 2017 refers to a "broken housing market" and identified that "not enough homes are being built" and thus prioritised initiatives that will seek to address this. Notable among the initiatives announced in the white paper were a raft of measures to encourage smaller builders to build more homes, through an improved planning framework. The government also expressed a desire that lenders should "back developers... in building more homes". The white paper represents a holistic assessment of the UK's housing needs, and it is encouraging to note the emphasis placed on supporting the small and medium sized developers who form our core audience for development finance.

3

Specialist residential lending
OneSavings Bank's manual underwriting and individual case assessment model provides a strong platform for specialist residential lending. Customers with unusual asset and income structures, or complex credit histories as well as those seeking shared ownership mortgages, are ill-served by the commoditised and inflexible decision making processes of mainstream lenders. We have identified strategic opportunities in this market that we will pursue in 2018.

Second charge lending
The second charge market saw approximately £1bn[10] of gross new lending in 2017 (2016: £874m). This market continues to adjust to the changes in regulation that came into effect in March 2016 and the short-term outlook is at best neutral; any significant increase in market size is considered unlikely. In this context, we continue to resist the market trend to aggressively chase business through widespread price reductions or relaxation of credit standards, believing the returns available to be insufficient reward for the risks involved.

Funding lines
There are a number of successful non-bank or alternative providers of finance to retail and SME customers in the UK. These businesses are funded through a variety of means including wholesale finance provided by banks, high net worth investors and market based/peer-to-peer finance. OSB is an active provider of secured funding lines to the non-bank finance market, to date focusing on short-term real estate finance, leasing and development finance. Through these activities the Bank has achieved senior secured exposure at attractive returns to asset classes that it knows well. This financing activity covers a broad range of business sectors and its overall size is thus difficult to quantify. OSB sees a regular flow of opportunities, adopts a very selective approach and has a strong pipeline of new business.

1. UK Finance, Property sale transactions, UK countries, PT2, 21 Feb 2018.
2. UK Finance, House price changes, UK countries and regions, HP14, 13 Feb 2018.
3. 4. UK Finance, New mortgages by purpose of loan, ML1, 1 Feb 2018.
5. UK Finance, First-time buyers, new mortgages and affordability, UK countries and regions, ML2, 1 Feb 2018.
6. Kent Reliance Buy-To-Let Britain Report, edition 7, Dec 2017.
7. UK Finance, New and outstanding buy-to-let new mortgages, 2 Feb 2018.
8. 9. JLL, The UK Commercial Property Market, Jon Neale, Jan 2018.
10. FLA, Second charge mortgage new business volumes grow in 2017, 9 Feb 2018.

Our business model

The Group leverages our unique business model to differentiate ourselves from the competition, offering well-defined propositions in our chosen markets. We apply a specialist, personal and flexible approach to our intermediary and customer relationships, focusing on delivering long-term value.

1. Resources and relationships

Brands and heritage
We have a family of specialist lending brands supported by our savings franchise with a 150-year heritage.

Employees
Our team of highly-skilled employees possess expertise and in-depth knowledge of the property and savings markets.

Infrastructure
We benefit from cost advantages provided by our wholly-owned subsidiary OSBIndia.

Relationships with intermediaries
We have strong and deep relationships with the mortgage intermediaries who distribute our products.

Financial
We have a strong equity Tier 1 capital ratio which can support significant loan book growth.

2. What we do

Attractive retail savings
We deliver straightforward products that meet customer needs for cash savings. We offer good and consistent value to attract and retain a loyal customer base, without having to price at the top of the best buy tables.

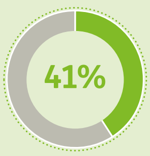
Our proven retail savings performance provides a stable, long-term funding platform to grow our loan book.

How we do it

Our channels:

Online

Direct



High street branches

+

Specialist lending business

We focus on specialist mortgage lending to consumers, entrepreneurs and SMEs in sub-sectors of the UK market where we have identified opportunities for high returns on a risk-adjusted basis and where we can take a leading position.

We adopt an expertise-based, bespoke and manual approach to underwriting in each market sub-sector, specifically geared to each individual customer. We do not use automated or scorecard-based processes for underwriting new loans.

How we do it

Our segments are:

Buy-to-Let/SME lending
77%

Residential lending
23%

Unique operating model

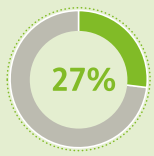
We capitalise on our cross-company expertise, operating under a common operational framework that supports our key lending brands. Distribution, sales, credit and risk processes operate under a simple, coordinated management structure giving us the ability to present our multiple lending brands with great efficiency.

We put customer needs first and drive continuous customer-focused improvement through our flexible and cost-effective operating platform.

How we do it

Our customer service administrative functions are based in our wholly-owned subsidiary OSBIndia.

Cost to income ratio



3. Outcomes and value creation

For shareholders

We aim for strong EPS growth and a dividend payout of at least 25% of underlying earnings.

EPS
51.1p

DPS
12.8p

For employees

We invest in training and development and employee engagement activities to make OSB the best workplace it can be.

Employees promoted in 2017
76

Employees who attended learning events in 2017
685

For customers

We provide a great customer experience and deliver high levels of customer satisfaction.

Customer NPS
+62

Customer retention[2]
90%

For communities

We have well-established community services programmes in the UK and India.

Sponsorship and donations
£209k

1. 25% of underlying profit after tax attributable to ordinary shareholders.
2. Retention is defined as monthly average ratio of maturing contractual retail deposits which withdraw their funds on maturity.

Strategic framework

Our strategic objective

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

Priorities	Our goals	2017 progress
Be a leading specialist lender in our chosen markets	**Grow profitable loan origination in key markets** • Deliver strong end-to-end propositions in target markets • Deliver incremental, non-organic business • Invest in highly responsive, customer-focused culture • Innovate to secure sustainable long-term market leadership	• Buy-to-Let/SME origination up 23% to £2.4bn • £176m originations in commercial lending through our InterBay brand • Received multiple awards including Best Specialist Lender (Mortgage Strategy Awards) and Best Specialist Lender of the Year (The Mortgage Introducer Awards)
Retain focus on bespoke and responsive underwriting	**High quality decisions protecting the business** • Skilled manual underwriting supported by clever technology • Deliver a high quality, differentiated service supported by highly responsive decision-making • Clear decisions recognised by intermediaries for their quality and fairness – a critical friend • Integrated underwriting across all brands	• More than 38,500 loans totalling £8.3bn originated since the Bank's creation in 2011 with only 137 cases of arrears over 3 months, with an aggregate balance of £18.4m and an average LTV of 63% • New technology solution for assessing multi-property portfolios • Transactional Credit Committee met 103 times to assist with more complex or larger new mortgage applications
Further deepen relationships and reputation for delivery with intermediaries	**Increase partner reach in response to demand** • Provide access to specialist products developed by listening to intermediary partners • Be accessible and available to intermediaries • One distribution model across all brands • Gain intermediary recognition for delivering long-term sustainable proposition • Deliver bespoke solutions to meet intermediary and customer needs	• Introduced high tech solution to ease the burden for assessing multi-property portfolios • Success of Choices programme in increasing retention rates in 2017 • Restructured relationship team to increase levels of engagement • Attended c.150 intermediary events across our target geographies • Enhanced marketing and brand support for intermediaries • Published periodic market leading 'Buy-to-Let Britain' reports
Maintain and build upon over 150 years of heritage in savings	**Stable, high quality funding platform** • Be primarily funded through attracting and retaining a loyal retail savings customer base • Provide access to our service for customers through their channel of choice • Ensure liquidity requirements are met through the economic cycle • Deliver a proposition offering transparent, straightforward savings products, providing long-term value combined with excellent service levels	• Gained c27,000 new savings customers • Achieved 90% customer retention • Received multiple awards for savings products including ISA Provider of the Year and Best Cash ISA Provider • Loan to deposit ratio of 92%[1] 1. Excluding impact of TFS/FLS drawdowns.
Leverage unique and cost-efficient operating model	**Best in class customer service** • Put customer service at the heart of everything that we do • Extend activity in OSBIndia, developing high quality areas of excellence • Create structure-delivering solutions using cross-company expertise • Deliver cost efficiencies through excellent process design and management	• Investments in training and process development contributed to enhanced customer NPS of +62 • Increased OSBI headcount by 33% to 366

1. Prior to 2017, OSB deducted coupons on equity Perpetual Subordinated Bonds ('PSBs') accounted for as dividends from underlying profit before and after tax, net interest margin and cost to income ratio. Following a review of market practice in advance of the Bank's AT1 issue in May 2017, OSB no longer deducts these

Looking forward

- Focus on organic growth in underserved sub-sectors
- Further develop commercial lending opportunities
- Enhance proposition in residential lending in light of progress to IRB
- Develop further opportunities in bridge finance
- Identify new market sub-sectors with high returns on a risk-adjusted basis

Key risks

- Market conditions affecting long-term demand
- Increased regulatory pressure
- Continued political uncertainty
- New specialist lenders entering the market

KPI

Loan book £7.3bn

+23%

Looking forward

- Identify additional technology to support decision making
- Continue training and coaching to further strengthen the underwriting expertise of our team
- Maintain focus on consistent decision making outcomes
- Find ways to be even more responsive to intermediaries and borrowers whilst remaining a critical friend

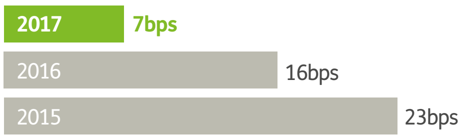
Key risks

- Changing regulation for underwriting
- More complex underwriting requirements
- Difficulty in recruiting experienced staff
- Increasing intermediary demands
- Demands of ever-changing technology

KPI

Loan loss ratio 7bps

improved by 9bps



Looking forward

- Develop enhanced intermediary education programme
- Continue to deliver direct relationships with high quality intermediaries
- Deliver deeper relationships with more of our target intermediaries
- Deliver best in class service performance as we grow and enter new market sub-sectors

Key risks

- Loss of key broker relationships
- Competition reducing pricing below OSB's risk-adjusted return appetite
- More complex underwriting requirements slowing the process

KPI

Gross new lending £2.6bn

+14%

Looking forward

- Enhance service proposition by investing in technology for digital transformation
- Continue to invest in and diversify distribution channels from branches to digital
- Broaden savings propositions further to include wider savings needs

Key risks

- Increased competition for retail funds
- Potential NS&I/government intervention in the market
- Increased customer expectation for technology compared to difficulty and cost of delivery
- Increased burden of regulatory compliance – for example, Open Banking (which currently does not apply to OSB)

KPI

Customer NPS +62

+3

Looking forward

- Extend measurement by benchmarking to best in class
- Introduce robotics technology and improve workflows to further enhance service in primary servicing
- Increase change capacity through enhanced end-to-end project management capability

Key risks

- Difficulty in continuous service improvement as OSB grows
- Global economic uncertainty increasing costs in India
- Increasing complexity from compliance with changing regulation
- Lack of operational resilience due to rapid growth

KPI

Cost to income ratio 27%

Stable despite increasing cost of regulation

1. continued
coupons from the calculation of these key performance indicators. The comparatives have been restated accordingly. Interest payments on AT1 securities classified as dividends are treated in the same way.

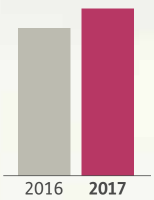
In focus

One specialist lender

Gross new organic lending

+14%

2017: £2.6bn
2016: £2.3bn



We focus on specialist mortgage lending to consumers, entrepreneurs and SMEs in sub-sectors of the UK market where we have identified opportunities for high returns on a risk-adjusted basis and where we can take a leading position.

Sub-sector market specialisation

The markets we focus on are:

- Buy-to-Let
- commercial and semi-commercial
- residential development
- bespoke specialist residential
- second charge residential
- shared ownership, and
- bridging and short-term loans.

OSB also provides funding lines to other lenders. The funding lines business is secured against pools of loan collateral with indirect access to certain high-yielding, specialist sub-segments, such as asset finance and residential bridging finance.

Intermediary relationships

Access to our specialist products and multiple brands is via intermediaries. Relationships are key and partnerships continue to flourish with our panel of selected specialist mortgage intermediaries, who are leaders in their sub-sectors.

We listen to and work with the intermediaries to develop new opportunities and bespoke solutions for our clients. In the year, we developed joint marketing and education campaigns and provided dedicated marketing support.

Our sales team was awarded The Best Business Development Team in 2017 by The Mortgage Strategy Awards.

Inorganic growth

The Group is focused on organic origination as its core growth strategy. In addition, we continue to evaluate selective inorganic opportunities that provide long-term value and meet our strategic objectives. In 2017, the Group made no portfolio acquisitions as market pricing did not meet the Group's stringent return conditions.

Bespoke underwriting

All of our loans are underwritten by experienced and skilled underwriters. At OSB, we do not use automated or scorecard-based processes. We take each loan on its own merits, responding quickly and flexibly to offer the best solution for each of our customers. For this bespoke approach, expertise and going out of our way for our clients, we received the Best Specialist Lender award at The Mortgage Strategy Awards and Specialist Lender of the Year from Mortgage Introducer Awards.

To support this manual and bespoke approach, in 2017 we implemented new technology to reduce administrative burdens on our underwriters and mortgage intermediaries. This provides a simple and speedy solution to enable landlords and brokers to meet the PRA's underwriting standards for portfolio landlords. Implemented in October 2017, the system provides valuations and verifications of entire portfolios in seconds, giving our underwriters high levels of confidence in their valuations.

No case is too complex for us and for those borrowers with more tailored or larger borrowing requirements our Transactional Credit Committee meets twice a week – and in 2017 met 103 times – to demonstrate our responsiveness to broker needs.

What we will do

We will continue to develop our sales and underwriting teams through attracting the top talent and then nurturing it through training and coaching programmes. We will also ensure that our relationships with intermediaries continue to flourish and that we deliver a high quality, differentiated service for our clients.

Our strategy in action

Be a leading specialist lender in our chosen markets

Further deepen relationships and reputation for delivery with intermediaries

EMILY MACHIN
NATIONAL ACCOUNT MANAGER

Our support goes way beyond words

2017 was an important year for me in the newly established role of National Account Manager. Our strategy is to continuously improve our working relationships with our large corporate clients and in 2017 we had a particular focus on the regulatory and market changes that brokers are currently facing.

We were recognised by our intermediaries for being able to assist even in the most complex of cases. One of the things that I am most proud of is how we coordinate our efforts across different parts of the Bank, including marketing and underwriting, to make sure that our support is demonstrated through our service rather than just words.

Of course, this also meant demonstrating how Kent Reliance can help as the Buy-to-Let market becomes more focused on professional landlords and the different demands that this will bring.

In focus

One fair place to save

New savings customers in 2017:

over 27,000

We deliver straightforward products that meet customers' needs for cash savings. We offer good and consistent value to attract and retain a loyal customer base.

Stable funding platform

OSB's proposition for savers is simple; we offer consistently good value savings products to attract and retain a loyal customer base, providing a stable funding platform for the business to grow its loan book. Our retail savings franchise has been a valued and recognised brand for over 150 years.

Transparent savings products

We deliver straightforward products that meet customer needs for cash savings. We offer good and consistent value, without having to price at the very top of the best buy tables. We do not offer 'new customer only' products, and existing customers benefit from loyalty rates.

Our clients can access savings products directly via post, online and in our nine branches. The products offered include fixed term bonds, ISAs, easy access and regular savings accounts. We also offer a childrens' account which supports one of our chosen charities, Demelza Hospice for Children.

We attracted over 27,000 new savings customers during 2017, and retained 90% of maturing fixed term deposit balances, demonstrating the strength of our long-term proposition.

The savings proposition to small and medium sized businesses, launched in 2016, has been very well received and continues to grow, with an average balance per account of nearly £78k.

In 2017, we were recognised by Consumer Moneyfacts as the ISA Provider of the Year and by Moneyfacts as Best Cash ISA Provider for the fifth year running.

Customer-focused philosophy

By maintaining our strong customer-centric approach we are rewarded with a loyal customer base that recognises long-term good value.

We reward our people based on the quality of service they provide to customers, further protecting our retail savings franchise. We measure customer satisfaction and net promoter score ('NPS') through regular customer surveys using independent experts. These measures are aligned to our business strategy and the client NPS score increased to +62 for the year, up from +59 in 2016.

We will continue to invest in enhancing our service in 2018, based on using technology and modern practices to support the brand traits customers have told us they prefer – heritage, trustworthy and traditional. We will also use our real-time customer feedback capability to identify and act on ideas for new products and service improvements.

Our strategy in action

Broaden savings propositions further

Provide access to customers through the channel of their choice

AMANDA LUDLOW
BRANCH NETWORK MANAGER

"Our customers are voting with their feet, and visiting our branches in ever-increasing numbers

Unlike most banks, we are seeing an increase in the number of customers visiting our branches, meaning some are getting a bit crowded. In Maidstone, we tackled this by moving into much larger premises, regenerating a listed building in a popular location on the busy high street.

We haven't just made it bigger though. Listening to our customers has helped us deliver a much improved service, with additional counter space, a larger team and more meeting rooms for private discussions and longer enquiries.

To match the new space, we have employed more local people, further adding to the community we serve. Results so far are positive. In the first full month after opening, customer service ratings for the branch shot up. And the best news is that we are going to do the same for our Canterbury customers this year.

In focus

One unique operating model

NPS +62
up 3

We work to an overarching risk appetite and single Group lending policy spanning all our brands and deliver our services with the aim of providing an excellent customer experience. We put customers' needs first.

Integrated multi-brand approach
We capitalise on our cross-company expertise, operating under a common operating framework that supports our key lending brands. Distribution, sales and risk processes operate under a simple, coordinated management structure giving us the ability to present our multiple lending brands with great efficiency.

We work to an overarching risk appetite and a single Group lending policy spanning all our brands, using our experience in specialist lending to enhance policy. We ensure that risks are modelled and that the comprehensive risk pricing model reflects latest market conditions and forecasts. This modelling ensures all product pricing goes through the same rigorous analysis, according to core principles set by our Group Assets and Liabilities Committee, comprised of senior management.

Cost-efficient operations
Our administrative functions, based in our wholly-owned subsidiary OSBIndia, support the strategic intent of delivering excellent customer experience. We drive continuous customer-focused improvement through our flexible and cost-effective operating platform, putting customer needs first.

Real-time customer satisfaction surveys inform a programme of continuous improvement.

We benchmark our processes against industry best practice, challenging what we do and eliminating customer pain points as they arise. We continue investing in developing skills that enable highly efficient service management, matching those to business needs both in India and the UK.

Investment in infrastructure and systems
We aim to deliver efficient, scalable and resilient infrastructure to support our business strategy objectives. We invest in complementary systems, both proprietary and industry standard, to deliver excellent service (measured against peers by industry experts), outstanding resilience and strong governance. OSB focuses on being a nimble bank with very few legacy issues.

We continue to invest in IT security, supported by market leading data security and resilience experts.

We will continue to leverage infrastructure investment across the Group in 2018, maximising customer and efficiency benefits. We will also ensure infrastructure and systems are regularly reviewed and tested, focusing on their security and resilience in cooperation with industry experts with particular focus on cyber security.

Our strategy in action

Put customer service at the heart of everything that we do

Extend activity in OSBI, developing high quality areas of excellence

NITIN JOSHI
HEAD OF OPERATIONS
OSBI

Not resting on our laurels

We worked hard in 2017 to deliver great customer satisfaction as evidenced in our NPS scores. However, we are not resting on our laurels. We always want to improve customer satisfaction even further.

So we look at all areas of our business. For example, staff retention is really important to us. We invest a lot in training both new staff members and also longer-serving employees of OSBI, continually refreshing and enhancing their knowledge, skills and capability.

Operating and financial review

OneSavings Bank
Group overview

OneSavings Bank delivered another year of strong performance in 2017 which 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, and
- maintain and build on our stable retail savings franchise.

Business highlights

2017 was another year of exceptional performance underpinned by organic originations of £2.6bn at attractive margins, strong risk management and cost-efficiency and discipline.

Net loans and advances grew by 23% in 2017 to £7.3bn. The growth was due primarily to an increase in new lending in the Buy-to-Let sub-segment, as the market became increasingly focused on our core audience of professional landlords. Regulatory change, introducing more complex underwriting standards to the Buy-to-Let industry in 2017, has driven additional business flow to specialist lenders resulting in growth in our market share. This growth was achieved whilst improving the Group's CET1 ratio to 13.7% from 13.3% in 2016, demonstrating the strength of the capital generation capability of the business through profitability. The Group's capital position was further strengthened in May 2017 by the issuance of £60m of Additional Tier 1 capital securities ('AT1 securities'), with the total capital ratio strengthening to 16.9% from 15.1% in 2016 and the leverage ratio also increasing to 6% from 5.5%. The successful issuance of AT1 securities highlights OSB's strong balance sheet and attractive investment proposition to debt investors.

The Group remains focused on organic origination as its core growth strategy and gross new organic lending of £2.6bn in 2017 was up 14% compared with £2.3bn in 2016. OSB continued to experience high demand for its products during 2017, particularly in Buy-to-Let where the Group targets professional landlords with larger portfolios. Buy-to-Let/SME is the Group's largest segment comprising 77% of the gross loan book with Residential Mortgages at 23% as at 31 December 2017. New organic originations in our residential book decreased, which, combined with redemptions in the back book and acquired mortgages in run-off contributed to the first charge gross loan book reducing to £1,240.6m from £1,322.1m in 2016.

The Bank made no portfolio acquisitions during 2017 (2016: portfolios of first and second charge residential mortgages for £180.7m). However, we continue to evaluate selective inorganic opportunities that provide long-term value and meet our strategic objectives when they arise. The Group conducts extensive due diligence when considering any portfolio acquisitions and in 2017, market pricing for deals under consideration did not meet the Group's stringent return conditions.

For all our lending segments, we manually underwrite all risks, providing us with a competitive advantage over more automated lenders, as we are able to identify and understand complex cases that others cannot. The weighted average LTV of the mortgage book remained low at 64% at the end of 2017, with an average LTV of 69% on new origination during the year, reflecting the strength of our balance sheet. Both the loan loss ratio and portfolio arrears rate improved in the year to 7bps and 1.2% respectively (2016: 16bps and 1.4% respectively), further demonstrating our disciplined underwriting and lending criteria. We also have limited exposure to high value properties, with only 4% of our total loan book secured on properties valued at greater than £2m and with an LTV above 65%.

The broker-led Choices mortgage product transfer scheme that we introduced in 2016 has encouraged greater levels of retention among those borrowers reaching the end of their initial product term. Since the implementation of the scheme in mid-2016, we have seen a consistently strong proportion of our borrowers choose a new product within three months of their initial product ending, at around 60% by December 2017. This is driven by success in switching borrowers who were otherwise remaining on standard variable rate ('SVR') and who, by definition, were therefore in the market for other lenders.

The Bank continued to offer secured funding lines to non-bank lenders, however kept a cautious approach in light of macroeconomic uncertainty. Total credit approved limits as at 31 December 2017 were £336.6m with total loans outstanding of £122.1m (31 December 2016: £330.2m and £122.3m respectively). During the year, two new funding lines in the Buy-to-Let/SME segment were extended.

The Group remained predominantly retail funded during the year with a loan to deposit ratio of 92%[1] as at 31 December 2017 (2016: 90%[1]).

Our customer-centric strategy of providing transparent savings products which offer long-term value for money continued to deliver high levels of customer satisfaction and loyalty during the year. Our customer NPS increased to +62 for 2017 and the maturing fixed term bond and ISA balance retention rate remained strong at 90% (2016: +59 and 87% respectively). Retail deposits were up 12% to £6.7bn as at 31 December 2017.

The business savings account, which was introduced in 2016, had a successful year with total deposits constituting just over 1% of the entire savings book, or £69.5m as at 31 December 2017.

Whilst remaining committed to our retail savings franchise, throughout 2017 we complemented it as a funding source by taking advantage of the government funding schemes: Term Funding Scheme ('TFS') and Funding for Lending Scheme ('FLS'). By the end of 2017, the Bank had completed its planned transition out of the FLS into the TFS and as at 31 December 2017, TFS drawdowns stood at £1,250.0m (31 December 2016: TFS at £101.0m and FLS £524.6m). Total funding through the schemes increased by £624.4m in the year.

Financial overview

The Group reported strong profit growth in 2017. Statutory profit before taxation of £167.7m was 3% higher than in 2016 (2016: £163.1m) despite the £24.9m net gain on exceptional items in the prior year. On an underlying basis, profit before taxation increased by 21% to £167.7m (2016: restated £138.2m[2]). This significant improvement in underlying profitability reflects the strength of our lending and funding franchises and our efficient operating model. Statutory and underlying basic earnings per share ('EPS') strengthened to 51.1p (2016: 49.4p and 41.7p respectively).

Our focus on cost discipline and efficiency continued throughout 2017, helping to deliver a very strong cost to income ratio of 27% (2016: 27%[2]) despite increased investment in the business and in meeting the growing cost of regulation.

Return on equity remained strong at 28% (2016: 29%) despite our strengthened capital position.

The Board is recommending a final dividend of 9.3 pence per share, which together with the interim dividend of 3.5 pence per share, represents 25% of underlying profit after taxation attributable to ordinary shareholders for the year, in line with the Bank's stated dividend policy.

1. Excluding the impact of TFS/FLS drawdowns. The unadjusted ratio was 109% as at 31 December 2017 (2016: 100%).
2. Prior to 2017, OSB deducted coupons on equity PSBs accounted for as dividends from underlying profit before and after tax, net interest margin and cost to income ratio. Following a review of market practice in advance of the Bank's AT1 issue in May 2017, OSB no longer deducts these coupons from the calculation of these key performance indicators. The comparatives have been restated accordingly. Interest payments on AT1 securities classified as dividends are treated in the same way.

Operating and financial review continued

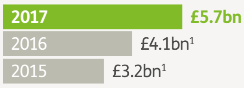
Buy-to-Let/SME

Gross loan book

£5,654.1m

+38%

2016: restated £4,104.3m[1]

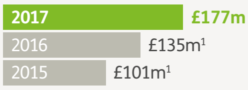


Net interest income

£177.1m

+31%

2016: restated £135.2m[1]

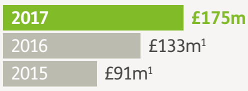


Contribution to profit

£174.8m

+32%

2016: restated £132.9m[1]



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

Buy-to-Let/SME sub-segments: gross loans

	Group 31-Dec-2017 £m	Group 31-Dec-2016 £m
Buy-to-Let	**5,033.8**	3,613.3
Commercial	**370.8**	268.3
Residential development	**143.9**	141.6
Funding lines	**104.5**	71.7
Personal loans[1]	**1.1**	9.4
Total	**5,654.1**	4,104.3

The Buy-to-Let market contracted during the year in response to tax and regulatory changes, which led to increased withdrawal of the amateur landlord from the private rented sector. According to UK Finance, Buy-to-Let gross advances in 2017 fell by 12% to £35.8bn[2] (2016: £40.6bn) with the decrease also reflecting the spike in lending recorded in March 2016 ahead of the Stamp Duty Land Tax ('SDLT') change. Even though the overall Buy-to-Let market shrank in 2017, the demand from professional landlords with larger portfolios continued its momentum, leading to strong growth in our market share over the year from c.4% of new Buy-to-Let mortgages in 2016 to c.6% in 2017. Professional/multi-property landlords accounted for 80% of completions for OSB by value during 2017, up from 75% in 2016.

The Group significantly increased its volume of new organic lending in this segment in 2017 to £2.4bn, an increase of 23% on 2016 new organic lending of £1.9bn. This included a significant increase in the Buy-to-Let and Commercial sub-segments lending through the Kent Reliance and InterBay brands. We continued to see strong growth opportunities, particularly in Buy-to-Let with gross loans of £5,033.8m at 31 December 2017 (2016: £3,613.3m), weighted average LTV of 69% and average loan size of c.£250,000.

A significant proportion of the Buy-to-Let market comes from refinancing. OSB's Buy-to-Let refinancing percentage was 60% during 2017, up from 58% in 2016.

From 1 October 2017, more comprehensive underwriting rules, including affordability assessment for multi-property landlords, came into effect. We have always assessed affordability for borrowers through our specialist underwriting model and apply stringent stress tests. Our weighted average interest coverage ratio ('ICR') for Buy-to-Let origination during 2017 increased to 185% (2016: 171%). The new underwriting rules and an expectation of further interest rate rises also caused a shift in the demand amongst our professional landlords towards five-year fixed rate products, which accounted for c.43% of Buy-to-Let completions in 2017.

In addition, to aid brokers in complying with the new underwriting rules, OSB partnered with a technology provider to develop a bespoke tool for assessing the health of a landlord's overall property portfolio, the first of its kind in the market.

Recent tax changes also had an impact on how borrowers structure their portfolios. In 2016, we saw a clear trend for borrowers to form limited companies in order to mitigate reductions in yield resulting from changes to personal taxation, and in 2017 OSB saw an increase in applications from limited companies for our main Buy-to-Let brand Kent Reliance, from 42% in 2016 to 69% in 2017.

We invested in sales capability across all of our lending brands and attracted new talent from large lenders during the year.

Through the Kent Reliance and InterBay brands, the Bank distributes via intermediaries throughout England and Wales with a bias towards properties in London and the South East, where the demand-supply gap is widest and most sustainable. We have further extended the geographical coverage of our business through investment in the intermediary sales team, ensuring we are seeing appropriate opportunities in other regions.

We have grown our commercial lending with a gross value of the portfolio at £370.8m as at 31 December 2017 (2016: £268.3m), low weighted average LTV of 63% and average loan size of £330,000. In March, we successfully piloted an entry to the bespoke bridging market, again leveraging the Bank's strengths in asset risk assessment and manual underwriting.

The Bank's Heritable Development Finance business provides development finance to smaller residential developers, with a preference for forging relationships with those active outside prime central London. The business continued to grow in spite of new entrants to the market, as customers sought an experienced and cautious lender. However, in line with our prudent approach given macroeconomic uncertainty, the number of potential development schemes which have withstood the business' stringent stress testing has reduced significantly. The residential development funding gross loan book at the end of 2017 was £143.9m, with a further £78.0m committed (31 December 2016: £141.6m and £70.0m respectively). Gross advances during 2017 totalled £123.7m (31 December 2016: £98.4m). Since inception the business has written £479m of loans.

In addition, the Bank continued to grow the provision of secured funding lines it provides to non-bank lenders which operate in certain high-yielding, specialist sub-segments, such as bridging finance and asset finance. Total credit approved limits as at 31 December 2017 were £303.0m with total loans outstanding of £104.5m (31 December 2016: £244.0m and £71.7m respectively). During 2017, two new funding lines were added. The pipeline remains robust, however given the macroeconomic uncertainties, the Bank continues to adopt a cautious approach.

OSB's combined Buy-to-Let/SME net loan book grew by 38% in 2017 to £5,640.9m (2016: restated £4,087.1m[1]) due to the gross new lending in the year, partially offset by back book redemptions, and is the Group's largest segment. Buy-to-Let/SME made a contribution to profit of £174.8m in 2017, up 32% compared to £132.9m[1] in 2016, reflecting the growth in the loan book, and low impairment losses of £0.8m (2016: restated £1.8m[1]).

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 2017 of 69% (31 December 2016: 69%) with only 0.7% of loans exceeding 90% LTV (31 December 2016: 0.4%). The average LTV for new Buy-to-Let/SME origination was 70% (2016: 70%).

1. The personal loan portfolio has largely completed its run-off and is therefore no longer considered as a separate segment by the Group. The remaining net loan book of £0.9m (31 December 2016: £9.1m) and negative contribution to profit for the period of £0.8m (2016: contribution to profit of £2.7m) have been reported in the Buy-to-Let/SME segment with comparatives restated accordingly.
2. UK Finance, New and outstanding buy-to-let new mortgages, 2 Feb 2018.

YEAR ENDED 31-DEC-2017	BTL/SME £m	Residential mortgages £m	Total £m
BALANCES AT THE REPORTING DATE			
Gross loans and advances to customers	**5,654.1**	**1,673.5**	**7,327.6**
Provision for impairment losses on loans and advances	**(13.2)**	**(8.4)**	**(21.6)**
Loans and advances to customers	**5,640.9**	**1,665.1**	**7,306.0**
Risk weighted assets	**2,642.8**	**705.7**	**3,348.5**
PROFIT OR LOSS FOR THE YEAR			
Net interest income	**177.1**	**68.3**	**245.4**
Other income/(expense)	**(1.5)**	**(5.8)**	**(7.3)**
Total income	**175.6**	**62.5**	**238.1**
Impairment (losses)/gains	**(0.8)**	**(3.6)**	**(4.4)**
Contribution to profit	**174.8**	**58.9**	**233.7**

YEAR ENDED 31-DEC-2016	Restated[1] BTL/SME £m	Residential mortgages £m	Total £m
BALANCES AT THE REPORTING DATE			
Gross loans and advances to customers	4,104.3	1,859.9	5,964.2
Provision for impairment losses on loans and advances	(17.2)	(7.8)	(25.0)
Loans and advances to customers	4,087.1	1,852.1	5,939.2
Risk weighted assets	1,944.3	798.7	2,743.0
PROFIT OR LOSS FOR THE YEAR			
Net interest income	135.2	71.4	206.6
Other income / (expense)	(0.5)	(4.7)	(5.2)
Total income	134.7	66.7	201.4
Impairment losses	(1.8)	(7.2)	(9.0)
Contribution to profit	132.9	59.5	192.4

Operating and financial review continued

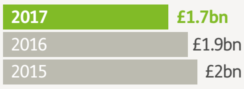
Residential mortgages

Gross loan book

£1,673.5m

-10%

2016: £1,859.9m

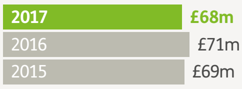


Net interest income

£68.3m

-4%

2016: £71.4m

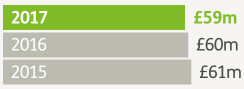


Contribution to profit

£58.9m

-1%

2016: £59.5m



This segment comprises lending to owner occupiers, secured via either first or second charges against the residential home. The Bank provides funding lines to non-bank lenders who operate in high-yielding, specialist sub-segments such as residential bridge finance.

Residential sub-segments: gross loans

	Group 31-Dec-2017 £m	Group 31-Dec-2016 £m
First charge	**1,240.6**	1,322.1
Second charge	**415.3**	487.2
Funding lines	**17.6**	50.6
Total	**1,673.5**	1,859.9

During the year, the Group organically originated residential lending of £243.9m (2016: £382.1m). We saw a significant reduction in originations in the residential sector in 2017. This contributed to the first charge gross loan book reducing to £1,240.6m from £1,322.1m in 2016, with new organic lending more than offset by redemptions in the back book and acquired mortgages in run-off.

Organic lending remains the Group's core strategy, however we continue to actively consider inorganic opportunities as they arise, particularly where we have in-house servicing expertise. However, in 2017, the Group made no acquisitions of portfolios due to market pricing not meeting our return hurdles (2016: portfolios of first and second charge mortgages for £180.7m).

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.

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. Competitive pressure in the second charge market caused price reductions and we allowed our market share to fall to ensure we continue to appropriately price for risk. The second charge residential loan book had a gross value as at 31 December 2017 of £415.3m (2016: £487.2m).

OSB continued to provide secured funding lines to non-bank lenders which operate in certain high-yielding, specialist sub-segments, such as residential bridge finance. The Bank continued its cautious approach in the more cyclical businesses given macroeconomic uncertainty. Total credit approved limits at 31 December 2017 were £33.6m with total loans outstanding of £17.6m (2016: £86.2m and £50.6m respectively). During 2017, one facility of £34.4m matured.

Innovative solutions

As the Bank has grown, we have continued to seek innovative solutions to help maintain our market leading efficiency. The finance team is a great example. We provide a 'one finance team' approach across locations in the UK and India, utilising the strengths that each site provides. We have further realised opportunities with an increasing amount of the financial reporting preparation work undertaken by OSBIndia.

We know that it is important for everyone to feel part of the team. So, as well as regular calls and virtual meetings, members of the Bangalore based team come to Chatham for specific projects such as the Annual Report, to work directly with their colleagues in head office. It bonds the finance team and helps build relationships with other functions across the Group.

The understanding formed by these visits makes sure we have a joined up team, and deliver the true efficiencies from working together.

PREETAM NANDA
FINANCIAL REPORTING ASSISTANT MANAGER

"Market leading efficiency

OSB's total residential loan portfolio had a net carrying value of £1,665.1m as at 31 December 2017 (2016: £1,852.1m). The average LTV remained low at 56% (2016: 58%) with only 3% of loans by value with LTVs exceeding 90% (2016: 3%). The average LTV of new residential origination during 2017 was 65% (2016: 66%).

Residential mortgages made a contribution to Group profit of £58.9m in 2017, down 1% (2016: £59.5m), reflecting the fall in the loan book, partially offset by the benefit of lower cost of funds and impairment losses. Impairment losses in 2016 included the impact of additional prudence in collectively assessed provision assumptions following the EU referendum result.

Key performance indicators

KPI	Definition	2017 performance
1. Gross new lending Performance £2.6bn +14% **2017 £2.6bn** 2016 £2.3bn 2015 £1.8bn	This is defined as gross new organic lending before redemptions.	Gross new lending in 2017 reflects growth in new origination, primarily in the BTL/SME segment.
2. Net interest margin Performance 316bps stable **2017 316bps** 2016* 316bps[1] 2015 309bps[1] * Restated	This is defined as net interest income as a percentage of average interest bearing assets (cash, investment securities, loans and advances to customers and credit institutions), including off balance sheet FLS drawings. It represents the margin earned on loans and advances and liquid assets after swap expense/income and cost of funds.	Net interest margin flat to prior year with lower asset yields in line with the reduced cost of funds.
3. Cost to income ratio Performance 27% stable **2017 27%** 2016 27%[1] 2015* 25%[1] * Restated	This is defined as administrative expenses including depreciation and amortisation as a percentage of total income. It is a measure of operational efficiency.	Cost to income ratio stable despite additional cost of meeting regulatory requirements in 2017 and continues to be market leading.
4. Underlying profit before taxation Performance £167.7m +21% **2017 £167.7m** 2016* £138.2m[1] 2015* £107.4m[1] * Restated	This is defined as statutory profit before taxation before exceptional items. See reconciliation of statutory profit to underlying profit in Alternative performance measures on page 29.	The increase reflects strong balance sheet growth, stable net interest margin, continued focus on cost discipline and efficiency and low loan losses. Statutory profit before taxation of £167.7m in 2017 increased by 3% compared to £163.1m in 2016.
5. Underlying basic EPS Performance 51.1 pence per share +23% **2017 51.1p** 2016 41.7p 2015 34.8p	This is defined as underlying profit attributable to ordinary shareholders, which is profit after taxation before exceptional items less after tax effect of coupons on equity PSBs and AT1 securities, divided by the weighted average number of ordinary shares in issue. See reconciliation of statutory profit to underlying profit in Alternative performance measures on page 29.	The strong growth is in line with the significant increase in underlying profitability of the Bank. On a statutory basis basic EPS increased to 51.1 pence per share in 2017 from 49.4 pence per share in 2016.

KPI	Definition	2017 performance
6. Return on equity Performance 28% -1% 2017 28% 2016 29% 2015 32%	This is defined as underlying profit after taxation and after deducting the after tax effect of coupons on equity PSBs and AT1 securities as a percentage of average shareholders' equity (excluding equity PSBs of £22m and £60m of AT1 securities). For further information on underlying profit after taxation, see reconciliation of statutory profit to underlying profit in Alternative performance measures on page 29.	Return on equity remained strong at 28% (2016: 29%) despite our strengthened capital position.
7. Dividend per share Performance 12.8 pence per share +22% 2017 12.8p 2016 10.5p 2015 8.7p	This is defined as the sum of the recommended final dividend for 2017 plus the interim dividend divided by the number of ordinary shares in issue at the year end.	The Board will recommend a final dividend of 9.3 pence per share in respect of 2017 at the Bank's AGM on 10 May 2018. This, together with the interim dividend of 3.5 pence per share, represents 25% of underlying profit after tax attributable to ordinary shareholders (after deducting the after tax impact of coupons on equity PSBs and AT1 securities) for 2017, in line with the Bank's target dividend payout ratio.
8. CRD IV fully-loaded Common Equity Tier 1 capital ratio Performance 13.7% +0.4% points 2017 13.7% 2016 13.3% 2015 11.6%	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.	The capital ratio of 13.7% reflects the ability of the business to generate capital through profitability to support significant loan book growth.
9. Loan loss ratio Performance 7bps improved 9bps 2017 7bps 2016 16bps 2015 23bps	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.	The improved ratio of 7bps for 2017 (2016: 16bps) mainly reflects the assumption updates that took place in 2016. It also reflects the continued strong performance from the front book of loans, originated by the Bank since its creation in 2011. From more than 38,500 loans totalling £8.3bn of new organic originations since the Bank's creation in February 2011, we only have 137 cases of arrears over three months in duration, with an aggregate balance of £18.4m and average LTV of 63%.
10. Customer satisfaction – net promoter score Performance +62 +3 2017 +62 2016 +59 2015 +55	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.	The Bank's customer NPS across the year for 2017 improved from +59 in 2016 to +62. This demonstrates that our investment in customer service in the UK and India and customer-centric strategy of providing transparent savings products which offer long-term value for money continues to deliver high levels of customer satisfaction.

1. Prior to 2017, OSB deducted coupons on equity Perpetual Subordinated Bonds ('PSBs') accounted for as dividends from underlying profit before and after tax, net interest margin and cost to income ratio. Following a review of market practice in advance of the Bank's AT1 issue in May 2017, OSB no longer deducts these coupons from the calculation of these key performance indicators. The comparatives have been restated accordingly. Interest payments on AT1 securities classified as dividends are treated in the same way.

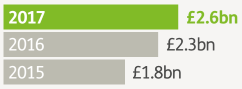
Financial review

Strong growth in gross new organic lending

£2.6bn

+14%

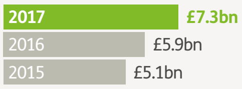
2016: £2.3bn



Net loan book growth

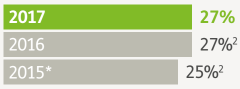
23%

2016: 16%
(20% excluding the impact of Rochester disposal)



Cost to income ratio

27%



* Restated

Strong income growth and continued focus on cost discipline and efficiency

2016: 27%[2]

	Group 31-Dec-2017 £m	Group 31-Dec-2016 £m
SUMMARY PROFIT OR LOSS		
Net interest income	**245.4**	206.6
Net losses on financial instruments	**(6.3)**	(4.3)
Net fees and commissions	**0.5**	1.7
External servicing fees	**(1.5)**	(2.6)
Administrative expenses[1]	**(65.1)**	(53.7)
FSCS and other regulatory provisions	**(0.9)**	(0.5)
Impairment losses	**(4.4)**	(9.0)
Exceptional items	**–**	24.9
Profit before taxation	**167.7**	163.1
Profit after taxation	**126.9**	120.9
Underlying profit before taxation[3]	**167.7**	138.2[2]
Underlying profit after taxation[3]	**126.9**	102.4[2]
KEY RATIOS		
Net interest margin[3]	**316bps**	316bps[2]
Cost to income ratio[3]	**27%**	27%[2]
Management expense ratio[4]	**0.86%**	0.86%
Loan loss ratio[3]	**0.07%**	0.16%
Basic EPS[3], pence per share	**51.1**	49.4
Underlying basic EPS[3], pence per share	**51.1**	41.7
Return on equity[3]	**28%**	29%
Dividend per share, pence per share	**12.8**	10.5

	£m	£m
EXTRACTS FROM THE STATEMENT OF FINANCIAL POSITION		
Loans and advances	**7,306.0**	5,939.2
Retail deposits	**6,650.3**	5,952.4
Total assets	**8,589.1**	6,580.9
KEY RATIOS		
Liquidity ratio[5]	**15.2%**	17.9%
CET1 capital ratio[6]	**13.7%**	13.3%
Total capital ratio	**16.9%**	15.1%
Leverage ratio	**6.0%**	5.5%

1. Including depreciation and amortisation.
2. Prior to 2017, OSB deducted coupons on equity Perpetual Subordinated Bonds ('PSBs') accounted for as dividends from underlying profit before and after tax, net interest margin and cost to income ratio. Following a review of market practice in advance of the Bank's AT1 issue in May 2017, OSB no longer deducts these coupons from the calculation of these key performance indicators. The comparatives have been restated accordingly. Interest payments on AT1 securities classified as dividends are treated in the same way.
3. See definition in Key performance indicators table on pages 26-27.
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.

Alternative performance measures

OSB believes that the use of alternative performance measures ('APMs') for profitability and earnings per share provides valuable information to the readers of the financial statements and presents a more consistent basis for comparing the Group's performance between financial periods, by adjusting for exceptional non-recurring items. APMs also reflect an important aspect of the way in which operating targets are defined and performance is monitored by the Board. However, any APMs in this document are not a substitute for IFRS measures and readers should consider the IFRS measures as well.

Reconciliation of statutory profit to underlying profit	Profit before taxation		Profit after taxation	
	Group 31-Dec-2017 £m	Restated Group 31-Dec-2016 £m	**Group 31-Dec-2017 £m**	Restated Group 31-Dec-2016 £m
Statutory profit	**167.7**	163.1	**126.9**	120.9
Gain on Rochester 1 disposal	**–**	(34.7)	**–**	(25.8)
Exceptional amortisation of fair value adjustments on hedged assets	**–**	9.8	**–**	7.3
Underlying profit	**167.7**	138.2	**126.9**	102.4

Statutory basic EPS of 51.1 pence per share (2016: 49.4 pence per share) is calculated by dividing profit attributable to ordinary shareholders of £124.2m (2016: £120.0m) which is profit after taxation of £126.9m (2016: £120.9m) less coupons on equity PSBs, including the tax effect of £0.7m (2016: £0.9m) and coupons on AT1 securities, including the tax effect of £2.0m (2016: £nil) by the weighted average number of ordinary shares in issue during the year of 243.2m (2016: 243.1m).

Underlying basic EPS of 51.1 pence per share (2016: 41.7 pence per share) is calculated by dividing underlying profit attributable to ordinary shareholders of £124.2m (2016: £101.5m), which is underlying profit after taxation of £126.9m (2016: restated £102.4m) less coupons on equity PSBs, including the tax effect of £0.7m (2016: £0.9m) and coupons on AT1 securities of £2.0m (2016: £nil) by the weighted average number of ordinary shares in issue during the year of 243.2m (2016: 243.1m). Further information can be found in note 12 to the financial statements.

Prior to 2017, OSB deducted coupons on equity PSBs accounted for as dividends from underlying profit before and after tax. Following a review of market practice in advance of the Bank's issuance of AT1 securities in May 2017, OSB no longer deducts these coupons and underlying profit before and after tax for 2016 have been restated throughout this document accordingly.

The table below illustrates the key ratios under previous and current methods and the impact of the change in calculation methodology.

Change in key ratio calculation	**2017 %**	2016 %
Cost to income ratio		
Previous method	**27**	27
Add back coupons on equity PSBs	**(0)**	(0)
Current method	**27**	27
Net interest margin		
Previous method	**3.15**	3.14
Add back coupons on equity PSBs	**0.01**	0.02
Current method	**3.16**	3.16

	2017 £m	2016 £m
Underlying profit before tax		
Previous method	**166.7**	137.0
Add back coupons on equity PSBs	**1.0**	1.2
Current method	**167.7**	138.2
Underlying profit after tax		
Previous method	**126.2**	101.5
Add back coupons on equity PSBs	**0.7**	0.9
Current method	**126.9**	102.4

Financial review continued

Strong profit growth

The Group reported profit growth of 3% in 2017 with profit before taxation of £167.7m (2016: £163.1m including net gain from exceptional items of £24.9m). On an underlying basis, the Bank recorded a 21% increase in underlying profit before taxation to £167.7m (2016: restated £138.2m[1]) reflecting strong balance sheet growth and a stable net interest margin combined with continued focus on cost discipline and efficiency.

Profit after taxation in 2017 increased by 5% to £126.9m (2016: £120.9m including the net gain after taxation from exceptional items of £18.5m). On an underlying basis, profit after taxation increased by 24% to £126.9m (2016: restated £102.4m[1]). The Group's effective tax rate was 24.1%[2] in 2017 (2016: 25.6%), with a lower proportion of the Group's profits subject to the Bank Corporation Tax Surcharge.

Net interest margin

The Group reported an increase in net interest income of 19% to £245.4m in 2017 (2016: £206.6m) reflecting the growth in the loan book and a stable NIM of 316bps (2016: restated 316bps[1]). The stable NIM in 2017 represents a reduction in asset yields in line with the falling cost of funds.

The average cost of retail funds fell year on year, although market rates started to rise again in 2017.

The Bank benefited from a higher average balance in the Bank of England schemes in 2017 versus the prior year and the transition from FLS into the cheaper TFS. As at December 2017, the TFS drawdowns stood at £1,250.0m (2016: £101.0m) and FLS at £nil (2016: £524.6m).

Margins on the Bank's fixed rate mortgage products, particularly five-year fixed rate Buy-to-Let, declined in the fourth quarter of 2017 as the market did not reprice these products following the Bank of England base rate rise and subsequent widening of swap spreads in anticipation of future increases in interest rates.

Losses on financial instruments

Fair value loss on financial instruments in 2017 of £6.3m (2016: loss £4.9m) includes £7.3m amortisation of fair value adjustments on hedged assets relating to cancelled swaps (2016: £4.9m). The amortisation of fair value adjustments in both years includes the impact of accelerating the amortisation in line with the run-off of the underlying legacy long-term fixed rate mortgages due to faster than expected prepayments.

In 2016, the Group also made a £0.6m gain on disposal of a portion of non-performing personal loans with a gross value of £10.9m.

Net fees and commissions

Net fees and commission income of £0.5m (2016: £1.7m) comprises fees and commission receivable of £1.5m (2016: £2.5m) partially offset by commission expense of £1.0m (2016: £0.8m). Fees and commissions receivable decreased in 2017 due primarily to lower arrangement fees on funding lines.

External servicing fees

External servicing fees decreased to £1.5m in 2017 (2016: £2.6m) due to the transfer of servicing for acquired first charge residential loan book to the Bank's operation in India during the year and the further run-off of the personal loans portfolio.

Efficient and scalable operating platform

Administrative expenses including depreciation were up 21% to £65.1m in 2017 (2016: £53.7m), reflecting the growth in the business and the increased demands of regulation, including projects relating to IFRS 9 and an internal ratings based approach to risk weights ('IRB').

The Group's cost to income ratio of 27% and the management expense ratio of 0.86% remained stable (2016: 27%[1] and 0.86% respectively) despite the increased cost of regulation, reflecting the Bank's focus on efficiency and use of its scalable low cost back office based in Bangalore, India.

FSCS and other regulatory provisions

Regulatory provisions expense of £0.9m (2016: £0.5m) includes levies due to the Financial Services Compensation Scheme ('FSCS') which continued to decrease (see note 31 to the financial statements for further details) and other regulatory provisions.

Impairment losses

Impairment losses decreased to £4.4m in 2017 (2016: £9.0m) representing 7bps on average gross loans and advances (2016: 16bps). The decrease was primarily due to increased prudency in assumptions introduced in 2016 following the UK referendum vote to leave the EU, as well as lower underlying loan losses on acquired residential portfolios, and the effect of increasing property values reducing potential loss.

The performance of the front book of mortgages remains strong, reflecting the continued strength of the Bank's underwriting and lending criteria. We kept tight control on credit quality, as seen in our reportable arrears statistics. From more than 38,500 loans totalling £8.3bn of new organic originations since the Bank's creation in February 2011, there were only 137 cases of arrears over three months or more as at 31 December 2017, with an aggregate value of just £18.4m and average LTV of 63%.

IFRS 9

We had a successful parallel run of the IFRS 9 models throughout 2017 and were operating live under the new standard from 1 January 2018. The day one impact of the implementation of IFRS 9 is an increase in the provisions of c.£4m, representing 9bps on the Bank's CET1 ratio as at 31 December 2017 on an end game basis, reflecting the strength of security underpinning our loan book. The Group continues to monitor the performance of the underlying IFRS 9 models whilst assessing the ongoing appropriateness of all key judgement and estimate areas ahead of the full reporting of IFRS 9 impact later in 2018.

Exceptional items

There were no exceptional items in 2017.

Exceptional items in 2016 of £24.9m comprised the gain on disposal of the Bank's entire economic interest in Rochester 1 of £34.7m and an exceptional loss of £9.8m in respect of accelerated amortisation of fair value adjustments on hedged assets relating to legacy back book long-dated swap cancellations, in line with the underlying mortgage asset run-off, due to faster than expected prepayments. The exceptional loss represented the impact of accelerating the amortisation in prior years from 2012 to 2015.

Dividend

The Board recommends a final dividend for 2017 of 9.3 pence per share. Together with the 2017 interim dividend of 3.5 pence per share, this represents 25% of underlying profit after taxation attributable to ordinary shareholders for 2017 in line with the Bank's target dividend payout ratio. The proposed final dividend will be paid on 16 May 2018, subject to approval at the AGM on 10 May 2018, with an ex-dividend date of 22 March 2018 and a record date of 23 March 2018.

Balance sheet growth

Net loans and advances grew by 23% in 2017 to £7,306.0m (31 December 2016: £5,939.2m) attributable primarily to an increase in new lending in the Buy-to-Let/SME segment.

Retail deposits and total assets grew by 12% and 30% respectively in 2017 with additional funding of £624.4m supplied by the FLS and TFS throughout the year. By the end of 2017, the Group had completed its planned transition out of the FLS scheme (31 December 2016: £524.6m) to the TFS with drawings under the scheme of £1,250.0m (31 December 2016: £101.0m).

The TFS drawdowns are offered in the form of collateralised cash loans. The scheme closed to new drawings at the end of February 2018 and the Group has four years from the date of each individual drawing to repay the existing loans.

Liquidity

OneSavings Bank operates under the PRA's liquidity regime. The Bank operates within a target liquidity runway in excess of the minimum regulatory requirement. In addition, the Bank maintains a strong retention track record on fixed term bond and ISA maturities. As at 31 December 2017, our liquidity coverage ratio of 250% (2016: 239%) was significantly in excess of the 2017 regulatory minimum of 90%, including drawings under the Bank of England FLS and TFS funding facilities. The Group's liquidity ratio as at 31 December 2017 was 15.2% (31 December 2016: 17.9%).

Capital

The Bank's fully-loaded CET1 capital ratio under CRD IV strengthened to 13.7% as at 31 December 2017 (31 December 2016: 13.3%), demonstrating the strong organic capital generation capability of the business to support significant growth through profitability.

We further optimised our capital structure through the issuance of £60m of AT1 securities in May 2017.

The Bank had a total capital ratio of 16.9% and a leverage ratio of 6.0% as at 31 December 2017 (31 December 2016: 15.1% and 5.5% respectively).

The Bank had a Pillar 2a requirement of 1.1% of risk weighted assets as at 31 December 2017 (31 December 2016: 1.2%).

Cash flow statement

In 2017, the Group replaced £524.6m of Bank of England FLS off balance sheet securities with cash drawn down under the TFS. This led to cash and cash equivalents increasing by £680.6m during the year to £1,165.9m as at 31 December 2017 (2016: restated £485.3m[3]).

The Group's loans and advances to customers grew by £1,371.2m during the year, partially funded by an additional £697.9m of deposits from retail customers which mainly contributed to £512.9m of cash used in operating activities. The remaining funding came primarily from additional drawdowns under the TFS, which in conjunction with replacing the FLS securities, totalled £1,149.0m during the year. Together with £59.4m of funding from the issuance of AT1 securities, this generated £1,167.5m of cash from financing activities. Cash generated from investing activities was £26.0m, primarily driven by the sale and maturity of investment securities and the purchase of additional equipment and intangible assets.

In 2016, the Group increased its loans and advances to customers by £1,031.3m. This was partially funded by an additional £588.6m of deposits from retail customers. Collectively, these were the main drivers of the £323.8m (restated[3]) of cash used in operating activities. The remaining funding came primarily from the Group replacing its maturing on balance sheet available for sale investment securities (£309.4m decrease, restated[3]) with off balance sheet securities under the FLS (£363.9m increase) in its liquidity portfolio. Together with £80.2m of cash received from the Rochester 1 disposal, this generated £381.9m (restated[3]) of cash inflows from investing activities. In addition, the Group drew down £101.0m of cash under the TFS which is reflected in the cash generated from financing activities.

Further information can be found in the Statement of Cash Flows on page 111.

1. Prior to 2017, OSB deducted coupons on equity PSBs accounted for as dividends from underlying profit before and after tax, net interest margin and cost to income ratio. Following a review of market practice in advance of the Bank's AT1 issue in May 2017, OSB no longer deducts these coupons from the calculation of these key performance indicators. The comparatives have been restated accordingly. Interest payments on AT1 securities classified as dividends are treated in the same way.
2. Effective tax rate excludes £0.4m of adjustments relating to prior years.
3. The 2016 comparatives have been reclassified to include investment securities with maturity less than three months and to exclude encumbered loans and advances to credit institutions within cash and cash equivalents.

SUMMARY CASH FLOW STATEMENT	Group 31-Dec-2017 £m	Restated[3] Group 31-Dec-2016 £m
Profit before tax	**167.7**	163.1
Net cash generated/(used in):		
Operating activities	**(512.9)**	(323.8)
Investing activities	**26.0**	381.9
Financing activities	**1,167.5**	56.7
Net increase/(decrease) in cash and cash equivalents	**680.6**	114.8
Cash and cash equivalents at the beginning of the period	**485.3**	370.5
Cash and cash equivalents at the end of the period	**1,165.9**	485.3

Risk review

Executive summary

During the year, the Group maintained a low and stable risk profile in line with the Board's risk management objectives. The Group continued to invest in its risk management infrastructure and resources to support the Group's growth objectives and to ensure ongoing compliance with the emerging industry good practice and regulatory standards.

By effectively leveraging its risk management framework, the Group actively managed its risk profile in accordance with the Board approved risk appetite. Through continuous monitoring and assessment of the underlying risk drivers, whilst actively engaging the Board and senior management, the Group took appropriate and timely management actions in the context of the changing economic, business and regulatory environment.

Through taking judicious and considered investment decisions, the Group improved its risk assessment and monitoring capabilities. In particular, the Group focused its risk-based investment to enhance its data governance and controls, upgrading its operational resilience assessment and management framework and delivering improvements to its risk analytical capabilities. The Group also expanded its risk management capacity through the recruitment of specialist risk and compliance resources within its UK and Indian operations.

The Group delivered strong and profitable growth whilst maintaining a low and stable risk profile. The underlying asset quality profile has continued to exhibit very strong performance and has continued to maintain sizeable and high quality buffers against minimum prudential solvency and liquidity requirements.

The underlying asset quality profile and the strength of its financial position helped to position the Group favourably in the context of uncertain economic, political and regulatory conditions. In particular, the Group continues to be mindful of the uncertainty surrounding Brexit negotiations and has leveraged its stress testing capabilities to identify potential points of vulnerability.

The new regulatory standards relating to Buy-to-Let underwriting and affordability testing represented an important area of focus for the Risk and Compliance functions. The inherent strength of the Group's underwriting procedures and its continued investment in customer data management enabled the Group to respond effectively to the regulatory changes. The Group also continued to improve its funding and liquidity forecasting procedures and has credible plans for when the Bank of England withdraws its Term Funding Scheme.

The other key regulatory developments to which the Group is responding include the General Data Protection Regulation ('GDPR') and Payment Services Directive ('PSD2'). Both these regulatory initiatives are supported by dedicated resources, structured programmes and engagement of external advisors to ensure that the Group complies effectively with the emerging requirements.

The Group continued to maintain a robust and secure IT infrastructure and remains acutely conscious that the level and sophistication of cyber-risk continues to evolve. Dedicated resources, improved detection capabilities and planning have helped the Group to minimise the risk of cyber-attacks.

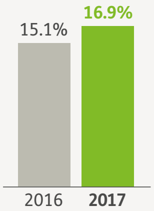
Key risk indicators

Commentary

CET1 ratio

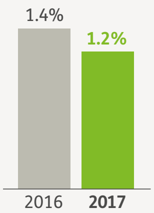
The Group further strengthened its fully-loaded CET1 ratio to 13.7% during 2017 (2016: 13.3%) demonstrating the strong organic capital generation capability of the business to support significant growth.

Total capital ratio



The Group's total capital ratio increased by 1.8% to 16.9% during 2017 driven by the strengthened CET1 ratio and the issuance of £60m of AT1 securities.

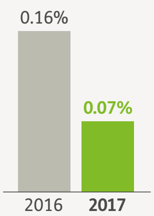
3+ months in arrears*



There was a reduction in the percentage of loans more than three months in arrears during 2017 driven by a strong performance across newly originated loans.

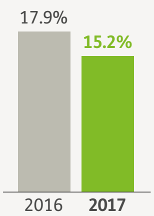
*Note: 3+ months in arrears ratio excludes legacy problem loans.

Cost of risk



Improved impairment performance was primarily driven by increased prudence in assumptions introduced in 2016 following the UK referendum vote to leave the EU, as well as lower underlying loan losses on acquired residential portfolios and the effect of increasing property values.

Liquidity ratio



The Group's liquidity ratio remained well above regulatory and risk appetite limits in 2017 finishing the year at 15.2%.

The Group managed liquidity levels within its target range in the year and its liquidity coverage ratio was 225% against a regulatory minimum of 90%.

High level key risk indicators
The Group aligns its risk appetite to a select range of key performance indicators that are used to assess the Group's success against strategic, business, operational and regulatory objectives. Actual performance against these indicators is continually assessed and reported. The table above outlines the comparative analysis of the leading risk indicators with supporting commentary.

Key achievements in 2017
The Group further enhanced and integrated its Strategic Risk Management Framework ('SRMF') to inform, guide and support business and strategic decision making. The Group generated shareholder value through the optimisation of its risk and reward profile within the constraints of its risk appetite.

The Group's approach to setting its risk appetite was enhanced through the use of improved borrower and loan level risk assessment, greater alignment with the financial planning process and the use of stress testing. The Board actively guided the process of setting risk appetite, ensuring that the risk appetite is fully reflective of the Board's attitude and tolerance for risks to its objectives.

The IFRS 9 programme continued to progress according to plan with the core processes being subject to a full parallel run throughout 2017. An independent validation of all underlying models, implementation standards and governance arrangements was performed. The Group was fully prepared to begin reporting under the IFRS 9 regime on 1 January 2018, the 'go-live' date.

The Group's secured business model, sensible loan to value profile and strong arrears performance result in a manageable day one impact post adoption of the IFRS 9 standard of c.£4m. For arrears balances purchased via the portfolio acquisition process, the Group conservatively assesses expected loss at the point of acquisition which is offset against the modelled future cash flows to derive the effective interest rate for the book. This incurred loss protection is therefore recognised over the life of the book against the unwind of any purchase discount or premium through interest income providing further protection.

The Internal Ratings Based ('IRB') programme was formally established to enable the Group to transition to the advanced approach to measuring its credit risk-based capital requirements. The programme progressed in accordance with the Board approved plan and the Group is well placed to commence parallel running its IRB models and capital calculation engine. The Group completed an internal self-assessment exercise against the Capital Requirements Regulation ('CRR') to develop detailed plans and a roadmap of key steps towards a formal regulatory application. The Group will be engaging actively with the PRA and external subject matter experts to ensure successful delivery of the programme.

As the Group increased the use of risk-based analytics and models, it also improved model validation, monitoring and back-testing. Appropriate controls were established to assess the ongoing robustness and usage of all risk models. The Group established Board and senior management oversight and governance procedures through a Board approved model risk policy.

A Group-wide programme was established to enhance the Bank's approach to data governance and controls in the context of industry good practice and regulatory standards. The programme is overseen by a senior level Steering Committee with cross-functional executive sponsorship. The programme is designed to deliver improved data controls and models, aggregation capabilities and end user reporting capabilities. The programme will support other strategic and regulatory initiatives including IRB, GDPR and securitisation.

To ensure a holistic and integrated approach to operational resilience, the Group established an Operational Resilience Programme to align its current approach to emerging industry good practice and regulatory standards. The programme will help to deliver an integrated approach to the ongoing assessment of critical operational functions and key dependencies, assessment of potential points of vulnerability and business continuity planning and crisis management.

The Group continued to enhance its Internal Capital Adequacy Assessment Process ('ICAAP'), through improved risk-based capital assessments and the use of stress testing. The Group worked with industry experts and engaged with the PRA to ensure that its ICAAP adheres to regulatory standards and represents an important mechanism by which the Board and senior management assess the adequacy and effectiveness of the Group's business and capital plans under normal and stressed operating conditions. Fully integrated funding and liquidity planning and stress testing analysis is used to support the Internal Liquidity Adequacy Assessment Process ('ILAAP'). The Group also enhanced its Recovery Plan through active assessment of risk drivers, identification of business model vulnerabilities and development of credible and reliable business recovery options.

Risk-based management information has been an important area of continued improvement. Through the use of a broad range of early warning indicators and risk drivers, a more forward-looking approach to risk identification and management was established. In particular, enhancements were made to the credit portfolio risk triggers by leveraging credit bureau data to supplement internal risk assessments. The Group is actively using its early warning risk indicators and risk assessment capabilities to identify and analyse any emerging trends, particularly during the current period of economic and market uncertainty.

Improved Financial Crime and Compliance team structures were implemented with continued investments made to materially build out specialist capabilities in relation to monitoring, testing and assurance.

Priority areas for 2018
The priority for both the Risk and Compliance functions during 2018 is to further embed the risk management frameworks into the culture and decision making processes at all levels of the organisation. Both functions intend to utilise the enhanced level of specialist risk and compliance resources to deliver on a number of key initiatives including:

- Delivery of an enhanced and integrated data governance and controls framework. Improved data aggregation, analytics and distribution channels to support ongoing business reporting requirements as well as key strategic and regulatory initiatives
- Continued progress against the Group's IRB plan, with particular focus on delivery of second generation credit risk models, improved adherence to emerging regulatory

Risk review continued

requirements and meeting the ‘use-test’ requirements. Improved model governance and controls, supported by an extensive training and awareness programme
- Continued improvements to the underlying risk forecasting and stress testing capabilities which supporting the Group ICAAP and ILAAP, including the roll-out of IRB and IFRS 9 compliant stress testing capabilities
- The Group’s operational resilience programmes to deliver an integrated approach to operational resilience assessment and improved aligned to Business Continuity Plan (‘BCP’) development and testing, through the leveraging of an integrated system solution.

The Board and senior management are providing an appropriate level of oversight across all key initiatives. The Group also engages external subject matter experts and consults with supervisory authorities to ensure appropriate levels of transparency and successful outcomes are achieved.

Risk management

Approach to risk management

Ongoing risk identification, assessment, monitoring and reporting are the primary risk disciplines underpinning the Group’s growth strategy and adherence to the prudential and conduct regulatory requirements. The Group’s approach to risk management is outlined within the SRMF.

The SRMF is the overarching framework which enables the Board and senior management to actively manage and optimise the risk-reward profile within the constraints of the Group risk appetite. Specifically, the SRMF enables the Board and senior management to take informed decisions by appropriately balancing the interests and expectations of the various stakeholders and to manage potential trade-offs within the context of the risk appetite.

The SRMF is a structured approach to aligning the Board’s overarching objectives against the risks assumed and the ongoing management of these risks. The SRMF enables the Board to articulate its expectations and tolerance in relation to the nature and level of risks it is willing to assume in pursuit of its strategic and business agenda. The Board also uses the SRMF to outline its expectations with respect to the appropriate level of risk management capabilities and the sophistication needed to actively manage the risk profile.

The modular construct of the SRMF provides for an agile approach to responding effectively to the evolving nature of the business and regulatory environment. The SRMF and its core modular components are subject to periodic review and approval by the Board and its oversight committees.

The following sections describe the key modules of the SRMF structure.

Key modular component 1: Risk principles and culture

The Board adopted a principle-based approach to articulating its expectations and guidance relating to how the Group should frame its risk management approach. The risk management principles are designed to set a clear ‘tone from the top’ with respect to the Group’s risk culture and values. The risk principles also provide the background context in which to articulate the Group’s risk management objectives, strategy and appetite.

The risk principles are:
- Customer outcomes: fair treatment and good customer outcomes are core business values which cannot be put at risk
- Proportionate and scalable: the approach to risk management needs to be commensurate with the complexity of the underlying risk profile and appropriately agile to respond to changing business and regulatory needs

- Actively managed: the risk profile needs to be actively managed within the Board approved risk appetite
- Comprehensive coverage: all risks and their underlying drivers impacting the Group's strategic, business, operational and regulatory objectives should be actively assessed, monitored and reported
- Segregation of duties: risk-taking, oversight and assurance responsibility to be organised in adherence to the 'three lines of defence' principle
- Integration and usage: risk assessment should be a critical feature of decision making processes at all levels of the organisation
- Versatile and progressive: the approach to managing risks should be subject to continuous review and challenge to keep pace with emerging good practice and regulatory standards.

In adherence to the risk management principles, the Group Board and senior management have cultivated a risk culture which encourages a proactive, transparent and analytical approach to risk management. Risks are assumed in a balanced and considered manner, taking into account stakeholder expectations, good customer outcomes, risk management capabilities and controls.

Key modular component 2: Risk strategy and appetite

Risk strategy

OSB's risk strategy is to create value through informed risk-based decisions and leveraging the Group's risk data and analytics in a timely and accurate manner to optimise the risk-reward profile. Risks are only to be assumed which can be effectively identified, assessed, measured and controlled across all phases of the risk life cycle.

This risk strategy is based on three key components:

- Creating value through generating returns which sufficiently exceed the cost of risk, funding costs and operating costs
- Risks are only to be assumed where they are subject to a structured and disciplined approach to risk management
- Risk management capabilities are scalable and agile enough to adequately address future evolution of the risk profile.

Risk appetite

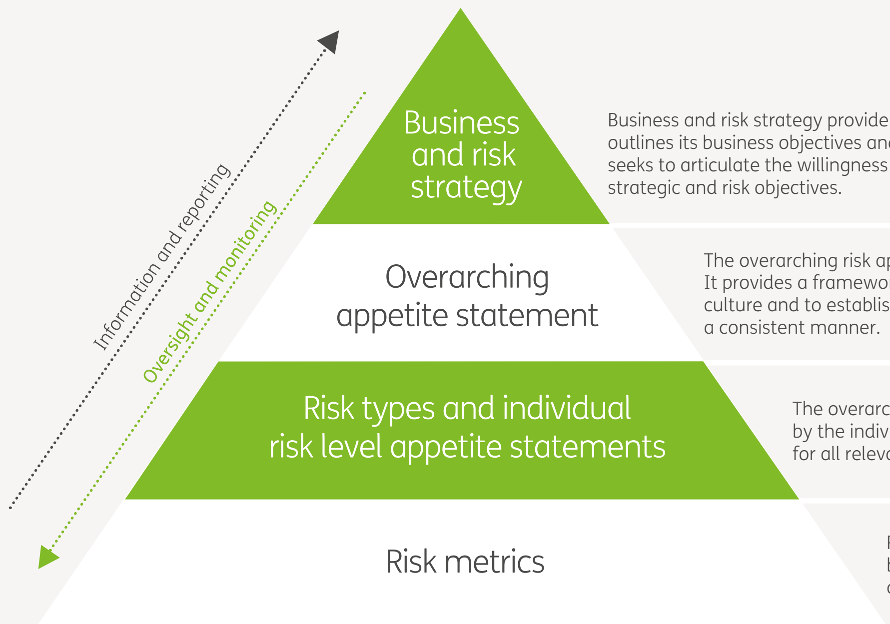
The Group effectively aligned its strategic and business objectives with its risk appetite, ensuring that the Board and senior management are able to monitor the underlying risk profile relative to the overarching risk principles, risk strategy and financial performance objectives of the Group. The risk appetite is a critical mechanism though which the Board and senior management are able to identify adverse trends and respond to unexpected developments in a timely and considered manner.

The risk appetite is calibrated to reflect the Group's strategic objectives, business operating plans, as well as external economic, business and regulatory constraints. In particular, the risk appetite is calibrated to ensure that the Bank continues to deliver against its strategic objectives and operates with sufficient financial buffers even when subjected to plausible but extreme stress scenarios. The objective of the Board risk appetite is to ensure that the strategy and business operating model is sufficiently resilient.

The risk appetite is calibrated using statistical analysis and stress testing to inform the process by which the Board set management triggers and limits against key risk indicators. The Board and senior management actively monitor actual performance against Board approved management triggers and limits to respond in a timely manner to adverse trends and breaches.

Overarching risk appetite statement

The Bank has a prudent and proportionate approach to risk taking and management, which is reflective of its straightforward business model. The inherent resilience of the Group's business model is underpinned by the fact that the Bank only lends on a secured basis, has established robust underwriting practices and relies on intermediary based distribution. The Group supports its lending activities by being predominantly reliant on stable retail funding, supported by strong and high quality financial buffers. The highly efficient business operating model is an important source of competitive advantage. The Group also places significant importance on its strong conduct and compliance culture as an important driver of its overall success.



Business and risk strategy provide the context within which the Group outlines its business objectives and establishes its SRMF. The risk appetite seeks to articulate the willingness of the Group to take risks in light of its strategic and risk objectives.

The overarching risk appetite sets the tone for risk management. It provides a framework to develop and cascade the Group's risk culture and to establish risk policies, controls and limits in a consistent manner.

The overarching risk appetite statement is supported by the individual, risk type level appetite statements for all relevant risks.

Risk appetite statements are supported by a broad range of qualitative and quantitative metrics.

Risk review continued

Key modular component 3: Risk governance and function organisation

Risk governance refers to the processes and structures established by the Board to ensure that risks are assumed and managed within the Board approved risk appetite, with clear delineation between risk-taking, oversight and assurance responsibilities. The Group's risk governance framework is structured to adhere to the 'three lines of defence' model. All risk-taking, oversight and assurance functions are allocated to accountable Executives.

The Group Board has the ultimate responsibility for the oversight of the Group's risk profile and management framework and where it deems it appropriate, it delegates its authority to its nominated Committees. The Board and its Committees are provided with appropriate and timely information relating to the nature and level of the risks to which the Group is exposed and the adequacy of the risk controls and mitigants. The Internal Audit function provides independent assurance to the Board and its Committees as to the effectiveness of the systems and controls and the level of adherence with internal policies and regulatory requirements.

The Executive Committee has day-to-day responsibility for managing the Group's risk profile within the parameters of the Board approved risk appetite. The Executive Committee discharges its risk control and oversight responsibilities through a number of management level risk committees covering all principal risks.

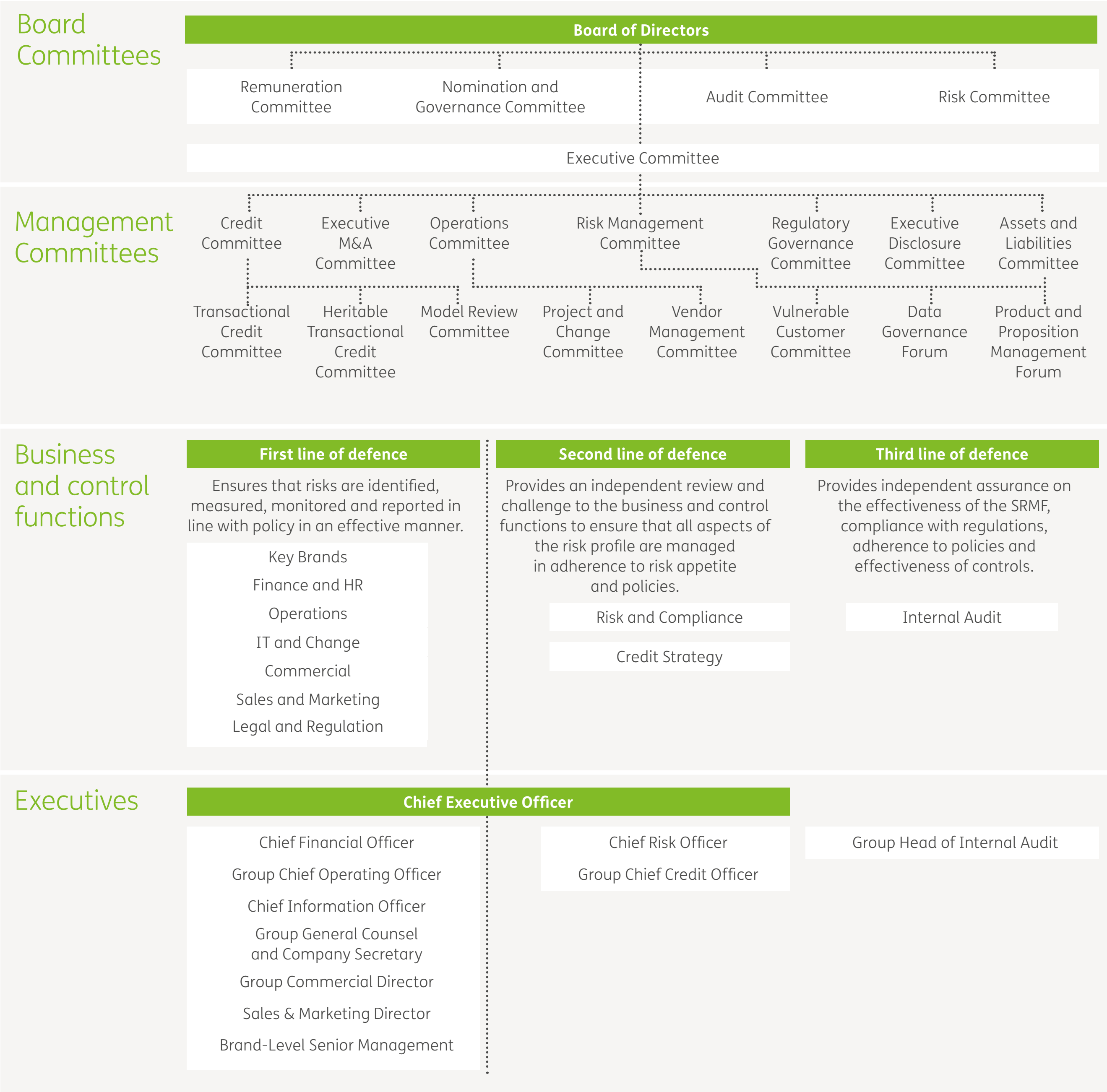
The Chief Risk Officer ('CRO') is the accountable Executive responsible for establishing an effective risk management framework supported by appropriately organised Risk and Compliance functions. In discharging his duties, the CRO has dual reporting lines into the Group CEO and the Chair of the Risk Committee. The CRO ensures that the Risk function is appropriately resourced and capable of identifying, assessing and reporting all principal risks to which the Bank is exposed.

The various management level risk committees have been established to ensure a more focused approach to monitoring and managing the specific risks. Additional sub-committees and working groups have also been established to focus on specific risk initiatives or projects.

The OSB risk governance structure is detailed below:

Risk	Credit	Market	Liquidity	Operational	Regulatory	Conduct
Board governance	Board					
	Risk Committee					
Management governance	**Executive Committee**					
	Credit Committee	Assets and Liabilities Committee		Risk Management Committee	Regulatory Governance Committee	
	Chief Risk Officer					
Frameworks	Strategic Risk Management Framework, Stress Testing Framework					
Key policies and documents	Credit Risk Management Framework, Lending Policy, Arrears, Repossession and Forbearance policies	Interest Rate Risk in the Banking Book Policy	Market & Liquidity Risk Management Framework, Treasury Policy, Funding and Liquidity Risk Policy	Operational Risk Management Framework, Operational Resilience Policy, Vulnerable Customer and Suicide Awareness Policy	Compliance Risk Management Framework, Financial Crime Risk Management Framework, Group Anti-Money Laundering and Counter Terrorist Financing Policy, SMR policies	Conduct Risk Management Framework, Conduct Risk Policy
	Risk Appetite Statement, ICAAP, Recovery Plan, Resolution pack					
		ILAAP				
Management information	Credit MI pack	ALCO MI pack		Operational risk MI pack	Compliance and Financial Crime MI pack	Conduct risk MI pack

The OSB risk organisational structure is detailed below:



Risk review continued

Key modular component 4: Risk definitions and categorisation

The Group's business activities, business model and external operating environment result in a unique risk profile. To ensure that the Bank is actively monitoring and responding to the evolving nature of its risk profile, it has established a broad range of early warning indicators and maintains risk registers covering all principal risks. Outlined below are the various financial and non-financial risks which constitute the Group's risk profile.

Business model characteristics

• Specialist, and primarily secured lender to underserved sectors	• Desired levels of credit exposure to key segments (Buy-to-Let/SME, residential) • Potential for concentrations	• Also incurs exposure to potentially riskier sub-sectors (second charge, bridging and development finance)	• Manage infrastructure and operations to support its core business activities • Perform activities to ensure regulatory compliance	• The Bank is subject to variations in the macroeconomic environment and movements in key variables (e.g. Gross Domestic Product, unemployment, interest rates)

Risk profile

Financial risks	Non-financial risks		
Portfolio credit risk The risk of losses due to one or more borrowers failing to meet all or part of their obligations towards the Bank. Credit risk also includes other elements such as pre-settlement and settlement risk, residual risk of credit risk mitigation and concentration risk. **Market risk (inc. IRRBB)** The risk of losses in on and off-balance sheet positions arising from adverse movements in market prices.	**Strategic and business risk** The risk to the Bank's earnings and profitability arising from its strategic decisions, change in the business conditions, improper implementation of decisions or lack of responsiveness to industry changes.	**Reputational risk** Refers to the potential adverse effects that can arise from the Bank's reputation being sullied due to factors such as unethical practices, adverse regulatory actions, customer dissatisfaction and complaints or negative/adverse publicity. Reputational risk can arise from a variety of sources and is a second order risk – the crystallisation of a credit risk or operational risk can lead to a reputational risk impact.	**Operational risk** Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It includes legal risk but excludes strategic and reputational risk. **Conduct risk** Conduct risk is the risk that the firm's culture, organisation, behaviours and actions result in poor outcomes and detriment for customers and/or damage to consumer trust and integrity in the markets in which we operate. **Regulatory/compliance risk** The risk of failure due to non-adherence to provisions of the PRA handbook and all relevant prudential and conduct standards in the UK or non-compliance with reporting requirements or submission of incorrect information.

Solvency risk

The potential inability of the Bank to ensure that it maintains sufficient capital levels for its business strategy and risk profile under both the base and stress case financial forecasts.

Liquidity and funding risk

The potential inability of the Bank to fund increases in assets, manage unplanned changes to funding sources and to meet obligations when required. It primarily arises due to the maturity mismatch associated with the Bank's assets and liabilities and the growth in mortgage lending.

Principal risks and uncertainties

The Board has carried out a robust assessment of the principal risks and uncertainties facing the Group, including those that could threaten its strategic objectives, business operating model, future financial performance and regulatory compliance commitments. The principal risks and uncertainties are outlined in the table below:

Strategic and business risk

Definition – The risk to the Bank's earnings and profitability arising from its strategic decisions, change in the business conditions, improper implementation of decisions or lack of responsiveness to industry changes.

Risk appetite statement	Risk	Mitigation	Direction
The Group's strategic and business risk appetite states that the Group does not intend to undertake any long to medium-term strategic actions that would put at risk its vision of being a leading specialist lender, backed by a strong and dependable saving franchise. The Group adopts a long-term sustainable business model which, while focused on niche sub-sectors, is capable of adapting to growth objectives and external developments.	**Performance against targets** Performance against strategic and business targets does not meet stakeholder expectations. This has the potential to damage the Group's franchise value and reputation.	Regular monitoring by the Board and the Executive Committee of business and financial performance against strategic agenda and risk appetite. The balanced business scorecard is the primary mechanism to support the Board and assesses management performance against key targets. Use of stress testing to flex core business planning assumptions to assess potential performance under stressed operating conditions.	**Increased** The Group's strategic and business operating environments are subject to ongoing changes primarily driven by market competition, economic outlook and regulation.
	Regulatory and economic environment The regulatory and economic environment are important factors impacting the strategic and business risk profile. In particular, the emerging regulatory underwriting standards and tax changes impacting the Buy-to-Let sector have resulted in a general slowdown in the sector.	The Group's robust underwriting standards and its focus on professional landlords have helped mitigate the impact of the regulatory changes and enabled to Group to continue to grow its share of the sector. The Group has continued to utilise and enhance its stress testing capabilities to assess and minimise potential areas of macroeconomic vulnerabilities.	**Increased** The Group's strategic and business risk profile is impacted by the uncertainty surrounding Brexit negotiations and potential future changes to regulatory standards.
	Term Funding Scheme withdrawal The withdrawal of the Term Funding Scheme ('TFS') could potentially increase competition for retail and wholesale savings resulting in increased funding costs. In particular, there is an increased level of risk related to the refinancing of the TFS drawdowns in 4 years time.	The Group's funding plan ensures a diverse funding profile and initiatives have been put in place to replace TFS with a comprehensive Retail Mortgage Backed Securities ('RMBS') programme.	**Increased** The full impact of the TFS withdrawal remains uncertain.
	Regulatory requirements The potential for emerging regulatory requirements to increase the demands on the Group's operational capacity and increase the cost of compliance.	The Group continues to invest in its IT and data management capabilities to increase the ability to respond to regulatory change. A structured approach to change management and fully leveraging internal and external expertise allows the Group to respond effectively to regulatory change.	**Increased** Performance against strategic and business targets does not meet stakeholder expectations. This has the potential to damage the Group's franchise value and reputation.

Reputational risk

Definition – The potential risk of adverse effects that can arise from the Bank's reputation being sullied due to factors such as unethical practices, adverse regulatory actions, customer dissatisfaction and complaints or negative/adverse publicity. Reputational risk can arise from a variety of sources and is a second order risk – the crystallisation of a credit risk or operational risk can lead to a reputational risk impact.

Risk appetite statement	Risk	Mitigation	Direction
The Group does not knowingly conduct business or organise its operations to put its reputation and franchise value at risk.	Potential loss of trust and confidence that our stakeholders place in us as a responsible and fair provider of financial services.	Culture and commitment to treating customers fairly and being open and transparent in communication with key stakeholders. Established processes to proactively identify and manage potential sources of reputational risk.	**Unchanged** The Group has increased the size and capabilities of its Risk and Compliance function to ensure appropriate oversight and challenge to how the Group discharges its responsibilities to the various stakeholders.

Principal risks and uncertainties continued

Credit risk

Definition – Potential for loss due to the failure of counterparty to meet its contractual obligation to repay a debt in accordance with the agreed terms.

Risk appetite statement	Risk	Mitigation	Direction
The Group seeks to maintain a high quality lending portfolio that generates adequate returns, under normal and stressed periods. The portfolio is actively managed to operate within set criteria and limits based on profit volatility, focusing on key sectors, recoverable values, and affordability and exposure levels. The Group aims to continue to generate sufficient income and control credit losses to a level such that it remains profitable even when subjected to a credit portfolio stress of a 1 in 20 intensity stress scenario.	**Individual borrower defaults** Borrowers may encounter idiosyncratic problems in repaying their loans, for example loss of a job or execution problems with a development project. While most of the Bank's lending is secured, some borrowers may 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. 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 if 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 stress testing the economics of the specific project. The Group's Transactional Credit Committee actively reviews and approves larger or more complex mortgage applications.	**Unchanged** The Group continues to observe strong and stable credit profile performance.
	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, affordability, name, sector and geographic concentration that are approved by the Risk Committee and the Board. These are reviewed on a semi-annual basis. In addition, stress testing is performed to ensure that the Group maintains sufficient capital to absorb losses in an economic downturn and continue to meet its regulatory requirements.	**Unchanged** Although the UK economy has remained stable during 2017, the economic outlook is uncertain with the final terms of Brexit to be confirmed.
	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.	**Unchanged** The Group continues to utilise a reserve account with the Bank of England, enabling it to eliminate credit risk on most of its liquidity portfolio.

Market risk

Definition – Potential loss due to changes in market prices or values.

Risk appetite statement	Risk	Mitigation	Direction
The Group actively manages market risk arising from structural interest rate positions. The Group does not seek to take a significant interest rate position or a directional view on rates and it limits its mismatched and basis risk exposures.	**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.	**Unchanged** The Group continues to assess interest on a monthly basis ensuring that the interest rate risk exposure is limited in the current economic environment.
	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.	**Unchanged** Product design and hedging has enabled the Group to maintain the overall level of basis risk through the year.

Liquidity and funding risk

Definition – The risk that the Group will be unable to meet its financial obligations as they fall due.

Risk appetite statement	Risk	Mitigation	Direction
The Group actively maintains stable and efficient access to funding and liquidity to support its ongoing operations. It also maintains an appropriate level and quality of liquid asset buffer so as to withstand market and idiosyncratic liquidity-related stresses.	**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. Increased competition for retail savings driving up funding costs, adversely impacting retention levels and wider damage to OSB franchise.	The Group's funding strategy is focused on a highly stable retail deposit franchise. The large number of depositors provides diversification and a high proportion of balances are covered by the FSCS and so there is no material risk of a retail run. In addition, the Group performs in-depth liquidity stress testing and maintains a liquid asset portfolio sufficient to meet obligations under stress. The Group holds prudential liquidity buffers to manage funding requirements under normal and stressed conditions. The Group proactively manages its savings proposition through both the Liquidity Working Group and the ALCO. Finally, the Group has prepositioned mortgage collateral with the Bank of England which allows it to consider other alternative funding sources to ensure it is not solely reliant on retail savings. The Group's funding plan ensures a diverse funding profile and initiatives have been put in place to replace TFS with a comprehensive Retail Mortgage Backed Securities ('RMBS') programme.	**Increased** The end of the Bank of England Term Funding Scheme ('TFS') may create increased competition for retail and wholesale funding.
	Term Funding Scheme withdrawal The potential impact of the withdrawal of the TFS programme is uncertain.	The Group's funding plan ensures a diverse funding profile and initiatives have been put in place to replace TFS with a comprehensive Retail Mortgage Backed Securities ('RMBS') programme.	**Increased** The end of the Bank of England Term Funding Scheme ('TFS') may create increased competition for retail and wholesale funding.

Principal risks and uncertainties continued

Solvency risk

Definition – The potential inability of the Bank to ensure that it maintains sufficient capital levels for its business strategy and risk profile under both the base and stress case financial forecasts.

Risk appetite statement	Risk	Mitigation	Direction
OSB seeks to ensure that it is able to meet its Board level capital buffer requirements under a 1 in 20 stress scenario. The Group's solvency risk appetite is constrained within the leverage ratio related requirements. We manage our capital resources in a manner which avoids excessive leverage and allows us flexibility in raising capital.	Key risks to solvency arise from balance sheet growth and unexpected losses which can result in the Bank's capital requirements increasing or capital resources being depleted such that it no longer meets the solvency ratios as mandated by the PRA and Board risk appetite. 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.	Currently the Bank operates from a strong capital position and has a consistent record of strong profitability. The Bank actively monitors its capital requirements and resources against financial forecasts and plans and undertakes stress testing analysis to subject its solvency ratios to extreme but plausible scenarios. The Bank also holds prudent levels of capital buffers based on CRD IV requirements and expected balance sheet growth. The Group engages actively with regulators, industry bodies, and advisers to keep abreast of potential changes and provide feedback through the consultation process.	**Decreased** The Group has improved both its CET1 capital and total capital position increasing its resilience against unexpected losses. In particular, the Group's capital position was strengthened in May 2017 by the issuance of £60m of Additional Tier 1 securities ('AT1 securities').

Operational risk

Definition – The risk of loss or negative impact to the Group resulting from inadequate or failed internal processes, people, or systems or from external events.

Risk appetite statement	Risk	Mitigation	Direction
The Group's operational processes, systems and controls are designed to minimise disruption to customers, damage to the Bank's reputation and any detrimental impact on financial performance. The Bank actively promotes the continual evolution of its operating environment through the identification, evaluation and mitigation of risks, whilst recognising that the complete elimination of operational risk is not possible.	**Cyber/data security risk** The risk of a loss of customer or proprietary data as a result of theft or through ineffective data management.	A series of tools designed to identify and prevent network/system intrusions are deployed across the Group. The effectiveness of the controls is overseen by a dedicated IT Security Governance Committee, with specialist IT security staff employed by the Bank.	**Increased** Whilst the Bank has made a series of enhancements to its defences with respect to IT security threats during 2017, it recognises that the threats to the industry continue to grow both in respect of the volume and the level of sophistication.
	Data risk The use of inaccurate, incomplete or outdated data may result in a range of risks impacting risk management and reporting services.	The Bank continues to invest in and enhance its data management architecture, systems, governance and controls.	**Increased** The increase in data risk has been primarily driven by the increased scale of operations and the multiple sources from which data is derived.
	Regulatory risk The operational risks arising from the management of a significant volume of regulatory change.	The Bank operates a series of controls to identify any relevant regulatory change at an early stage. Regulatory related changes are appropriately prioritised and resourced in order to ensure the timely implementation of any operational changes required.	**Increased** The increase in regulatory change has to date been offset by the increase in the Bank's change management capacity. Regulatory change continues to be well managed with the appropriate level of focus and oversight.

Operational risk (continued)

Risk appetite statement	Risk	Mitigation	Direction
	Operational and IT resilience Banks should have business resiliency, continuity monitoring and plans in place to ensure an ability to operate on an ongoing basis and limit losses in the event of severe business disruption. Technical failures (including bugs, network or data) resulting in critical system outage. These would include OSB's primary mortgage origination and servicing systems, savings processing system and core reporting and data management systems leading to loss of service, revenue, business performance and potential customer detriment.	The Bank has established an Operational Resilience Programme that is delivering a Group-wide approach in respect to planning and testing. In addition, the programme is designed to highlight any areas of specific vulnerability. A range of back-up technologies employed to provide real-time replication on various critical systems while disaster recovery capabilities are tested annually. Real-time system performance monitoring established and a dedicated testing team in place.	**Increased** The increasing scale and globalisation of operations together with dependencies on a number of third party service and network providers. The sophistication of cyber-crime continues to evolve.
	Operational execution and scalability The inability of the Bank to automate current operational processes at the speed the business requires in order to successfully meet future growth.	In order to mitigate incidents materialising from manual processes an established two-tier (dependent and independent within the first line) risk-based quality control programme is in place.	**Increased** The ongoing growth of the Bank has challenged its automation programmes and resulted in an increase in the number of manual processes. Whilst key manual processes are well managed and there is continuing investment in automation, the challenges presented by the pace of growth remain a key area of management focus.

Conduct risk

Definition – The risk that the Group's behaviours or actions result in customer detriment or negative impact on the integrity of the markets in which it operates.

Risk appetite statement	Risk	Mitigation	Direction
The Bank considers its culture and behaviours in ensuring the fair treatment of customers and in maintaining the integrity of the markets in which it operates a fundamental part of its strategy and a key driver to sustainable profitability and growth. OSB does not tolerate any systemic failure to deliver fair customer outcomes. On an isolated basis incidents can result in detriment owing to human and / or operational failures. Where such incidents occur they are thoroughly investigated, and the appropriate remedial actions are taken to address any customer detriment and to prevent recurrence.	**Product suitability** Whilst the Group originates relatively simple products, there remains a risk that (primarily legacy) products may be deemed to be unfit for their original purpose in line with the current regulatory definitions.	The Group has a strategic commitment to provide simple, customer-focused products. In addition, a Product Governance framework is established to oversee both the origination of new products and to revisit the ongoing suitability of the existing product suite. A dedicated Product Governance team – which is part of an independent Conduct Risk team – serves to effectively manage this risk.	**Decreased** Whilst this risk has further reduced in 2017 as a result of increased awareness and dedicated oversight, the Bank remains aware of the changes to the regulatory environment and their possible impact on product suitability.
	Data protection The risk that customer data is accessed inappropriately either as a consequence of network/system intrusion or through operational errors in the management of the data.	In addition to a series of network/system controls (documented within as part of the operational risks) the Bank performs extensive root cause analysis of any data leaks in order to ensure that the appropriate mitigating actions are taken.	**Unchanged** Despite a number of additional controls being introduced in 2017 the network/system threats continue to evolve in both volume and sophistication.

Principal risks and uncertainties continued

Compliance/regulatory risk

Definition – The risk that a change in legislation or regulation or an interpretation that differs from the Group's will adversely impact the Group.

Risk appetite statement	Risk	Mitigation	Direction
The Group views ongoing conformance with regulatory rules and standards across all the jurisdictions in which it operates as a critical facet of its risk culture. The Group does not knowingly accept compliance risk which could result in regulatory sanctions, financial loss or damage to its reputation. The Group will not tolerate any systemic failure to comply with applicable laws, regulations or codes of conduct relevant given its business operating model.	Key compliance regulatory changes that impacted the Bank included PRA's Buy-to-Let underwriting standards, certification regime under the SM&CR, PSD2, GDPR, Criminal Finances Act, European Fourth Money Laundering Directive, FCA guidance on automatic capitalisation for residential mortgage customers.	The Bank has an effective horizon scanning process to identify regulatory change. All significant regulatory initiatives are managed by structured programmes overseen by the change management team and sponsored at Executive management level. The Bank has proactively sought external expert opinions to support interpretation of the requirements and validation of its response.	**Increased** The Bank has historically responded effectively to regulatory changes however, the level and sophistication of emerging regulation continues to increase.
	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. For example, the Financial Policy Committee's increased focus on Buy-to-Let lending or tax changes such as the Bank profits surcharge must be considered.	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.

The Group proactively scans for emerging risks which may have an impact on its ongoing operations and strategy. The Group considers its top emerging risks to be:

Emerging risks	Description	Mitigation action
Political and macroeconomic uncertainty	As a result of the UK government triggering Article 50 and the subsequent general election result, there is an increased likelihood of a period of macroeconomic uncertainty. The Group's lending activity is solely focused in the United Kingdom and, as such, will be impacted by any risks emerging from changes in the macroeconomic environment.	The Group has implemented robust monitoring processes and via various stress testing activity (i.e. ad hoc, risk appetite and ICAAP) understands how the Group performs over a variety of macroeconomic stress scenarios and has subsequently developed a suite of early warning indicators which are closely monitored to identify changes in the economic environment.
General data usage	From 25 May 2018, the Group will comply with GDPR. This will result in increased regulatory requirements with respect to processing customer and employee personal and other data in the course of day-to-day business activities.	The Group has mobilised a project (with dedicated resources) to implement the GDPR as required.

RISK PROFILE PERFORMANCE OVERVIEW

Credit risk

Credit profile performance

The Group's credit profile performed strongly in 2017, driven by deep market knowledge of the specialist markets in which it operates, prudent lending policies and sound credit risk management.

During the year, the Group's portfolio composition mix continued to evolve with pre-2011 lending (prior to OneSavings Bank PLC being established) continuing to run off. Legacy problem loans reduced further in 2017 from £13.8m to £8.6m, following careful management by our experienced collections team. The Group's acquired portfolios also continued to perform in line with expectations in terms of run-off rates and credit profile performance.

The Group's funding lines and development finance businesses delivered a strong performance in 2017, with no impairment recognised across either segment.

Strong Group originations performance was observed in 2017, driven by performance across the Buy-to-Let/SME segment. Importantly, this lending was underwritten at sensible LTV levels, where tightened underwriting policy, following the United Kingdom's decision to leave the European Union, resulted in a greater clustering of LTV levels against the portfolio average. Post-2011 lending, incorporating enhanced lending criteria, continued to make up an increasing proportion of the Group's total loans and advances to customers, where 38,500 loans have been underwritten with only 137 loans being greater than three months arrears with aggregate loans totalling £18.4m with aggregate weighted average LTV of 63%.

This portfolio mix shift, coupled with strong credit risk management and continuing favourable economic conditions, supported the portfolio arrears rate reducing to 1.2% as at 31 December 2017 excluding legacy problem loans (31 December 2016: 1.4%).

Segment	Measure	31-Dec-2017	31-Dec-2016	Variance	Commentary
BTL/SME	New origination average LTV	**70%**	70%	–	New lending average LTV remained stable
	Weighted average Interest Coverage Ratio for new lending	**185%**	171%	+14%	Resulting from a tightening of affordability rules
Residential lending	New origination average LTV	**65%**	66%	-1%	New lending average LTV reduced
	Percentage of new residential lending with a loan to income (LTI) greater than 4.5	**3.2%**	2.6%	+0.6%	Increase in cases with LTI > 4.5

Other key risk measures also performed strongly within the period:

- Gross exposure to semi-commercial/commercial lending remains low at £370.8m with weighted average LTV of 63%
- Gross exposure to residential development finance remains low at £143.8m with a further £78.0m committed with a weighted average LTV of 37.7%
- The Group has limited exposure to high LTV loans on properties worth more than £2m. In total only 4% of the Group's loan portfolio is secured on properties valued at greater than £2m with a LTV greater than 65%.

Forbearance

Where borrowers experience financial difficulties which impacts their ability to service their financial commitments under the loan agreement, forbearance may be used to achieve an outcome which is mutually beneficial to both the borrower and the Bank.

By identifying borrowers who are experiencing financial difficulties pre-arrears or in arrears, a consultative process is initiated to ascertain the underlying reasons and to establish the best course of action to enable the borrower to develop credible repayment plans and to see them through the period of financial stress.

The specific tools available to assist customers vary by product and the customers' status. The various treatments considered for customers are as follows:

- Temporary switch to interest only: a temporary account change to assist customers through periods of financial difficulty where arrears do not accrue at the original contractual payment. Any arrears existing at the commencement of the arrangement are retained.
- Interest rate reduction: the Group may, in certain circumstances, where the borrower meets the required eligibility criteria, transfer the mortgages to a lower contractual rate. Where this is a formal contractual change the borrower will be requested to obtain independent financial advice as part of the process.
- Loan term extension: a permanent account change for customers in financial distress where the overall term of the mortgage is extended, resulting in a lower contractual monthly payment.
- Payment holiday: a temporary account change to assist customers through periods of financial difficulty where arrears accrue at the original contractual payment. Any arrears existing at the commencement of the arrangement are retained.
- Voluntary assisted sale: a period of time is given to allow borrowers to sell the property and arrears accrue based on the contractual payment.
- Reduced monthly payments: a temporary arrangement for customers in financial distress. For example, a short-term arrangement to pay less that the contractual payment. Arrears continue to accrue based on the contractual payment.

- Capitalisation of interest: arrears are added to the loan balance and are repaid over the remaining term of the facility or at maturity for interest only products. A new payment is calculated which will be higher than the previous payment.
- Full or partial debt forgiveness: where considered appropriate, the Group will consider writing off part of the debt. This may occur where the borrower has an agreed sale and there will be a shortfall in the amount required to redeem the Group's charge, in which case repayment of the shortfall may be agreed over a period of time subject to an affordability assessment or where possession has been taken by the Group, and on the subsequent sale where there has been a shortfall loss.

The Group aims to proactively identify and manage forborne accounts, utilising external credit reference bureau information to analyse probability of default and customer indebtedness trends over time, feeding pre-arrears watch list reports. Watch list cases are in turn carefully monitored and managed as appropriate.

Throughout 2017, the Group continued to observe low levels of accounts in forbearance.

Analysis of forbearance measures undertaken in 2017 by forbearance type:

Forbearance type	**Number of accounts 2017**	**2017 year-end balance £m**	Number of accounts 2016	2016 year-end balance £m (restated)	'17 vs. '16 variance number of accounts	'17 vs. '16 variance of balances £m
Interest only switch	**35**	**3.8**	60	6.3	-25	-2.5
Interest rate reduction	**–**	**–**	3	2.2	-3	-2.2
Term extension	**29**	**4.9**	31	5.9	-2	-1.0
Payment holiday	**50**	**1.5**	37	1.6	13	-0.1
Voluntary assisted sale	**2**	**0.7**	–	–	2	0.7
Payment concession (reduced monthly payments)	**42**	**0.8**	58	3.5	-16	-2.7
Capitalisation	**–**	**–**	3	0.1	-3	-0.1
Total	**158**	**11.7**	**192**	**19.6**	**-34**	**-7.9**

Analysis of forbearance measures undertaken in 2017 by loan type:

Loan type	**Number of accounts 2017**	**2017 year-end balance £m**	Number of accounts 2016	2016 year-end balances £m (restated)	'17 vs. '16 variance number of accounts	'17 vs. '16 variance of balances £m
First charge owner-occupier	**55**	**4.5**	117	12.4	-62	-7.9
Second charge owner-occupier	**77**	**1.6**	60	1.3	17	0.3
Buy-to-Let	**26**	**5.6**	14	5.5	12	0.1
Commercial	**–**	**–**	1	0.4	-1	-0.4
Total	**158**	**11.7**	**192**	**19.6**	**-34**	**-7.9**

Note: The 2016 year end forbearance balances have been restated for second charge owner occupier to remove the related first charge balance, to align to the enhanced approach adopted for 2017.

Fair value of collateral methodology

The Group ensures that security valuations are reviewed on an ongoing basis for accuracy and appropriateness. Commercial properties are subject to annual indexing, whereas residential properties are indexed against monthly house price index ('HPI') data. Where the Group identifies that an index is not representative, a formal review is carried out by the Group Real Estate function to ensure that property valuations remain appropriate.

The Group Real Estate function ensures that newly underwritten lending cases are written to appropriate valuations, where an independent assessment is carried out by an appointed, qualified surveyor accredited by RICS.

Impairment performance

Low arrears, sensible loan to values and growth in loans and advances to customers resulted in the Group observing a historically low impairment performance with a loan loss ratio of 0.07% (31 December 2016: 0.16%). Improved impairment performance was primarily driven by increased prudence in assumptions introduced in 2016 following the UK referendum vote to leave the EU, as well as lower underlying loan losses on acquired residential portfolios and the effect of increasing property values.

During the year, the Group made no changes to provisioning policy or methodologies utilised, however a number of key inputs and estimates used within the collectively assessed provisioning calculations were refreshed utilising the most recently available data and as per the standard governance process. This drove an increase in impairment provision during the six months from 30 June 2017 to 31 December 2017 of 0.09%, versus the annualised loan loss reported for the period 30 June 2017 of 0.04%.

The Group continues to closely monitor impairment coverage levels:

Impairment coverage review	31 December 2017	31 December 2016
Gross loans and advances to customers £m	**7,327.6**	5,964.2
Provisions for impairment losses £m	**21.6**	25.0
Incurred loss remaining £m[1]	**7.9**	8.4
Coverage ratio versus loans and advances %[2]	**0.40**	0.56
Coverage ratio versus impaired balances %[3]	**36.2**	41.5

1. Incurred loss is the expected loss of the portfolio at the point of acquisition and is offset against the modelled future cash flows to derive the effective interest rate for the book. The incurred loss protection is therefore recognised over the life of the book against the unwind of any purchase discount or premium through interest income. Incurred loss remaining is this protection reduced by the cumulative losses observed since acquisition.
2. Coverage ratio versus loans and advances is the total collective and specific provisions plus incurred losses remaining versus gross loans and advances.
3. Coverage ratio versus impaired balances is the total collective and specific provisions plus incurred losses remaining versus impaired balances. Impaired balances are defined as loans where a specific provision has been raised. Personal loans are not included in impaired balances.

The coverage ratio with respect to loans and advances to customers reduced to 0.40% from 0.56% as at 31 December 2016 driven by strong loans and advances growth. Coverage versus impaired balances remained strong at 36.2%. The reduction in provision balances was primarily driven by the resolution of a number of individually assessed legacy problem loans within the year.

Solvency risk

The Bank has maintained an appropriate level and quality of capital to support its prudential requirements with sufficient contingency to withstand a severe but plausible stress scenario. The solvency risk appetite is based on a stacking approach, whereby the various capital requirements (Pillar 1, ICG, CRD IV buffers and Board and management buffers) are incrementally aggregated as a percentage of available capital (CET1 and total capital).

Solvency risk is a function of balance sheet growth, profitability, access to capital markets and regulatory changes. The Bank actively monitors all key drivers of solvency risk and takes prompt action to maintain its solvency ratios at acceptable levels. The Board and management also assess solvency when reviewing the Bank's business plans and inorganic growth opportunities.

In 2017, the Bank strengthened its CET1 ratio by 0.4% to 13.7% and total capital ratio by 1.8% to 16.9% despite strong organic growth, demonstrating both the strength of internal capital generation capabilities through profitability and the ability to raise additional capital in the market.

Liquidity and funding risk

The Bank has a prudent approach to liquidity management through maintaining sufficient liquidity resources to cover cash flow imbalances and fluctuations in funding under both normal and stressed conditions arising from market-wide and Bank specific events. The Bank's liquidity risk appetite has been calibrated to ensure that the Bank always operates above the minimum prudential requirements with sufficient contingency for unexpected stresses whilst actively minimising the risk of holding excessive liquidity which would adversely impact the financial efficiency of the business model.

The Bank has successfully utilised the Bank of England FLS and TFS secured funding facilities to manage its liquidity throughout 2017, and continues to attract new retail savers and retain existing customers through loyalty-based product offerings.

In 2017 the Bank actively managed its liquidity and funding profile within the confines of its risk appetite as set out in the ILAAP. Its liquidity ratio at 15.2% and liquidity coverage ratio ('LCR') at 250% remain well above risk appetite and regulatory minimums.

Market risk

The Bank proactively manages its risk profile in respect of adverse movements in interest rates, foreign exchange rates and counterparty exposures. The Bank accepts interest rate risk and basis risk as a consequence of structural mismatches between fixed rate mortgage lending, sight and fixed term savings and the maintenance of a portfolio of high quality liquid assets. Interest rate exposure is mitigated on a continuous basis through portfolio diversification, reserve allocation and the use of financial derivatives within limits set by ALCO and approved by the Board.

Interest rate risk

The Bank does not actively assume interest rate risk, does not execute client or speculative securities transactions for its own account, and does not seek to take a significant directional interest rate position. Limits have been set to allow management to run occasional unhedged positions in response to balance sheet dynamics and capital has been allocated for this. Exposure limits are calibrated in accordance with a statistically-derived risk appetite, and are calibrated in proportion to available CET1 capital in order to accommodate balance sheet growth.

The Group sets limits on the tenor and rate reset mismatches between fixed rate assets and liabilities, including derivatives hedges, with exposure and risk appetite assessed with reference to historic and potential stress scenarios cast at consistent levels of modelled severity.

Throughout 2017 the Bank managed its interest rate risk exposure within its risk appetite limits. The Bank has also made significant progress in a project to replace its current interest rate risk management system with a new system allowing greater functionality which will enhance the management of interest rate risk. Implementation of the new system is scheduled to be completed during the first half of 2018.

Basis risk

Basis risk arises from assets and liabilities repricing with reference to different interest rate indices, including positions which reference variable market, policy and managed rates. As with structural interest rate risk, the Bank does not seek to take a significant basis risk position, but maintains defined limits to allow operational flexibility.

As with structural interest rate risk, capital allocation has been set in proportion to Common Equity Tier 1 capital, with exposure assessed and monitored monthly across a range of 'business as usual' and stressed scenarios.

Throughout 2017 the Bank managed its basis risk exposure within its risk appetite limits.

Operational risk

OSB continues to adopt a proactive approach to the management of operational risks. The operational risk management framework has been designed to ensure a robust approach to the identification, measurement and mitigation of operational risks, utilising a combination of both qualitative and quantitative evaluations in order to promote an environment of progressive operational risk management. The Group's operational processes, systems and controls are designed to minimise disruption to customers, damage to the Bank's reputation and any detrimental impact on financial performance. The Bank actively promotes the continual evolution of its operating environment through the identification, evaluation and mitigation of risks, whilst recognising that the complete elimination of operational risk is not possible.

Where risks continue to exist, there are established processes to provide the appropriate levels of governance and oversight, together with an alignment to the level of risk appetite stated by the OSB Board.

A strong culture of transparency and escalation has been cultivated throughout the organisation, with the operational risk function having a Group-wide remit, ensuring a risk management model that is well embedded and consistently applied. In addition, a community of Risk Champions representing each business line and location have been identified. Operational Risk Champions ensure that the operational risk identification and assessment processes are established across the Group in a consistent manner. Risk Champions are provided with appropriate support and training by the Operational Risk function.

Regulatory and compliance risk

The Bank is committed to the highest standards of regulatory conduct and aims to minimise breaches, financial costs and reputational damage associated with non-compliance. However, given the growing scale and complexity of regulatory changes, it is acknowledged that there may be isolated instances whereby the Bank's interpretation and response to new regulatory requirements reflects the Bank's specific circumstances and its desire to give the best customer outcomes.

The Bank has an established Compliance function which actively identifies, assesses and monitors adherence with current regulation and the impact of emerging regulation.

In order to minimise regulatory risk, OSB maintains a proactive relationship with key regulators, engages with industry bodies such as UK Finance, and seeks external advice from our auditors and/or other third parties. The Group also assesses the impact of upstream regulation on OSB and the wider market in which we operate, and undertakes robust assurance assessments from within the Risk and Compliance functions.

Conduct risk

The Bank considers its culture and behaviour in ensuring the fair treatment of customers and in maintaining the integrity of the markets in which it operates to be a fundamental part of its strategy and a key driver to sustainable profitability and growth. OSB does not tolerate any systemic failure to deliver fair customer outcomes.

On an isolated basis, incidents can result in detriment owing to human and/or operational failures. Where such incidents occur they are thoroughly investigated, and the appropriate remedial actions are taken to address any customer detriment and to prevent recurrence.

OSB considers effective conduct risk management to be a product of the positive behaviour of all employees, influenced by the culture throughout the organisation and therefore continues to promote a strong sense of awareness and accountability.

Strategic and business risk

The Board has clearly articulated the Bank's strategic vision and business objectives supported by performance targets. The Bank does not intend to undertake any medium to long-term strategic actions which would put at risk the Bank's vision of being a leading specialist lender in its chosen markets and being backed by a strong and dependable saving franchise.

To deliver against its strategic objectives and business plan, the Bank has adopted a sustainable business model based on a focused approach to core niche markets where its experience and capabilities give it a clear competitive advantage.

The Bank remains highly focused on delivering against its core strategic objectives and strengthening its market position further through strong and sustainable financial performance.

Reputational risk

The Bank considers reputational risk to be a second order risk which is likely to be the result of a failure related to one of its other principal risks. The Bank monitors reputational risk through tracking media coverage, customer satisfaction scores, the share price and net promoter scores provided by brokers.

Viability statement

In accordance with provision C.2.2 of the UK Corporate Governance Code, the Board of Directors have assessed the prospects and viability of the Group over a three-year period by comprehensively assessing the principal risks and uncertainties to which it is exposed and have concluded that they have a reasonable expectation that the Group will be able to continue to operate and meet its liabilities as they fall due over that period.

The three-year time period was selected for the following reasons:

- The Group's operating and financial plan covers a three-year period
- The three-year operating and financial plan considers, among other matters: the Board's risk appetite; macro-economic outlook; market opportunity; the competitive landscape; and sensitivity of the financial plan to volumes, margin pressures and capital requirements
- The Board believes that there is sufficient visibility over the economic and regulatory landscape and the market outlook offered by the three-year time horizon to make a reasonable assessment of viability; and
- Uncertainty in the UK economic outlook over the medium to long term following the EU referendum outcome.

The Company is authorised by the PRA, and regulated by the FCA and PRA, and undertakes regular analysis of its risk profile and assumptions. It has a robust set of policies, procedures and systems to undertake a comprehensive assessment of all the principal risks and uncertainties to which it is exposed on a current and forward-looking basis (as described in Principal risks and uncertainties on pages 39 to 44).

The Group manages and monitors its risk profile through its strategic risk management framework, in particular through its risk appetite statement and risk limits (as described in the Risk review on pages 32 to 38). Potential changes in its risk profile are assessed across the business planning horizon by subjecting the operating and financial plan to severe but plausible macroeconomic and idiosyncratic scenarios.

Stress testing is a vital discipline, which underpins the Group's ICAAP and ILAAP. The Group has developed a bespoke macroeconomic model which identifies the most predictive macroeconomic variables and their relative relationship to arrears, collateral valuations and loan losses. As a secured mortgage lender, the Group is most sensitive to changes in house price movements, unemployment and Bank of England base rate changes. The Group's stress testing capability then leverages the developed macroeconomic variable relationships to conduct detailed scenario analysis over a range of stress scenarios which feed key risk processes such as the setting of risk appetite, loan loss forecasts and ICAAP and ILAAP stress testing activity.

In addition, the Company identified a suite of credible management actions that would mitigate the impact of the stress scenarios. The Board and executive management use the outcome of the stress test analysis to evaluate the Company's management options and adequacy of the Company's capital and liquidity resources to withstand an extreme but plausible stress scenario. The Company holds sufficient capital to withstand such a stress scenario.

In addition, the Group identifies a range of catastrophic stress scenarios, which could result in the failure of its current business model. Business model failure scenarios (reverse stress tests) are primarily used to inform the Board and executive management of the outer limits of the Group's risk profile. Reverse stress tests play an important role in helping the Board and its executives to identify potential recovery options under a business model failure scenario, and form an important aspect of the Company's recovery and resolution plans prescribed by the regulator. During the year a number of reverse stress test scenarios were analysed including an extreme macroeconomic downturn (1 in 200 severity), a cyber-attack leading to a loss of customer data which is used for fraudulent activities, extreme regulatory and taxation changes impacting Buy-to-Let lending volumes and a liquidity crisis caused by severe market conditions combined with idiosyncratic consequences.

The ongoing monitoring of all principal risks and uncertainties that could impact the operating and financial plan, together with the use of stress testing to ensure that the Group could survive a severe but plausible stress, enables the Board to reasonably assess the viability of the business model over a three-year period.

Corporate responsibility report

Operating sustainably and responsibly is integral to our business model and strategy, and builds on OneSavings Bank's long tradition of putting the customer at the heart of everything we do.

Our Core Values: Specialist, Personal and Flexible reflect our commitment to interact ethically, responsibly and with integrity with all our stakeholders and the wider community in which we operate:

- We take a SPECIALIST approach to everything we do – we ensure we understand our stakeholders' requirements and use our creativity, skill and expertise to fulfil their requirements with honesty and integrity
- We take a PERSONAL approach to everything we do – we treat everyone with respect and take accountability for our actions
- We take a FLEXIBLE approach to everything we do – we ensure that we work collaboratively with our colleagues, customers and other stakeholders to achieve shared positive outcomes

What we achieved in 2017

In 2017, we successfully delivered on a number of initiatives across the business aimed at improving our relationships with key stakeholders and achieving strong results, including:

- Customers – consistently high consumer net promoter score, +62
- Employees – significantly improved employee engagement survey results
- Communities – donated over £209,000 to community and charitable causes

Focused on our customers

OneSavings Bank ('OSB') encourages a culture that aims to:

- Communicate and deal with each customer on an individual basis
- Act with consistency across all channels
- Be a confident, open and trustworthy workforce
- Offer simplicity and ease of business
- Offer long-term value for money, and
- Offer transparent products without the use of short-term bonus rates, and to offer existing customers the benefit of loyalty rates.

Our customers are part of our success and we aim to become a financial services provider of choice. To achieve that, the Group established a governance framework for consistent best practice across the Group to ensure there are robust policies and procedures to minimise the risk of failure to deliver the service our customers have come to expect from us.

The relevant policies include:

- Conduct Risk Policy, including treating customers fairly to ensure the Group conducts its business fairly and without causing customer detriment
- Responsible Lending Policy to ensure that the Group lends money responsibly
- Complaints Handling Policy to ensure the Group responds to complaints swiftly, fairly and consistently
- Vulnerable Customer and Suicide Awareness Policy to ensure that employees can identify vulnerability and potential suicide risks in our customers and put in place appropriate actions to deal with such issues as effectively as possible
- Anti-Money Laundering and Counter Terrorist Financing Policy to ensure the Group is not used to further criminal activities
- Anti-Bribery and Corruption Policy to ensure the Group carries out its business honestly
- A Conflicts of Interest Policy to ensure the Group can identify and, if possible, avoid conflicts, and where this is not possible to manage conflicts fairly
- Data Protection and Retention Policies to ensure the Group protects its customer data, manages and retains it fairly and appropriately
- Whistleblowing Policy to ensure that any employee who raises concerns around misconduct is protected
- Environmental Policy to conduct our business in an environmentally aware manner, and
- Diversity and Equality Policy to promote diversity and equality in our workforce.

Employees have mandatory training on all the key policies, with a completion rate of 100% in 2017.

Customer engagement

We take a personal approach to our customers, treating each customer as an individual and listening to their needs. Many of our customers are also members of the Kent Reliance Provident Society, the Society that took over the management of the membership of the former Kent Reliance Building Society. The Bank and the Society have benefited from member engagement through the online 'portal' launched late in 2015 enabling input from a geographically broader range of members. Topics of engagement have included key areas of customer literature, working with saving and borrowing members helping the Bank to maximise clarity and understanding, and product retention process enhancement. Each year we hold an AGM at which members can engage with senior management and discuss their ideas for improving our customer experience.

Our commitment to our customers is evidenced in the strong net promoter score (a measure of how likely a customer is to recommend a business on a scale of -100 to +100) we achieve across our lending and saving franchises, which in 2017 has improved to +62. In addition, we won numerous awards for being the best provider for a range of services from cash ISAs to Buy-to-Let mortgages.

Customer complaints

Whilst we concentrate on providing an excellent service, when things have gone wrong, we aim to put this right and learn from any mistakes made. We have a comprehensive, Group-wide complaints handling system and our staff complete rigorous training programmes to ensure a compliant and fair process is followed.

Kent Reliance savings

WINNER
Best Cash ISA Provider
Moneyfacts Awards 2017 (for the fifth year running)

WINNER
ISA Provider of the Year
Consumer Moneyfacts 2017 (for the second year running)

WINNER TWO TIMES
Moneyfacts Consumer Award 2016 & 2017
ISA Provider of the Year

Kent Reliance for intermediaries

WINNER
Best Specialist Lender
The Mortgage Strategy Awards 2017

WINNER
Best Business Development Managers Team
The Mortgage Strategy Awards 2017

WINNER
Specialist Lender of the Year
The Mortgage Introducer Awards 2017

mortgage strategy AWARDS '17 Best BDM Team WINNER

mortgage strategy AWARDS '17 Best Specialist Lender WINNER

Corporate responsibility report continued

Focused on our employees

Our employees are our key asset. Their skills, expertise and enthusiasm are central to achieving our strategic goals, and we continue to invest in their training, development and employee engagement activities to make OSB the best work-place it can be.

In 2017, the Group established a Talent Acquisition team in order to introduce an appropriate level of recruitment specialism within the HR function to better support business growth and implement a formalised, competency-based interview and selection process. Our recruitment procedures are fair and inclusive, with shortlisting, interviewing and selection always carried out without regard to gender reassignment, sexual orientation, marital or civil partnership status, colour, race, caste, nationality, ethnic or national origin, religion or belief, age, pregnancy or maternity leave or trade union membership.

No candidate with a disability is 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 are made to ensure that no applicant is disadvantaged because of their disability and questions asked during the process are not in any way discriminatory or unnecessarily intrusive. To that end, the Group achieved Disability Confident Committed (Level One) status in 2017 (for more details, see below).

We welcomed 177 new employees in the UK and 173 new employees in India in 2017, and in line with the continued growth of the business, OSB has acquired a third office in Chatham to accommodate our expanding workforce.

Training and development

We encourage employees to carry out their work to the best of their ability and promote learning and development opportunities across the organisation. Our newly created and consolidated People Development function manages the allocation and completion of monthly mandatory e-learning modules, the delivery of in-house workshops, programmes and coaching in addition to coordinating employees attending external or in-sourced training activities. In 2017, 685 employees attended 149 separate internal and external workshops or learning events. The completion rate for our mandatory monthly online compliance training throughout the year was 100%; demonstrating the importance we continue to place on ensuring our employees are suitably aware of key requirements.

The Group is also committed to supporting employees undertaking professional development and in 2017, ten employees received financial support in pursuit of their professional qualifications.

In 2018, the Group intends to extend its commitment to widening accessibility of employment opportunities at the Bank by implementing an Apprenticeship Scheme.

Talent management and leadership programmes

Following a robust talent mapping exercise, we have identified employees who constitute our Primary Talent Group, based on their respective performance and potential. Throughout 2017, a range of associated talent management activities have been undertaken.

At the end of 2017, all members of the Primary Talent Group had been retained, 60% were undertaking different or expanded roles and 27% had been formally promoted.

We are constantly seeking to identify outstanding employees and in line with this, talent mapping will be undertaken as an annual process in order to support the progression of those who are identified as potential senior leaders of the future.

While we are still a relatively small business in terms of employee numbers, we advertise vacancies internally on a weekly basis in order to provide career development opportunities for existing employees. In 2017, we filled 36% (84 of 233) of vacancies with internal candidates.

OSB has a genuine desire to retain, support and develop its employee base. During 2017, 66 employees in the UK and ten employees in India were formally promoted to a more senior grade. Our regretted attrition rate for 2017 was 12% for UK employees and 18% for our employees in India.

Remuneration and benefits

We believe in rewarding our employees fairly and transparently, enabling them to share in the success of the business. Details of the Group's remuneration policies can be found in the Remuneration Report on pages 81 to 95.

We offer our employees a comprehensive range of benefits, and continue to review these to ensure they are in line with market practice. Although the list is not exhaustive, our benefits include pension contributions, medical insurance, life cover, a childcare voucher scheme, interest free season ticket loan and a cycle purchase scheme. In 2017, we introduced a casual dress code throughout our offices following an employee vote.

We also encourage our employees to hold shares in the Bank for the long term, via an annual Sharesave Scheme. The scheme is open to all UK-based employees and allows them to save a fixed amount of between £5 and £500 per month over either three or five years in order to use these savings at the end of the qualifying period to buy the Company's shares at a fixed price established when the scheme was announced. The Group first launched its annual Sharesave Scheme in June 2014 and over 250 employees are members the scheme.

In 2017, 100 employees saw their 2014 Sharesave Scheme mature, with the total value of their respective individual plans increasing by around 300%.

Employee engagement

In 2017, OSB participated in the 2018 Sunday Times Best Companies Employee Engagement survey, with 83% of UK employees completing the survey.

The survey results demonstrated an overall increase of 4.8% and the achievement of a 1 Star Accreditation Rating, signifying very good levels of workplace engagement and represented a significant improvement when compared to the previous two annual surveys when the Bank achieved a 'One to Watch' rating.

As part of the continuing commitment to employee engagement, OSB also participated for the first time in the Banking Standards Board survey, which aims to influence positive change throughout the banking sector. The survey provided an insight into employees' perception of the application of their company's values, potential barriers to challenge and to speak up along with their observations of unethical or inappropriate behaviour. The results from this survey will help to shape the Group's agenda and commitment to a shared purpose and values for all employees in 2018.

OSBIndia ('OSBI') takes part in its own survey, run by the Great Place to Work Institute. In 2017, OSBI was officially certified as a 'Great place to work', with a strong performance in all indicators, including organisation trust, credibility of management, respect for people, fairness at the workplace, camaraderie and culture. OSBI's overall Trust index score improved significantly in 2017 to 75, up from 66 in 2016, and it received the highest score in Pride, reflecting the strong brand and culture that has been created.

Throughout 2018, OSB will be using the results of all of the surveys to establish opportunities to deepen employee engagement on both Group-wide and department levels. We will also be engaging with external consultants in order to define our Vision, Mission and Values and establish a range of related actions that will enable us to fully embed these and proactively drive positive cultural change throughout the business.

Employee recognition and awards

Through our Long Service Award programme, the significant tenure of 41 employees was recognised in 2017, each of whom reached a 5, 10, 15, 20 or 25 year milestone and one other employee who reached 30 years' service.

Every quarter, all of our employees have an opportunity to nominate their colleagues as part of OSB's Quarterly Employee Recognition Programme. In 2017, 306 separate nominations were received and each quarter, an Employee of the Quarter was selected along with two runners-up. Over the year, 12 employees received an award.

Our employees are valued for their expertise, not only by the Bank, but also by the wider industry. In 2017 Adrian Moloney, OSB's Sales Director was recognised by The British Specialist Lending Awards in the category Complex Buy-to-Let Lender.

Health and safety

We have a duty of care to all of our employees, and a safe and healthy work environment is paramount to OneSavings Bank. We are committed to fostering and maintaining a working environment in which our employees can flourish, and our customers can safely transact with us.

We operate a Group Health and Safety Policy and we review our employee and customer environment regularly.

Activities in 2017

- Undertaking mandatory Company-wide health and safety training with 100% completion
- Undertaking a full review and continuing to make improvements where necessary on recently acquired corporate real estate to ensure statutory health and safety compliance for all sites
- As part of achieving Level 1 of Disability Confident Scheme we have ensured that our office locations are accessible to disabled employees.

Diversity and inclusion

At OSB, we recognise the benefits that diversity of our people brings to the business and we actively promote and encourage a culture and environment which values and celebrates our differences. In 2017 we continued our journey to become a truly diverse and inclusive organisation, which is committed to providing equal opportunities through the recruitment, training and development of our employees. Some of our achievements included:

- Formalising our Diversity and Inclusion Policy and establishing a range of diversity initiatives including unconscious bias training for the Board and Executive Committee
- Attaining Disability Confident Committed (Level One) status, with an aim to achieve Level Two status in 2018. By becoming Disability Confident, the Group is committed to employing, supporting and retaining those with disabilities and health conditions and we will be partnering with Kent Council's Employability Advisor to ensure a proactive approach is taken in seeking to increase the current number of disabled staff who are employed within the Group.

disability confident
COMMITTED

- Implementing the requirement to seek to interview equal numbers of male and female candidates at the first round interview stage for more senior roles
- Including a set of diversity specific questions in the exit interview process to enable ongoing identification of potential issues and opportunities for further enhancements, and
- Becoming a signatory to HM Treasury's Women in Finance Charter, which is formally published on the Group's website and details our commitment that by 2020, 30% of our senior management roles will be undertaken by female employees. The Group has also implemented the requirement to ensure that the pay of members of the Executive Committee is linked to the delivery of the Group's gender diversity targets (see the Remuneration Report on page 81).

Corporate responsibility report continued

We recently published our gender pay gap in line with new legislation which requires UK companies with more than 250 employees to report their gender pay gap – the difference between the average amount that women and men are paid across the whole workforce. As at April 2017, the mean pay gap at OSB was 47%. Gender pay is not the same as equal pay and we are confident that we do not have any issue in respect of equal pay. Our gender pay gap relates directly to the structure of our workforce and reflects the fact that we have more men than women in senior roles.

We recognise that we need to focus on improving our gender balance and have a number of initiatives in place to do so:

- Aside from our existing aim of seeking to interview equal numbers of male and female candidates for roles at management level, we will be implementing a requirement that with senior management vacancies, a first round face to face interview with a female candidate must be undertaken before the recruitment process can proceed, with all exceptions to this requiring Executive approval. The same requirement will apply to vacancies at clerical level in respect of male candidates.
- We are in the process of establishing a broader suite of gender related management information. We will track monthly progress in respect of gender diversity and gender pay gap initiatives and share this openly and transparently with our employees.
- We have established a Women's Networking Forum to assist the internal progression of our existing female employees. This provides a forum for guest speakers and aims to provide practical development tips and encouragement for career progression.

Our full gender pay gap report can be found on our website: www.osb.co.uk.

Over 58% of our UK workforce is female, we have three female Directors (33% of the Board) and two female members of the Executive Committee (20%).

In our office in India, women constitute 36% of the total workforce.

	Male	Female
Number of Board Directors	7	3
Number of Directors of subsidiaries	13	1
Number of senior managers (not Directors)	58	17
All other employees[1]	318	517

1. Includes OSBIndia.

We already have 13% of our UK employees working under flexible working arrangements, with the majority of these employees working part-time hours and we will be seeking to further develop this by revising our Flexible Working Policy to provide increased support to those employees with parental and carer responsibilities.

Human rights

We want each member of our workforce and other stakeholders to be treated with dignity and respect. OSB endorses the UN Declaration of Human Rights and supports the UN Guiding Principles of Business and Human Rights. The Group adheres to the International Labour Organisation Fundamental Conventions. We seek to engage with stakeholders with fairness, dignity and respect. The Company does not tolerate child labour or forced labour. OSB respects freedom of association and the rights of employees to be represented by trade unions or works councils. The Group is a fair employer and does not discriminate on the basis of gender, religion, age, caste, disability or ethnicity. Our policy applies throughout the Group and is communicated to our employees during induction training.

In 2015, the Modern Slavery Act came into force and it encompasses slavery, human trafficking, forced labour and domestic servitude, and applies not only to OSB as a Group but also to our supply chain. The Group's Modern Slavery Statement was published on 30 June 2017. Coupled with the statement, the completion rate for the mandatory monthly online training on modern slavery was 100% with more focused training due to be implemented in 2018. As part of the Bank's continuing commitment to eliminating abuse and exploitation not just in our workplace but in that of our suppliers, the Bank has produced and is implementing a Vendor Code of Conduct by which all our suppliers will be expected to comply.

OSBIndia

OSBI is a wholly-owned subsidiary of the Group. OSBI operates from an office in Bangalore and currently employs 366 people. OSBI supports the Bank across various functions such as Customer Service, Operations, IT and other support services. We actively promote integration between our colleagues in the UK and India with frequent employee exchanges, transfers, overseas training and management visits. The state-of-the-art Bangalore office has been extended in the year to accommodate the growing number of our Indian colleagues and a new business continuity site in Hyderabad was opened. We have also completed ISO 9001 and 27001 certifications in 2017, a testament to the Group's commitment to information security at the highest level.

As part of the Group, OSBI falls under the same Group policies that are in force in the UK offices, most importantly, equal opportunities, non-discrimination and harassment, whistleblowing, information security and clear desk policies. There are only very slight differences in the Group's main HR policies due to local legislation.

In compliance with the Modern Slavery Act, we do not support excessive overtime and our employees in India are encouraged to work in accordance with local legislation. Employees in our Bangalore office enjoy a range of benefits which includes 21 days of annual leave, 10 days' sick leave and cafeteria services.

Focused on the environment

This year, we continued to implement the objectives set out in our Environmental Policy and as a result, the Bank has introduced many initiatives to enhance our commitment to conducting our business in an environmentally responsible way.

As an office-based financial services provider, we have a relatively low impact on the environment. However, we aim to further promote awareness of the environmental issues amongst our employees in order to reduce consumption of resources and take measures to minimise our negative impact on the environment in which we operate.

In 2017, we appointed an independent consultant to undertake an environmental audit which, once complete, will highlight areas where we can improve and assist us in setting more effective objectives for becoming a greener organisation in 2018.

Activities in 2017

Some of the activities that we implemented during the year include:

- Pro-active energy management and measures undertaken across our corporate real estate which resulted in a reduction of electricity and gas consumption in 2017
- We now source all of our energy from green energy providers
- Installation of a charging point for electric vehicles in our head office.

Greenhouse gas emissions

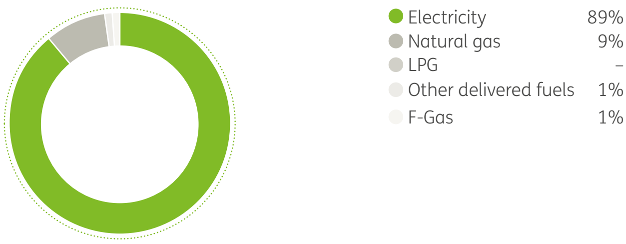
	CO_2e tonnes	
Emission type	**Location-based method**	**Market-based method**
Scope 1: Operation of facilities	12	–
Scope 1: Combustion	101	–
TOTAL SCOPE 1 EMISSIONS	113	–
Scope 2: Purchased energy (UK)	458	264
Scope 2: Purchased energy (rest of world)	452	
TOTAL SCOPE 2 EMISSIONS	910	264
Total emissions	**1,023**	**264**

1. Location-based figure used where market-based not available.

Greenhouse gas emissions intensity ratio:

	Total footprint (Scope 1 and Scope 2) – CO_2e		
	Previous year (2016)	**Current year (2017)**	**Year on year variance**
Turnover (£m)	201.4	**238.1**	**18%**
Intensity ratio – Scope 2 location-based method (tCO_2e/£100,000)	0.004	**0.004**	**–**
Intensity ratio – Scope 2 market-based method (tCO_2e/£100,000)	0.003	**0.003**	**–**

Emissions breakdown by source (tCO_2e)



Emissions breakdown by category (tCO_2e)

Notes:

- Our methodology has been based on the principles of the Greenhouse Gas Protocol, taking account of the 2015 amendment which sets out a ‘dual reporting’ methodology for the reporting of Scope 2 emissions. This means that UK electricity is reported using two methods
- 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
- The period of our report is 1 January 2017 to 31 December 2017
- This includes emissions under Scope 1 and 2, except where stated, but excludes any emissions from Scope 3
- Conversion factors for UK electricity (location-based methodology), gas and other emissions are those published by the Department for Environment, Food and Rural Affairs for 2017/18
- Conversion factors for UK electricity (market-based methodology) are published by electricityinfo.org
- The market-based methodology has only been applied to UK electricity supplies
- Conversion factors for overseas electricity, gas and other emissions are those published by the International Energy Agency for 2016
- Conversion factor used for R417A (F-Gas) is published by Linde Gas
- Conversion factor used for R22 (F-Gas) is published by Department for Environment, Food and Rural Affairs for 2016/17
- As the old office in India closed during the 2016 year, the following site and associated emission IDs have been retired and are not included within the 2017 report: India (Old Office)
- The following sites have been added to the portfolio during the 2017 year: India Disaster Recovery Site (Hyderabad) and The Observatory
- The addition of these two new sites into the portfolio has resulted in an increase in electricity usage and the associated Scope 2 Purchased Energy carbon figures

Corporate responsibility report continued

- There has been a significant reduction in both diesel fuel usage and F-Gas recharges between 2016 and 2017
- The reduction of reported diesel usage in 2017 is the result of increased usage in 2016 at the new India site where fuel purchased by OSB was used by contractors during the construction/refurbishment process
- The reduction in F-Gas recharges is the result of no UK F-Gas refills occurring during the 2017 year.

Statement of exclusions
- Global diesel/petrol use (for vehicles) has been excluded from the report on the basis that it is not material to our carbon footprint
- It has been confirmed there is no LPG use within the estate either in the UK or overseas
- It has been confirmed that there is no mains gas supply in relation to the India operations
- Two UK sites: Heritable and InterBay, have been excluded from reporting as it has been confirmed that these are managed rented properties and are therefore considered to be Scope 3 emissions and are not readily available. An additional managed rented site has been added in the 2017 year – Newman Street. This has been treated as an exclusion in order to be consistent with the methodology applied to the Heritage and Interbay sites. We intend to collect data relating to managed rented properties during the 2018 year so that they can be reported as Scope 3 emissions in the 2018 report.

Focused on our community

OSB has very strong links with the community in which it operates, especially through its Kent Reliance brand which has been synonymous with the county of Kent and has been a passionate supporter of its local community for over 150 years.

As we are one of the largest employers in the region, many of our employees live within the local community and therefore have a personal affinity with local causes and projects. Employee feedback is vital in helping to decide where support can be best placed within the community.

Our diverse community services programme includes being a major sponsor of South-East-based ‘Demelza Hospice Care for Children’ and staff-nominated national charity ‘Winston’s Wish’. We also donate to local Kent-based charitable causes through our ‘Kent Reliance Community Fund’ (‘KRCF’). KRCF is the key sponsor of the ‘Kent County Football Association’ (which includes 24 County Cup competitions and player development centres for under-represented groups) and ‘Kent County Cricket Club’, and provides sponsorship for the disability squads and academy programme which helps to develop new talent. Our ‘Project Kent’ and ‘Make Someone’s Christmas’ campaigns are undertaken with a local media partner to highlight and support local people and projects in need. For the fifth year running, we have supported a key reading initiative, called ‘Buster’s Book Club’ at Medway primary schools, which focuses on fun and innovative ways to help develop literacy levels.

In 2017, we refocused our community services programme to provide more of a ‘hands on’ approach by encouraging our employees to take an active role with all fundraising and volunteering opportunities. Each employee is given one day’s annual leave for volunteering which they can use to actively support any registered charity of their choosing, or to support the Bank’s charity partnerships. Furthermore, if employees choose to undertake additional fundraising activities then the Bank will match any funds raised up to a specific amount. During the year, employees carried out over 300 volunteering hours, which in monetary terms equates to nearly £7,000.

Overall, the Bank has contributed a total of over £209,000 to community and charitable causes in 2017 through sponsorship programmes, activities and donations.

Demelza Hospice Care for Children

Demelza is a children’s hospice charity in the South-East, providing compassionate and expert care for babies, children, young people and their families. As a registered charity, Demelza offers bespoke support, free of charge, to families and is available 24 hours a day, 365 days a year. In order to provide these vital services, it needs to raise over £10m a year.

As a locally-based charity, employees from Kent Reliance are hugely aware of and are keen supporters of Demelza. They participated in a number of fundraising events throughout the year including being headline sponsors and participants of the annual Kent Messenger Dragon Boat Race, which helped raise over £150,000 in sponsorship for local charities and good causes across the county in 2017. The event continues to be one of the biggest charity fundraising events staged in Kent and the Kent Reliance teams helped raise donations for Demelza through their efforts on the day and subsequent promotion.

Kent Reliance also takes huge pride in raising money for Demelza through a range of annual fundraising events involving quizzes and bake-off challenges. Aside from straightforward fundraising, we also engage with the local community by gifting our branch network as collection and promotion outlets for the charity. Engagement with the charity doesn't end with our sponsorship. Employees actively welcome opportunities to get hands-on with Demelza, with many visiting the Hospice on volunteer days to help clear and maintain the grounds, create a new sensory garden for families and any other tasks that may arise during the year.

Winston's Wish

Throughout 2017, we continued to support our nominated corporate charity, Winston's Wish, which was the first charity to establish child bereavement support services across the UK. Winston's Wish provides specialist support programmes for children affected by deaths related to homicide and suicide, as well as military families who have been bereaved.

The highlight of this year's fundraising activity took place in June as eight intrepid employees from across the Group cycled a 270-mile route, stopping at each of our UK branches and offices in three days. Fortunately, the team was blessed with great weather, no major mechanical incidents and only a few map reading glitches. 270 miles in three days was an ambitious target but, ably supported by huge helpings of food and encouragement at each of our branches and offices, the team managed to raise a grand total of £11,155 for Winston's Wish, bringing the total amount raised throughout 2017 to £17,700.

Project Kent

Project Kent was a new initiative that launched in 2017 in conjunction with the KM Media Group, led by KMFM. This community initiative was powered by nominations from local people who were asked to nominate a local scheme they thought was of benefit to the local community. Nominations received varied, including a community centre that had fallen into disrepair, a neighbourhood group that needed equipment for an afterschool club and a small local charity struggling to promote their services.

Throughout the selection process, it was clear that there were two schemes that fully deserved a helping hand as each presented a wonderful asset to their local communities. Both Farthing Corner Community Centre and Beltinge Nursery were integral assets within their community but due to lack of funds they were unable to make vital repairs or make improvements to their existing services.

The projects offered employees an opportunity to provide hands-on support through internal decorating, grounds clearance and general cleaning once building works had been carried out. Both projects have benefitted greatly from the improvements and are now better equipped to serve their local communities for many more years to come.

Kent County Football Association

The partnership between Kent FA and Kent Reliance has grown over the last five years and now covers all 24 Kent County Cup competitions. Kent Reliance is also a key sponsor of the Kent Girls and Disability Player Development Centre, resulting in us being named Kent FA's first official 'Community Partner'.

The Kent Reliance Girls and Disability Player Development Centres provide professional coaching to improve the standards of girls and disability grassroots football in Kent. The support from Kent Reliance will enable the transition of young players to elite football as well as providing a community exit route for players leaving the elite talent pathway.

Paul Dolan, Kent FA's Chief Executive, is delighted to have the continued support from Kent Reliance,

"We are now in the fifth and final season of the partnership between Kent Reliance and the Kent FA, which has always been about supporting and promoting our local community. Both organisations are totally committed to being inclusive and our innovative partnership has reflected this by engaging, developing and rewarding all areas of our diverse community.

The Kent Reliance Girls and Disability Player Development Centres have provided a unique opportunity for talented players in Kent to gain additional football coaching and the 24 Kent Reliance County Cup competitions have catered for over 1,000 community-based teams each season of all standards and ages to play competitive football. This community-based partnership between Kent Reliance and the Kent FA has been used as a model of best practice for other County Football Associations across the country to emulate in order to further the development of grassroots football."

This partnership also sees the continuation of the highly successful #MagicOfTheCup competition which is run on a monthly basis during the football season and encourages local teams to enter a submission which illustrates sportsmanship, goodwill and skilled play. In return, the winning team receives football equipment and is put forward to compete as overall winner. Over 15 teams won football equipment during the competition last season and this year the overall winner was Ramsgate Football Club Senior Team. The team won 16 tickets for the England vs Slovakia international match at Wembley on 4 September 2017.

Kent Charity Awards

The Kent Charity Awards ('KCA') showcase the hard work that charities and voluntary groups from around the county undertake to make the lives of others better. Celebrating and supporting the county at a grassroots level is key to Kent Reliance's charitable endeavours and our sponsorship of KCA reflects that.

Corporate responsibility report continued

Kent County Cricket Club

In 2017, Kent Reliance continued its partnership with KCCC, by supporting the Club's community programme. As with our commitment to Kent FA, this relationship is another opportunity to really support grassroots activity within the county and encourage people of all abilities to get involved and enjoy sport. Our sponsorship activity provides for funding for the Disability Performance Squads who currently operate two teams:

- The Kent Reliance Learning & Physically Disabled ('LDPD') Performance Squad
- The Kent Reliance Visually Impaired ('VI') Performance Squad
- Both squads train during the winter months and represent Kent in national competitions against other counties during the summer months. This is the first step to representing the national team managed by the England and Wales Cricket Board. The LDPD squad currently plays in two formats of cricket, both softball, and for the more experienced players, full cricket balls (hardball). The VI team play with size three footballs which have been adapted to contain beads which rattle, although the national team play with regular cricket ball size hardball, again adapted to rattle and the squad trains throughout the year at a number of venues around the county.

Jamie Clifford, CEO, KCCC, says "We have been delighted to once again enjoy the support of Kent Reliance in 2017. With Kent Reliance we have continued to develop the Academy programme. The partnership has enabled us to bring in specialist coaches and further develop players' life skills, which helps the preparation for a professional career. Our disability cricket programmes have also been boosted by the support of Kent Reliance which allows us to provide kit, coaching and facilities for our players. Thank you Kent Reliance for the difference you make."

Make Someone's Christmas

The Make Someone's Christmas campaign encourages listeners and readers of KMFM and KM Media Group and customers of Kent Reliance branches, to nominate those people they feel deserve an extra special treat during the festive season. Following the big success of the programme in previous years, this year had a hard act to follow but achieved as many nominations for the well-deserving and those in need. In 2017, we helped ten special people in Kent with ten bespoke prizes that really helped make their Christmas. Nominations were varied and included a father and daughter that had lost their wife and mum just before Christmas, an eight-year old boy who wanted to nominate his parents for their hard work in the community and a woman who annually put her Christmas Day on hold so that she could provide a Christmas lunch for the elderly. Each winner was announced live on the radio during a two-week period and received well-deserved prizes ranging from holiday vouchers to a spa day.

Kent Literacy Scheme

In 2017, Kent Reliance continued to support this educational charity to develop its new home reading initiative – Buster's Book Club – in ten Medway schools. The scheme was extremely successful across the county with more than 7.5 million minutes of reading achieved and making the 26,000 children involved official members of the Millionaire Reading Club.

OSBI fundraising

Corporate social responsibility ('CSR') is extremely important to OSBI. The concept of helping society is embedded in its corporate governance structure through the CSR policy and also through employee engagement.

As part of the OSBI CSR policy, funds are kept aside each year to spend on social causes. This is governed by a CSR Committee and implemented by the Corporate and Social Responsibility Group.

The focus is to help and contribute in areas where there is critical need and within the office locality so they are also able to contribute their time.

In 2017, the CSR Group agreed to support the areas of child welfare, education and healthcare.

Child welfare

OSBI has partnered with the SOS Children's Village, located in Bangalore, to fund education, food, clothing and housing for 20 orphans. Working together with SOS, OSBI employees helped to provide support for the holistic development of orphans, women and children belonging to vulnerable families. OSBI also hosted a couple of events at SOS for their staff to engage with the children, which was highly appreciated by both children and the employees.

Healthcare

OSBI is currently supporting affordable healthcare through a local government-run hospital called CV Raman General Hospital. The hospital provides subsidised medical facilities to the financially challenged members of the community in and around east Bangalore. OSBI has contributed various surgical and arthroscopy equipment that has enabled the hospital to conduct complex surgeries at a fraction of the price charged by private hospitals; for example, they are able to carry out keyhole surgery for ligament tears at under £5!

OSBI are now working with the hospital administration to provide employee volunteers to redo the gardens around the hospital which are currently in a poor state. OSBI plans to complete landscaping work with flowering trees and sprawling lawns along with a children's play area and believes that this will aid in the emotional recovery of the patients.

Portfolio landlord

We needed to verify the wider portfolio of a new customer to the Group who was applying for a Buy-to-Let purchase.

The applicant completed the cash flow statement, business plan and asset and liability statement, demonstrating their overall strategy, profit position and ability to cover rental voids. We then validated the existing portfolio via our new technology.

This showed up some anomalies so the underwriter reviewed the applicant's wider portfolio, confirming that the existing mortgage loans were on long-term fixed rates.

The underwriter re-verified the portfolio and the ICR threshold was met. Due to an experienced manual underwriter adopting a flexible approach, the case was approved quickly. Automated systems simply don't do this.

CRAIG RICHARDSON
HEAD OF UNDERWRITING

"Automated systems just don't do this

Animal welfare
OSBI contributed to the movement and construction of a pet shelter run by Compassion Unlimited Plus Action ('CUPA'). CUPA provides rescue and relief to thousands of injured, ill and needy street animals in Bangalore, Karnataka. Animals that come hurt, sick or abandoned are given the care and treatment they need to recover and then are re-homed or rehabilitated.

Looking forward to 2018
The activities undertaken in 2017 delivered a stronger emphasis on staff engagement within the local community to deliver real, tangible benefits and lasting value and we want to build on that in 2018.

As the sponsorship deals with Kent County Cricket Club and the Kent County Football Association come to an end this year, there is an opportunity to build on the community-based projects and initiatives that have been trialled in 2017 including:

- Increased community involvement
- Greater staff engagement, and
- Activities that bring KR branches into the mix as 'community hubs'.

The Strategic report is approved by the Board and signed on its behalf by:

Jason Elphick
Group General Counsel and Company Secretary
15 March 2018

Directors' Report
Board of Directors (Biographies)

David Weymouth*
Non-Executive Chairman

Appointment
David was appointed to the Board in September 2017.

Committee membership
Member of the Nomination and Governance Committee.

Key skills
David has nearly 40 years' experience in the financial services industry and has a degree in modern languages from University College London and an MBA from the University of Exeter.

Experience & qualifications
David was previously Chief Information Officer at Barclays Bank plc and Chief Risk Officer at RSA Insurance Group plc. He sat on the Executive Committee of both companies. His experience as an executive includes a wide range of senior roles in operations, technology, risk and leadership. David is also Chairman of Mizuho International Plc and his other current Non-Executive directorships include Fidelity International Holdings (UK) Limited and The Royal London Mutual Insurance Society. He also served on the Board of the Bank of Ireland (UK) plc until November 2017.

Andy Golding
Chief Executive Officer

Appointment
Andy was appointed to the Board in December 2011.

Committee membership
None.

Key skills
Andy has over 30 years' experience in financial services.

Experience & qualifications
Andy was previously CEO of Saffron Building Society, where he had been since 2004. Prior to that he held senior positions at NatWest, John Charcol and Bradford & Bingley. He was a Non-Executive Director of Kreditech until 1 November 2017. 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.

April Talintyre
Chief Financial Officer

Appointment
April joined the Bank in May 2012 and was appointed to the Board in June 2012.

Committee membership
Member of the Risk Committee.

Key skills
April has broad financial services experience. She has been a member of the Institute of Chartered Accountants in England and Wales since 1992.

Experience & qualifications
April was previously an Executive Director in the Rothesay Life pensions insurance business of Goldman Sachs and worked for Goldman Sachs International for over 16 years, including as an Executive Director in the Controllers division in London and New York. April began her career at KPMG in a general audit department.

Graham Allatt*
Non-Executive Director

Appointment
Graham was appointed to the Board in May 2014.

Committee membership
Chair of the Risk Committee and member of the Audit Committee.

Key skills
Graham has significant banking, credit risk experience and financial services experience.

Experience & qualifications
Graham was previously 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 Deputy Chairman 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.

Eric Anstee*
Non-Executive Director

Appointment
Eric was appointed to the Board in December 2015.

Committee membership
Chair of the Audit Committee and member of the Risk Committee.

Key skills
Eric has extensive corporate finance and Mergers & Acquisitions experience over a broad range of business sectors.

He is a member of the Takeover Panel Appeals Board and Visiting Professor, London Metropolitan University Business School.

Experience & qualifications
Eric was Chairman of CPP Group plc from 2014 to 2015. Prior to this he was Chief Executive of the City of London Group plc, the first Chief Executive of the Institute of Chartered Accountants in England and Wales and Group Finance Director of Old Mutual plc. Eric was also Group Finance Director at The Energy Group plc and advisor to Lord Hanson on the demerger of Hanson plc. Prior to this Eric spent 17 years at Ernst & Young. Eric is also a Non-Executive Director of Sun Life Financial of Canada Limited and Insight Asset Management Limited.

*Independent Non-Executive Director

Andrew Doman*
Non-Executive Director

Appointment
Andrew was appointed to the Board in July 2016.

Committee membership
Member of Audit, Nomination and Governance, Remuneration and Risk Committees.

Key skills
Andrew is an experienced financial services executive.

Experience & qualifications
Andrew is currently Chairman at Castle Trust Capital plc and was previously CEO of Premium Credit Limited and CEO, President and later Chairman of Frank Russell Company. He was also a Senior Director of McKinsey & Company, management consultants, based in the London office. He focused on the financial services sector, serving a number of leading banks, insurance companies and asset managers across a wide range of topics including strategy, performance improvement and risk. He was formerly a Non-Executive Director of The Wesleyan.

Rod Duke*
Senior Independent Director

Appointment
Rod was appointed to the Board in July 2012 and was appointed Senior Independent Director in 2014.

Committee membership
Chair of the Nomination and Governance Committee and member of the Remuneration Committee.

Key skills
Rod has extensive experience in operations, investments, risk management and corporate finance across retail and commercial banking.

Experience & qualifications
Rod was previously 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.

Margaret Hassall*
Non-Executive Director

Appointment
Margaret was appointed to the Board in July 2016.

Committee membership
Member of Audit and Risk Committees.

Key skills
Margaret brings a broad range of experience developed across various industry sectors including manufacturing, utilities and financial services.

Experience & qualifications
Margaret spent seven years working for Deloitte and Touche as a consultant and led the financial services consulting business for Charteris Plc. More latterly Margaret has been engaged as Chief Operations Officer or Chief Information Officer for divisions within some of the world's largest banks, namely Bank of America Merrill Lynch, Barclays and RBS. Margaret is a Non-Executive Director for Ascension Trust (Scotland).

Mary McNamara*
Non-Executive Director

Appointment
Mary was appointed to the Board in May 2014.

Committee membership
Chair of Remuneration and member of Risk and Nomination and Governance Committees.

Key skills
Mary has broad senior management experience in the banking and finance sectors.

Experience & qualifications
Mary is a Non-Executive Director of Dignity plc and Motorpoint plc. She was previously CEO of the Commercial Division and Board Director of the Banking Division at Close Brothers Group PLC. Prior to that, Mary was Chief Operating Officer of Skandia, the European arm of Old Mutual Group and prior to that, Mary spent 17 years at GE Capital, running a number of businesses including GE Fleet Services Europe and GE Equipment Finance.

Executive team

Top row from left to right: Jason Elphick; Jens Bech; Hasan Kazmi; Richard Davis; John Eastgate.
Bottom row from left to right: Richard Wilson; Lisa Odendaal; Clive Kornitzer.

Jason Elphick
Group General Counsel and Company Secretary

Experience & qualifications
Jason joined the Bank in June 2016. He has over 20 years of legal private practice and in-house financial services experience.

Jason's private practice experience was primarily in Australia with King & Wood Mallesons and in New York with Sidley Austin LLP and he has been admitted to practice in Australia, New York and England and Wales.

Jason's in-house financial services experience was most recently as Director and Head of Bank Legal at Santander in London. Prior to this Jason held various roles at National Australia Bank, including General Counsel Capital & Funding, Head of Governance, Company Secretary and General Counsel Product, Regulation and Resolution.

John Eastgate
Sales and Marketing Director

Experience & qualifications
John joined the Bank in 2012. John has over 25 years' experience in financial services and prior to joining the Bank he was Sales & Marketing Director at Saffron Building Society from 2008 until 2012.

Between 2003 and 2008, John was Head of Banking, Head of Mortgages and Group Account Director at Experian. He held the position of Practice Manager (Financial Services) at BroadVision UK Limited from 2001 until 2002. Between 1999 and 2001, John was a Senior Manager at Barclays.

Jens Bech
Group Commercial Director

Experience & qualifications
Jens joined the Bank as Chief Risk Officer in 2012, before becoming Group Commercial Director in 2014.

Jens joined the Bank from the Asset Protection Agency, an executive arm of HM Treasury, where he held the position of Chief Risk Officer. Prior to joining the Asset Protection Agency, Jens spent nearly a decade at management consultancy Oliver Wyman where he advised a global portfolio of financial services firms and supervisors on strategy and risk management. Jens led Oliver Wyman's support of Iceland during the financial crisis.

Richard Wilson
Group Chief Credit Officer

Experience & qualifications
Richard joined the Bank in 2013.

Prior to joining the Bank, Richard was head of the credit function for Morgan Stanley's UK origination business and subsequently looked after Credit and Collections strategy within their UK, Russian and Italian businesses. Between 1988 and 2006, Richard held various roles at Yorkshire Building Society, including the position of Mortgage Application Centre Manager.

Hasan Kazmi
Chief Risk Officer

Experience & qualifications
Hasan joined the Bank in September 2015 as Chief Risk Officer.

Hasan has over 19 years of risk experience having worked at several financial institutions, including Barclays Capital, Royal Bank of Canada and Standard Chartered Bank. Prior to joining the Bank, Hasan was a Senior Director at Deloitte within the Risk and Regulatory practice with responsibility for leading the firm's enterprise risk; capital, liquidity, recovery and resolution practices. Hasan graduated from the London School of Economics with a MSc in Systems Design and Analysis and a BSc in Management.

Lisa Odendaal
Group Head of Internal Audit

Experience & qualifications
Lisa joined the Bank in April 2016 as Group Head of Internal Audit. Prior to joining the Bank Lisa worked for Grant Thornton where she was an Associate Director within their Business Risk Services division.

Lisa has over 20 years of internal audit and operational experience gained in the UK, UAE and Switzerland having worked at several financial institutions, including PwC, Morgan Stanley, HSBC and Man Investments.

Richard Davis
Chief Information Officer

Experience & qualifications
Richard joined the Bank in 2013. Richard has worked for 20 years in financial services rising to Chief Information Officer at GE Money UK in 2004.

He subsequently helped launch MoneyPartners (an Investec subsidiary), as IT Director, through to the eventual sale to Goldman Sachs. Prior to joining the Bank, Richard worked for four years at Morgan Stanley covering IT, Projects and Transaction Management for the European Residential business as an Interim Director.

Clive Kornitzer
Group Chief Operating Officer

Experience & qualifications
Clive joined the Bank in 2013. Clive has over 25 years of financial services experience, having worked at several financial organisations including Yorkshire Building Society, John Charcol and Bradford and Bingley.

Prior to joining the Bank, Clive spent six years at Santander where he was the Chief Operating Officer for the intermediary mortgage business. Clive has also held positions at the European Financial Management Association and has been the Chair of the FS Forums Retail Banking Sub-Committee. Clive is a Fellow of the Chartered Institute of Bankers.

Corporate Governance Report

The statement of corporate governance practices, including the Reports of Committees, set out on pages 64 to 98 and information incorporated by reference, constitutes the Corporate Governance Report of OneSavings Bank.

Uk Corporate Governance Code ('the Code') – Compliance Statement

During 2017, the Company applied all of the main principles of the Code and has complied with all Code provisions. The Code is available at www.frc.org.uk.

Dear Shareholder,

I am pleased to present to you the Company's Corporate Governance Report for 2017, and to report our full compliance throughout the year with the Code as updated in 2016.

This is my first report to you as Chairman of the Board and I am pleased to report that the Board continues to be committed to the highest standards of corporate governance and 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. The Board and its Committees have undertaken a formal performance review exercise during 2017, details of which are set out in the Report below. The review highlighted that the Board and its Committees continue to operate effectively.

Mike Fairey, Nathan Moss and Tim Hanford left the Board during 2017. I would like to thank them for their enormous contribution towards the success of the Bank over the years. I wish them well in all their future ventures.

The Investor Relations function continues to assist the Board in developing a programme of meetings and presentations to both institutional and private shareholders, details of which are also set out in the Report. We welcome shareholders to attend the AGM, which will be held at the offices of Addleshaw Goddard LLP, 60 Chiswell Street, London, EC1Y 4AG on 10 May 2018 at 11am.

David Weymouth
Non-Executive Chairman
15 March 2018

The role and structure of the Board
The Board of Directors (the 'Board') is responsible for the long-term success of the Company and provides 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 appropriate financial and business systems and controls are in place to safeguard shareholders' interests and to maintain effective corporate governance.

The Board is also responsible for setting the tone from the top in relation to conduct, culture and values, and for ensuring continuing commitment to treating customers fairly, carrying out business honestly and openly and preventing bribery, corruption, fraud or the facilitation of tax evasion.

The Board operates in accordance with the Company's Articles of Association (the 'Articles') and its own written terms of reference. The Board has established a number of Committees as indicated in the chart on page 37. Each Committee has its own terms of reference which are reviewed at least annually. Details of each Committee's activities during 2017 are shown in the Nomination and Governance, Audit, Risk and Remuneration Committee reports on pages 72 to 95.

The Board retains specific powers in relation to the approval of the Bank's strategic aims, policies and other matters, which must be approved by it under legislation or the Articles. These powers are set out in the Board's written 'Terms of Reference' and 'Matters Reserved to the Board' which are reviewed at least annually. 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 capital expenditure budgets
- Review of performance against strategy and objectives

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

Risk management
- Overall risk appetite of the Group
- Approval of the strategic risk management framework

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

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

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

Accountability
In line with the Code provisions, the Board ensures that a fair, balanced and understandable assessment of the Group's position and prospects is presented in all financial and business reporting. The Board is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives and maintains sound risk management and internal control systems. The Board has established formal and transparent arrangements for considering how they should apply the corporate reporting, risk management and internal control principles and for maintaining an appropriate relationship with the Group's auditors.

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. To achieve this, the Board reviews each report and considers the level of consistency throughout: whether there is a balanced review of the competitive landscape; the use of sufficiently simple language; the analysis of risks facing the business; and that there is equal prominence given to statutory and underlying profit. The Board has established an Audit Committee to assist in making its assessment. The activities of the Audit Committee are set out on pages 74 to 78.

Risk management and internal control
The Board retains ultimate responsibility for setting the Group'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 carried out a robust assessment of the principal risks facing the business, including those that would threaten its business model, future performance, solvency or liquidity. Further details are contained in the viability statement on page 49.

The Board has established a Risk Committee to which it has delegated authority 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, 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.

Corporate Governance Report continued

Further details of the Group's risk management approach, structure and principal risks are set out in the Risk review on pages 32 to 48. The Board has delegated to the Audit Committee authority 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. Details of the review of the effectiveness of the Company's internal control systems are set out in the Audit Committee report on page 76.

Control environment

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

The first line of defence 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 defence. The second line of defence 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 Financial Conduct Authority ('FCA') and the Prudential Regulation Authority ('PRA') handbooks. Policy documents also include key controls that map back to the key controls framework.

The third line of defence is the Internal Audit function.

The Board is committed to the consistent application of appropriate ethical standards, and the conduct risk policy sets out the basic principles to be followed to ensure ethical considerations are embedded in all business processes and decision making forums. The Group also maintains detailed policies and procedures in relation to the prevention of bribery and corruption, and a whistleblowing policy.

Directors

The Directors who served during the year are listed in the table below. Mike Fairey, Nathan Moss and Tim Hanford retired on 10 May, 31 May and 31 December 2017 respectively. The Board currently consists of nine Directors, being the Chairman, two Executive Directors and six independent Non-Executive Directors. The biographies of Directors can be found on pages 60 to 61.

Board meetings and attendance

The Board met nine times during the year. The Board has a formal meeting schedule with ad hoc meetings called as and when circumstances require. This includes 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. The Board has established a number of Committees as shown on the table below. The table below shows each Director's attendance at the Board and Committee meetings they were eligible to attend in 2017.

Director	Board	Audit Committee	Remuneration Committee	Nomination and Governance Committee	Risk Committee
David Weymouth[1] (Chairman)	3/3	n/a	n/a	2/2	n/a
Mike Fairey[2]	3/5	n/a	n/a	2/5	n/a
Graham Allatt	10/10	6/6	n/a	n/a	7/7
Eric Anstee	10/10	6/6	n/a	n/a	7/7
Andrew Doman	9/10	5/6	3/3	n/a	6/7
Rod Duke	10/10	n/a	7/7	8/9	n/a
Andy Golding	10/10	n/a	n/a	n/a	n/a
Tim Hanford[3]	9/10	n/a	n/a	6/9	n/a
Margaret Hassall	9/10	n/a	n/a	n/a	6/7
Mary McNamara	10/10	n/a	7/7	9/9	6/7
Nathan Moss[4]	5/5	4/4	3/3	3/6	n/a
April Talintyre	10/10	n/a	n/a	n/a	7/7

1. Joined the Board on 1 September 2017.
2. Retired from the Board on 10 May 2017.
3. Retired from the Board on 31 December 2017.
4. Retired from the Board on 31 May 2017.

In October 2017, the Board attended a strategy away 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 the meeting materials in advance to the Chairman, to ensure that their views are recorded and taken into account during the meeting.

Key Board activities during the year included:

- Strategy
- Risk monitoring and review
- Governance and compliance
- External affairs and competitor analysis
- Talent review
- Annual, interim and quarterly reporting
- Customer/brand/product review
- Policy review and update
- Investment proposals

Role of the Chairman and Chief Executive Officer

The roles of Chairman and Chief Executive Officer ('CEO') are held by different people. There is a clear division of responsibilities, which has been agreed by the Board and is formalised in a schedule of responsibilities for each.

As Chairman, David Weymouth is responsible for setting the 'tone at the top' and ensuring that the Board has the right mix of skills, experience and development so that it can focus on the key issues affecting the business and for leading the Board and ensuring it acts effectively. Our CEO, Andy Golding, 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 CEO, and how these have been discharged during the year, are set out below and overleaf.

Chairman's responsibilities	Activities carried out in 2017
Chairing the Board and general meetings of the Company.	The Chairman chaired almost all of the Board meetings held in 2017 and the 2017 AGM. The Senior Independent Director assumed the role of Interim Chairman from May to August 2017.
Setting Board agenda and ensuring that adequate time is available for discussion of all agenda items.	The Chairman, in liaison with the Company Secretary, sets the annual calendar of Board business and the agendas for the individual meetings. Time is allocated for each item of business at meetings.
Promoting the highest standards of integrity, probity and corporate governance throughout the Company.	The Board received regular updates from its Committees and reviewed its responsibilities and obligations at its meeting in May.
Ensuring that the Board receives accurate, timely and clear information in advance of meetings.	The Chairman, in liaison with the Company Secretary and the CEO, agrees the information to be circulated to the Board in advance of each meeting.
Promoting a culture of openness and debate by facilitating the effective contribution of all Non-Executive Directors. Ensuring constructive relations between Executive and Non-Executive Directors and the CEO in particular.	The Chairman runs the meetings in an open and constructive way, encouraging contribution from all Directors. He regularly meets with the Non-Executive Directors without management present so that any concerns could be expressed.
Regularly considering succession planning and the composition of the Board.	The Board receives regular updates from the Nomination and Governance Committee. Details of the Committee's activities are explained in the Nomination and Governance Committee report on pages 72 and 73.
Ensuring training and development needs of all Directors are met, and that all new Directors receive a full induction.	The Chairman, in liaison with the Company Secretary, has reviewed Directors training requirements. Details of induction and training held during the year are given on page 70.
Ensuring effective communication with shareholders and stakeholders.	The Chairman, with the Board, assisted by the CEO, Chief Financial Officer and Investor Relations Manager, agrees a programme of investor relations meetings. Details of those carried out during the year are shown on page 71.

Corporate Governance Report continued

Chief Executive Officer's responsibilities

Andy Golding's responsibilities as CEO are to ensure that the Company operates effectively at strategic, operational and administrative levels. He is responsible for all the Bank's activities: provides leadership and direction to encourage others to effect strategies agreed by the Board; channels expertise, energy and enthusiasm; builds individuals' capabilities within the team; develops and encourages talent within the business; identifies commercial and business opportunities for the Group, building strengths in key areas; and is responsible for all commercial activities of the Group, liaising with regulatory authorities where appropriate. He is responsible for the quality and financial wellbeing of the Group, represents the Group to external organisations and builds awareness of the Group externally.

An experienced Executive team comprising of specialists in finance, banking, risk, legal, and IT matters assist the CEO in carrying out his responsibilities. The biographies for the Executive team are set out on page 63.

Executive Committee

The CEO chairs the Executive Committee ('ExCo'), whose members also include the Chief Financial Officer, the Group Chief Operating Officer, Chief Risk Officer, Group General Counsel and Company Secretary (advisory), Group Commercial Director, Chief Information Officer, Group Chief Credit Officer, Sales and Marketing Director and Group Head of Internal Audit (advisory). The ExCo is supported by Management Committees.

The purpose of the ExCo is to assist the CEO in the performance of his duties, including:

- The development and implementation of the strategic plan as approved by the Board
- The development, implementation and oversight of a strong operating model that supports the strategic plan
- The development and implementation of systems and controls to support the strategic plan
- To review and oversee operational and financial performance
- To prioritise and allocate the Group's resources in accordance with the strategic plan
- To oversee the development of a high performing senior management team
- To oversee the customer proposition and experience consistent with the Group's obligation to treat customers fairly
- To oversee the appropriate protection and control of private and confidential data.

The ExCo's activities during the year included:

- Business review
- Capital and funding
- Human resources and succession planning
- Governance, control and risk environment – current and forward-looking
- System transformation
- Monitoring target operating model progress.

Senior Independent Director

Rod Duke is the Senior Independent Director ('SID'). His 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.

Company Secretary

The Company Secretary, Jason Elphick, plays a key role within the Company, advising on good governance and assisting the Board to discharge its responsibilities, acting with integrity and independence to protect the interests of the Company, its shareholders and employees. Jason advises the Company to ensure that it complies with all statutory and regulatory requirements and he works closely with the Chairman, CEO and Chairs of the Committees of the Board so that Board procedures (including setting agendas and the timely distribution of papers) are complied with, and that there is a good communication flow between the Board, its Committees, senior management and Non-Executive Directors. Jason also provides the Directors with advice and support, including facilitating induction programmes and training in conjunction with the Chairman.

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 comprise a balance of skills, experience, independence and knowledge to encourage constructive debate and challenge to the decision making process.

The Board comprises seven Non-Executive Directors including the Chairman and two Executive Directors. All of the Non-Executive Directors including the Chairman have been 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. Andrew Doman is considered independent notwithstanding that he is Chairman of Castle Trust Capital plc, an unlisted company whose business is focused on first and second charge Buy-to-Let mortgages, online and in-store credit and residential and development finance. The independence of the Non-Executive Directors is reviewed continually, including formal review annually.

The size and composition of the Board is kept under review by the Nomination and Governance Committee and the Board to ensure an appropriate balance of skills and experience is represented. 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 provide constructive challenge to the Executives and the Chairman ensures that the views of all Directors are taken into consideration in the Board's deliberations. Directors' biographies can be found on pages 60 and 61.

Non-Executive Directors terms of appointment

Non-Executive Directors are appointed for terms of three years, subject to annual re-election by shareholders. The initial term may be renewed up to a maximum of three terms (nine years). The terms of appointment of the Non-Executive Directors specify the amount of time they are expected to devote to the business which is a minimum of two and half days per month, 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.

Appointment, retirement and re-election of Directors

The Board may appoint a Director, either to fill a vacancy or as an addition to the existing Board. The new Director must then retire at the next AGM and is put forward for election by the shareholders. All other Directors are put forward for re-election annually. In addition to any power of removal conferred by the Companies Act, any Director may be removed by special resolution, before the expiration of his or her period of office and, subject to the Articles, another person who is willing to act as a Director may be appointed by ordinary resolution in his or her place.

Relationship Agreement

On admission of its shares to the London Stock Exchange following the IPO in June 2014, the Company entered into a relationship agreement (the 'Relationship Agreement') with its then major shareholder OSB Holdco Limited. Pursuant to the Relationship Agreement, OSB Holdco Limited has been granted the right to appoint one Non-Executive Director to the Board for so long as it holds at least 10% of the Company's ordinary shares and a further Non-Executive Director for so long as it holds at least 30% of ordinary shares. Following the resignation of Tim Hanford on 31 December 2017, there are no representatives of OSB Holdco Limited on the Board. The Directors believe that the terms of the Relationship Agreement enable the Group to carry on its business independently of OSB Holdco Limited and ensure that all agreements and transactions between the Group, on the one hand, and OSB Holdco Limited and its associates and/or persons acting in concert with OSB Holdco Limited or its associates, on the other hand, are at arm's length and on a normal commercial basis. So far as the Group is aware such terms have been complied with throughout the year.

Conflicts of interest

The Company's Articles 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 the conflict.

Directors are required to complete an annual confirmation including a 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 interests of new Directors are reviewed during the recruitment process and authorised, if appropriate, by the Board at the time of their appointment. The Nomination and Governance Committee also annually reviews conflicts of interest relating to Directors.

The Group has also adopted a conflicts of interest policy which includes a procedure for identifying potential conflicts of interest within the Group.

No Director has a material interest in any contract of significance in relation to the Group's business at any time during the year or at the date of this report.

Directors' indemnities

The Articles provide, subject to the provisions of UK legislation, an indemnity for Directors and Officers of 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 Group. Directors' and Officers' liability insurance cover is in place in respect of all Directors.

Corporate Governance Report continued

Directors' powers

As set out in the Articles, the business of the Company is managed by the Board who may exercise all the powers of the Company. In particular, save as otherwise provided in company law or in the Articles, the Directors may allot (with or without conferring a right of renunciation), grant options over, offer, or otherwise deal with or dispose of shares in the Company to such persons at such times and generally on such terms and conditions as they may determine. The Directors may at any time after the allotment of any share but before any person has been entered in the Register as the holder, recognise a renunciation thereof by the allottee in favour of some other person and may accord to any allottee of a share a right to effect such renunciation upon and subject to such terms and conditions as the Directors may think fit to impose. Subject to the provisions of company law, the Company may purchase any of its own shares (including any redeemable shares).

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 Group as soon as possible. The induction programme is facilitated and 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 key documents and face-to-face sessions covering the governance, regulatory and other arrangements of the Group.

As senior managers, under the Senior Managers Regime operated by the PRA and FCA under the FSMA, all Directors have had to maintain the skills, knowledge and expertise required to meet the demands of their positions of 'significant influence' within the Bank. As part of the annual fitness and propriety assessment, Directors are required to complete a self-certification that they have undertaken sufficient training during the year to maintain their skills, knowledge and expertise and to make declarations as to their fitness and propriety. 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 senior managers and other matters impacting on the business.

Information and support

The Company Secretary and the Chairman agree an annual calendar of matters to be discussed at each Board meeting to ensure that all key Board responsibilities are discharged over the year. Board agendas are then circulated with accompanying detailed papers to the Board in advance of each Board meeting. 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. The Board and Audit Committee also receive further regular and specific reports to allow the monitoring of the adequacy of the Group'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 for purpose and that it enables sound decision making.

There is a formal procedure through which Directors may obtain independent professional advice at the Group's expense. The Directors also have access to the services of the Company Secretary as described on page 68.

Performance evaluation

The Board undertakes an evaluation of its performance and that of its Committees and individual Directors annually with an external review every third year. The last externally-facilitated review was conducted in 2016. In 2017, the internal review concluded that the Board, including its Committees, discharges its duties effectively; and that the current Directors have an appropriate range of knowledge and experience giving rise to open and effective challenge, scrutiny and debate and the structure of the governance arrangements works well. The relationship between the Board and senior management is open and transparent and is reflected in Board discussions. The Board were satisfied that no individual or group of Directors dominated the discussions or had undue influence in the decision making process. It has been a particularly busy year for the Group and the focus in 2018 will be on continuing to enhance and embed the performance improvement actions taken during 2017.

An update of the actions disclosed in our 2016 Annual Report is provided below.

Theme	Action taken
The frequency of meetings and the breadth and frequency of matters discussed	The Board has reviewed the frequency of its meetings and the timings of meetings of its Committees. A revised calendar is now in place to enhance the flow of recommendations from Committees to the Board.
Alignment of terms of reference	All terms of reference relating to the Board and its Committees were reviewed and substantially updated in 2017.
The length and quality of papers	A series of improvement initiatives was introduced in 2017. Training has been provided to the preparers of papers and a revised template is now used to assist those preparers when drafting.

Treasury operations

The Board has approved a treasury policy setting out 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 ('ALCO') which reports to the Risk Committee.

Whistleblowing

The Group has 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. The Chair of the Audit Committee has overall responsibility for whistleblowing arrangements.

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

The Company has 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 on the Board agenda. There will be additional focus on investor relations during 2018 given greater liquidity in OSB stock following the significant sales by JC Flowers in 2017, and, as the impact on research availability caused by the EU regulatory reforms known as MiFID II becomes apparent.

An ongoing dialogue with the key stakeholders continued throughout the year with topics relating to the performance of the Group including strategy and new developments. In 2017, the Company has engaged in active discussion with shareholders and investors, both on an individual basis and through attendance at investor conferences and events. Following full year and interim results presentations, senior management undertake results roadshows and meet with larger investors. The Investor Relations team and management held a total of 136 meetings with existing and potential investors during 2017.

A comprehensive plan of Investor Relations activity is in place for the coming year. The Chairman, Senior Independent Director and other Non-Executive Directors are available to discuss any matter stakeholders might wish to raise and to attend meetings with investors and analysts. In addition, shareholders are able to question the Company through the Investor Relations function or the Company Secretariat.

The Group introduced a new OneSavings Bank website during 2017 which provides relevant information to both institutional and private shareholders, including performance updates and presentations made to analysts and investors. The website is www.osb.co.uk.

Annual General Meeting

The AGM will be held at the offices of Addleshaw Goddard LLP, 60 Chiswell Street, London EC1Y 4AG on 10 May 2018 at 11am. The Chairs of each of the Committees of the Board will be present to answer questions put to them by shareholders. The Annual Report and Accounts and Notice of the AGM 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 and made available on the Company's website www.osb.co.uk.

Shareholders may require the Directors to call a general meeting other than an AGM as provided by the Companies Act 2006. Requests to call a general meeting may be made by members representing at least 5% of the paid-up capital of the Company as carries the right of voting at general meetings of the Company (excluding any paid-up capital held as treasury shares). A request must state the general nature of the business to be dealt with at the meeting and may include the text of a resolution that may properly be moved and is intended to be moved at the meeting. A request may be in hard copy form or in electronic form and must be authenticated by the person or persons making it. A request may be made in writing to the Company Secretary to the registered office or by sending an email to company.secretariat@osb.co.uk. At any general meeting convened on such request no business shall be transacted except that stated by the requisition or proposed by the Board.

Nomination and Governance Committee Report

Dear Shareholder,

I am pleased to present the report of the Nomination and Governance Committee.

Membership and meetings
The Committee met nine times during 2017.

I would like to welcome David Weymouth, Chairman of the Board, who became a member of this Committee on 1 September 2017. The other members are myself (Rod Duke) and Mary McNamara. I would also like to thank Tim Hanford, who retired from the Board on 31 December 2017, for his contribution to this Committee.

Appointment of the Chairman
The previous Chairman, Mike Fairey, retired at the conclusion of the 2017 AGM. In anticipation of his retirement, the Committee had instructed Per Ardua[1] to conduct an extensive search for candidates with strong financial services experience. The remit was to provide, where possible, a 50/50 split of female and male candidates. The search was thorough and refined by preliminary interviews, to a diverse shortlist of high quality candidates. David Weymouth was selected on merit as our preferred candidate following a number of interviews, meetings, mutual due diligence and regulatory approval. David was appointed Chairman of our Bank with effect from 1 September 2017. David's biography is included on page 60, which demonstrates his extensive financial services experience in top executive, and non-executive board roles. We are satisfied that the composition of the Board is operating well, and we will continue to monitor Board and Committee membership in 2018. Further details on the composition and balance of the Board and its Committees are provided below.

Rod Duke
Chair of the Nomination and Governance Committee and Senior Independent Director
15 March 2018

Responsibilities
The specific responsibilities and duties of the Committee are set out in its terms of reference which are available on our website www.osb.co.uk.

Composition of the Board and its Committees
The Committee conducted a review of the composition of the Audit, Remuneration and Risk Committees; and its own composition during 2017, carefully considering the skills of the existing members and looking at any skills gaps applicable to each Committee. During the year, David Weymouth was appointed Chairman of the Board and Margaret Hassall was appointed as a member of the Audit Committee.

In addition, the Committee discussed and considered the size of the Board and acknowledged the benefit of maintaining the Board at its current size.

Succession planning
The Committee considered both Board and Executive level succession planning during 2017. This included the progress of employees identified as part of the talent development programme which was rolled out the prior year. Executives are also regularly invited to attend Board and Committee meetings as part of their development.

Diversity
Our Bank recognises and embraces the benefits of having a diverse Board and workforce, and sees diversity at Board level as an essential element in maintaining a competitive advantage. We believe that a truly diverse Board and Company workforce will include and make good use of differences in the skills, regional and industry experience, background, race, gender and other distinctions between people. The Board recognises for itself that diversity is the key to better decision making and avoiding 'group think'.

These differences are considered in determining the optimum composition of the Board and when possible will be balanced appropriately. All Board appointments are made on merit, in the context of the skills, experience, independence and knowledge which the Board as a whole requires to be effective.

1. Does not have any other connection with the Company.

The Committee regularly reviews diversity initiatives including its annual review of the Equality and Diversity policy. The Board remains committed to the Women in Finance Charter and has introduced measurable objectives with our aim continuing to be that 30% of senior management positions within the Group's UK population will be undertaken by female employees by the end of 2020. Currently, 33% of our Board are female. Our Bank has also appointed a Diversity Champion to promote a series of diversity initiatives such as our commitment to those with a disability, mental health in the workplace and unconscious bias training.

Further details relating to diversity and inclusion are set out on page 53.

Governance
The Committee reviewed changes in the regulatory landscape, particularly the proposals on Corporate Governance Reform, the government's nine point action plan and the Company's approach to addressing them.

Activities during 2017
In last year's report the Committee identified six key priorities.

A summary of actions taken and outcomes are set out in the table below:

Objective	Action taken
Review and embed Board effectiveness recommendations from the Promontory Report[2]	The recommendations from the Promontory Report[2] have been implemented and the Committee will continue to monitor and ensure that they are embedded.
Chairman search	The Committee spent a considerable amount of time searching for a new Chairman. A new Chairman has been appointed with effect from 1 September 2017.
Succession planning for senior executives	The Committee considered succession planning of senior executives.
Developing the talent pipeline	The Committee considered reports on the talent pool and the actions being taken to develop and retain key talent.
Development of corporate purpose and sustainability	The Group has enhanced its environmental policy. This will continue to be an area of focus in 2018.
Oversee the successful implementation of diversity initiatives	A number of diversity initiatives relating to disability, mental health and unconscious bias were introduced throughout the Group.
Focusing on the attainment of the Women in Finance Charter target by 2020	With an Executive Committee and senior management team that to date have seen little attrition, we are aware that this target is something that will take time to achieve. To address our current position we are introducing a range of initiatives, including seeking to interview equal numbers of male and female candidates at first round interview stage for all vacant roles at management level and above.

2. Promontory Financial Group LLC, does not have any other connection with the Company.

Priorities for 2018
The Committee's priorities for 2018 are:
- Continue to focus on fulfilling our commitment to the Women in Finance Charter
- Oversee the development and implementation of our action plan for Gender Pay Gap Reporting
- Oversee a revised approach to cultural engagement within the Group
- Corporate governance reform
- Corporate purpose and sustainability
- Board and Committee succession planning
- Embedding diversity initiatives
- Board and Committee effectiveness
- Oversee development of the talent pipeline

Audit Committee Report

Dear Shareholder,

I am pleased to present the report of the Audit Committee for 2017. During the year the Committee continued to focus on areas of significant judgement in the financial statements as set out in the report below.

The Committee also closely monitored the Group's preparations for IFRS 9, including key areas of interpretation and assumption, the impact analysis from the parallel run, the use of models and the governance and control environment.

The Committee also commenced a competitive tender process for the external audit of the Group from 2019, against the backdrop of the UK's adoption of EU legislation to reform the statutory audit market, which became effective for the Bank in 2017.

Membership and meetings

The Committee met six times in 2017, reflecting the workload of the Committee during the year. All members of the Audit Committee are independent Non-Executive Directors. The Chair of the Committee, Eric Anstee, has a wealth of recent and relevant financial and accounting experience in financial services. Taken as a whole, the Committee has an appropriate balance of skills, including recent and relevant financial experience. Standing invitations are extended to the Executive Directors, Chief Risk Officer, Group Head of Internal Audit and Group 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 Group Head of Internal Audit and the external auditors attend all meetings and also meet in private with the Committee; they also have regular contact with the Chair throughout the year. The Chair also meets with the Chief Financial Officer and Group Head of Internal Audit in advance of each meeting to agree the agenda and receive a full briefing on the key agenda items.

Nathan Moss served on the Committee from 7 February 2017 until 31 May 2017 when he resigned from the Board.

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

Eric Anstee
Chair of the Audit Committee
15 March 2018

Responsibilities

The primary role of the 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 are reviewed at least annually. These are available on the Company's website www.osb.co.uk and cover external and internal audit, financial and narrative reporting, compliance, whistleblowing, fraud and internal controls.

In addition, the Chair of the Audit Committee has informed management that he is available to meet with the Company's investors on request, in accordance with the Financial Reporting Council's Stewardship Code.

Activities during 2017

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

Significant areas of judgement considered by the Committee

The following significant accounting judgements were considered by the Committee in relation to the 2017 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 default rates ('PD') on different segments of the loan book. The PD calculations include assumptions for emergence periods, cure rates and forbearance. Loss given default ('LGD') includes assumptions on forced sale discounts and the level of house prices. Significant judgement needs to be exercised in deciding how to apply historic experience to current market conditions in both the PD and LGD calculations.

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 assessed the appropriateness of proposed enhancements to the methodologies, judgements and estimates underpinning the collective provision calculations. During the year the management did not make any changes to collectively assessed impairment methodologies, however it did assess the ongoing appropriateness of all judgements and estimates. The Committee assessed and approved enhancements proposed by management relating to forced sale discount and time to sale assumptions, which fed LGD calculations.

The Committee reviewed 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 three months or more in arrears and impaired balances to help with their assessment of the reasonableness of provisions.

The Committee asked the Risk Committee to review and provide advice on the collective provision methodologies and assumptions and to review the 'top 20' impaired loans for the half year and year end. At least two members of the Committee were also members of the Risk Committee throughout 2017 and as such received additional detailed credit information on the loan book throughout the year.

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

The Committee also received regular reports from management on the Group's preparations for and approach to IFRS 9: Financial Instruments, which became effective from 1 January 2018. The reports covered the classification and measurement of financial instruments and the determination of impairment provisions and a hedging update. The key focus was on IFRS 9 models, interpretation of results, key assumptions and judgements, scenario and macroeconomic variables used within models, the results of the 2017 parallel run and the proposed ongoing business as usual as well as model governance, controls and procedures.

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 EIRs on loan books purchased at significant discounts are particularly sensitive to the prepayment and default rates derived as the purchase discount is recognised over the expected life of the loan book through the EIR. New defaults are modelled at zero loss (as losses will be recognised in profit and loss as impairment losses and therefore have the same impact on EIR as prepayments). Incurred losses at acquisition are calculated using the Group's collective provision model. 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 significant 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 reviewed 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. Certain mortgage products offered by the Bank include significant directly attributable net fee income, in particular Buy-to-Let, and/or revert to the standard variable rate ('SVR') after an initial discount or fixed period. Judgement is used in assessing the expected rate of prepayment during the discounted or fixed period of these mortgages and the expected life of those that prepay. The Group uses historical experience in its assessment. Judgement is also used in assessing whether and for how long mortgages that reach the end of the product term stay on SVR. The most significant area of judgement is the period spent on SVR. The Group prudently assumes no period on SVR before the borrower refinances onto a new product or redeems, until a consistent trend has emerged from the newly enhanced broker led retention programme. 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 product lives including a period on the Company's SVR. Based on this work, the Committee is satisfied that the approach taken and judgements made were reasonable.

Further details of the above significant areas of judgement can be found in note 2 to the financial statements.

In addition, the Committee reviewed the Group's approach to hedge accounting and received reports on the effectiveness of the Group's macro-hedging throughout the year.

Audit Committee Report continued

The Committee also considered the results of management's regular reviews of the amortisation profile of fair value adjustments on hedged assets associated with cancelled swaps against the roll-off of the underlying legacy back book of long-dated fixed rate mortgages. Following the half year review, the Group accelerated the amortisation of fair value adjustments on hedged assets in line with the mortgage asset run-off, due to faster than expected prepayments.

Fair, balanced and understandable

The Committee considered on behalf of the Board whether the 2017 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 and the use of alternative performance measures and associated disclosures.

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 Group's position and performance, business model and strategy, and has advised the Board accordingly.

Pillar 3 disclosures – The Committee approved the Group's Pillar 3 regulatory disclosures for publication on the Group's website, following a review of the governance and control procedures around their preparation.

Internal Audit

The Company continued to use in-house Internal Audit resource during the year with the Group Head of Internal Audit and her team supported by a panel of external accountancy firms who provided expert resource when requested on specific internal audits, on a co-source basis.

The primary role of Internal Audit is to help the Board and executive management to protect the Group's assets, reputation and sustainability. It assists the Company in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of the risk management, control and governance processes.

The Internal Audit Charter, which formally defines internal audit's purpose, authority and responsibility, was approved by the Committee in December 2017. The Committee also approved the annual Internal Audit Plan, which was developed, based on a prioritisation of the audit universe using a risk-based methodology, including input from senior management and the Committee. A written report is prepared following the conclusion of each internal audit engagement and distributed to the Committee and senior management. Responsibility for ensuring appropriate corrective action is taken lies with management. The Internal Audit function follows up on engagement findings and recommendations until remedial action has been completed.

The Committee carries out an annual review of the effectiveness of the Internal Audit function. This was facilitated for 2017 by a survey completed by Committee members, certain executives and the external auditors 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.

Systems of internal control and risk management

The Committee received regular reports from the Internal Audit function during 2017, which included progress updates against the Internal Audit Plan, the results of audits undertaken and any outstanding audit action points. The Committee approved the annual review of the Compliance Framework and Assurance Plan and received reports from the Group's Compliance function and the Annual Statement of Compliance from the Group Head of Compliance. The Committee used the Internal Audit and Compliance Reports 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 CEO, which was based on a self-assessment process completed by senior managers and executives in the Group.

The Committee received and reviewed reports from management on the status of the substantiation of balance sheet general ledger accounts prior to the reporting date.

The Committee reviewed and approved a number of policies following their annual refresh, including: anti-bribery and corruption, data protection, data retention and record management, fraud, sanctions and whistleblowing and anti-money laundering and counter terrorist financing. The Committee received reports on fraud prevention arrangements and fraud incidents, whistleblowing and an annual report from the Group's MLRO during the year.

The Committee also received regular updates on data governance and controls as the Group enhances its data governance arrangements in connection with its planned application for an Internal Ratings Based ('IRB') model for capital requirements.

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 relating to the auditor's appointment (subject to shareholder approval) or otherwise.

Appointment and tenure

KPMG was appointed as the first external auditor of the Group for the period ended 31 December 2011. Prior to that date it fulfilled the external audit function for Kent Reliance Building Society from the period ended 31 December 2010. The current lead audit partner, Pamela McIntyre, has been in role since the 2016 audit. The Audit Committee confirms that the Group is in compliance with the Statutory Audit Services for Large Companies Market Investigation (mandatory use of competitive tender processes and Audit Committee Responsibilities) Order 2014 which requires FTSE 350 companies to put their statutory audit services out to tender not less frequently than every ten years.

New EU legislation adopted by the UK in 2016 set a maximum audit tenure of 20 years and also requires a tender at least every ten years. The new legislation is effective for financial periods commencing on or after 17 June 2016. Against this backdrop, the Group has decided to put the external audit contract out for tender for its 2019 financial year.

To that end, a formal tender process was launched in the fourth quarter of 2017 with a desk top review of audit firms, focusing on expertise and experience in FTSE 350 audits in financial services. A number of firms were then invited to take part in a request for information ('RFI') process in December, followed by face to face meetings between the proposed lead audit partners and senior managers and a sub-set of the Committee in early 2018. The Committee then selected a shortlist of two firms in March 2018 to take through to a formal request for proposal ('RFP') process.

Effectiveness

The Committee assesses the effectiveness of the external audit function on an annual basis. In 2017, the review was facilitated through a survey completed by members of the Committee, certain Executive Directors and other key employees 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.

The audit carried out by KPMG in respect of the Group's financial statements for 2016 was the subject of an in-depth review during the year by the Financial Reporting Council's (FRC) Audit Quality Review Team. The Committee reviewed the findings and discussed them with KPMG and the matters raised have been addressed in the planning and execution for the audit for 2017. The Committee remains satisfied with the efficiency and effectiveness of the audit.

Prohibited services	Approved permitted services
Book-keeping and preparing accounting records and financial statements	General accounting advice on the application of IFRS and training support
Financial information systems design and implementation. Internal control or risk management procedures relating to financial information design or implementation	Regulatory advice and reporting tools
Valuation services, including those in connection with actuarial or litigation support services	Comfort letters, accounting opinions as required by the regulator, FLS/TFS net lending assurance opinions, agreed upon procedures in relation to securitisations
HR and payroll services	Other audit-related services; interim profit verification; half year review
Services linked to the financing, capital structure and allocation and investment strategy of the Company other than assurance services in relation to the financial statements such as comfort letters	Such other activities as may be agreed by the Committee from time to time
Promoting, dealing in or underwriting shares in the Company	
Legal services with respect to the provision of general counsel, negotiating on behalf of the audit entity and acting in an advocacy role in the resolution of litigation	
Internal audit services	
HR and payroll services	
Tax services, including tax compliance and advice	
Services that play any part in the management or decision making of the Company	

Audit Committee Report continued

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 approved permitted services (as detailed in the table on page 77 for 2017) 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's policy governing the use of the external auditor for non-audit services was updated in 2017 to comply with new EU statutory audit market reform legislation adopted in the UK. Restrictions on the nature of permissible non-audit services became effective for financial periods commencing on or after 17 June 2016. These included certain restrictions on the use of the statutory auditor for tax compliance and advice. Accordingly, the Group ceased using KPMG for tax compliance or advice after 31 December 2016.

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.

The new EU statutory audit market reform legislation adopted in the UK also applies a cap on permissible non-audit services of 70% of the proceeding three-year average of audit fees. This is applicable for financial periods commencing on or after 17 June 2019.

The Committee pre-approved a number of permitted services in 2017: interim profit verifications and the half year review. The Committee also pre-approved other permitted non-audit services subject to an overall threshold of 50% of the final cost of the 2016 Group annual audit services and subject to any single item above £100,000 being pre-agreed with the Committee Chair. The Committee reviews a schedule of year-to-date non-audit services at each meeting.

The fees paid to the external auditor in respect of non-audit services during 2017 totalled £151,000 representing 19% of 2017 Group audit services of £816,000 (2016: £250,000 representing 47% of 2016 Group audit services of £535,000) and are detailed in the table below. The 2017 audit fee includes non-recurring fees of £207,000 in respect of the audit of system migrations and the Group's adoption of IFRS 9.

The Committee's assessment of the external auditor's independence in 2017 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.

Nature of service	**2017 £'000**	2016 £'000
Audit-related assurance services including half year review and interim profit verifications	**96**	96
Tax compliance and advice	**–**	70
Regulatory advice and support	**8**	36
Other[1]	**47**	48
Total non-audit services	**151**	250

1. Other non-audit services included AT1 issuance and hedge accounting advice in 2017 and in 2016 related to agreed upon procedures in respect of a new securitisation vehicle and assurance work in relation to net lending for the Funding For Lending Scheme.

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 during the year to increase their knowledge and understanding of the business.

Effectiveness

The Committee formally considers its effectiveness annually. The assessment was facilitated for 2017 using a survey completed by members of the Committee. The review concluded that the Committee operated effectively throughout 2017 with no significant improvements required.

Risk Committee Report

Dear Shareholder,

I am pleased to present the report of the Risk Committee.

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 Group 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.

The Committee reviewed and commented on various reports, including the Internal Capital Adequacy Assessment Process ('ICAAP'), Internal Liquidity Adequacy Assessment Process ('ILAAP') and Recovery Plan, 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.

Graham Allatt
Chair of Risk Committee
15 March 2018

Responsibilities

The primary objective of the Committee is 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 at www.osb.co.uk.

Activity during 2017

In 2017, the Group continued to implement its enhanced strategic risk management framework, which represents the overarching framework established to manage its risk profile in line with its business strategy and objectives. The strategic risk management framework of the Group is set out in detail on pages 34 to 38.

In order to discharge its duties and responsibilities, the Committee receives reports from those responsible for specific areas of risk within that framework. Examples of how the Committee has discharged its responsibilities during the year are set out below.

Credit risk

The Committee received and reviewed regular detailed credit reports during the year, identifying large exposures, loan to values and arrears within various categories (e.g. residential loans, Buy-to-Let). The Committee also reviewed forward-looking credit risk data including debt service coverage ratios for Buy-to-Let and external bureau data covering credit quality and affordability levels. 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.

The Committee reviewed and approved updates to policies including the Group Lending Policy, the Arrears, Repossession and Forbearance Policies and the Loan Loss Provisioning Policy. The Committee also reviewed model governance updates from the Risk function.

During 2017, the Committee oversaw and was involved in the Group making further developments to model governance, particularly in light of the IFRS 9 and IRB programmes.
The Committee reviewed and approved methodologies underpinning impairment calculations on collectively assessed accounts under IAS 39 and also reviewed and approved key judgement and estimate assumptions which feed IFRS 9 expected loss calculations. The Committee also assessed and approved the Group's provision adequacy levels throughout the year.

Risk Committee Report continued

Market risk and liquidity risk
Market risk and liquidity risk are continually monitored by the Assets and Liabilities Committee ('ALCO') which reports to this Committee. The Committee reviewed ALCO's regular assessments of the UK macroeconomic environment and potential impacts on the Group's assets and liquidity.

The Committee also reviewed and commented on updates to the Funding Risk Policy and the Interest Rate Risk in the Banking Book Policy prior to submission to the Board for approval.

Operational risk
The Committee received reports on operational risks at each of its meetings. The reports cover risk incidents that have arisen to allow the Committee to assess management's response and remedial action proposed. The reports also cover key risk indicators ('KRI'), which can be quantitative or qualitative and provide insights regarding changes in the Group's operational risk profile.

Although there were operational incidents during the course of 2017, the Committee was satisfied that the action taken was appropriate and that the control of operational incidents continued to improve.

The Committee reviewed and commented on the Group-wide risk and control self-assessment exercise and an enhanced operational risk management framework.

Compliance and regulatory risk
The Committee received reports covering compliance and financial crime KRIs, which can be quantitative or qualitative and provide insights regarding changes in the Group's compliance and regulatory risk profile. The Committee also reviewed the Compliance and Financial Crime Target Operating Model.

Conduct risk
The Committee reviewed the conduct risk profile against the conduct risk appetite and approved the conduct risk framework.

ICAAP
The Committee was involved with the design and approval of appropriate macroeconomic scenarios to be used in the Group's ICAAP. The ICAAP demonstrates how the Group would manage its business and capital during adverse macroeconomic and idiosyncratic stresses. The Committee reviewed the results of all risk assessments and stress testing before finally endorsing the full ICAAP document.

The Board is engaged in the preparation of the ICAAP and the ongoing assessment of risks. Following the Committee's review and comment the ICAAP was submitted to the Board for approval.

Recovery Plan
The Recovery Plan process is designed to ensure that in a time of stress the Group has a credible recovery plan that can be implemented in a timely manner. The Committee reviewed and commented on the proposed Recovery Plan prior to its submission to the Board for approval.

Risk appetite
The Committee reviewed and commented on the Group's enhanced risk appetite framework resulting in a number of refinements being made to the process. The Committee also reviews the Group's position against risk appetite across all principal risks at each meeting.

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 policy updates.

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, market risk, compliance and regulatory risks, solvency risk, conduct risk, reputational risk and operational risk exposures by reference to risk appetite
- Review strategic risk management framework
- Review the ICAAP framework
- Monitor actual and forecast risk and regulatory capital positions
- Recommend changes to capital utilisation
- Review the ILAAP framework
- Monitor the actual and forecast liquidity position
- Review reports on material breaches of risk limits and the adequacy of proposed actions
- Review the Recovery Plan framework

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 Assets and Liabilities and Risk Management Committees

Directors' Remuneration Report
Annual Statement by the Chair of the Remuneration Committee

Dear Shareholder,

I am pleased to present the 2017 Directors' Remuneration Report which sets out details of Directors' remuneration in respect of 2017, our new 2018 Directors' Remuneration Policy and how we intend to implement the new Policy in 2018.

Overview of 2017 performance
In 2017, the Bank continued to perform strongly delivering financial growth underpinned by an excellent reputation for customer service. Underlying pre-tax profits grew by 21% to £167.7m and the loan book grew by 23% to £7.3bn whilst maintaining a stable net interest margin of 3.16%.

Customer NPS was an outstanding +62 and the Bank had a customer retention rate of 90% in 2017. In addition, whilst the Bank's headcount continues to grow with the business, the 2017 employee engagement survey showed improvement in all categories.

Incentive outcomes for 2017
The 2017 Executive Bonus Scheme was based 75% on the Business Balanced Scorecard, which measures corporate performance against Financial, Customer, Quality and Staff metrics, and 25% on Personal objectives. Targets for each measure were set at the start of the year and were assessed by the Committee following year-end.

There was strong performance across the 2017 bonus scorecard with many of the maximum targets being met including those for profit, customer NPS, number of high severity operational incidents and employee engagement. There was, however, room for improvement under the diversity and broker NPS metrics with the threshold targets not being met. Alongside the outstanding performance against individual targets, the Committee determined that 85% and 84% of the bonus was earned by the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) respectively. Full details are set out on pages 91 to 92. As in previous years, 50% of this award will be deferred into shares for a three-year period.

The first awards under the Performance Share Plan following the IPO were made in March 2015 with a three-year performance period ending on 31 December 2017. Given the strong performance over this period, OSB has met the relative TSR and EPS growth targets in full and as such the awards vested to the participants in March 2018.

New Remuneration Policy and implementation in 2018
During 2017 the Committee reviewed the Directors' Remuneration Policy, which having last been approved by shareholders at the 2015 AGM, is required to be submitted to our shareholders for approval at the 2018 AGM.

Following extensive discussion and engagement with our main shareholders, the Committee concluded that certain changes should be made to our Remuneration Policy to support the continued long-term success of the Bank and to ensure the structure remains in line with evolving regulatory and investor guidelines.

The changes are summarised below.

Fixed pay
At the time of the IPO in 2014, the salary levels for the CEO and CFO were consciously set below a level associated with the scope of the role, with the intention that these would be increased over time if the executives delivered the corporate strategy, individual performance was strong and as they grew into their roles as directors of a listed company. Based on these factors, over the last policy period (i.e. 2015 to 2017) we have therefore increased salaries, each year, above the average for the wider employee population.

The Committee feels that the salaries, taken together with pension and benefits, are now appropriately positioned. Going forward, subject to performance, the Committee anticipates that salary increases will be in line with the wider employee population for the life of the new policy, unless there are exceptional circumstances such as a significant increase in the scope of the role or complexity of the business. For 2018, the base salary increase for Executive Directors will be 3%, slightly below the average increase for the workforce generally (3.9%).

We have also maintained the pension contribution at 13% of salary which is in line with the policy for the wider senior management population.

Directors' Remuneration Report continued

Annual bonus plan and Performance Share Plan structure

Whilst we have taken steps to ensure that the fixed pay levels are now positioned appropriately, in the view of the Committee, the current incentive opportunity no longer rewards executives suitably for the continued delivery of outstanding performance and building on the growth in value to date.

Therefore, we propose to increase the annual bonus opportunity under the policy from 100% to 150% of salary and set the bonus opportunity at this policy level for the duration of the policy period. The maximum Performance Share Plan (PSP) award under the policy will remain unchanged at 200% of salary. However, within this unchanged policy maximum, the 'usual' PSP award will be increased from 130% and 100% of salary for the CEO and CFO respectively, to 150% of salary for both. Awards above 150% of salary would only be made in exceptional circumstances. If the Committee determines that the usual PSP award should be increased above 150% of salary, this would only be done with prior investor consultation.

We have a track record of setting stretching targets appropriate for the growth prospects of the Company and taking account of risk, and the increase to incentive opportunity ensures that any increase in remuneration levels will only be made if superior performance continues to be delivered. Furthermore, the increase in opportunity is part of a package of structural proposals, as detailed below, which provides greater alignment with the business strategy and our shareholders' long-term interests.

Finally, increasing the incentive opportunity would lead to total remuneration being broadly at a mid-market level.

Performance conditions attached to 2018 annual bonus and Performance Share Plan

The annual bonus in 2017 was based 75% on the Business Balanced Scorecard and 25% on Personal performance. We propose to reduce the weighting on personal performance to 10%, with the 15% balance moved to the financial element of the Business Balanced Scorecard for the duration of the policy.

For the 2018 PSP award of 150% of salary, a new return measure (ROE) will be introduced for 20% of the award, to drive and reward the efficient use of capital. This new measure will be alongside the focus on profitable growth (EPS, 40% of the award) and continued stock market outperformance (relative TSR vs the FTSE 250 constituents, 40% of the award). The addition of a third measure will mean the executives will have to deliver performance across a higher number of metrics to receive the increase in PSP quantum, making it harder to receive the higher quantum.

In addition, in line with regulatory requirements and to strengthen the alignment of performance and reward further, the discretionary assessment on vesting of the PSP will also be strengthened. At the time of vesting, the Committee will assess whether the formulaic vesting outcome is aligned with the underlying performance of the Company, risk appetite and individual conduct over the period.

Improving alignment of interest with shareholders

We are also introducing mechanisms to align further the executives' interests with shareholders and the long-term success of the Company, including the introduction of a two-year post-vesting holding period for PSP awards made from 2018 and increasing the shareholding guidelines for the CEO and CFO by 50% of salary (CEO: 250% of salary, CFO: 200% of salary). The requirement to defer 50% of any bonus earned into shares for three years will also continue to operate. We have also reviewed malus and clawback provisions to ensure that these are readily enforceable if required.

Concluding remarks

I would like to thank Nathan Moss who stepped down as a member of the Committee when he left the Board in May 2017 and to welcome Andrew Doman, who joined the Committee as a member in September 2017.

I hope you agree with the rationale for the proposed changes and will support the resolutions to approve the Remuneration Policy and the Remuneration Report at the 2018 AGM.

Mary McNamara
Chair of the Remuneration Committee
15 March 2018

Remuneration Policy

This section describes our Directors' Remuneration Policy (the 'Remuneration Policy') which is subject to shareholder approval at the AGM on 10 May 2018 and, if approved, will be effective from this date.

Changes to the Policy

The following changes have been made to the previous Directors' Remuneration Policy.

Annual bonus

The maximum opportunity has been increased to 150% of salary to provide greater incentive for delivering the future growth of the Company.

The proportion of bonus based on the Business Balanced Scorecard and personal performance has been changed from 75:25 to 90:10.

Performance Share Plan

A post-vesting holding period will be introduced on awards made from 2018. Any shares vesting may not be sold for two years (after selling sufficient shares to pay tax). This provides greater alignment between shareholders and executives and extends the time horizon of each grant to five years.

In line with regulatory guidance, the performance underpin has been strengthened such that the Committee will undertake a discretionary assessment of the level of vesting to ensure it is in line with the underlying performance of the Company, takes into account financial and non-financial risk and the individual's conduct.

Share ownership guidelines

The share ownership guidelines have been increased by 50% of salary to 250% of salary for the CEO and 200% of salary for the CFO in order to strengthen the alignment of interest with shareholders.

Other changes

The maximum pension contribution will remain at 13% of salary, however the individual will not be required to make a contribution into the plan to receive this. This is in line with the senior leadership population and enables greater flexibility within HMRC pension limits.

The flexibility to change the benefits offered has been included should the Company offer other market competitive benefits in the future.

Policy overview

This Policy has been prepared in accordance with the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, as amended in 2013. The Policy has been developed taking into account a number of regulatory and governance principles, including:

- The UK Corporate Governance Code 2016
- The regulatory framework applying to the Financial Services Sector (including the Dual-regulated firms Remuneration Code and provisions of CRD IV)
- The executive remuneration guidelines of the main institutional investors and their representative bodies.

Objectives of the Remuneration Policy

The overarching principles of the Remuneration Policy are to:

- Promote the long-term success of the Company.
- 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 to meet the needs of our customers.
- 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.

How the views of employees and shareholders are taken into account

The Committee does not formally consult directly with employees on executive pay but receives periodic updates 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 line (in percentage of salary terms) 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 Board has begun work to examine how it can engage more widely with stakeholders, including employees. As part of this initiative, the Committee will look into the best way to engage with employees on how executive pay aligns with the pay of the wider workforce.

The Committee will seek to engage with major shareholders and the main shareholder representative bodies and proxy advisory firms when it is proposed that any material changes are to be made to the Remuneration Policy or its implementation. 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 the effectiveness of the Remuneration Policy.

Directors' Remuneration Report continued

THE REMUNERATION POLICY FOR EXECUTIVE DIRECTORS

The table below and accompanying notes describe the Policy for Executive Directors.

Element	Purpose and link to strategy	Operation and performance conditions	Maximum
Salary	To reward Executives for the role and duties required. Recognises individual's experience, responsibility and performance.	Paid monthly. Base salaries are usually reviewed annually, with any changes usually 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 individual and corporate performance, increases provided to the wider workforce and the external market for UK listed companies both in the financial services sector and across all sectors.	Increases will generally be broadly in line with the average of the workforce. Higher increases may be awarded in exceptional circumstances such as a material increase in the scope of the role, following the appointment of a new executive (which could also include internal promotions) to bring an initially below-market package in line with market over time or in response to market factors.
Benefits	To provide market competitive benefits to ensure the well-being of employees.	The Company currently provides: • car allowance • life assurance • income protection • private medical insurance, and • may pay other benefits as appropriate for the role.	There is no maximum cap on benefits, as the cost of benefits may vary according to the external market.
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.
Annual bonus	To incentivise and reward individuals for the achievement of pre-defined, Committee approved, annual financial, operational and individual objectives which are closely linked to the corporate strategy.	The annual bonus targets will have a 90% weighting based on performance under an agreed balanced scorecard which includes an element of risk appraisal. Within the scorecard at least 50% of the bonus will be based on financial performance. 10% of bonus 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 flex the payout (including to zero) to ensure there is a strong link between payout and performance. 50% of any bonus earned will be deferred into an award over shares. These deferred shares will normally 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 150% of salary. The threshold level for payment is up to 25% for any measure.

1. Clawback and malus provisions apply to both the annual bonus, including amounts deferred into shares, and PSP. These provide for incentive recovery in the event of (i) the discovery of a material misstatement of results, (ii) an error which has resulted in higher incentive payouts than would have otherwise been earned, (iii) a significant failure of risk management, (iv) regulatory censure, (v) in instances of individual gross misconduct discovered within five years of the end of the performance period (vi) or any other exceptional circumstance as determined by the Board. 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: withhold deferred bonus shares, future PSP awards or cash bonuses, or seek to recoup cash already paid.

Element	Purpose and link to strategy	Operation and performance conditions	Maximum
Performance Share Plan	To incentivise and recognise execution of the business strategy over the longer term. Rewards strong financial performance over a sustained period.	PSP awards will typically be made annually at the discretion of the Committee, usually following the announcement of full-year results. Normally, awards will be based on a mixture of internal financial performance targets and relative TSR. The performance targets will normally be measured over three years. Any vesting will be subject to an underpin, whereby the Committee must be satisfied (i) that the vesting reflects the underlying performance of the Company, (ii) that the business has operated within the Board's risk appetite framework and (iii) that individual conduct has been satisfactory. Awards granted after 1 January 2018 will include a holding period whereby any shares earned at the end of the performance period may not be sold for a further two years, other than to pay tax. Clawback and malus provisions apply as described in note 1 below.	The maximum PSP grant limit is 200% of salary in respect of any financial year. The threshold level for payment is 25% for any measure. For 2018, it is intended that awards of 150% of salary will be made to the CEO and CFO.
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%.	Maximum permitted savings based on HMRC limits.
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 any share awards (net of tax) until the required holding is attained.	At least 250% of salary for the CEO and at least 200% of salary for the CFO or such higher level as the Committee may determine from time to time.

Directors' Remuneration 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 corporate 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 TSR, in line with our key objectives of sustained growth in earnings leading to the creation of shareholder value over the long term. TSR provides a close alignment between the relative returns experienced by our shareholders and the rewards to executives.

There is an underpin in place on the PSP to ensure that the payouts are aligned with underlying performance, financial and non-financial risk and individual conduct.

In line with HMRC regulations for such schemes, the Sharesave Plan 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
- The form of the award (i.e. conditional share award or nil cost option)
- 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.

OSB operates in a heavily regulated sector, the rules of which are subject to frequent evolution. The Committee therefore also retains the discretion to make adjustments to payments under this Policy as required by financial services regulations. For example, this may include increasing the proportion of bonus deferred or extending the time horizons for variable pay.

Awards granted prior to the effective date

Any commitments entered into with Directors prior to the effective date of this Policy will be honoured. 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.

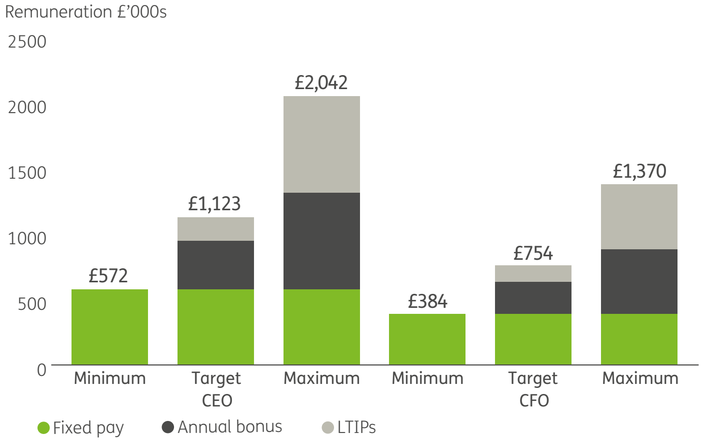
A highly collegiate approach is followed in the assessment of annual bonus, with our corporate scorecard being used to assess bonus outcomes throughout the organisation, with measures weighted according to role, where relevant.

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 implemented in 2018, would vary under various performance scenarios.



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. 75% of salary) and 25% of maximum is achieved under the LTIP (i.e. 37.5% of salary)
3. At maximum full vesting is achieved under both plans (i.e. 150% of salary).

Share price growth and all-employee share plan participation are not considered in these scenarios.

Service contracts

The terms and provisions that relate to remuneration in the Executive Directors' service agreements are set out below. Service contracts are available for inspection at the Company's registered office.

Provision	Policy
Notice period	12 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 below. 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	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; and nine-month restrictive covenants against soliciting clients, suppliers and key employees.
Contract date	Andy Golding 4 June 2014, April Talintyre 19 May 2014.
Unexpired term	Rolling contracts.

Directors' Remuneration Report continued

Payments for loss of office

On termination, other than for gross misconduct, the executives will be contractually entitled to salary, pension and contractual benefits (car allowance, private medical cover, life assurance and income protection) over their notice period. The Company may make a payment in lieu of notice equivalent to the salary for the remaining notice period. Payments in lieu of notice may be phased and subject to mitigation.

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

Annual bonus on termination

There is no automatic/contractual right to bonus payments and the default position is that the individual will not receive a payment. The Committee may determine that an individual is a 'good leaver' and may elect to pay a pro-rata bonus for the period of employment at its discretion and based on full year performance.

DSBP awards on termination

Awards normally lapse on termination of employment. However, in certain good leaver situations, awards may instead vest on the normal vesting date (or on cessation of employment in exceptional circumstances). Good leaver scenarios include (i) death; (ii) injury, ill-health or disability; (iii) retirement with the agreement of the Company; (iv) redundancy; (v) the employing company ceasing to be a member of the Group; or (vi) any other circumstance the Committee determines good leaver treatment is appropriate.

PSP awards on termination

Awards normally lapse on termination of employment. However, in certain good leaver situations, awards may vest on the normal vesting date and to the extent that the performance conditions are met. The Committee is, however, permitted under the rules to allow early vesting of the award to the extent it considers appropriate taking into account performance to date. Unless the Committee determines otherwise, awards vesting in good leaver situations will be pro-rated for time employed during the performance period.

Approach to recruitment and promotions

The ongoing remuneration package for a new Director would be set in accordance with the terms of the Company's approved Remuneration Policy.

On recruitment, the salary may (but need not necessarily) be set at a lower rate, with phased increases (which may be above the average for the wider employee population) as the executive gains experience. The salary would in all cases be set to reflect the individual's experience and skills and the scope of the role.

The Company may compensate for remuneration foregone upon leaving 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 all appointments, the Committee may agree that the Company will meet certain appropriate relocation costs.

For an internal appointment, including in the situation where a Director is appointed following corporate activity, any variable pay element awarded in respect of their prior role would 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.

Should an individual be appointed to a role (executive or non-executive) on an interim basis, the Company may provide additional remuneration, in line with the Policy for the specific role, for the duration the individual holds the interim role.

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, which will consider 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.

THE REMUNERATION POLICY FOR THE CHAIRMAN AND NON-EXECUTIVE DIRECTORS

The table sets out the 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 for additional responsibilities including the Chair of the Audit, Remuneration, Nomination and Risk Committees and for acting as the Senior Independent Director. Fees are reviewed periodically. The Chairman and Non-Executive Directors are entitled to reimbursement of travel and other reasonable expenses incurred in the performance of their duties.	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 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 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.

Directors' Remuneration Report continued

2017 Annual Report on Remuneration

Introduction

This section sets out details of the remuneration received by Executive and Non-Executive Directors (including the Chairman) in respect of the financial year ended 31 December 2017. This Annual Report on Remuneration will, in conjunction with the Annual Statement of the Committee Chair on pages 81 to 82, be proposed for an advisory vote by shareholders at the forthcoming AGM to be held on 10 May 2018. Where required, data has been audited by KPMG LLP and this is indicated where appropriate.

Membership

The Committee met seven times during the year. Mary McNamara (Chair), Rod Duke and Andrew Doman are members. Nathan Moss ceased to be a Director and member on 31 May 2017. The attendance of individual Committee members, is set out in the Corporate Governance Report.

The Board considers each of the members of the Committee to be independent in accordance with the UK Corporate Governance Code.

Responsibilities

The Committee's responsibilities are set out in its terms of reference which are available on the Company's website. In summary, the responsibilities of the Committee include:

- Pay for employees under the Committee's scope:
  - Setting the Remuneration Policy
  - Determine the total individual remuneration (including salary increases, bonus opportunities and outcomes and LTIP awards)
  - 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
- Approve the design of, and determine targets for, any performance related pay schemes operated by the Company and approve total payments made under such schemes.

Employees under the Committee's scope include Executive Directors, the Chairman of the Board, the Company Secretary and all employees that are identified as Code Staff for the purposes of the PRA and FCA's Dual Regulated Remuneration Code ('Code Staff').

Key matters considered by the Committee

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

- A detailed review of the Executive Directors' Remuneration Policy and investor consultation ahead of the new Policy being approved at the 2018 AGM
- For employees under the Committee's scope:
  - Review and approve salary increases
  - Review and approve bonus awards
  - Determine the grants under the Performance Share Plan
- Consider and approve the 2017 Directors' Remuneration Report
- Consider market trend and regulation updates.

Advisers to the Committee

Following a tender process in 2017, Korn Ferry was appointed as independent adviser to the Committee and provided advice on all aspects of executive remuneration including development of the new Remuneration Policy. The total fees paid to Korn Ferry were £58,000.

Korn Ferry has no other connection with the Group and therefore the Committee is satisfied that it provides objective and independent advice. Korn Ferry 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.

New Bridge Street were the Committee's adviser until April 2017 and were paid fees of £52,000.

The Committee consults with the Chairman of the Board and/or Chief Executive Officer (CEO), as appropriate, and seeks input from the Risk Committee to ensure that any remuneration or pay scheme reflect the Company's risk appetite and profile and considers current and potential future risks.

The Committee also takes input on senior executive remuneration from the Chief Financial Officer (CFO) and Group Head of Human Resources. The Group General Counsel and Company Secretary acts as Secretary to the Committee and advises on regulatory and technical matters, ensuring that the Committee fulfils its duties under its terms of reference. No individual is present in discussions directly relating to their own pay.

DIRECTORS' PAY OUTCOMES FOR 2017

Remuneration and fees payable for 2017 – (audited information)

The table below sets out a single figure for the total remuneration received by each Executive Director and Non-Executive Director for the years ending 31 December 2017 and 31 December 2016.

Executive Directors	Year	Basic salary £000	Taxable benefits[1]	Pension	Annual bonus paid[2]	Amount bonus deferred[2]	LTIP	Total
Andy Golding	2017	480	19	62	208	208	682	1,659
	2016	440	13	57	200	200	n/a	910
April Talintyre	2017	324	14	42	138	138	482	1,138
	2016	305	9	40	135	135	n/a	624

1. Taxable benefits received include car allowance (CEO £18,000; CFO £13,000), private medical cover and life assurance.
2. 50% of bonus is payable in cash and 50% deferred in shares for three years.

Total fees £000	2016	2017
Chairman		
David Weymouth (from 1 September 2017)	–	**83**
Mike Fairey (until 10 May 2017)	161	**69**
Non-Executive Directors		
Graham Allatt	73	**88**
Eric Anstee	72	**78**
Andrew Doman	26	**60**
Rod Duke	77	**138**
Tim Hanford (paid to JC Flowers until 31 December 2017)	60	**60**
Margaret Hassall	26	**60**
Malcolm McCaig (until 31 December 2016)	60	**–**
Mary McNamara	70	**70**
Dr David Morgan (until 31 December 2016)	60	**–**
Nathan Moss (until 31 May 2017)	60	**25**
Stephan Wilcke (until 11 May 2016)	22	**–**
Total	767	**731**

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

Executive bonus scheme: 2017 performance against the Business Balanced Scorecard (audited)

In 2017, the bonus plan was simplified to focus on a smaller number of KPIs derived from our Business Balanced Scorecard.

		Targets					
Category	Key performance indicator	Threshold (25%)	Budget (50%)	Max (100%)	Actual result	Outcome CEO (%)	Outcome CFO (%)
Financial (35%)	Underlying PBT	£151m	£155m	£163m	£167.7m	31.25	31.25
	All-in ROE	25.1%	26.1%	28.1%	27.8%		
	Cost to income ratio	28.8%	27.8%	25.8%	27.3%		
	Net loan book growth	17.1%	18.1%	20.1%	23.0%		
	CET1 ratio[1]	<12%	12%	>13%	13.7%		
Customer (15%)	Customer satisfaction	35	40	50	62	12	12
	Broker satisfaction	37.5	40	45	6		
	Complaints	0.8%	0.5%	0.17%	0.07%		
Quality (15%)	Deficient internal audits	1	n/a	0	4	8.75	8.75
	Arrears	1.25%	1%	0.50%	0.53%		
	IT system up-time	99%	99.5%	99.7%	99.9%		
	High severity incidents	8	6	2	2		
Staff (10%)	Diversity[2]	26%	27%	29%	25%	8	7
	Employee engagement[3]	3	4	6	8		
Personal (25%)	Vary by executive – see section below					25	25
Total						85	84

1. CET1 – the calculation of the metric was changed during the year to align it with the externally reported metric.
2. Diversity – based on the gender diversity of the senior leadership team.
3. Employee engagement – the employee engagement represents the number of categories which showed improvement versus the prior year.

Directors' Remuneration Report continued

2017 Personal performance

The Executive Directors were allocated up to a maximum of 25% of their bonus based on their personal performance against agreed objectives.

The priorities for 2017 were identified in our 2016 Annual Report and objectives built around these. Performance against the objectives for both executives was outstanding as was their overall leadership of the Bank.

The key achievements delivered by the CEO during 2017 were:
- Exceptional stakeholder management at all levels
- Driving the culture agenda evidenced by significant improvements in employee engagement
- Successful issuance of £60m Additional Tier 1 capital securities
- Oversight of delivery of 2017 risk management and modelling projects including preparation for IFRS 9 implementation and planned IRB application
- Delivery of improvements in IT systems including new technology solution for assessing multi-property portfolios
- Excellent progress in relation to the development of the OSBIndia business.

The key achievements delivered by the CFO during 2017 were:
- Successful issuance of £60m Additional Tier 1 capital securities including interaction with investors on debt roadshow
- Oversaw significant improvements in the finance control environment and HR operations
- Built strong relationships with key stakeholders including shareholders, regulators and the Board
- Further improvement in reporting and forecasting internal processes
- Excellent preparation for IFRS 9 implementation with parallel reporting undertaken throughout 2017
- Oversaw significant recruitment activity for the Group and their successful integration into the business.

Based on this performance, the Committee agreed that 100% of the individual element of the bonus should be paid to the CEO and CFO. Accordingly, 25% out of a possible 25% was awarded for this element.

Long-term incentive plan

The first LTIP award after the IPO was granted on 18 March 2015 and was based on EPS and TSR performance conditions measured over the three financial years to 31 December 2017.

Performance level	Percentage of that part of the award vesting	EPS element (50% of total award)	EPS performance	Vesting of EPS part	TSR element (50% of total award)	TSR performance	Vesting of TSR part (50% of total award)
Below 'threshold'	0%	Less than 12% CAGR	>18%	100%	Below median	Above upper quartile	100%
'Threshold'	25%	12% CAGR			Median		
'Stretch'	100%	18% CAGR			Upper quartile		

The 2015 PSP awards will therefore vest as follows:

Executive Directors	Number of shares awarded	Number of shares due to vest	Total £000[1]
Andy Golding	171,233	171,233	682
April Talintyre	121,005	121,005	482

1. Value of shares based on a three-month average share price of £3.985 on 31 December 2017.

EXECUTIVE PAY OUTCOMES IN CONTEXT

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 are the analogous population (based on service and location).

	Average percentage change 2016–2017		
	Salary	Taxable benefits	Annual bonus
CEO	9.1%	38.5%	4%
UK employees	7.9%	0%	4.48%

Comparison of Company performance and CEO remuneration

The following table summarises the CEO single figure for total remuneration, annual bonus and LTIP pay-out as a percentage of maximum opportunity in 2013–2017:

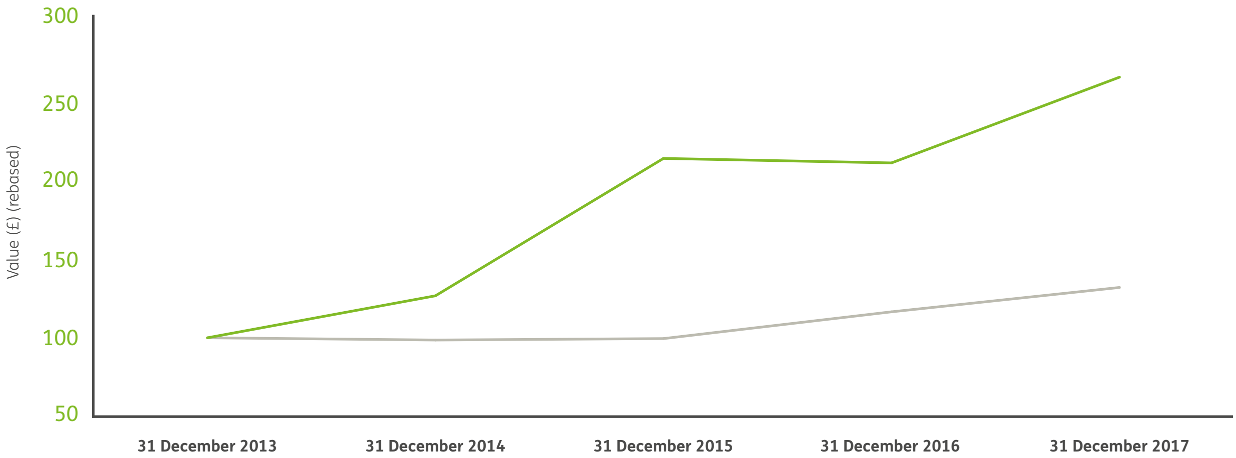
	2013	2014	2015	2016	2017
Andy Golding					
Annual bonus (as a percentage of maximum opportunity)	92.5%	92.63%	93.00%	88.75%	**85%**
LTIP vesting (as a percentage of maximum opportunity)	–	–	–	–	**100%**
CEO single figure of remuneration (£'000)	518	777	848	910	**1,659**

Total shareholder return

The table below shows the total shareholder return (TSR) performance of the Company over the period from listing to 31 December 2017 compared 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.

TOTAL SHAREHOLDER RETURN

Source: Datastream (Thomson Reuters)



This graph shows the value, at 31 December 2017, of £100 invested in OneSavings Bank plc on admission (5 June 2014) compared with the value of £100 invested in the FTSE All Share Index on the same date.

The other points plotted are the values at intervening financial year-ends.

Relative importance of the spend on pay

The table below shows the Company's total employee remuneration (including the Directors) compared to distributions to shareholders and operating profit before tax for the year under review and the prior year. In order to provide context for these figures, underlying operating profit as a key financial metric used for remuneration purposes has been shown.

	2016	2017
Total employee costs	£29.5m	**£35.9m**
Distributions to shareholders	£25.5m	**£31.2m**
Underlying profit before tax	£163.1m	**£167.7m**
Total employee costs v PBT	21.5%	**21.4%**
Average headcount	674	**813**
Average PBT per employee	£203,264	**£206,273**

OTHER DISCLOSURE ON 2017 EXECUTIVE REMUNERATION

Scheme interests awarded during the financial year

The table below shows the conditional share awards made to Executive Directors in 2017 under the Performance Share Plan and the performance conditions attached to these awards:

Executive	Face value of award (percentage of salary)	Face value of award	Percentage of awards released for achieving threshold targets	End of performance period	Performance Conditions
Andy Golding	130%	£585,000	25%	31 December	
April Talintyre	100%	£310,000		2019	EPS & TSR

1. The number of shares awarded was calculated using a share price of £4.0754 (the average mid-market quotation for the preceding five days before grant on 16 March 2017.
2. Performance conditions are (i) 50% TSR versus the FTSE 250 (25% vesting for median performance increasing to maximum vesting for upper quartile performance); and (ii) 50% EPS (25% vesting for growth in EPS of 6% per annum increasing to maximum vesting for 12% per annum).

Directors' Remuneration Report continued

All-employee share plans

The Executive Directors have the following interests under the scheme:

Executive	Date of grant	Exercise price £	Market price (31 December 2017) £	Exercise period: Beginning	Exercise period: End	Number of options: Beginning of period	Number of options: Granted/ exercised/ forfeited/ lapsed	Number of options: End of period
April Talintyre	2014	1.34	4.1260	18-Jul-17	18-Jan-18	6,716	6,716	–

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

Total shares owned by Directors:

	Interest in shares		Interest in share awards		Shareholding requirements	
	Beneficially owned at 1 January 2017	Beneficially owned at 31 December 2017	Without performance conditions at 31 December 2017	Subject to performance conditions as at 31 December 2017	Shareholding requirement (percentage of basic salary)	Current shareholding (percentage of basic salary)[2]
Executive						
Andy Golding[1]	1,650,000	1,100,000	203,661	476,832	250%	1,530% (Met)
April Talintyre[1]	579,415	336,131	139,464	311,696	200%	1,003% (Met)
Non-Executive						
Graham Allatt	–	–				
Eric Anstee	4,960	4,960				
Andrew Doman	100,499	102,437				
Rod Duke	94,537	94,537				
Margaret Hassall	–	–				
Mary McNamara	22,350	22,350				
David Weymouth	–	13,178				

1. Includes shares in OSB Holdco Limited.
2. Shareholding based on the closing share price on 31 December 2017 – £4.1260 and year end salaries.
3. There were no changes to Directors' interests in the Company's shares during the period 31 December 2017 to 15 March 2018.

External Board appointments

Andy Golding is a Director/trustee of Building Societies Trust Limited. He receives no remuneration for this position.

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.

HOW WE WILL IMPLEMENT THE REMUNERATION POLICY FOR DIRECTORS IN 2018

Base salary

The CEO and CFO's salary will be increased by 3% to £504,700 and £338,460 respectively. Benefits and pension provision will remain unchanged.

Annual bonus

The performance measures for the 2018 annual bonus have been set in line with the business balanced scorecard. For 2018 we have reduced the weighting on personal performance to 10%, with the 15% balance moved to the financial element of the Business Balanced Scorecard. Accordingly, the balance of the metrics are as follows:

Financial	Customer	Quality	Staff	Personal objectives
50% of bonus opportunity	15% of bonus opportunity	15% of bonus opportunity	10% of bonus opportunity	10% of bonus opportunity
Underlying PBT All-in ROE Cost to income ratio Net loan book growth CET1 ratio	Customer satisfaction Broker satisfaction Complaints	Overdue management actions Arrears High severity incidents	Diversity Employee engagement	Vary by executive Details of objectives (and performance against these) will be disclosed retrospectively in next year's report

Performance targets are considered to be commercially sensitive so will not be published in advance. However, there will be full disclosure of the targets set and the extent of their achievement in the 2018 Annual Report on Remuneration.

Subject to approval of the new Policy the maximum opportunity will be 150% of salary. 50% of any bonus earned will be deferred in shares for three years.

Performance Share Plan
PSP awards of 150% of salary will be made to the Executive Directors following the 2018 AGM. The performance conditions will continue to be partly driven by EPS (40% weighting), and TSR (40% weighting) and, for the 2018 PSP award, a new return measure based on return on equity will be introduced (20% weighting) to drive and reward the efficient use of capital. This new measure will be alongside the focus on profitable growth (EPS) and continued stock market outperformance (relative TSR vs the FTSE 250 constituents).

At the time of vesting, the Committee will assess whether the formulaic vesting outcome is aligned with the underlying performance, risk appetite and individual conduct over the period.

Following vesting, shares must be held for a further two years (after selling sufficient to pay tax). The performance targets are as follows:

Performance level	EPS element (40% of total award)	TSR element (40% of total award)	Return on equity (20% of total award)	Percentage of that part of the award vesting
Below 'threshold'	Less than 6% CAGR	Below median	Below 20%	0%
'Threshold'	6% CAGR	Median	20%	25%
'Stretch'	12% CAGR	Upper quartile	25%	100%
	Pro rata vesting in between the above points			

Share ownership guidelines
The share ownership guidelines for the CEO and CFO have been increased by 50% of salary in 2018. The CEO is required to accumulate and maintain a holding in ordinary shares in the Company equivalent to no less than 250% of salary and 200% of salary for the CFO. 50% of any vested share awards must be retained until the guideline is achieved.

Chairman and Non-Executive Director fees
The current Non-Executive Director fees are as follows:

Base fees	£000
Chairman	250
Non-Executive Director	60
Additional fees	
Senior Independent Director	10
Audit Committee Chair	20
Remuneration Committee Chair	10
Nomination Committee Chair	10
Risk Committee Chair	20

Statement of voting at Annual General Meeting
Shareholders were asked to approve the 2016 Annual Report on Remuneration at the 2017 AGM and the Remuneration Policy was last approved at the 2015 AGM. The votes received were:

Resolution	Votes for	% of votes cast	Votes against	% of votes cast	Total votes cast	Votes withheld
To approve the Remuneration Report (2017 AGM)	193,983,897	89.65	22,383,343	10.35	216,367,240	1,256,531
To approve the Remuneration Policy (2015 AGM)	216,736,072	97.21	6,231,805	2.79	222,967,877	492

Approval
This report was approved by the Board of Directors, on the recommendation of the Remuneration Committee, on 15 March 2018 and signed on its behalf by:

Mary McNamara
Chair of the Remuneration Committee
15 March 2018

Directors' Report: Other Information

Share capital and rights attaching to shares
The Company had 243,464,688 ordinary shares of £0.01 each in issue as at 31 December 2017. 382,597 ordinary shares were issued during 2017, 379,624 at a price of £1.34 and 2,973 at a price of £2.27. Further details relating to share capital can be found in note 40.

Without prejudice to any special rights previously conferred on the holders of any existing shares or class of shares, any share in the Company may be issued with such rights (including preferred, deferred or other special rights) or such restrictions, whether in regard to dividend, voting, return of capital or otherwise as the Company may from time to time by ordinary resolution determine (or, in the absence of any such determination, as the Directors may determine).

Authorities to allot and pre-emption rights
At the 2017 AGM, shareholders renewed the general authority for the Directors to allot up to £810,274 of the nominal value of ordinary shares of £0.01 each. In addition, shareholders gave authority for the Directors to grant rights to subscribe for, or to convert any security into regulatory capital convertible instruments up to £291,698 of the nominal value of ordinary shares equivalent to 12% of issued share capital.

Repurchase of shares
The Company has an unexpired authority to repurchase ordinary shares up to a maximum of 24,308,209 ordinary shares. The Company did not repurchase any of its ordinary shares during 2017 (2016: none).

Employee share schemes
The details of the Company's employee share schemes are set out on pages 84 to 85 in the Remuneration Report.

Results and dividends
The results for the year are set out in the Statement of Profit or Loss on page 107. The Directors recommend the payment of a final dividend of 9.3 pence per share on 16 May 2018, subject to approval at the AGM on 10 May 2018, with an ex-dividend date of 22 March 2018 and a record date of 23 March 2018. This is in addition to the 2017 interim dividend of 3.5 pence per share paid during the year (2016: 10.5 pence total dividend).

Directors' interests
Directors' interests in the shares of the Company are set out on pages 91 and 94 in the Remuneration Report. None of the Directors had interests in shares of the Company greater than 0.7% of the ordinary shares in issue. There were no changes to Directors' interests in shares since 31 December 2017.

Equal opportunities
The Group 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. This commitment also applies to existing employees.

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. The Sharesave 'save as you earn' Scheme is an all-employee share option scheme which is open to all UK-based employees. The Sharesave Scheme allows employees to purchase options by saving a fixed amount of between £5 and £500 per month over a period of either three or five years at the end of which the options, subject to leaver provisions, are usually exercisable. The Sharesave Scheme has been in operation since June 2014 and is granted annually, with the exercise price set at a 20% discount of the share price on the date of grant.

Greenhouse gas emissions
Information relating to greenhouse gas emissions can be found on page 55 in the Strategic report.

Political donations
Shareholder authority to make aggregate political donations not exceeding £50,000 was obtained at the 2017 AGM. Neither the Company nor any of its subsidiaries made any political donations this year.

Notifiable interests in share capital

At 31 December 2017, the Company had received the following notifications of major holdings of voting rights pursuant to the requirements of Rule 5 of the Disclosure Guidance and Transparency Rules:

	No. of ordinary shares	% of issued share capital
OSB Holdco Limited	52,447,557	21.54
Old Mutual plc	33,905,324	13.94
Aggregate of Standard Life Aberdeen plc	13,974,322	5.74
JPMorgan	13,035,838	5.36
Norges Bank	7,267,358	2.99

Since 31 December 2017, the following notifications were received.

	No. of ordinary shares	% of issued share capital
Old Mutual plc*	36,560,557	15.02
OSB Holdco Limited	23,664,922	9.72
Norges Bank	7,732,546	3.18

* In addition, 133,665 financial instruments with similar economic effect, representing 0.05%, were also disclosed.

Annual General Meeting

Accompanying this report is the Notice of the AGM which sets out the resolutions to be proposed to the meeting, together with an explanation of each. This year's AGM will be held at the offices of Addleshaw Goddard, 60 Chiswell Street, London, EC1Y 4AG on 10 May 2018. The meeting will start at 11am with registration from 10.30am.

Going concern statement

The Directors have undertaken a going concern assessment in accordance with 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting', published by the Financial Reporting Council in September 2014.

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 a period in excess of 12 months from the date of this report 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 ILAAP, the Directors are satisfied that the Group and the Company have adequate resources to continue in operational existence for a period in excess of 12 months.

Key information in respect of the Group's strategic risk management framework, objectives and processes for mitigating risks including liquidity risk are set out in detail on pages 34 to 48.

Jason Elphick
Group General Counsel and Company Secretary
OneSavings Bank plc
Registered number: 07312896
15 March 2018

Statement of Directors' responsibilities in respect of the Annual Report and the financial statements

The Directors are responsible for preparing the Annual Report and the Group and financial statements 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 International Financial Reporting Standards (IFRS) as adopted by the EU and applicable law and have elected to prepare the parent company financial statements on the same basis.

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 Group and parent company and of the profit or loss of the Company for that period.

In preparing each of the Group and parent company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently
- make judgements and estimates that are reasonable, relevant and reliable
- state whether they have been prepared in accordance with IFRS as adopted by the EU
- assess the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company, and enable them to ensure that the financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect 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 Statement 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.

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, 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; and
- the Strategic report includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

We consider the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

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.

Other information

Likely future developments in the Company and its subsidiaries are contained in the Strategic report on pages 1 to 59.

Information on financial instruments including financial risk management objectives and policies including the policy for hedging the exposure of the Company and its subsidiaries to price risk, credit risk, liquidity risk and cash flow risk can be found in the Risk Review on pages 32 to 38.

Approved by the Board and signed on its behalf by:

Jason Elphick
Group General Counsel and Company Secretary
15 March 2018

KPMG

Independent auditor's report

to the members of OneSavings Bank plc

1. Our opinion is unmodified

We have audited the financial statements of OneSavings Bank plc ('the Bank') for the year ended 31 December 2017 which comprise the Consolidated Statement of Profit or Loss, the Consolidated Statement of Other Comprehensive Income, the Consolidated and Bank Statements of Financial Position, the Consolidated and Bank Statements of Changes in Equity, the Consolidated and Bank Statements of Cash Flows, and the related notes, including the accounting policies in note 1.

In our opinion:

– the financial statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 31 December 2017 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 (IFRSs as adopted by the EU);

– the parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; 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.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ('ISAs (UK)') and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the Audit Committee.

We were appointed as auditor on 28 May 2010. The period of total uninterrupted engagement is for the 8.25 financial years ended 31 December 2017. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed public interest entities. No non-audit services prohibited by that standard were provided.

Overview		
Materiality: group financial statements as a whole	£6.4m (2016: £5.2m) 4% (2016: 4%) of group profit before tax	
Coverage	100% (2016:100%) of group profit before tax	
	Risks of material misstatement	**vs 2016**
Recurring risks	Recognition of revenue on organic and acquired loans	▼
	Loan impairment	▲

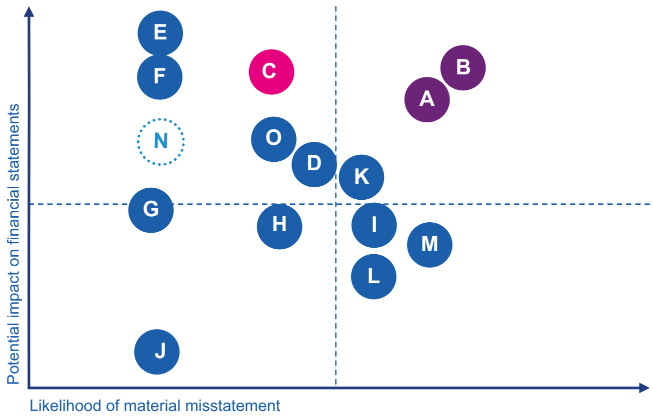
2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise on the following pages the key audit matters, in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

Our assessment of the Group's, and the Bank's, significant risks was the starting point for our audit. This considered both internal and external risks to the Group's business model and how these have been mitigated. The internal factors considered were:
Control environment – we 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; and
Capital and liquidity – we considered the strength of the Group's capital and liquidity position, the diversification of assets, the flexibility and composition of its balance sheet and the management of its cost base.
Business activity – we assessed the risk in relation to recognition of revenue on acquired books to have decreased due to there being no new loan books purchased in the year.

The external factors considered were:
Economic changes – we considered the audit risk in relation to loan impairment to have been increased by the impact on the economy of the results of the EU referendum, given the Group's exposure to properties in London and the South East, and the recent Bank of England base rate change, which introduces unpredictability of forecasting in comparison to the previously benign market.
Political and regulatory changes – the regulatory and tax changes in the buy-to-let market, together with the greater competition in this market, have introduced greater uncertainty over the expected remaining lives of current buy-to-let lending.
Market developments – increasing levels of competition in the market, and the advancement of technological solutions and platformisation, including the upcoming changes from Open Banking.

We first considered these in June 2017, and refreshed our assessments through our half year review and year end audit. That consideration includes conversations not only with the Group, and ongoing knowledge gained through reading pertinent information, but also reflected the views of the Prudential Regulatory Authority, market analysts, specialists within our firm, and peer comparisons. The final result of our risk consideration is shown in the table.



A Loan impairment including forborne loans

B Recognition of revenue on organic and acquired loans

C Management override of controls (risk required by ISAs)

D Valuation of treasury and hedge accounting

E Going concern risk and longer term viability

F Risk of fraudulent transactions

G Recoverability of deferred tax assets

H Accounting for executive compensation scheme

I Use of third parties for loan book servicing

J Valuation of investments in subsidiaries

K IT environment and effectiveness of general IT controls

L Legal, compliance and regulatory developments

M Financial reporting and robustness of reporting processes

N Disposal of Rochester securitisation vehicle (2016 only)

O Uncertain economic outlook

- Risks of greater significance – assessed below
- Other financial statement audit risks
- Significant risk as required by the International Standards on Auditing

Consistent with 2016, we are of the view that the recognition of revenue on organic and acquired loans and loan impairment carry the greatest significance. As in the prior year, due to the similarity in the underlying principles of revenue recognition on acquired loans, EIR on organic loans and amortisation of the fair value hedge asset, we have continued to assess these as one key audit matter below. As described on pages 74 to 76 these are also areas that have been focused on by the Group's Audit Committee.

Given the proportion of the Group that the Bank comprises, and the fact that the Bank is the main trading entity of the Group, we have considered the Bank and Group significant risk areas to be the same.

Recognition of revenue on organic and acquired loans

(£332.7 million; 2016: £309.5 million)

Refer to pages 75 and 76 (Audit Committee Report), page 113 (accounting policy) and page 124 (financial disclosures).

The risk

Group and Parent
Subjective estimate:
The effective interest rate calculation, which uses relevant interest rates, fees and transaction costs, incorporates assumptions around loan expected lives (driven by estimations of loan repayment profiles). Forecast loan repayment profiles also underpin the amortisation of the fair value hedge asset. In the case of acquired credit impaired mortgages and loans, additional variables such as the purchase price and estimated recoverable values of the loans are also used.

Originated assets
The directors apply judgement in deciding and assessing the expected repayment profiles used to determine the EIR period. The most critical element of judgement in this area is the estimation of the future redemption profiles of the loans, which is informed by product mix and past customer behaviour of when loans are repaid.

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 from which to estimate future customer behaviour and performance.

Acquired loan portfolios
For the Group's acquired debt portfolio, the risk is that estimated future cash collections are not reflected by actual cash receipts. Estimation of future cash collections requires significant judgement to make assumptions about the value, probability and timing of expected future cash flows for each type of asset class within a portfolio.

For acquired loan portfolios, any change in the repayment profile results in the discount received or premium paid on purchase of the portfolio to be adjusted through a 'catch 'up' adjustment and spread over the revised expected life.

As further portfolios are purchased by the Group, there is a need to assess the consistency and accuracy of the effective interest rate calculations across the individual models.

A number of the acquired portfolios are serviced by third parties, leading to data inputs from a number of sources. This increases the risk that the loan and repayment data used in the model is inaccurate.

Fair value hedge asset
The fair value hedge asset relating to the legacy back book mortgages matched to interest rate swaps prior to their cancellation is being amortised in line with the estimated expected future cash flows at the point of cancellation, driven by the assumed future redemption profile of the mortgages. Where this redemption profile subsequently differs from the expectation at the time of cancellation there is a risk that the amortisation profile may not be correctly adjusted to reflect this change.

Our response

For organic loans our procedures included:

- **Methodology implementation:** We tested the consistency of methodology and application across the loan portfolios owned by the Group;
- **Test of details:** We tested the accuracy of data inputs from the mortgage systems into the effective interest rate models, including interest rates and product lives;
- We compared the observed repayment profiles of loans originated by the Bank to the assumed repayment profiles and assessed the quantitative impact of variations noted;
- **Sensitivity analysis:** We performed stress testing analysis on the assumptions noted above;
- **Independent reperformance:** We checked the mathematical accuracy of models through re-performance of the model calculations, and tested that the effective interest rates used within the monthly interest calculations agreed to the models; and
- **Assessing transparency:** We considered the adequacy of the Group's disclosures in respect of the degree of estimation involved in arriving at the revenue recognised.

In addition, for acquired loans we also performed the following:

- **Historical comparisons:** We performed regression testing to assess any significant deviations from the original forecast cash flows;
- **Assessing forecasts:** We considered whether any 'catch up' adjustments were required on portfolios where the repayment profile actual cash flow experience had differed from that originally predicted. For those loans where catch up adjustments have been recorded, we assessed the appropriateness of the payment assumptions used in the forecast cash flow calculations, by comparing to payment rates previously experienced;
- **Control operations:** We visited each of the servicers for the mortgage books where these were not administered by the Group to test the relevant controls over the recording of loan balances and interest at these entities; and
- **Data capture:** We performed sample testing to assess the accuracy and consistency of the information provided by the servicer companies to the Group and that this was appropriately captured in the models.

We tested the amortisation of the fair value hedge asset through:

- **Assessing forecasts:** We considered whether any 'catch up' adjustments were required to the amortisation where the actual cash flow experience had differed from the repayment profile originally predicted and determined whether the correct amounts had been recognised.

Our results
As a result of our work we found the level of revenue recognised to be acceptable (2016: acceptable)

KPMG

Loan impairment

(£21.6 million; 2016: £25.0 million)

Refer to pages 74 and 75 (Audit Committee Report), pages 115 and 116 (accounting policy) and pages 134 and 135 (financial disclosures).

The risk

Group and Parent
Subjective estimate:
This is a key judgemental area due to the level of subjectivity inherent in estimating the recoverability of loan balances, compounded by the fact that lower levels of lending historically have provided the Group with limited historical experience to use in predicting the likelihood of loans falling into arrears.

Individual impairment – the Group identifies individual mortgage loan cases for a specific impairment assessment based on the current level of arrears and nature of the loan. The individual impairment requirement for the loan is determined based on estimated future cash flows discounted to present value at the rate inherent in the loan. This is a highly manual process, with a number of data inputs and assumptions including the cost of obtaining and selling the repossessed property, probable sale proceeds and any rental income prior to sale.

Collective impairment – an assessment is performed collectively on all other loans for impairment, with the key assumptions being:

- the probability of an account falling into arrears and subsequently defaulting,
- the market valuations of any collateral provided,
- the emergence period for losses, and
- the estimated time and cost to sell any collateral property repossessed by the Group.

The assumptions noted above 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, development finance, and personal loans, which reflects the diverse nature of lending performed by the Group and different characteristics of each book.

There is a risk that the overall provision is not reflective of the incurred losses at the end of the period due to changes in customer credit quality resulting in unrepresentative probabilities of default, the period of time assumed that it takes for incurred losses to emerge, or other market factors not sufficiently incorporated into the model, such as house prices. Given the relatively young nature of these loan books, which result in limited historical information, and sensitivity of the impairment assessments to these assumptions, there is increased risk that actual experience may differ from the Group's current expectations.

Our response

For loans assessed for specific impairment, our procedures included:

- **Test of details:** 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;
- We agreed the key data inputs to third party documentation; namely projected selling price and costs to valuation reports, rental income to tenancy agreements and discount rates to the interest rate of the loan;
- **Sensitivity analysis:** We stress tested the collateral valuations, time to sale and discount rates to assess the sensitivity of the provision to these assumptions; and
- **Independent reperformance:** We re-performed the impairment provision calculation for a sample of loans, utilising the outcome of our testing of the data inputs and assumptions.

For loans assessed collectively for impairment:

- **Methodology choice:** We assessed the methodology used by the Group to calculate the propensity of accounts with different arrears profiles to fall into and out of default, and considered the consistency of the probabilities of default and the emergence periods with the limited historical internal data available;
- **Test of detail:** We agreed the data inputs in the model to the mortgage data system and third party reports;
- **Our sector experience:** We critically assessed the assumptions inherent in the model against our understanding of the different loan portfolios across the Group, their recent performance and industry developments;
- **Independent reperformance:** We recalculated the probability of default rates based on the Group's actual historical experience. We also re-performed the collective impairment model calculations based on the outcome of the testing of key assumptions to assess the overall validity of the assumptions used in the collective impairment assessment;
- **Sensitivity analysis:** We stress tested the collateral valuations, forced sales discount, and time and costs to sell the collateral (being the expected recovery on sale of the property) to assess the sensitivity of the impairment provision to these assumptions;
- **Historical comparisons:** We considered the accuracy of previous estimates of the collective provision against the current book arrears profile and losses incurred in the year;

Loan impairment (continued)

The risk

Increased lending in recent years has been at a time of historically low interest rates, which may distort customer behaviour and loss experience data for use in future assumptions, particularly if interest rates were to increase in coming years.

The Group implements a number of forbearance procedures on selected loans in arrears, such as restructuring of a loan or capitalisation of arrears balances. As this is a manual process, there is the risk that these measures are not appropriately taken into consideration when calculating the required provisions, as the apparent improvement in the arrears on the loans could result in a lower impairment provision if the loans are not identified as forborne.

Data capture:
The collective impairment model uses a combination of static (e.g. original collateral valuations) and dynamic data (e.g. current balances and interest rates) about the Group's loans as well as from external sources (e.g. house price index tables to derive indexed collateral valuations).

Owing to the majority of the acquired portfolios being serviced by third parties, the collective provision calculation requires data inputs from a number of different sources, increasing the risk that data included in the models is inaccurate.

Our response

For all loans:

- **Control operations:** We tested the design, implementation and operating effectiveness of key controls over the monitoring and reporting of loans and advances to customers;
- **Benchmarking assumptions:** We compared the provision coverage rates and the Group's assumptions such as forced sale discounts, emergence period and costs to sell collateral 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;
- **Assessing application:** We monitored credit trends in the portfolio over the year, to assess whether emerging trends are reflected in the provision level;
- **Methodology implementation:** We checked that forbearance activity is accurately reflected in the impairment provision calculation by checking that for each forborne loan, the uplift to the propensity to default assumption in the collective impairment assessment was appropriately applied;
- **Assessing transparency:** We assessed the adequacy of the Group disclosures in relation to the degree of estimation involved in arriving at the provisions;
- **Data comparison:** We checked a sample of the internal data and the data totals used in the models back to the Group's underlying source systems. We also checked the external inputs used by the Group such as house price indices to external sources;
- **Control operations:** We visited each of the servicers for the mortgage books where these were not administered by the Group to test the relevant controls over the recording of loan balances and arrears status of loans at these entities; and
- **Data capture:** We performed sample testing to assess the accuracy and consistency of the information provided by the servicer companies to the Group.

Our results

- We found the resulting estimate of the provision for loan impairment to be acceptable (2016: acceptable).

3. Our application of materiality and an overview of the scope of our audit

Materiality

Materiality for the group financial statements as a whole was set at £6.4 million, determined with reference to a benchmark of group profit before tax, of which it represents 4% (2016: 4% of profit before tax adjusted to remove the exceptional profit on disposal of Rochester Financing No1 plc).

Materiality for the parent company financial statements as a whole was set at £4.8m, determined with reference to a benchmark of company profit before tax, of which it represents 4%. This figure represents 3% of Group profit before tax.

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.3m, in addition to other identified misstatements that warranted reporting on qualitative grounds.

Scope – Group

In 2017, as in 2016, the Group audit team performed the audit of the Group as if it was a single aggregated set of financial information, completing testing over the Interbay, Prestige and OSBIndia components, and visiting the Prestige and Interbay client offices. The audit was performed using the materiality level set out above and covered 100% of total Group revenue, Group profit before tax, and total Group assets.

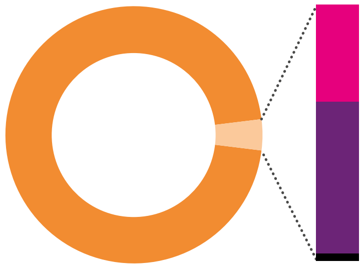
Scope – disclosure of IFRS 9 effect

The Group is adopting IFRS 9 Financial Instruments from 1 January 2018 and have included an estimate of the financial impact of the change in accounting standard in accordance with IAS 8 Changes in Accounting Estimates and Errors as set out in note 1. While further testing of the financial impact will be performed as part of our 2018 year end audit, we have performed sufficient audit procedures for the purposes of assessing the disclosures made in accordance with IAS 8. We spent considerable time assessing the key areas of judgement inherent in the IFRS 9 transition which supports our assessment of the appropriateness of the disclosure but also supports our 2018 year end audit. Specifically we have:

- Considered the appropriateness of key technical decisions, judgements, assumptions and elections made by management
- Considered key Classification and Measurement decisions, including Business Model Assessments and Solely Payment of Principal and Interest (SPPI) outcomes
- Risk rated key credit models to determine our level of work and considered credit risk modelling decisions and macroeconomic variables, including forward economic guidance and generation of multiple economic scenarios
- Considered key data flows, transitional controls and governance processes related to the approval of the estimated transitional impact.

Profit before tax
£159.0m (2016: £129.2m)

Group materiality
£6.4m (2016: £5.2m)



4. We have nothing to report on going concern

We are required to report to you if:

- we have anything material to add or draw attention to in relation to the Directors' statement in note 1 to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Group and Company's use of that basis for a period of at least 12 months from the date of approval of the financial statements; or
- the related statement under the Listing Rules set out on page 97 is materially inconsistent with our audit knowledge.

We have nothing to report in these respects.

5. We have nothing to report on the other information in the Annual Report

The directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Strategic report and Directors' report

Based solely on our work on the other information:

- We have not identified material misstatements in the strategic report and the Directors' report;
- In our opinion, the information given in those reports for the financial year is consistent with the financial statements; and
- In our opinion, those reports have been prepared in accordance with the Companies Act 2006.

Directors' remuneration report

In our opinion, the part of the Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Disclosures of principal risks and longer-term viability

Based on the knowledge we acquired during our financial statements audit, we have nothing material to add or draw attention to in relation to:

- the Directors' confirmation within the viability statement on page 49 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency and liquidity;
- the Principal Risks and Uncertainties disclosures describing these risks and explaining how they are being managed and mitigated; and
- the Directors' explanation in the viability statement of how they have assessed the prospects of the Group, over what period they have done so and why they considered that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Under the Listing Rules, we are required to review the viability statement. We have nothing to report in this respect.

Corporate governance disclosures

We are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our financial statements 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 position and performance, business model and strategy; or
- the section of the Annual Report describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We are required to report to you if the Corporate Governance Report does not properly disclose a departure from the 11 provisions of the UK Corporate Governance Code specified by the Listing Rules for our review.

We have nothing to report in these respects.

6. We have nothing to report on the other matters on which we are required to report by exception

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 parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements and the part of the 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.

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 98, the Directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud, other irregularities, or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. The risk of not detecting a material misstatement resulting from fraud or other irregularities is higher than for one resulting from error, as they may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control and may involve any area of law and regulation not just those directly affecting the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities

Irregularities – ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our sector experience, through discussion with the Directors and other management (as required by auditing standards), and from inspection of the Group's regulatory and legal correspondence.

We had regard to laws and regulations in areas that directly affect the financial statements including financial reporting (including related company legislation) and taxation legislation. We considered the extent of compliance with those laws and regulations as part of our procedures on the related annual accounts items.

In addition, we considered the impact of laws and regulations in the specific areas of regulatory capital and liquidity and certain aspects of company legislation recognising the financial and regulated nature of the Group's activities and its legal form. With the exception of any known or possible non-compliance, and as required by auditing standards, our work in respect of these was limited to enquiry of the Directors and other management and inspection of regulatory and legal correspondence. We considered the effect of any known or possible non-compliance in these areas as part of our procedures on the related annual accounts items.

We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

As with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.

8. The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Pamela McIntyre (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London
E14 5GL

15 March 2018

Statement of Profit or Loss

For the year ended 31 December 2017

	Notes	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
Interest receivable and similar income	3	**332.7**	309.5
Interest payable and similar charges	4	**(87.3)**	(102.9)
Net interest income		**245.4**	206.6
Fair value losses on financial instruments	5	**(6.3)**	(4.9)
Gains on sales of financial instruments	6	**–**	0.6
Fees and commissions receivable		**1.5**	2.5
Fees and commissions payable		**(1.0)**	(0.8)
External servicing fees		**(1.5)**	(2.6)
Total income		**238.1**	201.4
Administrative expenses	7	**(61.6)**	(51.1)
Depreciation and amortisation	23,24	**(3.5)**	(2.6)
Impairment losses	19	**(4.4)**	(9.0)
FSCS and other regulatory provisions	31	**(0.9)**	(0.5)
Exceptional gain on sale	10	**–**	34.7
Exceptional accelerated amortisation of fair value adjustments on hedged assets	10	**–**	(9.8)
Profit before taxation		**167.7**	163.1
Taxation	11	**(40.8)**	(42.2)
Profit for the year		**126.9**	120.9
Dividend, pence per share	13	**12.8**	10.5
Earnings per share, pence per share			
Basic	12	**51.1**	49.4
Diluted	12	**50.7**	49.0

The above results are derived wholly from continuing operations.

The notes on pages 112 to 177 form part of these accounts.

The financial statements on pages 107 to 177 were approved by the Board of Directors on 15 March 2018.

Statement of Other Comprehensive Income

As at 31 December 2017

	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
Profit for the year	**126.9**	120.9
Other comprehensive income/(expense)		
Items which may be reclassified to profit or loss:		
Fair value changes on available-for-sale securities:		
Arising in the year	**0.1**	0.1
Revaluation of foreign operations	**(0.3)**	0.9
	(0.2)	1.0
Total comprehensive income for the year	**126.7**	121.9

The notes on pages 112 to 177 form part of these accounts.

The financial statements on pages 107 to 177 were approved by the Board of Directors on 15 March 2018.

Statement of Financial Position

As at 31 December 2017

	Note	**Group As at 31-Dec-17 £m**	Group As at 31-Dec-16 £m	**Bank As at 31-Dec-17 £m**	Bank As at 31-Dec-16 £m
Assets					
Cash in hand		**0.5**	0.4	**0.5**	0.4
Loans and advances to credit institutions	15	**1,187.2**	417.8	**1,179.3**	413.5
Investment securities	16	**19.1**	141.7	**19.1**	141.7
Loans and advances to customers	17	**7,306.0**	5,939.2	**6,051.0**	4,893.5
Derivative assets	20	**6.1**	1.8	**6.1**	1.8
Fair value adjustments on hedged assets	21	**31.9**	46.9	**31.9**	46.9
Deferred taxation asset	25	**5.1**	3.4	**2.5**	0.8
Intangible assets	23	**6.8**	4.7	**6.1**	4.1
Property, plant and equipment	24	**21.5**	13.1	**15.4**	9.9
Investments in subsidiaries and intercompany loans	22	**–**	–	**1,194.3**	984.0
Other assets	26	**4.9**	11.9	**4.7**	3.8
Total assets		**8,589.1**	6,580.9	**8,510.9**	6,500.4
Liabilities					
Amounts owed to retail depositors	27	**6,650.3**	5,952.4	**6,650.3**	5,952.4
Amounts owed to credit institutions	28	**1,250.3**	101.7	**1,250.3**	101.7
Amounts owed to other customers	29	**25.7**	4.0	**25.7**	4.0
Derivative liabilities	20	**21.8**	24.4	**21.8**	24.4
Fair value adjustments on hedged liabilities	21	**–**	1.9	**–**	1.9
Current taxation liability		**18.3**	21.1	**14.8**	18.1
Intercompany loans	22	**–**	–	**31.2**	1.9
Other liabilities	30	**16.3**	18.6	**13.4**	7.4
FSCS and other regulatory provisions	31	**1.4**	1.5	**1.4**	1.5
Subordinated liabilities	32	**10.9**	21.6	**10.9**	21.6
Perpetual subordinated bonds	33	**15.3**	15.3	**15.3**	15.3
		8,010.3	6,162.5	**8,035.1**	6,150.2
Equity					
Share capital	34	**2.4**	2.4	**2.4**	2.4
Share premium	34	**158.4**	157.9	**158.4**	157.9
Retained earnings		**337.5**	240.7	**237.1**	175.3
Other reserves	35	**80.5**	17.4	**77.9**	14.6
		578.8	418.4	**475.8**	350.2
Total equity and liabilities		**8,589.1**	6,580.9	**8,510.9**	6,500.4

The notes on pages 112 to 177 form part of these accounts.

The financial statements on pages 107 to 177 were approved by the Board of Directors on 15 March 2018.

Andy Golding
Chief Executive Officer
15 March 2018

April Talintyre
Chief Financial Officer
15 March 2018

Company number: 07312896

Statement of Changes in Equity

For the year ended 31 December 2017

Group	Share capital £m	Share premium £m	Capital contribution £m	Transfer reserve £m	Foreign exchange reserve £m	Available-for-sale reserve £m	Share-based payment reserve £m	Retained earnings £m	Equity bonds[1] £m	Total £m
Balance at 1 January 2017	**2.4**	**157.9**	**6.2**	**(12.8)**	**0.1**	**–**	**1.9**	**240.7**	**22.0**	**418.4**
Profit for the year	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**126.9**	**–**	**126.9**
Coupon paid on equity bonds[2]	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(2.7)**	**–**	**(2.7)**
Dividends paid	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(27.0)**	**–**	**(27.0)**
Other comprehensive income	**–**	**–**	**–**	**–**	**(0.3)**	**0.1**	**–**	**–**	**–**	**(0.2)**
Share-based payments	**–**	**0.5**	**0.2**	**–**	**–**	**–**	**3.1**	**0.2**	**–**	**4.0**
Additional Tier 1 securities issuance[3]	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(0.6)**	**60.0**	**59.4**
Balance at 31 December 2017	**2.4**	**158.4**	**6.4**	**(12.8)**	**(0.2)**	**0.1**	**5.0**	**337.5**	**82.0**	**578.8**

Group	Share capital £m	Share premium £m	Capital contribution £m	Transfer reserve £m	Foreign exchange reserve £m	Available-for-sale reserve £m	Share-based payment reserve £m	Retained earnings £m	Equity bonds[1] £m	Total £m
Balance at 1 January 2016	2.4	157.9	5.8	(12.8)	(0.8)	(0.1)	0.9	144.0	22.0	319.3
Profit for the year	–	–	–	–	–	–	–	120.9	–	120.9
Coupon paid on equity bonds[2]	–	–	–	–	–	–	–	(0.9)	–	(0.9)
Dividends paid	–	–	–	–	–	–	–	(23.3)	–	(23.3)
Other comprehensive income	–	–	–	–	0.9	0.1	–	–	–	1.0
Share-based payments	–	–	0.4	–	–	–	1.0	–	–	1.4
Balance at 31 December 2016	2.4	157.9	6.2	(12.8)	0.1	–	1.9	240.7	22.0	418.4

Bank	Share capital £m	Share premium £m	Capital contribution £m	Transfer reserve £m	Foreign exchange reserve £m	Available-for-sale reserve £m	Share-based payment reserve £m	Retained earnings £m	Equity bonds[1] £m	Total £m
Balance at 1 January 2017	**2.4**	**157.9**	**5.9**	**(15.2)**	**–**	**–**	**1.9**	**175.3**	**22.0**	**350.2**
Profit for the year	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**91.9**	**–**	**91.9**
Coupon paid on equity bonds[2]	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(2.7)**	**–**	**(2.7)**
Dividends paid	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(27.0)**	**–**	**(27.0)**
Other comprehensive income	**–**	**–**	**–**	**–**	**–**	**0.1**	**–**	**–**	**–**	**0.1**
Share-based payments	**–**	**0.5**	**0.2**	**–**	**–**	**–**	**3.0**	**0.2**	**–**	**3.9**
Additional Tier 1 securities issuance[3]	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(0.6)**	**60.0**	**59.4**
Balance at 31 December 2017	**2.4**	**158.4**	**6.1**	**(15.2)**	**–**	**0.1**	**4.9**	**237.1**	**82.0**	**475.8**

Bank	Share capital £m	Share premium £m	Capital contribution £m	Transfer reserve £m	Foreign exchange reserve £m	Available-for-sale reserve £m	Share-based payment reserve £m	Retained earnings £m	Equity bonds[1] £m	Total £m
Balance at 1 January 2016	2.4	157.9	5.6	(15.2)	–	(0.1)	0.8	104.4	22.0	277.8
Profit for the year	–	–	–	–	–	–	–	95.1	–	95.1
Coupon paid on equity bonds[2]	–	–	–	–	–	–	–	(0.9)	–	(0.9)
Dividends paid	–	–	–	–	–	–	–	(23.3)	–	(23.3)
Other comprehensive income	–	–	–	–	–	0.1	–	–	–	0.1
Share-based payments	–	–	0.3	–	–	–	1.1	–	–	1.4
Balance at 31 December 2016	2.4	157.9	5.9	(15.2)	–	–	1.9	175.3	22.0	350.2

1. Equity bonds comprise £22.0m of Perpetual Subordinated Bonds and £60m of Additional Tier 1 securities (‘AT1 securities’).
2. Coupon paid on equity bonds is shown net of tax.
3. Additional Tier 1 securities issuance costs of £0.6m are shown net of tax.

The reserves are further disclosed in note 35.

Statement of Cash Flows

For the year ended 31 December 2017

	Note	Group Year ended 31-Dec-17 £m	Restated[1] Group Year ended 31-Dec-16 £m	Bank Year ended 31-Dec-17 £m	Restated[1] Bank Year ended 31-Dec-16 £m
Cash flows from operating activities					
Profit before tax		**167.7**	163.1	**124.0**	130.8
Adjustments for non-cash items:					
Depreciation and amortisation		**3.5**	2.6	**3.0**	2.2
Interest on subordinated liabilities		**0.9**	1.2	**0.9**	1.2
Interest on Perpetual subordinated bonds		**0.9**	0.9	**0.9**	0.9
Impairment charge on loans		**4.4**	9.0	**2.0**	6.9
Gain on sale of financial instruments		**–**	(0.6)	**–**	(0.6)
FSCS and other provisions		**0.9**	0.5	**0.9**	0.5
Fair value losses on financial instruments		**6.3**	4.9	**6.3**	4.9
Share-based payments		**2.4**	1.5	**2.3**	1.5
Exceptional items		**–**	(24.9)	**–**	(24.9)
Changes in operating assets and liabilities:					
Increase in loans and advances to credit institutions[1]		**(6.3)**	(5.9)	**(6.3)**	(5.9)
Increase in loans to customers		**(1,371.2)**	(1,031.3)	**(1,159.5)**	(951.7)
Increase in retail deposits		**697.9**	588.6	**697.9**	588.6
Increase in intercompany balances		**–**	–	**(181.0)**	(42.5)
Net decrease/(increase) in other assets		**7.0**	–	**(0.9)**	(14.7)
Net (increase)/decrease in derivatives and hedged items		**(0.1)**	0.9	**(0.1)**	0.9
Increase/(decrease) in credit institutions and other customers deposits		**21.3**	(2.7)	**21.3**	(2.7)
Net (decrease)/increase in other liabilities		**(3.3)**	(1.4)	**5.5**	(3.2)
Exchange differences on working capital		**(0.3)**	0.9	**–**	–
Cash used in operating activities		**(468.0)**	(292.7)	**(482.8)**	(307.8)
Interest paid on bonds and subordinated debt		**(1.8)**	(2.1)	**(1.8)**	(2.1)
Sales of financial instruments		**–**	1.9	**–**	1.9
FSCS and other provisions paid		**(1.0)**	(1.3)	**(1.0)**	(1.3)
Net tax paid		**(42.1)**	(29.6)	**(34.4)**	(24.3)
Net cash used in operating activities		**(512.9)**	(323.8)	**(520.0)**	(333.6)
Cash flows from investing activities					
Maturity and sales of investment securities		**40.0**	712.2	**40.0**	712.2
Purchases of investment securities[1]		**–**	(402.8)	**–**	(402.8)
Proceeds from disposal of a subsidiary[2]		**–**	80.2	**–**	99.0
Purchases of equipment and intangible assets		**(14.0)**	(7.7)	**(10.5)**	(6.5)
Cash generated from investing activities		**26.0**	381.9	**29.5**	401.9
Cash flows from financing activities					
Bank of England TFS drawdowns	28	**1,149.0**	101.0	**1,149.0**	101.0
Coupon paid on equity bonds		**(3.7)**	(1.2)	**(3.7)**	(1.2)
Dividends paid	13	**(27.0)**	(23.3)	**(27.0)**	(23.3)
AT1 securities issuance net of costs	35	**59.4**	–	**59.4**	–
Proceeds from issuance of shares under employee SAYE schemes	34	**0.5**	–	**0.5**	–
Repayment of debt[3]	32	**(10.7)**	(19.8)	**(10.7)**	(3.0)
Cash generated from financing activities		**1,167.5**	56.7	**1,167.5**	73.5
Net increase in cash and cash equivalents		**680.6**	114.8	**677.0**	141.8
Cash and cash equivalents at the beginning of the year[1]	14	**485.3**	370.5	**481.0**	339.2
Cash and cash equivalents at the end of the year[1]	14	**1,165.9**	485.3	**1,158.0**	481.0
Movement in cash and cash equivalents		**680.6**	114.8	**677.0**	141.8

1. The 2016 comparatives have been restated to include investment securities with maturity less than 3 months and to exclude encumbered loans and advances to credit institutions (being the cash ratio deposit and swap margin paid) within cash and cash equivalents. This has no effect on the balance sheet.
2. Proceeds from a disposal of a subsidiary relate to the Group's disposal of the entire economic interest in Rochester Financing No.1 plc during 2016.
3. Repayment of debt comprises the 2017 LIBOR linked floating rate subordinated liabilities of £5.7m and the 2017 average standard mortgage rate linked floating subordinated liabilities of £5.0m.

Notes to the Financial Statements

For the year ended 31 December 2017

1. Accounting policies

The principal accounting policies applied in the preparation of the financial statements 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 a historical cost basis, as modified by the revaluation of available-for-sale ('AFS') financial assets, derivative contracts and financial assets held at fair value through profit or loss ('FVTPL').

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 Group is a going concern in the light of current economic conditions and all available information about future risks and uncertainties.

Projections for the Group 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 requirements as set out by the Prudential Regulatory Authority ('PRA').

The Board has therefore concluded that the Group has sufficient resources to continue in operational existence for a period in excess of 12 months 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 deconsolidated from the date that control ceases. Upon consolidation intercompany 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 retranslated at the rate prevailing at the period end.

Foreign exchange gains and losses resulting from the retranslation and settlement of these items are recognised in profit or loss. Non-monetary items measured at cost in the foreign currency are translated using the spot FX rate at the date of the transaction. Non-monetary items measured at fair value in the foreign currency are translated into the functional currency at the spot FX rate at the date of which the fair value is determined.

The assets and liabilities of foreign operations with functional currencies other than Pounds 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.

e) Segmental reporting

IFRS 8 requires operating segments to be identified on the basis of internal reports and components of the Group which are 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 within the UK and the Channel Islands.

The Group segments its lending by product, focusing on the customer need and reason for a loan. It operates under two segments: Buy-to-Let/SME ('BTL/SME') and Residential mortgages.

The personal loan portfolio has largely completed its run-off and is therefore no longer considered as a separate segment by the Group. The remaining net loan book and contribution to profit for the year have been reported in the BTL/SME segment with comparatives reclassified accordingly.

1. Accounting policies continued

e) Segmental reporting continued

The comparatives have been reclassified in the following notes:

- note 3 – Interest receivable and similar income
- note 17 – Loans and advances to customers
- note 18 – Provisions for impairment losses on loans and advances
- note 37 – Risk management
- note 41 – Operating segments.

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 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.

When calculating the EIR, the Group estimates cash flows considering all contractual terms of the instrument and behavioural aspects (for example, prepayment options) but not considering future credit losses. The calculation of the EIR includes all transaction costs and fees paid or received that are an integral part of the interest rate, together with the discounts or premiums arising on the acquisition of loan portfolios. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial instrument.

The Group monitors the actual cash flows for each acquired book and where they diverge significantly from expectation, the future cash flows are reset (an AG8 adjustment). In assessing whether to adjust future cash flows on an acquired portfolio, the Group considers the cash variance on an absolute and percentage basis. The Group also considers the total variance across all acquired portfolios. Where cash flows for an acquired portfolio are reset, they are discounted at the EIR to derive a new carrying value, with changes taken to profit or loss as interest income. The EIR rate is adjusted for AG7 events where there is a change to the reference interest rate (LIBOR or Base Rate) affecting portfolios with a variable interest rate which will impact future cash flows. The revised EIR is the rate which exactly discounts the revised cash flows to the net carrying value of the loan portfolio.

Interest income on AFS 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.

Interest paid on equity Perpetual Subordinated Bonds ('PSBs') and AT1 securities is recognised directly in equity as paid.

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 foreseeable future.

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 maturities of less than three months 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.

Notes to the Financial Statements continued

For the year ended 31 December 2017

1. Accounting policies continued

l) Property, plant and equipment

Property, plant and equipment comprise freehold land and buildings, major alterations to office premises, computer equipment 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
Leasehold improvements	10 years
Equipment and fixtures	5 years

Land, deemed to be 25% of purchase price of buildings, 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

i. Recognition

The Group initially recognises loans and advances, deposits, debt securities issued and subordinated liabilities on the date on which they are originated. All other financial instruments are accounted for on the trade date which is when the Group becomes a party to the contractual provisions of the instrument.

The Group initially recognises financial assets and financial liabilities at fair value plus, for instruments not at FVTPL, transaction costs that are directly attributable to its acquisition or issue. Transaction costs relating to the acquisition or issue of a financial instrument at FVTPL are recognised in the profit or loss as incurred.

ii. Classification

The Group classifies its financial instruments in accordance with IAS 39 and IAS 32, with financial assets being classified into the following categories:

- Loans and receivables
- Available-for-sale
- At fair value through profit or loss

The Group classifies non-derivative financial liabilities as measured at amortised cost.

The Group has no financial assets nor liabilities classified as held for trading or held to maturity.

iii. Derecognition

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. Where contractual cash flows are significantly modified (e.g. through the broker-led Choices programme) the original financial asset is derecognised with a new financial asset recognised for the modified cash flows.

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

iv. Offsetting

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group currently has a legally enforceable right to offset the amounts and it intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously in accordance with the requirements of IAS 32.

The Group's derivatives are covered by industry standard master netting agreements. Master netting agreements create a right of set-off that becomes enforceable only following a specified event of default or in other circumstances not expected to arise in the normal course of business. These arrangements do not qualify for offsetting under IAS 32 and as such the Group reports derivatives on a gross basis.

Collateral in respect of derivatives is subject to the standard industry terms of International Swaps and Derivatives Association ('ISDA') Credit Support Annex. This means that the cash received or given as collateral can be pledged or used during the term of the transaction but must be returned on maturity of the transaction. The terms also give each counterparty the right to terminate the related transactions upon the counterparty's failure to post collateral. Collateral paid or received does not qualify for offsetting under IAS 32, and is recognised in loans and advances to credit institutions and amounts owed to credit institutions respectively.

Income and expenses are presented on a net basis only when permitted under IFRS, or for gains and losses arising from a group of similar transactions.

v. Amortised cost measurement

The amortised cost of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition, plus or minus the cumulative amortisation using the EIR method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

vi. Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date.

When available, the Group measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. The Group measures the fair value of its investment securities and PSBs using quoted market prices.

If there is no quoted price in an active market, then the Group uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique is system generated and calculates fair value based on known cash flow dates and interest rates and expected future interest rates extrapolated from an input zero coupon 24 point yield curve.

The Group uses LIBOR curves to value its derivatives, however, using overnight index swap ('OIS') curves would not materially change their value. The fair value of the Group's derivative financial instruments incorporates credit valuation adjustments ('CVA') and debit valuation adjustments ('DVA'). The DVA and CVA take into account the respective credit ratings of the Bank and counterparty and whether the derivative is collateralised or not. In considering which similar instruments to use, management takes into account the sensitivity of the instrument to changes in market rates and the credit quality of the instrument. Interest rate derivatives are valued using discounted cash flow models and observable market data and will be sensitive to benchmark interest rate curves.

vii. Identification and measurement of impairment

The Group regularly assesses its financial assets valued at amortised cost for impairment. During the reporting period, the main category within the scope was loans and advances to customers.

The Group individually assesses for impairment loans over £0.5m which are more than three months in arrears, where LPA receivers are appointed, the property is taken in possession or there are any other events that suggest a high probability of credit loss. Loans are considered at a connection level, i.e. including all loans belonging to and connected to the customer.

The Group estimates cash flows from these loans, including expected interest and principal payments, rental or sale proceeds, selling and other costs. The Group obtains up-to-date independent valuations for properties put up for sale.

The Group ensures that security valuations are reviewed on an ongoing basis for appropriateness, with ongoing annual indexing of commercial properties and residential properties indexed against monthly House Price Index ('HPI') data. Where the Group identifies that a published index is not representative, a formal review is carried out by the Group's real estate function to assess valuations appropriately. The Group's real estate function ensures that newly underwritten lending cases are written to appropriate valuations, with assessment being carried out by appointed, qualified chartered surveyors, accredited by the Royal Institute of Chartered Surveyors. The Group has ensured that the real estate function is placed within the Group's assurance team and is therefore independent from all credit making decisions.

If the present value of estimated future cash flows discounted at the original EIR is less than the carrying value of the loan, a specific provision is recognised for the difference. Such loans are classified as impaired. If the present value of the estimated future cash flows exceeds the carrying value no specific provision is recognised.

All loans which have not been individually assessed are subsequently assessed for impairment collectively with each loan being assigned a one year probability of default ('PD') and a loss given default ('LGD') generally consistent with the requirements of the internal ratings based ('IRB') approach, leading to the expected loss ('EL'). The provision is the sum of all ELs. The calculation uses indexed valuations from ONS statistics applied at a postcode level. All provisions on loans greater than three months in arrears are treated as a specific provision as they are considered to be impaired. Loans less than three months in arrears are assigned a collective provision.

Different PDs are used for BTL/SME mortgages, Residential mortgages and unsecured loans. Interest-only mortgages, which are predominantly within the BTL/SME segment, are not differentiated further from capital repayment mortgages. As PDs are generated from historic portfolio performance using a mix of interest-only and repayment loans, they capture the impact of interest only mortgages as long as the mix remains similar.

The Group has been contacting owner-occupied residential customers with upcoming interest-only loan maturities and tracking responses and outcomes through specific campaigns since 2014. There is no provision for the non-repayment risk of these loans.

Notes to the Financial Statements continued
For the year ended 31 December 2017

1. Accounting policies continued
vii. Identification and measurement of impairment continued
Second charge mortgages are considered separately to first charge residential mortgages in that separate PDs are calculated and used in loss calculations based on previous experience of losses on second charge loans. The LGD calculation on second charge mortgages considers the fact that the holder of the first charge on collateral has first claim on the proceeds of a sale.

Incurred but not reported losses ('IBNR'), where a loss trigger has occurred but the borrower has not yet missed a payment, are captured through the Group's collective provisioning process. PD rates are calculated for loans that are not in arrears based on historic loss data and a provision value is calculated for these accounts. The calculation of PD rates incorporates assumptions for emergence periods ('EP'), cure rates and forbearance. The Group conducts detailed analysis to calculate the time taken for a customer to fall into arrears post a loss event occurring (i.e. loss of employment). This EP is then considered within a wider observation period utilised to model the time taken post loss event for the customer to reach a default state.

Loans and the related provision are written off when the underlying security is sold or an unsecured loan customer has not paid for 12 months. Subsequent recoveries of amounts previously written off are taken through profit or loss.

The Group classifies a loan as forborne at the point a concession is granted based on the deteriorated financial status of the borrower. Accounts are classified as forborne only for the period of time which the loan is known to be, or may still be, in financial difficulty. When the borrower is no longer experiencing financial difficulties the loan will revert to standard terms. If the forbearance eliminates the arrears, the loan is no longer considered past due.

None of the currently used forbearance measures modify the overall cash flows to an extent that requires derecognition of the existing and recognition of a new loan under IAS 39.

Loans that have ever had forbearance applied are assigned a higher PD in the collective provision calculation. Forborne accounts are not treated differently in relation to impairments in any other way.

viii. Designation at fair value through the profit or loss account
The Group has not irrevocably designated any financial assets or financial liabilities at FVTPL during the current and previous year.

n) Loans and receivables
Loans and receivables are predominantly mortgage loans and advances to customers 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 hedged loans and advances is reported in fair value adjustments for hedged assets.

Loans and advances over which the Group transfers its rights to the collateral thereon to the Bank of England under the Funding for Lending ('FLS') and Term Funding Scheme ('TFS') are not derecognised from the statement of financial position, as the Group retains substantially all the risks and rewards of ownership, including all cash flows arising from the loans and advances and exposure to credit risk. The Group accounts for TFS and FLS under IAS 39 Financial Instruments.

o) Investment securities
Investment securities comprise securities held for liquidity purposes (UK treasury bills and supranational bonds in the nature of investment securities). These assets are non-derivatives that are designated as AFS. 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.

The treasury bills that the Group borrows against the transferred assets under the FLS are not recognised in the statement of financial position.

p) Deposits, debt securities issued and subordinated liabilities
Deposits, debt securities issued and subordinated liabilities are the Group's sources of debt funding. They comprise deposits from retail customers and credit institutions, including collateralised loan advances from the Bank of England under the TFS, issued debt securities and subordinated liabilities. Subordinated liabilities include the Sterling PSBs where the terms allow no discretion over the payment of interest. These financial liabilities are initially measured at fair value less direct transaction costs, and subsequently held at amortised cost using the EIR method.

Cash received under the TFS is recorded in deposits from credit institutions. Interest is accrued over the life of the agreements on an EIR basis.

The Group classifies certain financial instruments as equity where they meet the following conditions:
- the financial instrument includes no contractual obligation to deliver cash or another financial asset on potentially unfavourable conditions;

p) Deposits, debt securities issued and subordinated liabilities continued
- the financial instrument is a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
- the financial instrument is a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.

Equity financial instruments comprise own shares, equity PSBs and AT1 securities. Accordingly, the coupon paid on the equity PSBs and AT1 securities, and related tax effects, are recognised directly in retained earnings when paid. See note 35 for additional details.

q) Sale and repurchase agreements
Financial assets sold subject to repurchase agreements ('repo') are retained in the financial statements if they fail derecognition criteria of IAS 39 described in paragraph m(iii) above. 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 where the transaction is financing in nature ('reverse repo') 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.

r) 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 taken to 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. Derivatives covered by master netting agreements are settled and therefore recognised on a net basis.

In accordance with IAS 39, the Group adopts hedge accounting where the criteria specified in IAS 39 (EU endorsed) are met. A hedged item is defined as a recognised asset or liability which exposes the entity to risk of changes in fair value or future cash flows, and is designated as being hedged. The Group uses fair value hedge accounting for a portfolio hedge of interest rate risk (IAS39 – AG 114). Portfolio hedge accounting allows for hedge effectiveness testing and accounting over an entire portfolio of derivatives.

Where there is an effective hedge relationship for fair value hedges, the Group recognises the change in fair value of each hedged item in profit or loss with the cumulative movement in their value being shown separately in the statement of financial position as 'Fair value adjustments on hedged assets and liabilities'. The fair value changes of both the derivative and the hedge substantially offset each other to reduce profit volatility. To qualify for hedge accounting at inception, the hedge relationship is 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 has derivatives in place against the pipeline, with loans originating in subsequent months. The derivative is included within hedge accounting once loans have originated. Fair value movements prior to loans originating, when the derivative is against the pipeline, are recognised in full in the period in profit or loss. These are subsequently unwound over the remaining life of the derivative on a straight-line basis from the period the derivative is hedge accounted for against originated loans.

The Group discontinues hedge accounting when the derivative ceases through expiry, when the derivative is cancelled or the underlying hedged item matures, is sold or is repaid.

If a derivative is cancelled, it is derecognised from the statement of financial position. If a derivative no longer meets the criteria for hedge accounting or is cancelled whilst still effective, the fair value adjustment relating to the hedged assets or liabilities within the hedge relationship prior to the derivative becoming ineffective or being cancelled remains on the statement of financial position and is amortised over the remaining life of the hedged assets or liabilities. The rate of amortisation over the remaining life is in-line with the income or cost generated from the hedged assets or liabilities.

s) Debit and credit valuation adjustments
The DVA and CVA are 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 CVA reflects the Group's risk of the counterparty's default.

The methodology is based on a standard calculation, taking into account:
- the one year PD, updated on a regular basis;
- the expected exposure at default;
- the expected LGD; and
- the average maturity of the swaps.

Notes to the Financial Statements continued

For the year ended 31 December 2017

1. Accounting policies continued

t) 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.

u) Employee benefits – defined contribution scheme

Obligations for contributions to defined contribution pension arrangements are recognised as an expense in profit or loss as incurred.

v) Share-based payments

In accordance with IFRS 2 Share-based payments, options and awards granted to employees over the Bank's shares under the Group's share-based incentive schemes are measured at fair value at grant and are charged on a straight-line basis to profit or loss (with a corresponding increase in the share-based payment reserve within equity) over the vesting period in which the employees become unconditionally entitled to the awards. The cumulative expense within the share-based payment reserve is reclassified to retained earnings upon vesting.

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 conditions at the vesting date. The amount recognised as an expense for awards subject to market conditions is based on the proportion that is expected to meet the condition as assessed at the grant date. No adjustment is made for the actual proportion that meets the market condition at vesting. Share-based payments that vest on grant are immediately expensed in full with a corresponding increase in equity.

The grant date fair value of a nil price option over the Bank's shares which vests at grant or which carries the right to dividends or dividend equivalents during the vesting period (IPO share awards) is the share price at the grant date. The grant date fair value of awards of the Bank's shares that do not carry automatic rights to dividends or dividend equivalents (the Deferred Share Bonus Plan ('DSBP')) is based on the Bank's share price at the grant date adjusted for the impact of the expected dividend yield. The fair value at grant date of awards made under the Share Save Schemes is determined using a Black-Scholes Option model.

The grant date fair value of awards that are subject to non-market conditions and which do not carry automatic rights to dividends or dividend equivalents (the earnings per share ('EPS') element of the Performance Share Plan ('PSP')) is based on the share price at the grant date adjusted for the impact of the expected dividend yield. An assessment is made at each reporting date on the proportion of the awards expected to meet the related non-market vesting conditions.

The fair value of an award that is subject to market conditions (the relative share price element of the PSP) is determined at grant date using a Monte Carlo model. No adjustment is made for the actual proportion that meets the market condition at vesting.

Where the allowable cost of share-based awards for tax purposes is greater than the cost determined in accordance with IFRS 2, the tax effect of the excess is taken to the share-based payment reserve within equity. The tax effect is reclassified to retained earnings upon vesting.

Employer's national insurance is charged to profit or loss at the share price at the reporting date on the same vesting schedule as the underlying awards.

w) Exceptional items

Exceptional items are material income or expense items which are non-recurring in nature. Exceptional items are reported separately in profit or loss to highlight the underlying performance of the Group and make it more relevant for comparison with other periods. There were no exceptional items during 2017.

In 2016, the Group's exceptional items comprised the gain on disposal of the entire economic interest in Rochester Financing No.1 plc ('Rochester 1') securitisation vehicle and a loss in respect of accelerated amortisation of fair value adjustments on hedged assets relating to prior years. Further details can be found in note 10.

x) Securitisation

The Group assesses whether it controls special purpose entities ('SPE') and the requirement to consolidate them under the criteria of IFRS 10. The criteria include the power to direct relevant activities, exposure or rights to variable returns and the ability to use its power to affect the amount of these returns.

The Group had no economic interest in SPEs at the 2017 and 2016 reporting dates.

y) Adoption of new standards
In 2017 the Group adopted amendments to existing standards that were endorsed for adoption by the EU and mandatory for annual reporting periods beginning on or after 1 January 2017.

In adopting the amendments to IAS 7: Statement of cash flows, a reconciliation has been added to the Group's subordinated liabilities (note 32) to enable the reconciliation of amounts included within financing activities in the statement of cash flows.

There was no impact on these financial statements or accounting policies applied in their preparation upon adopting the amendments to IAS 12 Income taxes in relation to the recognition of deferred tax assets for unrealised losses.

Included below are standards and amendments which are being considered for future reporting periods which have not been applied in preparing these financial statements.
- IFRS 9 Financial Instruments, effective from 1 January 2018

i. Background

In July 2014 the International Accounting Standards Board ('IASB') issued the finalised version of IFRS 9 Financial Instruments: Recognition and Measurement, replacing the earlier accounting standard for financial instruments IAS 39, responding to concerns raised during the financial crisis about the timeliness of impairment recognition.

The new standard has three key areas of change relating to:
- Classification and measurement
- Hedge accounting
- Impairment

The recognition and measurement of impairment is intended to be more forward looking than under IAS 39 and therefore the resulting impairment charge may be more volatile. The day one adoption will drive a higher Group provision requirement which is detailed in section (f) below.

ii. Classification and measurement

IFRS 9 requires classification of financial assets into one of three measurement categories, based on the Group's business model and the contractual cash flow characteristics of the financial instruments including:
- Fair value through other comprehensive income ('FVOCI')
- Fair value through profit and loss, or
- Amortised cost.

The Group completed its assessment of solely payment of principal and interest ('SPPI') compliance that reviews the cash flow characteristics of financial assets to establish which business model they should be held under.

Following the SPPI compliance review, the Group completed its classification and measurement review of financial assets and liabilities with no material impact to the current classification of financial asset and liabilities. Current loans to customers that are classified as loans and receivables and measured at amortised cost under IAS 39 will continue to be measured at amortised cost under IFRS 9. Securities held for liquidity purposes that are classified as AFS and designated as FVOCI under IAS 39 will continue to be measured as FVOCI under IFRS 9.

Under IFRS 9, the provision of forbearance measures is considered a modification event. Forbearance measures reflect a change in credit risk on existing contracts where the contractual cash flows are not wholly different. Forbearance measures therefore do not give rise to a derecognition event.

The IASB issued a modification to IFRS 9 in October 2017 dealing with negative compensation for prepayments that will not affect the Group.

iii. Hedge accounting

The IASB is currently finalising its project to address macro hedge accounting strategies. Until this is finalised IFRS 9 allows firms to continue to apply IAS 39 fair value hedge accounting.

The Group has elected to continue with the IAS 39 hedge accounting rules. The Group will implement the revised hedge accounting disclosure requirements by the related amendments to IFRS 7 financial instruments disclosure requirements from 2018.

iv. Impairment (Expected credit loss, 'ECL')

IFRS 9 replaces the IAS 39 'incurred loss' impairment recognition framework with a three stage ECL approach. The IFRS 9 approach results in an earlier recognition of potential future losses.

Notes to the Financial Statements continued
For the year ended 31 December 2017

1. Accounting policies continued

y) Adoption of new standards continued

The three impairment stages are as follows:

- Stage 1 – entities are required to recognise a 12 month ECL allowance on initial recognition.
- Stage 2 – a lifetime loss allowance is held for assets where a significant increase in credit risk has been identified since initial recognition. The assessment of whether credit risk has increased significantly since initial recognition is performed for each reporting period for the life of the loan.
- Stage 3 – requires objective evidence that an asset is credit impaired at which point a lifetime ECL allowance is required.

Key accounting judgements and estimates

The IFRS 9 accounting standard requires significant levels of judgement and estimates to be made by the Group, upon adoption which are discussed below:

Measurement of ECL

The assessment of credit risk and the estimation of ECL must be unbiased and probability weighted. ECL is measured on either a 12 month or lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or where an account meets the Group's definition of default.

The expected credit loss calculation is a product of an individual loans PD, EAD and LGD discounted at the effective interest rate.

For stage 2 and 3, the Group applies lifetime PDs but uses 12 month PDs for stage 1. The ECL drivers of PD, EAD and LGD are modelled at an account level. The assessment of whether a significant increase in credit risk has occurred is based on the lifetime PD estimate.

Key inputs into ECL calculations

The Group has developed a suite of bespoke PD, LGD and EAD models using segmentation based on the underlying characteristics of the Group's loan portfolios.

PD models – The Group developed a number of PD models to assess the likelihood of default event occurring within the next 12 months, utilising internal and external credit bureau information. Consequently the Group also computes a lifetime PD estimate for each loan exposure once recognised, underpinned by the 12 month PD estimate.

LGD model – The Group has developed a single LGD model, which includes a number of judgement and estimate inputs including propensity to go to possession given default ('PPD'), forced sale discount ('FSD'), time to sale ('TTS') and sale cost estimates.

EAD model – The Group has developed a single EAD model to cover all applicable exposures.

Significant increase in credit risk ('SICR') (movement to stage 2)

The Group's transfer criteria determines what constitutes a significant increase in credit risk, which results in an exposure being moved from stage 1 to stage 2.

At the point of recognition a loan is assigned a lifetime PD estimate, for each monthly reporting date thereafter an updated lifetime PD estimate is computed for the life of the loan. The Group's transfer criteria analyses relative changes in lifetime PD versus the origination lifetime PD, where if prescribed thresholds are met an account will be transferred from stage 1 to stage 2.

The Group's risk function constantly monitors the ongoing appropriateness of the transfer criteria, where any proposed amendments will be reviewed and approved by the Group's management committees and the Board Risk and Audit Committees at least semi-annually or more frequently if required.

The IFRS 9 standard includes a rebuttable presumption that if an account is 30 days past due it has experienced a significant increase in credit risk. The Group considers 30 days past due to be an appropriate back stop measure and therefore has not rebutted this presumption.

A borrower will move back into stage 1, where the SICR definition is no longer satisfied.

Definition of default (movement to stage 3)

The Group has identified a number of quantitative and qualitative criteria to determine whether an account meets the definition of default and therefore moves to stage 3.

The criteria currently includes:

- The rebuttable assumption that 90 days past due is an indicator of default. The Group has not rebutted this assumption and therefore deems 90 days past due as an indicator of default. This also ensures alignment between the Group's Internal Ratings Based Models and the Basel/Regulatory definition of default.
- The Group has also deemed it appropriate to classify accounts that have moved into forbearance or repossession as meeting the definition of default.

A borrower will move out of stage 3 when their credit risk improves such that they roll back to zero days past due and remain there for 12 consecutive months. The borrower will move to stage 1 or stage 2 dependent on whether the SICR applies.

Forward looking macroeconomic scenarios
The IFRS 9 standard requires firms to consider the risk of default and impairment loss taking into account expectations of economic changes that are reasonable.

The Group has developed a bespoke macroeconomic model to determine the most significant factors which may influence the likelihood of an exposure defaulting in the future. At present the most significant macroeconomic factors relate to (1) HPI (2) unemployment and (3) the Bank of England base rate.

The Group has consequently derived an approach for factoring probability weighted macroeconomic forecasts into ECL calculations, adjusting PD and LGD estimates. An accounts lifetime PD is impacted by the probability weighted macroeconomic scenario and therefore impacts whether an account meets the Group's significant increase in credit risk transfer criteria moving the exposure between stage 1 and stage 2. Finally the macroeconomic scenarios feed directly into the ECL calculation, as the adjusted PD, lifetime PD and LGD estimates are used within the individual account ECL allowance calculations.

The Group currently does not have an in-house economics function and therefore sources economic forecasts from an appropriately qualified third party. The Group will consider a minimum of three probability weighted scenarios, including base, upside and downside scenarios. However, the Group will constantly monitor the ongoing appropriateness of its approach referencing industry best practise.

The base case is also utilised within the Group's impairment forecasting process which in turn feeds the wider business planning processes. This economic forecast is also used within analysis to set the Group's credit risk appetite thresholds and limits.

Expected life
The IFRS 9 standard requires lifetime expected credit losses to be measured over the expected life. Currently the Group considers the loan's behavioural life is equal to the full mortgage term. This approach will continue to be monitored and enhanced if and when deemed appropriate.

Purchase or originated credit impaired ('POCI')
Under IFRS 9, acquired loans that meet a firms definition of default (90 days past due or forbearance) at acquisition are treated as a POCI asset. These assets will attract a lifetime ECL allowance over the full term of the loan, even when the loan asset does not meet the definition of default post acquisition.

v. Implementation and programme governance

The Group delivered the requirements of IFRS 9 from 1 January 2018 after completing the successful parallel testing phase of its IFRS 9 programme throughout the full year to 31 December 2017. The IFRS 9 programme included senior representatives from the finance and risk functions, overseen by an IFRS 9 Executive Steering Committee which oversaw the Group's implementation of the requirements ensuring compliance to the standard.

The Group's Model Review Committee continues to oversee the ongoing performance of the underlying IFRS 9 suite of models. During the period, a number of independent model validation reports were received from external third parties, covering the full spectrum of PD, lifetime PD, LGD, EAD and macroeconomic models.

Existing committee structures will be utilised to oversee IFRS 9 impairment performance on an ongoing basis, including the Group's Credit Committee which receives monthly impairment performance reports from the risk function and the Group's Assets and Liabilities Committee ('ALCO') which oversees and approves the use of macroeconomic scenarios.

The Board Risk and Audit Committees received regular updates from the risk function and IFRS 9 programmes, ensuring Board level oversight, review and challenge and ultimate approval of all key judgements and estimates which underpin IFRS 9 impairment calculations. Going forward the Risk and Audit Committees will continue to oversee the ongoing implementation of IFRS 9.

The Group's external auditors have undertaken audit procedures covering classification and measurement and expected credit loss calculations.

vi. Impact of transition to IFRS 9

Adoption of IFRS 9 will result in c. £4m (c.+19%) increase in total Group impairment provision balances, reflecting the strength of security underpinning the loan book, the ongoing strong credit profile performance (driven by conservative LTV and low arrears levels) and the incurred loss protection held against acquired portfolio assets.

Incurred loss protection is the simulated loss estimate of the portfolio at the point of acquisition and is offset against modelled future cash flows to derive the EIR for the book. The incurred loss protection is therefore recognised over the life of the book through interest income. Incurred loss remaining is the protection at acquisition reduced by the cumulative losses observed since acquisition.

The only transitional accounting adjustments required by the Group on the adoption of IFRS 9 will be in the area of impairment. The initial impact of IFRS 9 will be shown in the opening reserves.

Notes to the Financial Statements continued

For the year ended 31 December 2017

1. Accounting policies continued

y) Adoption of new standards continued

vi. Impact of transition to IFRS 9 continued

In terms of capital, the Group has advised the PRA that it is adopting the transitional rules and will disclose its capital on a transitional and end state in its annual accounts and Pillar 3 report from 2018 onwards. The end state capital impact of adopting IFRS 9 based on the 2017 year end position would be a 0.09% decrease in fully loaded Common Equity Tier 1 ('CET 1') capital. The transitional period is from 2018 to 2022.

The Group continues to track the predictability of the models and make changes where this falls below an acceptable threshold, whilst assessing the ongoing appropriateness of all key judgement and estimate areas ahead of the full reporting of IFRS 9 impacts later in 2018.

The Group's strategy is to continue to be a specialist lender of secured loan products at sensible loan to value and development values. As such, collateral valuations are a key driver of movements in the Group's impairment allowance requirements, where a 10% reduction in house prices would result in an approximate £9m (36%) increase in expected impairment provision balances which are not individually assessed.

The Group remains cautious around the uncertainty that remains with respect to the volatility which the IFRS 9 approach may bring in response to changes in economic expectations and the speed of recognition of loss in a downturn scenario.

The transition to the IFRS 9 approach has resulted in the development and implementation of new processes and controls across both the risk and finance functions. The Group is well prepared for the wider changes required for other key risk management processes, including the development of detailed management reporting (including Pillar 3 reporting and FINREP), development of enhanced stress testing capabilities to support the setting of credit and solvency risk appetite and the Group's ICAAP.

Capital planning and performance

The impact of IFRS 9 has been included within the Group's capital and annual business planning processes. No changes were made to the Group's strategic plan and the Group does not expect a change to the go forward business model.

- IFRS 15 Revenue from Contracts with Customers, effective from 1 January 2018, replaces IAS 11 Construction contracts, IAS 18 Revenue and several related interpretations. IFRS 15 introduces a single framework for revenue recognition based on a five-step model to determine when to recognise revenue and at what amount. The five steps of the model are: identify the contract; identify performance obligations; determine the transaction price; allocate the transaction price; and recognise revenue. Depending on whether certain criteria are met, revenue is recognised either over time, in a manner that depicts the entity's performance, or at a point in time, when control of the goods or services is transferred to the customer. The new standard is not expected to have a significant impact on the financial statements.
- IFRS 16 Leases, effective from 1 January 2019, replaces IAS 17 Leases, IFRIC 4 Determining Whether an Arrangement Contains a Lease and two related SIC interpretations. The new standard requires lessees to recognise right-of-use assets and lease liabilities for most leases over 12 months long. Lessor accounting has largely remained unchanged. Adoption of IFRS 16 in respect of rented properties is not expected to have a material effect on the financial statements.

2. 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:

i. Loan book impairments: This section provides details of the critical elements of judgement which underpin loan impairment calculations. Less significant judgements are not disclosed.

Individual impairment

Assessments for individually significant loans involve significant judgement to be made by management 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 significant area of judgement is the likely sale proceeds. The individually assessed provisioning process is therefore underpinned by updated external valuations being obtained once a case is adopted by the collections team. All assets which do not have an individually assessed provision are assessed on a collective basis.

Collective impairment

Collective provision assessments are also subject to estimation uncertainty, underpinned by a number of judgements and estimates being made by management which are utilised within impairment calculations. Key areas of judgement utilised within collective provisioning calculations include PD, the LGD and the EP. Provisions on loans three months plus in arrears are treated as specific provisions. Provisions on loans less than three months in arrears are treated as collective provisions.

Probability of default

To compute PD rates the Group analyses how accounts transition from up-to-date and varying arrears severity positions to the default state which is reached once an account is greater than six months in arrears. Embedded within the PD calculation is a computed cure rate, which allows the Group to model the probability of an account curing from each state. A 10% relative worsening of the PD rate would increase total provisions by £0.4m as at 31 December 2017 (2016: £0.3m). The increase year on year is primarily driven by the increasing asset base.

Loss given default
The LGD model simulates the likely loss once a default event has occurred. The key components of the LGD calculation relate to the valuation of the underlying collateral, forced sale discount rates post repossession and the costs to sell (variable and fixed). Therefore the LGD is sensitive to the application of the HPI. As at 31 December 2017, a 10% fall in house prices would result in an incremental £5.0m (2016: £4.7m) of provision being required. The increase year on year is primarily driven by the increasing asset base.

Emergence period
The current collective provision methodology does not utilise an explicit EP within IBNR calculations, however the observation period which is utilised within PD calculations includes an implied EP. During 2016, the Group conducted a detailed analysis to understand the time it takes for a loss event (e.g. becoming unemployed) to be identified (i.e. missed payment) using external and internal data sources. The outcome of this review resulted in the observation period used within PD calculations elongating due to a lengthening of the implied EP.

ii. Loan book acquisition accounting and income recognition: Acquired loan books are initially recognised at fair value. Significant judgement is exercised in calculating their 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 EIR on loan books purchased at significant discounts or premiums is particularly sensitive to the prepayment ('CPR') and default ('CDR') rates derived, as the purchase discount or premium is recognised over the expected life of the loan book through the EIR. New defaults are modelled at zero loss (as losses will be recognised in profit or loss as impairment losses) and therefore have the same impact on the EIR as prepayments.

Different assumptions to derive the CPR and CDR in the cash flow models at acquisition will impact EIR rates. A 10% increase/decrease in the EIR% for each of the Bank's acquired mortgage books would increase/decrease interest income by c. £3.5m in 2017 (2016: c. £4.8m).

Incurred losses at acquisition are calculated using the Group's collective provision model (see (i) Loan book impairments above for further details).

The EIR calculated at acquisition is not changed for subsequent variances in actual to expected cash flows. The Group monitors the actual cash flows for each acquired book and where they diverge significantly from expectation, the future cash flows are reset (an 'AG8' adjustment). In assessing whether to adjust future cash flows on an acquired portfolio, the Group considers the cash variance on an absolute and percentage basis. The Group also considers the total variance across all acquired portfolios and the economic outlook. Where cash flows for an acquired portfolio are reset, they are discounted at the EIR to derive a new carrying value, with changes taken to profit or loss as interest income. The Group recognised a loss of £0.3m in 2017 as a result of resetting cash flows on acquired mortgage books (2016: gain of £1.4m).

iii. Effective interest rate: A number of assumptions are made when calculating the EIR for newly originated loan assets. These include their expected lives, likely redemption profiles and the anticipated level of any early redemption charges.

Certain mortgage products offered by the Group include significant directly attributable net fee income, in particular Buy-to-Let, and/or revert to the standard variable rate ('SVR') after an initial discounted or fixed period. Judgement is used in assessing the expected rate of prepayment during the discounted or fixed period of these mortgages and the expected life of those that prepay. The Group uses historical experience in its assessment. Judgement is also used in assessing whether and for how long mortgages that reach the end of the product term stay on SVR. The most significant area of judgement is the period spent on SVR.

A 10% increase/decrease in the rate of prepayments during the product term for 2017 new originations would increase/decrease interest income for 2017 by c. £0.1m (2016: c. £0.1m). A three month shorter/longer life for those prepaying mortgages would increase/decrease interest income in 2017 by c. £0.4/£0.3m (2016: c. £0.4/£0.3m).

The Group prudently assumes no period on SVR before the borrower refinances on to a new product or redeems as it waits for a stable trend to emerge following the automation of the broker-led Choice programme in late 2016. Since then, there has been a significant and consistent decrease in the number of borrowers remaining on SVR for more than three months, to around 20%.

The impact of a three month longer expected life on 2017 new origination, that is expected to reach the end of the discounted or fixed period, would be to recognise an additional £1.9m (2016: £0.8m) of interest income, 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.

Notes to the Financial Statements continued
For the year ended 31 December 2017

3. Interest receivable and similar income

	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
At amortised cost:		
On BTL/SME mortgages	**247.3**	208.8
On Residential mortgages	**91.8**	107.1
On investment securities	**0.1**	1.2
On other liquid assets	**2.0**	1.6
At fair value through profit or loss:		
Net expense on derivative financial instruments	**(8.5)**	(9.2)
	332.7	309.5

Included within interest receivable is £1.3m (2016: £1.3m) in respect of interest accrued on accounts with an individually assessed specific provision.

4. Interest payable and similar charges

	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
On retail deposits	**86.1**	101.8
On Perpetual Subordinated Bonds	**0.9**	0.9
On subordinated liabilities	**0.9**	1.2
On wholesale borrowings	**3.1**	3.2
Net income on derivative financial instruments	**(3.7)**	(4.2)
	87.3	102.9

5. Fair value gains and losses on financial instruments

	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
Fair value changes in hedged assets	**(8.7)**	3.2
Hedging of assets	**10.0**	(3.0)
Fair value changes in hedged liabilities	**2.9**	(0.5)
Hedging of liabilities	**(3.1)**	0.3
Ineffective portion of hedges[1]	**1.1**	–
Amortisation of fair value adjustments on hedged assets	**(7.3)**	(4.9)
Net gain on unmatched swaps	–	0.1
Debit and credit valuation adjustment	**(0.1)**	(0.1)
	(6.3)	(4.9)

1. Ineffective portion of hedges was less than £0.1m for 2016.

Amortisation of fair value adjustments on hedged assets relates to hedged assets and liabilities where the hedges were terminated before maturity and were effective at the point of termination.

The DVA adjustment is calculated on the Group's derivative liabilities and represents exposure of their holders to the risk of the Group's default. The CVA reflects the Group's risk of the counterparty's default.

6. Gain 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 gain of less than £0.1m (2016: less than £0.1m).

During 2016, the Group sold £10.9m of non-performing loans from its personal loan portfolio. These loans had a carrying value of £1.3m after provisions of £5.6m and prior year write-offs of £4.0m. The loans were sold for cash proceeds of £1.9m, creating a £0.6m gain on sale.

7. Administrative expenses

	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
Staff costs	**35.9**	29.5
Facilities costs	**2.4**	2.4
Marketing costs	**2.7**	2.2
Support costs	**8.4**	6.2
Professional fees	**5.0**	5.6
Other costs[1]	**7.2**	5.2
	61.6	51.1

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 Year ended 31-Dec-17 £'000	Group Year ended 31-Dec-16 £'000
Audit of the Bank and Group accounts	**638**	414
Audit of the Group's subsidiary undertakings pursuant to legislation	**178**	121
Audit related assurance services	**96**	96
Tax compliance and advice	**–**	70
Regulatory advice and support	**8**	36
All other non-audit services	**47**	48
	967	785

Included within the audit of the Bank and Group accounts is £165k (2016: £nil) relating to the audit of IFRS 9. Other non-audit services in 2017 include support for the AT1 securities issuance and treasury hedge accounting.

Staff numbers and costs
Staff costs comprise the following categories:

	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
Salaries, incentive pay and other benefits	**28.9**	24.4
Share-based payments	**2.4**	1.5
Social security costs	**3.3**	2.5
Other pension costs	**1.3**	1.1
	35.9	29.5

The average number of people employed by the Group (including Executive Directors) during the year was 813 (2016: 674), analysed below:

	Group 2017	Group 2016
Operations	**442**	315
Support functions	**371**	359
	813	674

Notes to the Financial Statements continued
For the year ended 31 December 2017

8. Directors' emoluments and transactions

	Bank Year ended 31-Dec-17 £'000	Bank Year ended 31-Dec-16 £'000
Directors' emoluments[1]	**1,912**	1,869
Payments in respect of personal pension plans	**104**	97
Gains made on the exercise of share options[2]	**17**	–
	2,033	1,966

1. Director's emoluments comprise salary costs, NED fees and other short-term incentive benefits as disclosed in the Annual Report on Remuneration.
2. Gains made on the exercise of share options relate to the Sharesave Scheme, further discussed in note 9.

In addition to the total Directors' emoluments above, the Executive Directors were granted a deferred bonus of £346k (2016: £335k) in the form of shares deferred for three years under the DSBP. The DSBP 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.

The Executive Directors received a further share award under the PSP with a grant date face value of £895k (2016: £700k) using a share price of £4.08 (2016: £2.53) (the average mid-market quotation for the preceding five days before grant). These shares vest in three years subject to performance conditions discussed in note 9 and the Annual Report on Remuneration.

There was no compensation for loss of office during either 2017 or 2016.

There were no outstanding loans granted in the ordinary course of business to Directors and their connected persons as at 31 December 2017 and 2016.

The Annual Report on Remuneration and note 9 Share-based payments provide further details on Directors' emoluments.

9. Share-based payments
The Group operates the following share-based schemes:

IPO Share Awards
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 in June 2014. 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 administrative expenses in profit or loss and is offset fully by an additional capital contribution as the awards were granted by OSB Holdco Limited, the Bank's major shareholder at the time of the IPO.

Sharesave Scheme
The Save As You Earn ('SAYE') or Sharesave Scheme is an all-employee share option scheme which is open to all UK-based employees. The Sharesave Scheme allows employees to purchase options by saving a fixed amount of between £5 and £500 per month over a period of either three or five years at the end of which the options, subject to leaver provisions, are usually exercisable. The Sharesave Scheme has been in operation since 2014 and is granted annually, with the exercise price set at a 20% discount of the share price on the date of grant.

Deferred Share Bonus Plan
The DSBP applies to Executive Directors and certain senior managers and requires 50% of their performance bonuses to be deferred in shares for three or five years. There are no further performance conditions attached, but the share awards are subject to clawback provisions. The DSBP is a share-based award and as such is expensed over its vesting period. The first DSBP relating to 2014 bonuses was granted in March 2015.

Performance Share Plan
Executive Directors and certain senior managers are also eligible for a PSP based on performance conditions linked to EPS and total shareholder return ('TSR') over a three year vesting period. The first award was issued in March 2015.

The performance conditions applying to PSP awards are based on a combination of EPS and TSR equally weighted and assessed independently. For the EPS element, growth targets are linked to the Company's three year growth plan, measuring growth from the base figure for the prior year. For the TSR element, OSB share's relative performance is measured against the FTSE All Share index, excluding investment trusts.

The share-based expense for the year includes a charge in respect of the remaining IPO awards with future vesting provisions, Sharesave scheme, the DSBP and PSP. All charges are included in employee expenses within note 7 Administrative expenses.

The share-based payment expense during the year comprised of the following:

	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
IPO share award expensed in the year	**0.3**	0.4
Sharesave Scheme	**0.2**	0.1
Deferred Share Bonus Plan	**0.9**	0.5
Performance Share Plan	**1.0**	0.5
	2.4	1.5

Movements in the number of share awards and their weighted average exercise prices are presented below:

	IPO share awards	**Sharesave Scheme**		**Deferred Share Bonus Plan**	**Performance Share Plan**
	Number	**Number**	**Weighted average exercise price, £**	**Number**	**Number**
At 1 January 2017	**652,198**	**818,253**	**1.78**	**758,381**	**1,080,991**
Granted	**–**	**336,288**	**3.15**	**433,534**	**510,094**
Exercised	**–**	**(382,597)**	**1.35**	**–**	**–**
Forfeited	**–**	**(39,603)**	**2.43**	**(5,153)**	**(2,055)**
At 31 December 2017	**652,198**	**732,341**	**2.60**	**1,186,762**	**1,589,030**
Exercisable at					
At 31 December 2017	**–**	**–**	**–**	**–**	**–**

	IPO share awards	Sharesave Scheme		Deferred Share Bonus Plan	Performance Share Plan
	Number	Number	Weighted average exercise price, £	Number	Number
At 1 January 2016	1,237,844	761,927	1.66	301,575	579,157
Granted	–	149,675	2.40	456,806	519,757
Exercised	(465,855)	(2,126)	1.34	–	–
Forfeited	(119,791)	(91,223)	1.83	–	(17,923)
At 31 December 2016	652,198	818,253	1.78	758,381	1,080,991
Exercisable at					
At 31 December 2016	–	–	–	–	–

For the share-based awards granted during the year, the weighted average grant date fair value was 383 pence (2016: 251 pence).

There were no IPO share awards exercised during 2017. The weighted average market price at exercise for IPO share awards exercised during 2016 was 307 pence.

Notes to the Financial Statements continued
For the year ended 31 December 2017

9. Share-based payments continued
The range of exercise prices and weighted average remaining contractual life of outstanding awards are as follows:

	2017		2016	
Exercise price	Number	Weighted average remaining contractual life (years)	Number	Weighted average remaining contractual life (years)
IPO share awards				
Nil	**652,198**	**0.4**	652,198	1.4
Sharesave Scheme				
134-315 pence	**732,341**	**2.1**	818,253	1.6
Deferred Share Bonus Plan				
Nil	**1,186,762**	**1.4**	758,381	1.8
Performance Share Plan				
Nil	**1,589,030**	**1.2**	1,080,991	1.7
	4,160,331	**1.3**	3,309,823	1.6

The valuation of share awards is based on the following assumptions:

IPO Share Awards
The grant date fair value of the IPO share awards was the issue price of 170 pence 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 nil (2016: nil) per annum. This is lower than the overall expected staff attrition rate as nil attrition was assumed for certain senior managers who received larger awards.

Sharesave Scheme
The grant date fair values of awards under the Sharesave Scheme were determined using a Black-Scholes model. This determined the fair value of options over 1 ordinary share in the 2017 three and five year Sharesave Scheme as 75 pence and 71 pence respectively (2016: 18 pence and 20 pence), using the following input assumptions in the valuation models:

	2017	2016	2015	2014
Contractual life, years	**3/5 years**	3/5 years	3/5 years	3/5 years
Share price at issue, £	**3.93**	3.00	2.84	1.68
Exercise price, £	**3.15**	2.40	2.27	1.34
Expected volatility[1]	**17.9%**	18.7%	20.0%	20.0%
Attrition rate	**11.8%**	12.0%	9.6%	10.5%
Dividend yield	**4.1%**	4.6%	3.6%	3.0%

1. The volatility was based on a benchmark of the FTSE 350 diversified financials as insufficient history was available for the Bank's shares.

Deferred Share Bonus Plan
The grant date fair value of awards under the DSBP of 361 (2016: 271) pence per share for three year and 337 pence per share for five year plans are based on the mid-market share price at the grant date of 404 (2016: 309) pence per share, adjusted for the impact of dividends, as the awards do not carry automatic rights to dividends. A dividend yield of 4.1% (2016: 4.6%) was used based on available analyst consensus. The expense for 2017 assumes an attrition rate of 11.8% (2016: 12.0%).

Performance Share Plan
The grant date fair value of awards under the PSP of 361 (2016: 271) pence per share is based on the mid-market share price at the grant date of 404 (2016: 309) pence per share, adjusted for the impact of dividends, as the awards do not carry automatic rights to dividends. A dividend yield of 4.1% (2016: 4.6%) was assumed based on available analyst consensus. The expense for 2017 assumes an attrition rate of 11.8% (2016: 12.0%).

A vesting rate is incorporated into the EPS element of the PSP, based on the expectation that the required target growth will be achieved over the vesting period. A vesting rate is also calculated for the TSR element of the PSP, based on a Monte Carlo model using historical share price performance data for the target benchmark FTSE All Share Index excluding investment trusts and the FTSE 350 Diversified Financials as a proxy for the Company's shares as insufficient history was available.

10. Exceptional items

The Group had no exceptional items during 2017.

Exceptional items to December 2016 consist of the gain on disposal of the Group's entire economic interest in Rochester 1 securitisation vehicle and an exceptional loss of £9.8m in respect of accelerated amortisation of fair value adjustments on hedged assets relating to legacy back-book long-dated interest rate swap cancellations.

The Rochester 1 sale resulted in derecognition of securitised mortgage assets from the Group's balance sheet and the deconsolidation of Rochester 1. This removed a total of £239.8m of securitised mortgage assets and cash reserves in the vehicle and £171.6m of debt securities in issue from the Group's balance sheet.

The Group uses interest rate swaps to hedge fixed rate mortgages and adopts fair value hedge accounting where the criteria specified in IAS39 (EU endorsed) are met. Under hedge accounting, the change in the fair value of hedged mortgages for interest rate risk is recognised in profit or loss, as an offset to fair value movements on the swaps, with the cumulative movement reflected as fair value adjustments on hedged assets in the statement of financial position. A number of long-dated legacy swaps were cancelled in 2012 and 2013 whilst still effective. Following the cancellations, the fair value adjustment on the legacy hedged long-term fixed rate mortgages (c. 25 years at origination) remained in the statement of financial position to be amortised over their remaining lives. Both the cancelled swaps and hedged mortgages were inherited from the Kent Reliance Building Society.

During 2016, the Group reviewed the roll-off of the legacy long-dated fixed rate mortgages. Following this review, the Group accelerated the amortisation of the associated fair value adjustments in line with the mortgage asset run-off, due to faster than expected prepayments since cancellation. The exceptional loss represents the impact of accelerating the amortisation in prior years from 2012 to 2015, which was not material in any individual year. It has been presented as an exceptional item and excluded from 2016 underlying profit before tax to provide an appropriate measure of the underlying performance of the Group in 2016.

Exceptional items are summarised in the table below:

	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
Gain on disposal of Rochester 1	**–**	34.7
Amortisation of fair value adjustments for hedged assets	**–**	(9.8)
	–	24.9

11. Taxation

	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
Corporation tax	**(41.5)**	(42.3)
Deferred taxation	**0.7**	0.1
Total taxation	**(40.8)**	(42.2)

Notes to the Financial Statements continued
For the year ended 31 December 2017

11. 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:

	Year ended 31-Dec-17 £m	Year ended 31-Dec-16 £m
Profit before taxation	**167.7**	163.1
Profit multiplied by the weighted average rate of corporation taxation in the UK during 2017 of 19.25% (2016: 20.00%)	**(32.3)**	(32.6)
Bank surcharge	**(8.3)**	(8.6)
Taxation effects of:		
Expenses not deductible for taxation purposes	**(0.2)**	(0.4)
Adjustments in respect of earlier years	**(0.4)**	(0.5)
Tax adjustments in respect of share-based payments	**0.3**	0.1
Impact of tax losses carried forward	**0.2**	0.1
Timing differences on capital items	**(0.1)**	(0.2)
Other	**–**	(0.1)
Total taxation charge	**(40.8)**	(42.2)

A reduction in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and a further reduction to 18% (effective from 1 April 2020) were substantively enacted on 26 October 2015. An additional reduction to 17% (effective 1 April 2020) was substantively enacted on 6 September 2016. This will reduce the Group's future tax charge accordingly.

12. Earnings per share
EPS are based on the profit for the period and the number of ordinary shares in issue. 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 EPS take into account share options and awards which can be converted to ordinary shares.

For the purpose of calculating EPS, profit attributable to ordinary shareholders is arrived at by adjusting profit for the year for the after-tax amounts of the coupon on PSBs and AT1 securities classified as equity. The tax on coupons is based on the rate of taxation applicable to the Bank, including the bank surcharge:

	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
Profit for the year	**126.9**	120.9
Adjustments:		
Coupon on PSBs and AT1 securities classified as equity	**(3.7)**	(1.2)
Tax on coupons	**1.0**	0.3
Profit attributable to ordinary shareholders	**124.2**	120.0
Exceptional items:		
Gain on disposal of Rochester 1	**–**	(34.7)
Amortisation of fair value adjustments for hedged assets	**–**	9.8
Tax on above	**–**	6.4
Underlying profit attributable to ordinary shareholders	**124.2**	101.5

	Group Year ended 31-Dec-17	Group Year ended 31-Dec-16
Weighted average number of shares, millions		
Basic	**243.2**	243.1
Diluted	**245.1**	244.6
Earnings per share, pence per share		
Basic	**51.1**	49.4
Diluted	**50.7**	49.0
Underlying earnings per share, pence per share		
Basic	**51.1**	41.7
Diluted	**50.7**	41.5

13. Dividends

During the year, the Bank paid the following dividends:

	Bank Year ended 31-Dec-17		Bank Year ended 31-Dec-16	
	£m	**Pence per share**	£m	Pence per share
Final dividend for the prior year	**18.5**	**7.6**	16.3	6.7
Interim dividend for the current year	**8.5**	**3.5**	7.0	2.9
	27.0		23.3	

A summary of the Bank's distributable reserves from which dividends can be paid are shown below:

	Bank	
	As at 31-Dec-17 £m	As at 31-Dec-16 £m
Net assets	**475.8**	350.2
Less:		
– Share capital	**(2.4)**	(2.4)
– Share premium	**(158.4)**	(157.9)
– Other non-distributable reserves[1]	**(93.1)**	(29.8)
Distributable reserves	**221.9**	160.1

1. Other non-distributable reserves include the capital contribution, equity bonds, foreign exchange reserve, AFS reserve and share-based payment reserve.

The Directors propose a final dividend of 9.3 pence per share (2016: 7.6 pence) payable on 16 May 2018 with an ex-dividend date of 22 March 2018 and a record date of 23 March 2018. This dividend is not reflected in these financial statements as it is subject to approval by shareholders at the AGM on 10 May 2018. Together with the interim dividend of 3.5 pence (2016: 2.9 pence), it makes a total dividend for 2017 of 12.8 pence (2016: 10.5 pence) per share.

14. Cash and cash equivalents

		RESTATED		RESTATED
	Group As at 31-Dec-17 £m	Group As at 31-Dec-16 £m	**Bank As at 31-Dec-17 £m**	Bank As at 31-Dec-16 £m
Cash in hand	**0.5**	0.4	**0.5**	0.4
Unencumbered loans and advances to credit institutions	**1,165.4**	402.3	**1,157.5**	398.0
Investment securities with maturity less than 3 months	**–**	82.6	**–**	82.6
	1,165.9	485.3	**1,158.0**	481.0

The 2016 comparatives have been restated to include investment securities with maturity less than three months and to exclude encumbered loans and advances to credit institutions (being the cash ratio deposit and swap margin paid) within cash and cash equivalents.

Unencumbered loans and advances to credit institutions excludes £10.0m (2016: 9.1m) held in the cash ratio deposit with the Bank of England and excludes £11.8m (2016: £6.4m) of encumbered assets in the form of cash margin collateral paid in relation to the Group's derivatives.

Notes to the Financial Statements continued

For the year ended 31 December 2017

15. Loans and advances to credit institutions

Loans and advances to credit institutions have remaining maturities as follows:

	Group As at 31-Dec-17 £m	Group As at 31-Dec-16 £m	**Bank As at 31-Dec-17 £m**	Bank As at 31-Dec-16 £m
Repayable on demand	**1,161.4**	402.3	**1,157.5**	398.0
Less than three months	**15.8**	6.4	**11.8**	6.4
More than five years	**10.0**	9.1	**10.0**	9.1
	1,187.2	417.8	**1,179.3**	413.5

Included within repayable on demand is £1,136.9m (2016: £391.9m) in the Bank of England reserve account.

Included within less than three months is £11.8m (2016: £6.4m) of loans and advances with other credit institutions in the form of margin cash collateral paid in relation to the Group's derivatives which is considered to be encumbered.

Included within more than five years is £10.0m (2016: £9.1m) held in the cash ratio deposit with the Bank of England which is considered to be encumbered.

16. Investment securities

	Group and Bank As at 31-Dec-17 £m	Group and Bank As at 31-Dec-16 £m
Government investment securities	**19.1**	141.7
	19.1	141.7
Investment securities have remaining maturities as follows:		
Less than three months	**–**	82.6
Three months to one year	**–**	40.0
One to five years	**19.1**	19.1
	19.1	141.7

At 31 December 2017, the Group held £nil (2016: £524.6m) of treasury bills received from the Bank of England under the FLS. These securities are accounted for off balance sheet but included in liquid assets for regulatory purposes. In exchange, the Group pledges with the Bank of England either loans to customers or other investment securities. These assets cannot be sold or pledged further under normal circumstances.

At the reporting date, the Group had no treasury assets (2016: £nil) pledged with the Bank of England in exchange for the treasury bills. The value of pledged loans to customers is disclosed in note 17.

The Group had no assets sold under repos at the 2017 and 2016 reporting dates.

The Directors 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 Group's activities and are classified as AFS.

Movements during the year of investment securities are analysed as follows:

	Group and Bank 2017 £m	Group and Bank 2016 £m
At 1 January	**141.7**	393.4
Additions	**–**	460.4
Disposals and maturities	**(122.7)**	(712.2)
Changes in fair value	**0.1**	0.1
At 31 December	**19.1**	141.7

17. Loans and advances to customers

	Group As at 31-Dec-17 £m	Group As at 31-Dec-16 £m	**Bank As at 31-Dec-17 £m**	Bank As at 31-Dec-16 £m
BTL/SME mortgages	**5,654.1**	4,104.3	**4,588.7**	3,299.5
Residential mortgages	**1,673.5**	1,859.9	**1,477.8**	1,613.1
	7,327.6	5,964.2	**6,066.5**	4,912.6
Less: provision for impairment losses on loans and advances (see note 18)	**(21.6)**	(25.0)	**(15.5)**	(19.1)
	7,306.0	5,939.2	**6,051.0**	4,893.5

Maturity analysis
Loans and advances to customers are repayable from the reporting date as follows:

	Group As at 31-Dec-17 £m	Group As at 31-Dec-16 £m	**Bank As at 31-Dec-17 £m**	Bank As at 31-Dec-16 £m
Less than three months	**139.4**	150.8	**119.0**	135.9
Three months to one year	**224.9**	162.9	**158.8**	123.3
One to five years	**308.6**	279.5	**151.0**	170.2
More than five years	**6,654.7**	5,371.0	**5,637.7**	4,483.2
	7,327.6	5,964.2	**6,066.5**	4,912.6
Less: provision for impairment losses on loans and advances (see note 18)	**(21.6)**	(25.0)	**(15.5)**	(19.1)
	7,306.0	5,939.2	**6,051.0**	4,893.5

The above analysis is based on contractual maturity and may not reflect actual experience of repayments, since many mortgage loans are repaid early.

The Group purchased no mortgage books from other financial institutions during 2017. During 2016, the Group purchased mortgage books with a gross value of £205.2m for a total of £180.7m.

At 31 December 2017, mortgages with a carrying value of £2,303.2m (2016: £1,413.9m) were pledged with the Bank of England under their asset purchase facilities, FLS and TFS. The Group considers these loans to be encumbered.

Included within loans and advances to customers are mortgages totalling £28.9m (2016: £32.0m) retained by the Group, who act as master servicer for securitisation vehicles, to comply with the EU risk retention requirements. The Group considers these loans to be encumbered.

Notes to the Financial Statements continued

For the year ended 31 December 2017

18. Provision for impairment losses on loans and advances

Movement in provision for impairment losses on loans and advances to customers is as follows:

2017

Specific	BTL/SME £m	Residential mortgages £m	Total £m
Group			
At 1 January 2017	16.8	6.6	23.4
Write-offs in year	(4.8)	(3.0)	(7.8)
Charge for the year net of recoveries	0.7	3.3	4.0
At 31 December 2017	12.7	6.9	19.6
Bank			
At 1 January 2017	12.9	4.8	17.7
Write-offs in year	(4.9)	(0.8)	(5.7)
Charge for the year net of recoveries	1.1	0.7	1.8
At 31 December 2017	9.1	4.7	13.8
Collective			
Group			
At 1 January 2017	0.4	1.2	1.6
Write-offs in year	–	–	–
Charge for the year net of recoveries	0.1	0.3	0.4
At 31 December 2017	0.5	1.5	2.0
Bank			
At 1 January 2017	0.2	1.2	1.4
Charge for the year net of recoveries	0.1	0.2	0.3
At 31 December 2017	0.3	1.4	1.7
Total			
Group			
At 1 January 2017	17.2	7.8	25.0
Write-offs in year	(4.8)	(3.0)	(7.8)
Charge for the year net of recoveries	0.8	3.6	4.4
At 31 December 2017	13.2	8.4	21.6
Bank			
At 1 January 2017	13.1	6.0	19.1
Write-offs in year	(4.9)	(0.8)	(5.7)
Charge for the year net of recoveries	1.2	0.9	2.1
At 31 December 2017	9.4	6.1	15.5

2016 (Restated)

Specific	BTL/SME £m	Residential mortgages £m	Total £m
Group			
At 1 January 2016	17.3	0.9	18.2
Write-offs in year	(2.9)	(1.6)	(4.5)
Transfer between reserves[1]	0.4	4.8	5.2
Charge for the year net of recoveries	2.0	2.5	4.5
At 31 December 2016	16.8	6.6	23.4
Bank			
At 1 January 2016	14.5	–	14.5
Write-offs in year	(3.0)	(1.4)	(4.4)
Transfer between reserves[1]	0.4	4.7	5.1
Charge for the year net of recoveries	1.0	1.5	2.5
At 31 December 2016	12.9	4.8	17.7

Collective			
Group			
At 1 January 2016	7.8	1.3	9.1
Write-offs in year	(1.2)	–	(1.2)
Disposals[2]	(5.6)	–	(5.6)
Transfer between reserves[1]	(0.4)	(4.8)	(5.2)
(Credit)/charge for the year net of recoveries	(0.2)	4.7	4.5
At 31 December 2016	0.4	1.2	1.6
Bank			
At 1 January 2016	7.7	1.1	8.8
Write-offs in year	(1.1)	–	(1.1)
Disposals[2]	(5.6)	–	(5.6)
Transfer between reserves[1]	(0.4)	(4.7)	(5.1)
(Credit)/charge for the year net of recoveries	(0.4)	4.8	4.4
At 31 December 2016	0.2	1.2	1.4

Total			
Group			
At 1 January 2016	25.1	2.2	27.3
Write-offs in year	(4.1)	(1.6)	(5.7)
Disposals[2]	(5.6)	–	(5.6)
Charge for the year net of recoveries	1.8	7.2	9.0
At 31 December 2016	17.2	7.8	25.0
Bank			
At 1 January 2016	22.2	1.1	23.3
Write-offs in year	(4.1)	(1.4)	(5.5)
Disposals[2]	(5.6)	–	(5.6)
Charge for the year net of recoveries	0.6	6.3	6.9
At 31 December 2016	13.1	6.0	19.1

1. In 2016, there was an update to the categorisation where all loans greater than three months in arrears are treated as specific provisions, in addition to loans that are individually assessed. This resulted in an increase in specific provisions of £5.2m for the Group and £5.1m for the Bank during 2016, with a corresponding decrease in collective provisions.
2. During 2016, the Group sold a portion of non-performing loans from its personal loan portfolio. See note 6 for further details.

Notes to the Financial Statements continued

For the year ended 31 December 2017

19. Impairment losses

	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
Write-offs in the year	**7.8**	5.7
Disposals	**–**	5.6
Decrease in provision	**(3.4)**	(2.3)
	4.4	9.0

20. Derivatives

The table below reconciles the gross amount of derivative contracts to the carrying balance shown in the statement of financial position:

Group and Bank	Gross amount of recognised financial assets/ (liabilities) £m	Net amounts of financial assets/ (liabilities) presented in the statement of financial position £m	Contracts subject to master netting agreements not offset in the statement of financial position £m	Cash collateral paid/(received) not offset in the statement of financial position £m	Net amount £m
As at 31 December 2017					
Derivative assets	**6.1**	**6.1**	**(5.9)**	**(0.3)**	**(0.1)**
Derivatives liabilities	**(21.8)**	**(21.8)**	**5.9**	**11.8**	**(4.1)**
As at 31 December 2016					
Derivatives assets	1.8	1.8	(1.5)	(0.6)	(0.3)
Derivative liabilities	(24.4)	(24.4)	1.5	6.4	(16.5)

The effects of over collateralisation have not been taken into account in the above table.

Included within derivative liabilities is £4.6m (2016: £16.0m) of derivative contracts not covered by master netting agreements and therefore no cash collateral has been paid.

The Group recognises cash collateral received within amounts owed to credit institutions and cash collateral paid within loans and advances to credit institutions.

21. Fair value adjustments on hedged items

	Group and Bank As at 31-Dec-17 £m	Group and Bank As at 31-Dec-16 £m
Hedged assets		
Current hedge relationships	**15.9**	23.6
Cancelled hedge relationships	**16.0**	23.3
	31.9	46.9
Hedged liabilities		
Current hedge relationships	**–**	(1.9)

The fair value adjustments on hedged assets in respect of cancelled hedge relationships represent the fair value adjustment for interest rate risk on legacy long-term fixed rate mortgages (c. 25 years at origination) where the interest rate swap hedges were terminated before maturity and were effective at the point of termination.

The movement in cancelled hedge relationships is as follows:

	Group and Bank 2017 £m	Group and Bank 2016 £m
Balance at 1 January	**23.3**	37.8
New cancellations	**–**	0.2
Amortisation (see note 5)	**(7.3)**	(4.9)
Exceptional loss (see note 10)	**–**	(9.8)
Balance at 31 December	**16.0**	23.3

22. Investments in subsidiaries, intercompany loans and transactions with related parties

The balances between the Bank and its subsidiaries at the reporting date are summarised in the table below:

2017

	Shares in subsidiary undertakings £m	Intercompany loans receivable £m	Intercompany loans payable £m	Total £m
At 1 January	**1.8**	**982.2**	**(1.9)**	**982.1**
Additions	**–**	**298.4**	**(29.4)**	**269.0**
Repayments	**–**	**(88.1)**	**0.1**	**(88.0)**
At 31 December	**1.8**	**1,192.5**	**(31.2)**	**1,163.1**

2016

	Shares in subsidiary undertakings £m	Intercompany loans receivable £m	Intercompany loans payable £m	Deemed loan liability £m	Total £m
At 1 January	1.8	942.7	(4.9)	(169.5)	770.1
Additions	–	126.0	(0.6)	–	125.4
Repayments	–	(86.5)	3.6	–	(82.9)
Disposals	–	–	–	169.5	169.5
At 31 December	1.8	982.2	(1.9)	–	982.1

Notes to the Financial Statements continued

For the year ended 31 December 2017

22. Investments in subsidiaries, intercompany loans and transactions with related parties continued

A list of the Bank's direct and indirect subsidiaries are below. Subsidiaries have a registered office of Reliance House, Sun Pier, Chatham, Kent, ME4 4ET ('Reliance House') unless otherwise stated.

2017

Direct investments	Class of shares	Activity	Registered office	Ownership	Charged by/(to) the Bank during the year £m	Balance due to/(by) the Bank £m
Easioption Limited	Ordinary	Holding company	Reliance House	100%	–	0.5
Guernsey Home Loans Limited	Ordinary	Mortgage provider	Reliance House	100%	(0.3)	17.5
Guernsey Home Loans Limited (Guernsey)	Ordinary	Mortgage provider	1st Floor, Tudor House, Le Bordage, St Peter Port, Guernsey, GY1 1DB	100%	(1.0)	46.6
Heritable Development Finance Limited[1]	Ordinary	Mortgage originator and servicer	Reliance House	85%	1.9	(0.9)
Interbay Group Holdings Limited	Ordinary	Holding company	Reliance House	100%	–	–
Jersey Home Loans Limited	Ordinary	Mortgage provider	Reliance House	100%	(0.1)	3.2
Jersey Home Loans Limited (Jersey)	Ordinary	Mortgage provider	26 New Street, St Helier, Jersey, JE2 3RA	100%	(4.3)	201.4
OSB India Private Limited[2]	Ordinary	Back office processing	Salarpuria Magnificia, 10th floor, 78 Old Madras Road, Bangalore, 560016, Karnataka, India	100%	5.4	5.9
Prestige Finance Limited	Ordinary	Mortgage originator and servicer	Reliance House	100%	3.2	(1.3)
Reliance Property Loans Limited	Ordinary	Mortgage provider	Reliance House	100%	(0.1)	4.1
Rochester Mortgages Limited	Ordinary	Mortgage provider	Reliance House	100%	–	–
Indirect investments						
Inter Bay Financial I Limited	Ordinary	Holding company	Reliance House	100%	(0.3)	19.8
Inter Bay Financial II Limited	Ordinary	Holding company	Reliance House	100%	(0.2)	17.7
Interbay Funding, Ltd	Ordinary	Mortgage servicer	Reliance House	100%	–	(28.9)
Interbay ML, Ltd	Ordinary	Mortgage provider	Reliance House	100%	(10.2)	875.6
Interbay Holdings Ltd	Ordinary	Holding company	Reliance House	100%	–	–
5D Finance Limited	Ordinary	Mortgage servicer	Reliance House	100%	–	0.2
5D Lending Ltd	Ordinary	Mortgage provider	Reliance House	100%	–	(0.1)
					(6.0)	1,161.3

1. Heritable Development Finance Limited is a business development partnership with Heritable Capital Limited. The entity is majority owned and controlled by the Bank. It has minimal retained earnings and immaterial non-controlling interest which is not presented separately in the Group reserves.
2. OSB India Private Limited is owned 70.28% by the Bank and 29.72% by Easioption Limited.

2016

Direct investments	Class of shares	Activity	Registered office	Ownership	Charged by/(to) the Bank during the year £m	Balance due to/(by) the Bank £m
Easioption Limited	Ordinary	Holding company	Reliance House	100%	–	0.5
Guernsey Home Loans Limited	Ordinary	Mortgage provider	Reliance House	100%	(0.5)	21.3
Guernsey Home Loans Limited (Guernsey)	Ordinary	Mortgage provider	1st Floor, Tudor House, Le Bordage, St Peter Port, Guernsey, GY1 1DB	100%	(1.5)	64.1
Heritable Development Finance Limited	Ordinary	Mortgage originator and servicer	Reliance House	85%	2.1	(1.0)
Interbay Group Holdings Limited	Ordinary	Holding company	Reliance House	100%	–	–
Jersey Home Loans Limited	Ordinary	Mortgage provider	Reliance House	100%	(0.1)	4.5
Jersey Home Loans Limited (Jersey)	Ordinary	Mortgage provider	26 New Street, St Helier, Jersey, JE2 3RA	100%	(6.1)	262.2
OSB India Private Limited	Ordinary	Back office processing	Salarpuria Magnificia, 10th floor, 78 Old Madras Road, Bangalore, 560016, Karnataka, India	100%	3.7	0.5
Prestige Finance Limited	Ordinary	Mortgage originator and servicer	Reliance House	100%	3.0	(0.9)
Reliance Property Loans Limited	Ordinary	Mortgage provider	Reliance House	100%	(0.1)	4.4
Rochester Mortgages Limited	Ordinary	Mortgage provider	Reliance House	100%	–	–
Indirect investments						
Cavenham Financial Services Limited[1]	Ordinary	Dormant entity	Reliance House	100%	0.1	–
Inter Bay Financial I Limited	Ordinary	Holding company	Reliance House	100%	(0.4)	19.6
Inter Bay Financial II Limited	Ordinary	Holding company	Reliance House	100%	(0.4)	17.5
Interbay Funding, Ltd	Ordinary	Mortgage servicer	Reliance House	100%	(0.1)	4.4
Interbay ML, Ltd	Ordinary	Mortgage provider	Reliance House	100%	(12.0)	583.1
Interbay Holdings Ltd	Ordinary	Holding company	Reliance House	100%	–	–
5D Finance Limited	Ordinary	Mortgage servicer	Reliance House	100%	–	0.2
5D Lending Ltd	Ordinary	Mortgage provider	Reliance House	100%	–	(0.1)
					(12.3)	980.3

1. Cavenham Financial Services Limited was struck off on 17 January 2017.

All of the above investments are reviewed annually for impairment. All of the subsidiaries are either actively trading 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. KRPS runs member engagement forums for the Bank. In exchange, 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 £0.3m (2016: £0.3m).

All related party transactions were made on terms equivalent to those that prevail in arm's length transactions. During the year 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. Directors' remuneration is disclosed in note 8 and the Annual Report on Remuneration.

No loans were issued to related parties during 2017 (2016: £nil).

Key management personnel and connected persons held deposits with the Group of £1.5m (2016: £1.4m).

Notes to the Financial Statements continued

For the year ended 31 December 2017

23. Intangible assets

	Group 2017 £m	Group 2016 £m	Bank 2017 £m	Bank 2016 £m
Cost				
At 1 January	**8.5**	5.6	**6.8**	4.3
Additions	**4.2**	2.9	**3.9**	2.5
Disposals and write-offs	**(0.3)**	–	**(0.3)**	–
At 31 December	**12.4**	8.5	**10.4**	6.8
Amortisation				
At 1 January	**3.8**	2.5	**2.7**	1.6
Charged in year	**1.8**	1.3	**1.6**	1.1
Disposals and write-offs	**–**	–	**–**	–
At 31 December	**5.6**	3.8	**4.3**	2.7
Net book value				
At 31 December	**6.8**	4.7	**6.1**	4.1

Intangible assets consist of computer software. There were no capitalised costs related to the internal development of software during the period.

24. Property, plant and equipment

Group 2017	**Freehold land and buildings £m**	**Leasehold improvements £m**	**Equipment and fixtures £m**	**Total £m**
Cost				
At 1 January	**8.7**	**0.5**	**7.5**	**16.7**
Additions	**7.5**	**0.1**	**2.5**	**10.1**
Disposals and write-offs	**–**	**–**	**(0.1)**	**(0.1)**
At 31 December	**16.2**	**0.6**	**9.9**	**26.7**
Depreciation				
At 1 January	**0.4**	**0.1**	**3.1**	**3.6**
Charged in year	**0.2**	**0.1**	**1.4**	**1.7**
Disposals and write-offs	**–**	**–**	**(0.1)**	**(0.1)**
At 31 December	**0.6**	**0.2**	**4.4**	**5.2**
Net book value				
At 31 December	**15.6**	**0.4**	**5.5**	**21.5**

Group 2016	Freehold land and buildings £m	Leasehold improvements £m	Equipment and fixtures £m	Total £m
Cost				
At 1 January	5.9	0.4	5.8	12.1
Additions	2.8	0.1	1.9	4.8
Disposals and write-offs	–	–	(0.3)	(0.3)
Translation difference	–	–	0.1	0.1
At 31 December	8.7	0.5	7.5	16.7
Depreciation				
At 1 January	0.3	–	2.2	2.5
Charged in year	0.1	0.1	1.1	1.3
Disposals and write-offs	–	–	(0.3)	(0.3)
Translation difference	–	–	0.1	0.1
At 31 December	0.4	0.1	3.1	3.6
Net book value				
At 31 December	8.3	0.4	4.4	13.1

Bank 2017	Freehold land and buildings £m	Leasehold improvements £m	Equipment and fixtures £m	Total £m
Cost				
At 1 January	**6.4**	**0.5**	**5.7**	**12.6**
Additions	**5.1**	**0.1**	**1.7**	**6.9**
At 31 December	**11.5**	**0.6**	**7.4**	**19.5**
Depreciation				
At 1 January	**0.4**	**0.1**	**2.2**	**2.7**
Charged in year	**0.2**	**0.1**	**1.1**	**1.4**
At 31 December	**0.6**	**0.2**	**3.3**	**4.1**
Net book value				
At 31 December	**10.9**	**0.4**	**4.1**	**15.4**

Bank 2016	Freehold land and buildings £m	Leasehold improvements £m	Equipment and fixtures £m	Total £m
Cost				
At 1 January	3.6	0.4	4.6	8.6
Additions	2.8	0.1	1.1	4.0
At 31 December	6.4	0.5	5.7	12.6
Depreciation				
At 1 January	0.3	–	1.3	1.6
Charged in year	0.1	0.1	0.9	1.1
At 31 December	0.4	0.1	2.2	2.7
Net book value				
At 31 December	6.0	0.4	3.5	9.9

25. Deferred taxation asset

	Group 2017 £m	Group 2016 £m	Bank 2017 £m	Bank 2016 £m
At 1 January	**3.4**	3.4	**0.8**	0.7
Profit or loss credit	**0.7**	0.1	**0.7**	0.1
Tax taken directly to equity	**1.0**	(0.1)	**1.0**	–
At 31 December	**5.1**	3.4	**2.5**	0.8
Analysed as:				
Losses carried forward	**2.5**	2.3	**–**	–
Accelerated depreciation	**0.1**	0.1	**–**	–
Share-based payments	**2.5**	1.0	**2.5**	0.8
	5.1	3.4	**2.5**	0.8

The deferred tax has been calculated using the relevant rates for the expected periods of utilisation.

As at 31 December 2017, the Group had £3.7m (2016: £5.1m) of losses for which a deferred tax asset has not been recognised.

A reduction in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and a further reduction to 18% (effective from 1 April 2020) were substantively enacted on 26 October 2015. An additional reduction to 17% (effective 1 April 2020) was substantively enacted on 6 September 2016.

Notes to the Financial Statements continued
For the year ended 31 December 2017

26. Other assets

	Group As at 31-Dec-17 £m	Group As at 31-Dec-16 £m	Bank As at 31-Dec-17 £m	Bank As at 31-Dec-16 £m
Prepayments	**1.9**	1.4	**1.7**	1.3
Other assets[1]	**3.0**	10.5	**3.0**	2.5
	4.9	11.9	**4.7**	3.8

1. During the year, the Group reclassified deferred broker fees paid in the Interbay group of subsidiaries from other assets to loans and advances to customers. The amount of deferred broker fees as at 31 December 2016 was £7.3m.

27. Amounts owed to retail depositors

	Group and Bank As at 31-Dec-17 £m	Group and Bank As at 31-Dec-16 £m
Amounts owed to retail depositors	**6,650.3**	5,952.4

Repayable in the ordinary course of business as follows:

	Group and Bank As at 31-Dec-17 £m	Group and Bank As at 31-Dec-16 £m
On demand	**2,051.8**	1,932.5
Less than three months	**862.0**	702.4
Three months to one year	**2,590.7**	1,977.2
One to five years	**1,145.8**	1,340.3
	6,650.3	5,952.4

28. Amounts owed to credit institutions

Repayable in the ordinary course of business as follows:

	Group and Bank As at 31-Dec-17 £m	Group and Bank As at 31-Dec-16 £m
Less than three months	**0.3**	0.7
Three months to one year	**–**	–
One to five years	**1,250.0**	101.0
	1,250.3	101.7

As at 31 December 2017, amounts owed to credit institutions included £1,250.0m (2016: £101.0m) owed to the Bank of England under the TFS. In exchange, the Group pledges with the Bank of England either loans and advances to customers or other investment securities. The value of pledged loans and advances to customers is disclosed in note 17.

29. Amounts owed to other customers

Repayable in the ordinary course of business as follows:

	Group and Bank As at 31-Dec-17 £m	Group and Bank As at 31-Dec-16 £m
Less than three months	**0.5**	4.0
Three months to one year	**25.2**	–
	25.7	4.0

30. Other liabilities

	Group As at 31-Dec-17 £m	Group As at 31-Dec-16 £m	Bank As at 31-Dec-17 £m	Bank As at 31-Dec-16 £m
Falling due within one year:				
Accruals and deferred income	**11.8**	7.6	**9.8**	6.0
Other creditors[1]	**4.5**	11.0	**3.6**	1.4
	16.3	18.6	**13.4**	7.4

1. During the year, the Group reclassified accrued arrangement fees received on the completion of new loans in the Interbay group of subsidiaries from other liabilities to loans and advances to customers. The amount of accrued arrangement fees as at 31 December 2016 was £8.7m.

31. FSCS and other regulatory provisions

The Financial Services Compensation Scheme ('FSCS') provides protection of deposits for the customers of authorised financial services firms, should a firm collapse. FSCS protects retail deposits of up to £85,000 (2016: £75,000) for single account holders and £170,000 (2016: £150,000) for joint holders.

The compensation paid out to consumers is initially funded through loans from the Bank of England and HM Treasury. In order to repay the loans and cover its costs, the FSCS charges levies on firms regulated by the PRA and the Financial Conduct Authority ('FCA'). The Group is among those firms and pays the FSCS a levy based on its share of total UK deposits. In accordance with IFRIC 21 interpretation of IAS 37, the FSCS liability for 2017 will be recognised in 2018. The FSCS balance at the reporting date relates to the levy from previous years.

The Group has reviewed its current exposure to Plevin Payment Protection Insurance claims and other FCA conduct rules exposures and has recognised a provision of £0.9m (2016: £0.1m) to cover potential future claims.

An analysis of the Group and Bank's FSCS and other provisions are presented below:

Group and Bank	FSCS 2017 £m	Other provisions 2017 £m	Total 2017 £m	FSCS 2016 £m	Other provisions 2016 £m	Total 2016 £m
As at 1 January	**1.4**	**0.1**	**1.5**	2.2	0.1	2.3
Paid during the year	**(1.0)**	**–**	**(1.0)**	(1.3)	–	(1.3)
Charge	**0.1**	**0.8**	**0.9**	0.5	–	0.5
At 31 December	**0.5**	**0.9**	**1.4**	1.4	0.1	1.5

32. Subordinated liabilities

	Group and Bank 2017 £m	Group and Bank 2016 £m
At 1 January	**21.6**	24.6
Repayment of debt at maturity	**(10.7)**	(3.0)
As at 31 December	**10.9**	21.6

The Group's outstanding subordinated liabilities are summarised below:

	Group and Bank As at 31-Dec-17 £m	Group and Bank As at 31-Dec-16 £m
Linked to LIBOR:		
Floating rate subordinated liabilities 2017 (LIBOR + 1.5%)	**–**	5.7
Floating rate subordinated loans 2022 (LIBOR + 5%)	**0.3**	0.3
Floating rate subordinated loans 2022 (LIBOR + 2%)	**0.4**	0.4
Linked to the average standard mortgage rate of the five largest building societies:		
Floating rate subordinated liabilities 2017 (+5.963%)	**–**	5.0
Fixed rate:		
Subordinated liabilities 2019 (7.45%)[1]	**5.1**	5.1
Subordinated liabilities 2024 (6.45%)[2]	**5.1**	5.1
	10.9	21.6

1. On 27 September 2016, the Group decided not to call the £5.0m first tranche of the subordinated debt with original maturity of 27 September 2024. As the debt was not called, the coupon rate reset to 7.45% until maturity.
2. The Group has the option to call the £5.0m second tranche of the subordinated debt on 27 September 2019.

Notes to the Financial Statements continued

For the year ended 31 December 2017

32. Subordinated liabilities continued

Subordinated liabilities are repayable at the dates stated or earlier at the option of the Group with the prior consent of the PRA. All subordinated liabilities are denominated in sterling and are unlisted.

The rights of repayment of the holders of these subordinated liabilities are subordinated to the claims of all depositors and all creditors.

33. Perpetual Subordinated Bonds

	Group and Bank As at 31-Dec-17 £m	Group and Bank As at 31-Dec-16 £m
Sterling Perpetual Subordinated Bonds	**15.3**	15.3

The bonds are listed on the London Stock Exchange. They were issued with no discretion over the payment of interest and may not be settled in the Group's own equity. They are therefore classified as financial liabilities. The coupon rate is 5.9884%.

34. Share capital

	Number of shares	**Nominal value (£m)**	**Premium (£m)**
At 1 January 2017	**243,082,091**	**2.4**	**157.9**
Shares issued under OSB employee share plan	**382,597**	**–**	**0.5**
At 31 December 2017	**243,464,688**	**2.4**	**158.4**
At 1 January 2016	243,079,965	2.4	157.9
Shares issued under OSB employee share plan	2,126	–	–
At 31 December 2016	243,082,091	2.4	157.9

35. Other reserves

Transfer reserve

The transfer reserve of £12.8m (Bank: £15.2m) represents the difference between the 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 £0.1m (2016: £nil) represents the cumulative net change in the fair value of investment securities measured at FVOCI.

Perpetual Subordinated Bonds

In addition to the PSBs in note 33, the Bank has issued £22.0m of PSBs which are classified as equity in accordance with the conditions contained in note 1(p). The classification of these PSBs means that any coupon payments on them are treated within retained earnings rather than through profit or loss. The coupon rate was 6.591% until the reset date on 7 March 2016, after which it was reset to 4.5991% until the next reset date on 7 March 2021.

AT1 securities

On 25 May 2017, OSB issued £60m of Fixed Rate Resetting Perpetual Subordinated Contingent Convertible Securities ('AT1 securities') that qualify as Additional Tier 1 capital under CRD IV. The securities will be subject to full conversion into ordinary shares of OSB in the event that its CET1 capital ratio falls below 7%. The AT1 securities will pay interest at a rate of 9.125% per annum until the first reset date of 25 May 2022, with the reset interest rate equal to 835.9 basis points over the five-year semi-annual mid-swap rate for such a period. Interest is paid semi-annually on 25 May and 25 November. OSB may at any time cancel any interest payment at its full discretion and must cancel interest payments in certain circumstances specified in the terms and conditions of the AT1 securities. The AT1 securities are perpetual with no fixed redemption date. OSB may, in its discretion and subject to satisfying certain conditions, redeem all (but not some) of the AT1 securities at the principal amount outstanding plus any accrued but unpaid interest from the first reset date and on any interest payment date thereafter.

Transaction costs directly related to the AT1 securities issuance have been recognised directly in equity within retained earnings net of tax.

36. Financial commitments and guarantees

a) As at 31 December 2017, the Group's contracted or anticipated capital expenditure commitments not provided for amounted to £0.3m (2016: £1.1m). 2017 consists of branch refurbishment costs. 2016 consisted of branch refurbishment costs and UK head office improvements.

b) The Group's minimum lease commitments under operating leases are summarised in the table below:

	Group As at 31-Dec-17 £m	Group As at 31-Dec-16 £m	**Bank As at 31-Dec-17 £m**	Bank As at 31-Dec-16 £m
Land and buildings: due within:				
One year	**0.5**	0.4	**0.3**	0.4
Two to five years	**1.0**	0.9	**0.8**	0.8
	1.5	1.3	**1.1**	1.2

c) Undrawn mortgage loan facilities:

	Group As at 31-Dec-17 £m	Group As at 31-Dec-16 £m	**Bank As at 31-Dec-17 £m**	Bank As at 31-Dec-16 £m
BTL/SME mortgages	**485.9**	188.5	**390.5**	120.3
Residential mortgages	**44.3**	176.9	**44.3**	176.9
	530.2	365.4	**434.8**	297.2

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 2017 (2016: £nil).

37. Risk management

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 definition 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 call 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 and drawdowns under the Bank of England TFS, supported by debt securities, subordinated debt, wholesale and other funding. Equity instruments include own shares, perpetual bonds and AT1 securities meeting the equity classification criteria. The Group's main activity is mortgage 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 its financial risks. Derivative financial instruments ('derivatives') are financial instruments whose value changes in response to changes in underlying variables such as interest rates. 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 from value changes without the need to buy or sell the whole underlying product. The most common derivatives comprise futures, forwards and swaps. Among these, the Group only uses swaps.

Derivatives are used by the Group solely to reduce ('hedge') 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. Interest rate swaps convert fixed interest rates to floating or vice versa. As with other derivatives, the underlying product is not sold and payments are based on notional principal amounts.

Notes to the Financial Statements continued

For the year ended 31 December 2017

37. Risk management continued

Unhedged fixed rate liabilities create the risk of paying above-the-market rate if interest rates subsequently decrease. Unhedged fixed rate mortgages and liquid assets bear the opposite risk of earning below-the-market income when rates go up. While fixed rate assets and liabilities naturally hedge each other to a certain extent, this hedge is usually never balanced.

The Group uses swaps to convert its instruments, such as mortgages, deposits and liquid assets, from fixed or base rate-linked rates to LIBOR-linked variable rates. This ensures a guaranteed margin between the interest income and interest expense, regardless of changes in the Risk review.

Types of risk

The principal financial risks to which the Group is exposed are credit, liquidity and market risks, the latter comprising of interest and exchange rate risk. In addition to financial risks, the Group is exposed to various other risks, most notably operational, conduct and regulatory, covered in the Risk review.

The financial risks are analysed below. Additional information is contained within the Principal risks and uncertainties on pages 39 to 44.

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 and Basel III 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 call account, call and current accounts with other credit institutions and investment securities. The maximum credit risk exposure equals the total carrying amount of the above categories plus off balance sheet undrawn mortgage facilities.

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 Assets and Liabilities Committee ('ALCO') regularly monitor lending activity, taking appropriate actions to reprice 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 As at 31-Dec-17		Group As at 31-Dec-16	
	£m	**%**	£m	%
BTL/SME mortgages	**5,654.1**	**77**	4,104.3	69
Residential mortgages	**1,673.5**	**23**	1,859.9	31
Total loans before provisions	**7,327.6**	**100**	5,964.2	100

	Bank As at 31-Dec-17		Bank As at 31-Dec-16	
	£m	**%**	£m	%
BTL/SME mortgages	**4,588.7**	**76**	3,299.5	67
Residential mortgages	**1,477.8**	**24**	1,613.1	33
Total loans before provisions	**6,066.5**	**100**	4,912.6	100

Property values are updated to reflect changes in the HPI. A breakdown of loans and advances to customers by indexed loan-to-value ('LTV') is as follows:

LTV analysis by band for all loans:

Group	As at 31-Dec-17 BTL/SME £m	Residential £m	Total £m	%
Band				
0%–50%	**747.6**	**808.3**	**1,555.9**	**21**
50%–60%	**960.5**	**260.6**	**1,221.1**	**16**
60%–70%	**1,606.8**	**228.3**	**1,835.1**	**25**
70%–80%	**1,939.4**	**184.5**	**2,123.9**	**29**
80%–90%	**359.1**	**138.2**	**497.3**	**7**
90%–100%	**15.1**	**31.6**	**46.7**	**1**
>100%	**24.5**	**22.0**	**46.5**	**1**
Total mortgages before provisions	**5,653.0**	**1,673.5**	**7,326.5**	**100**
Personal loans	**1.1**	**–**	**1.1**	**–**
Total loans before provisions	**5,654.1**	**1,673.5**	**7,327.6**	**100**

Group	As at 31-Dec-16 BTL/SME £m	Residential £m	Total £m	%
Band				
0%–50%	755.9	761.7	1,517.6	25
50%–60%	859.6	278.7	1,138.3	19
60%–70%	1,202.4	282.7	1,485.1	25
70%–80%	1,041.2	257.1	1,298.3	22
80%–90%	194.8	196.9	391.7	7
90%–100%	5.0	48.0	53.0	1
>100%	36.0	34.8	70.8	1
Total mortgages before provisions	4,094.9	1,859.9	5,954.8	100
Personal loans	9.4	–	9.4	–
Total loans before provisions	4,104.3	1,859.9	5,964.2	100

Bank	As at 31-Dec-17 BTL/SME £m	Residential £m	Total £m	%
Band				
0%–50%	**587.1**	**738.2**	**1,325.3**	**22**
50%–60%	**745.4**	**225.8**	**971.2**	**16**
60%–70%	**1,259.2**	**188.0**	**1,447.2**	**24**
70%–80%	**1,631.2**	**161.7**	**1,792.9**	**29**
80%–90%	**333.1**	**121.5**	**454.6**	**7**
90%–100%	**10.4**	**26.3**	**36.7**	**1**
>100%	**21.2**	**16.3**	**37.5**	**1**
Total mortgages before provisions	**4,587.6**	**1,477.8**	**6,065.4**	**100**
Personal loans	**1.1**	**–**	**1.1**	**–**
Total loans before provisions	**4,588.7**	**1,477.8**	**6,066.5**	**100**

Notes to the Financial Statements continued

For the year ended 31 December 2017

37. Risk management continued

Bank	As at 31-Dec-16 BTL/SME £m	Residential £m	Total £m	%
Band				
0%–50%	613.0	714.8	1,327.8	27
50%–60%	663.7	251.1	914.8	19
60%–70%	940.0	249.7	1,189.7	24
70%–80%	892.5	206.8	1,099.3	22
80%–90%	157.8	129.5	287.3	6
90%–100%	1.1	38.4	39.5	1
>100%	22.0	22.8	44.8	1
Total mortgages before provisions	3,290.1	1,613.1	4,903.2	100
Personal loans	9.4	–	9.4	–
Total loans before provisions	3,299.5	1,613.1	4,912.6	100

LTV analysis by band for BTL/SME:

Group	As at 31-Dec-17 Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Band					
0%–50%	**567.0**	**66.8**	**88.3**	**25.5**	**747.6**
50%–60%	**841.2**	**62.3**	**42.8**	**14.2**	**960.5**
60%–70%	**1,437.7**	**120.6**	**8.9**	**39.6**	**1,606.8**
70%–80%	**1,811.5**	**112.8**	**3.9**	**11.2**	**1,939.4**
80%–90%	**343.1**	**2.5**	**–**	**13.5**	**359.1**
90%–100%	**14.2**	**0.4**	**–**	**0.5**	**15.1**
>100%	**19.1**	**5.4**	**–**	**–**	**24.5**
Total mortgages before provisions	**5,033.8**	**370.8**	**143.9**	**104.5**	**5,653.0**
Personal loans					**1.1**
Total loans before provisions					**5,654.1**

Group	As at 31-Dec-16 Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Band					
0%–50%	534.1	85.2	104.7	31.9	755.9
50%–60%	750.4	67.1	23.5	18.6	859.6
60%–70%	1,096.8	71.0	13.4	21.2	1,202.4
70%–80%	1,006.2	35.0	–	–	1,041.2
80%–90%	193.0	1.8	–	–	194.8
90%–100%	5.0	–	–	–	5.0
>100%	27.8	8.2	–	–	36.0
Total mortgages before provisions	3,613.3	268.3	141.6	71.7	4,094.9
Personal loans					9.4
Total loans before provisions					4,104.3

Bank	As at 31-Dec-17 Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Band					
0%–50%	**466.8**	**6.5**	**88.3**	**25.5**	**587.1**
50%–60%	**686.3**	**2.1**	**42.8**	**14.2**	**745.4**
60%–70%	**1,204.4**	**6.3**	**8.9**	**39.6**	**1,259.2**
70%–80%	**1,607.9**	**8.2**	**3.9**	**11.2**	**1,631.2**
80%–90%	**319.5**	**0.1**	**–**	**13.5**	**333.1**
90%–100%	**9.9**	**–**	**–**	**0.5**	**10.4**
>100%	**17.0**	**4.2**	**–**	**–**	**21.2**
Total mortgages before provisions	**4,311.8**	**27.4**	**143.9**	**104.5**	**4,587.6**
Personal loans					**1.1**
Total loans before provisions					**4,588.7**

Bank	As at 31-Dec-16 Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Band					
0%–50%	458.6	17.8	104.7	31.9	613.0
50%–60%	613.2	8.4	23.5	18.6	663.7
60%–70%	905.1	0.3	13.4	21.2	940.0
70%–80%	891.2	1.3	–	–	892.5
80%–90%	157.8	–	–	–	157.8
90%–100%	1.1	–	–	–	1.1
>100%	17.7	4.3	–	–	22.0
Total mortgages before provisions	3,044.7	32.1	141.6	71.7	3,290.1
Personal loans					9.4
Total loans before provisions					3,299.5

LTV analysis by band for Residential mortgages:

Group	As at 31-Dec-17 First charge £m	Second charge £m	Funding lines £m	Total £m
Band				
0%–50%	**647.1**	**150.2**	**11.0**	**808.3**
50%–60%	**163.3**	**94.2**	**3.1**	**260.6**
60%–70%	**147.9**	**78.4**	**2.0**	**228.3**
70%–80%	**136.1**	**47.2**	**1.2**	**184.5**
80%–90%	**116.4**	**21.6**	**0.2**	**138.2**
90%–100%	**22.2**	**9.3**	**0.1**	**31.6**
>100%	**7.6**	**14.4**	**-**	**22.0**
Total mortgages before provisions	**1,240.6**	**415.3**	**17.6**	**1,673.5**

Group	As at 31-Dec-16 First charge £m	Second charge £m	Funding lines £m	Total £m
Band				
0%–50%	579.6	154.5	27.6	761.7
50%–60%	166.4	103.1	9.2	278.7
60%–70%	173.3	102.3	7.1	282.7
70%–80%	188.3	64.0	4.8	257.1
80%–90%	168.3	27.2	1.4	196.9
90%–100%	31.9	16.0	0.1	48.0
>100%	14.3	20.1	0.4	34.8
Total mortgages before provisions	1,322.1	487.2	50.6	1,859.9

Notes to the Financial Statements continued
For the year ended 31 December 2017

37. Risk management continued

Bank	As at 31-Dec-17 First charge £m	Second charge £m	Funding lines £m	Total £m
Band				
0%–50%	**577.0**	**150.2**	**11.0**	**738.2**
50%–60%	**128.5**	**94.2**	**3.1**	**225.8**
60%–70%	**107.6**	**78.4**	**2.0**	**188.0**
70%–80%	**113.3**	**47.2**	**1.2**	**161.7**
80%–90%	**99.7**	**21.6**	**0.2**	**121.5**
90%–100%	**16.9**	**9.3**	**0.1**	**26.3**
>100%	**1.9**	**14.4**	**–**	**16.3**
Total mortgages before provisions	**1,044.9**	**415.3**	**17.6**	**1,477.8**

Bank	As at 31-Dec-16 First charge £m	Second charge £m	Funding lines £m	Total £m
Band				
0%–50%	532.7	154.5	27.6	714.8
50%–60%	138.8	103.1	9.2	251.1
60%–70%	140.3	102.3	7.1	249.7
70%–80%	138.0	64.0	4.8	206.8
80%–90%	100.9	27.2	1.4	129.5
90%–100%	22.3	16.0	0.1	38.4
>100%	2.3	20.1	0.4	22.8
Total mortgages before provisions	1,075.3	487.2	50.6	1,613.1

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 collateral position by LTV bands is captured in the LTV analysis above.

In 2016, there was an update to the categorisation where collectively assessed provisions on loans greater than three months in arrears are now treated as specific provisions, in addition to those that are individually assessed, as disclosed in note 18.

Below is a summary of capped collateral:

	Group As at 31-Dec-17		Group As at 31-Dec-16	
	Loan balance £m	**Capped collateral £m**	Loan balance £m	Capped collateral £m
Not past due and not impaired	**6,792.9**	**6,784.8**	5,478.4	5,464.5
Past due but not impaired	**452.2**	**452.1**	395.9	395.8
Impaired	**81.4**	**76.6**	80.5	69.1
Total mortgages before provisions	**7,326.5**	**7,313.5**	5,954.8	5,929.4
Personal loans	**1.1**		9.4	
Total loans before provisions	**7,327.6**		5,964.2	

	Bank As at 31-Dec-17		Bank As at 31-Dec-16	
	Loan balance £m	**Capped collateral £m**	Loan balance £m	Capped collateral £m
Not past due and not impaired	**5,613.8**	**5,606.5**	4,494.3	4,481.3
Past due but not impaired	**394.4**	**394.2**	349.1	349.0
Impaired	**57.2**	**52.9**	59.8	50.9
Total mortgages before provisions	**6,065.4**	**6,053.6**	4,903.2	4,881.2
Personal loans	**1.1**		9.4	
Total loans before provisions	**6,066.5**		4,912.6	

A breakdown of the table above by payment due status is as follows:

	Group As at 31-Dec-17		Group As at 31-Dec-16	
	Loan balance £m	Capped collateral £m	Loan balance £m	Capped collateral £m
Not impaired:				
Not past due	**6,792.9**	**6,784.8**	5,478.4	5,464.5
Past due < 1 month	**307.1**	**307.1**	183.5	183.5
Past due 1 to 3 months	**102.0**	**101.9**	168.2	168.2
Past due 3 to 6 months	**20.9**	**20.9**	24.4	24.3
Past due 6 to 12 months	**14.1**	**14.1**	12.8	12.8
Past due over 12 months	**7.6**	**7.6**	6.2	6.2
Possessions[1]	**0.5**	**0.5**	0.8	0.8
	7,245.1	**7,236.9**	5,874.3	5,860.3
Impaired[2]:				
Not past due	**12.3**	**7.7**	3.2	0.4
Past due < 1 month	**0.8**	**0.8**	1.0	1.0
Past due 1 to 3 months	**2.2**	**2.1**	1.2	1.2
Past due 3 to 6 months	**23.7**	**23.7**	14.8	14.8
Past due 6 to 12 months	**16.3**	**16.3**	16.3	16.2
Past due over 12 months	**14.5**	**14.4**	31.8	24.9
Possessions	**11.6**	**11.6**	12.2	10.6
	81.4	**76.6**	80.5	69.1
Total mortgages before provisions	**7,326.5**	**7,313.5**	5,954.8	5,929.4
Personal loans	**1.1**		9.4	
Total loans before provisions	**7,327.6**		5,964.2	
Contractual maturity:				
Past due but not impaired				
Less than three months	**9.3**		5.0	
Three months to one year	**7.2**		4.3	
One to five years	**27.7**		22.4	
More than five years	**408.0**		364.2	
	452.2		395.9	
Impaired				
Less than three months	**11.2**		17.0	
Three months to one year	**0.9**		1.2	
One to five years	**5.9**		2.5	
More than five years	**63.4**		59.8	
	81.4		80.5	

1. Mortgages with properties in possession are not considered impaired if the fair value of collateral exceeds the value of debt.
2. Impaired is defined as loans with a specific provision against them.

Notes to the Financial Statements continued

For the year ended 31 December 2017

37. Risk management continued

	Bank As at 31-Dec-17 Loan balance £m	Bank As at 31-Dec-17 Capped collateral £m	Bank As at 31-Dec-16 Loan balance £m	Bank As at 31-Dec-16 Capped collateral £m
Not impaired:				
Not past due	**5,613.8**	**5,606.5**	4,494.3	4,481.3
Past due < 1 month	**267.7**	**267.6**	162.2	162.2
Past due 1 to 3 months	**87.2**	**87.1**	146.8	146.7
Past due 3 to 6 months	**19.8**	**19.8**	21.5	21.5
Past due 6 to 12 months	**12.9**	**12.9**	12.1	12.1
Past due over 12 months	**6.3**	**6.3**	5.7	5.7
Possessions[1]	**0.5**	**0.5**	0.8	0.8
	6,008.2	**6,000.7**	4,843.4	4,830.3
Impaired[2]:				
Not past due	**7.0**	**2.7**	2.7	0.4
Past due < 1 month	**0.5**	**0.5**	0.5	0.5
Past due 1 to 3 months	**–**	**–**	–	–
Past due 3 to 6 months	**20.8**	**20.8**	12.5	12.5
Past due 6 to 12 months	**12.4**	**12.4**	12.9	12.9
Past due over 12 months	**12.1**	**12.1**	26.7	20.1
Possessions	**4.4**	**4.4**	4.5	4.5
	57.2	**52.9**	59.8	50.9
Total mortgages before provisions	**6,065.4**	**6,053.6**	4,903.2	4,881.2
Personal loans	**1.1**		9.4	
Total loans before provisions	**6,066.5**		4,912.6	
Contractual maturity:				
Past due but not impaired				
Less than three months	**7.6**		3.0	
Three months to one year	**1.4**		2.9	
One to five years	**21.1**		15.8	
More than five years	**364.3**		327.4	
	394.4		349.1	
Impaired				
Less than three months	**7.1**		16.0	
Three months to one year	**0.3**		1.2	
One to five years	**5.4**		2.5	
More than five years	**44.4**		40.1	
	57.2		59.8	

1. Mortgages with properties in possession are not considered impaired if the fair value of collateral exceeds the value of debt.
2. Impaired is defined as loans with a specific provision against them.

Analysis of mortgage portfolio by arrears for BTL/SME

Group	As at 31-Dec-17 Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Not impaired:					
Not past due	4,810.7	360.8	143.9	104.5	5,419.9
Past due < 1 month	160.4	2.8	–	–	163.2
Past due 1 to 3 months	31.9	0.6	–	–	32.5
Past due 3 to 6 months	2.7	–	–	–	2.7
Past due 6 to 12 months	0.7	–	–	–	0.7
Past due over 12 months	0.3	0.8	–	–	1.1
Possessions	–	–	–	–	–
	5,006.7	365.0	143.9	104.5	5,620.1
Impaired:					
Not past due	4.6	4.5	–	–	9.1
Past due < 1 month	–	0.1	–	–	0.1
Past due 1 to 3 months	–	–	–	–	–
Past due 3 to 6 months	9.1	–	–	–	9.1
Past due 6 to 12 months	4.0	0.4	–	–	4.4
Past due over 12 months	1.6	0.1	–	–	1.7
Possessions	7.8	0.7	–	–	8.5
	27.1	5.8	–	–	32.9
Total mortgages before provisions	5,033.8	370.8	143.9	104.5	5,653.0
Personal loans					1.1
Total loans before provisions					5,654.1
Contractual maturity:					
Past due but not impaired					
Less than three months	5.8	–	–	–	5.8
Three months to one year	5.6	–	–	–	5.6
One to five years	5.1	0.8	–	–	5.9
More than five years	179.5	3.4	–	–	182.9
	196.0	4.2	–	–	200.2
Impaired					
Less than three months	6.9	–	–	–	6.9
Three months to one year	0.6	–	–	–	0.6
One to five years	1.1	0.1	–	–	1.2
More than five years	18.5	5.7	–	–	24.2
	27.1	5.8	–	–	32.9

Notes to the Financial Statements continued

For the year ended 31 December 2017

37. Risk management continued

Group	As at 31-Dec-16 Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Not impaired:					
Not past due	3,468.7	252.9	141.6	71.7	3,934.9
Past due < 1 month	62.5	3.3	–	–	65.8
Past due 1 to 3 months	56.5	1.1	–	–	57.6
Past due 3 to 6 months	2.0	0.3	–	–	2.3
Past due 6 to 12 months	0.4	0.7	–	–	1.1
Past due over 12 months	–	0.3	–	–	0.3
Possessions	–	–	–	–	–
	3,590.1	258.6	141.6	71.7	4,062.0
Impaired:					
Not past due	2.5	0.1	–	–	2.6
Past due < 1 month	–	0.4	–	–	0.4
Past due 1 to 3 months	–	0.3	–	–	0.3
Past due 3 to 6 months	1.1	0.2	–	–	1.3
Past due 6 to 12 months	2.3	0.1	–	–	2.4
Past due over 12 months	9.0	6.0	–	–	15.0
Possessions	8.3	2.6	–	–	10.9
	23.2	9.7	–	–	32.9
Total mortgages before provisions	3,613.3	268.3	141.6	71.7	4,094.9
Personal loans					9.4
Total loans before provisions					4,104.3
Contractual maturity:					
Past due but not impaired					
Less than three months	0.1	–	–	–	0.1
Three months to one year	0.4	–	–	–	0.4
One to five years	4.1	–	–	–	4.1
More than five years	116.8	5.7	–	–	122.5
	121.4	5.7	–	–	127.1
Impaired					
Less than three months	15.4	–	–	–	15.4
Three months to one year	–	–	–	–	–
One to five years	–	–	–	–	–
More than five years	7.8	9.7	–	–	17.5
	23.2	9.7	–	–	32.9

Bank	Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
	As at 31-Dec-17				
Not impaired:					
Not past due	4,119.2	22.7	143.9	104.5	4,390.3
Past due < 1 month	145.7	0.5	–	–	146.2
Past due 1 to 3 months	25.5	–	–	–	25.5
Past due 3 to 6 months	2.3	–	–	–	2.3
Past due 6 to 12 months	0.6	–	–	–	0.6
Past due over 12 months	0.3	–	–	–	0.3
Possessions	–	–	–	–	–
	4,293.6	23.2	143.9	104.5	4,565.2
Impaired:					
Not past due	2.4	4.2	–	–	6.6
Past due < 1 month	–	–	–	–	–
Past due 1 to 3 months	–	–	–	–	–
Past due 3 to 6 months	7.6	–	–	–	7.6
Past due 6 to 12 months	3.0	–	–	–	3.0
Past due over 12 months	0.9	–	–	–	0.9
Possessions	4.3	–	–	–	4.3
	18.2	4.2	–	–	22.4
Total mortgages before provisions	4,311.8	27.4	143.9	104.5	4,587.6
Personal loans					1.1
Total loans before provisions					4,588.7
Contractual maturity:					
Past due but not impaired					
Less than three months	4.4	–	–	–	4.4
Three months to one year	–	–	–	–	–
One to five years	2.7	–	–	–	2.7
More than five years	167.3	0.5	–	–	167.8
	174.4	0.5	–	–	174.9
Impaired					
Less than three months	6.6	–	–	–	6.6
Three months to one year	–	–	–	–	–
One to five years	0.8	–	–	–	0.8
More than five years	10.8	4.2	–	–	15.0
	18.2	4.2	–	–	22.4

Notes to the Financial Statements continued

For the year ended 31 December 2017

37. Risk management continued

Bank	As at 31-Dec-16 Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Not impaired:					
Not past due	2,922.4	25.1	141.6	71.7	3,160.8
Past due < 1 month	53.6	1.4	–	–	55.0
Past due 1 to 3 months	50.2	0.3	–	–	50.5
Past due 3 to 6 months	0.6	–	–	–	0.6
Past due 6 to 12 months	0.4	–	–	–	0.4
Past due over 12 months	–	0.3	–	–	0.3
Possessions	–	–	–	–	–
	3,027.2	27.1	141.6	71.7	3,267.6
Impaired:					
Not past due	2.6	0.1	–	–	2.7
Past due < 1 month	–	–	–	–	–
Past due 1 to 3 months	–	–	–	–	–
Past due 3 to 6 months	0.8	–	–	–	0.8
Past due 6 to 12 months	1.2	–	–	–	1.2
Past due over 12 months	8.5	4.9	–	–	13.4
Possessions	4.4	–	–	–	4.4
	17.5	5.0	–	–	22.5
Total mortgages before provisions	3,044.7	32.1	141.6	71.7	3,290.1
Personal loans					9.4
Total loans before provisions					3,299.5
Contractual maturity:					
Past due but not impaired					
Less than three months	0.1	–	–	–	0.1
Three months to one year	–	–	–	–	–
One to five years	0.8	0.1	–	–	0.9
More than five years	103.9	1.9	–	–	105.8
	104.8	2.0	–	–	106.8
Impaired					
Less than three months	15.4	–	–	–	15.4
Three months to one year	–	–	–	–	–
One to five years	–	–	–	–	–
More than five years	2.1	5.0	–	–	7.1
	17.5	5.0	–	–	22.5

Analysis of mortgage portfolio by arrears for Residential mortgages

Group	As at 31-Dec-17 First charge £m	Second charge £m	Funding lines £m	Total £m
Not impaired:				
Not past due	1,023.6	331.8	17.6	1,373.0
Past due < 1 month	123.1	20.8	–	143.9
Past due 1 to 3 months	46.4	23.1	–	69.5
Past due 3 to 6 months	10.5	7.7	–	18.2
Past due 6 to 12 months	8.1	5.3	–	13.4
Past due over 12 months	3.2	3.3	–	6.5
Possessions	0.5	–	–	0.5
	1,215.4	392.0	17.6	1,625.0
Impaired:				
Not past due	2.9	0.3	–	3.2
Past due < 1 month	0.7	–	–	0.7
Past due 1 to 3 months	2.2	–	–	2.2
Past due 3 to 6 months	7.5	7.1	–	14.6
Past due 6 to 12 months	6.6	5.3	–	11.9
Past due over 12 months	2.2	10.6	–	12.8
Possessions	3.1	–	–	3.1
	25.2	23.3	–	48.5
Total mortgages before provisions	1,240.6	415.3	17.6	1,673.5
Contractual maturity:				
Past due but not impaired				
Less than three months	3.3	0.2	–	3.5
Three months to one year	1.0	0.6	–	1.6
One to five years	11.5	10.3	–	21.8
More than five years	176.0	49.1	–	225.1
	191.8	60.2	–	252.0
Impaired				
Less than three months	4.2	0.1	–	4.3
Three months to one year	–	0.3	–	0.3
One to five years	0.8	3.9	–	4.7
More than five years	20.2	19.0	–	39.2
	25.2	23.3	–	48.5

Notes to the Financial Statements continued

For the year ended 31 December 2017

37. Risk management continued

Group	As at 31-Dec-16 First charge £m	Second charge £m	Funding lines £m	Total £m
Not impaired:				
Not past due	1,100.6	392.3	50.6	1,543.5
Past due < 1 month	99.8	17.9	–	117.7
Past due 1 to 3 months	80.2	30.4	–	110.6
Past due 3 to 6 months	12.8	9.3	–	22.1
Past due 6 to 12 months	5.0	6.7	–	11.7
Past due over 12 months	2.8	3.1	–	5.9
Possessions	0.8	–	–	0.8
	1,302.0	459.7	50.6	1,812.3
Impaired:				
Not past due	0.6	–	–	0.6
Past due < 1 month	0.6	–	–	0.6
Past due 1 to 3 months	0.9	–	–	0.9
Past due 3 to 6 months	6.0	7.5	–	13.5
Past due 6 to 12 months	5.8	8.1	–	13.9
Past due over 12 months	4.9	11.9	–	16.8
Possessions	1.3	–	–	1.3
	20.1	27.5	–	47.6
Total mortgages before provisions	1,322.1	487.2	50.6	1,859.9
Contractual maturity:				
Past due but not impaired				
Less than three months	4.3	0.6	–	4.9
Three months to one year	2.8	1.1	–	3.9
One to five years	9.1	9.2	–	18.3
More than five years	185.2	56.5	–	241.7
	201.4	67.4	–	268.8
Impaired				
Less than three months	1.3	0.3	–	1.6
Three months to one year	0.2	1.0	–	1.2
One to five years	–	2.5	–	2.5
More than five years	18.6	23.7	–	42.3
	20.1	27.5	–	47.6

Bank	As at 31-Dec-17 First charge £m	Second charge £m	Funding lines £m	Total £m
Not impaired:				
Not past due	874.1	331.8	17.6	1,223.5
Past due < 1 month	100.7	20.8	–	121.5
Past due 1 to 3 months	38.6	23.1	–	61.7
Past due 3 to 6 months	9.8	7.7	–	17.5
Past due 6 to 12 months	7.0	5.3	–	12.3
Past due over 12 months	2.7	3.3	–	6.0
Possessions	0.5	–	–	0.5
	1,033.4	392.0	17.6	1,443.0
Impaired:				
Not past due	0.1	0.3	–	0.4
Past due < 1 month	0.5	–	–	0.5
Past due 1 to 3 months	–	–	–	–
Past due 3 to 6 months	6.1	7.1	–	13.2
Past due 6 to 12 months	4.1	5.3	–	9.4
Past due over 12 months	0.6	10.6	–	11.2
Possessions	0.1	–	–	0.1
	11.5	23.3	–	34.8
Total mortgages before provisions	1,044.9	415.3	17.6	1,477.8
Contractual maturity:				
Past due but not impaired				
Less than three months	3.0	0.2	–	3.2
Three months to one year	0.8	0.6	–	1.4
One to five years	8.1	10.3	–	18.4
More than five years	147.4	49.1	–	196.5
	159.3	60.2	–	219.5
Impaired				
Less than three months	0.4	0.1	–	0.5
Three months to one year	–	0.3	–	0.3
One to five years	0.7	3.9	–	4.6
More than five years	10.4	19.0	–	29.4
	11.5	23.3	–	34.8

Notes to the Financial Statements continued

For the year ended 31 December 2017

37. Risk management continued

Bank	As at 31-Dec-16 First charge £m	Second charge £m	Funding lines £m	Total £m
Not impaired:				
Not past due	890.6	392.3	50.6	1,333.5
Past due < 1 month	89.3	17.9	–	107.2
Past due 1 to 3 months	65.9	30.4	–	96.3
Past due 3 to 6 months	11.6	9.3	–	20.9
Past due 6 to 12 months	5.0	6.7	–	11.7
Past due over 12 months	2.3	3.1	–	5.4
Possessions	0.8	–	–	0.8
	1,065.5	459.7	50.6	1,575.8
Impaired:				
Not past due	–	–	–	–
Past due < 1 month	0.5	–	–	0.5
Past due 1 to 3 months	–	–	–	–
Past due 3 to 6 months	4.2	7.5	–	11.7
Past due 6 to 12 months	3.6	8.1	–	11.7
Past due over 12 months	1.4	11.9	–	13.3
Possessions	0.1	–	–	0.1
	9.8	27.5	–	37.3
Total mortgages before provisions	1,075.3	487.2	50.6	1,613.1
Contractual maturity:				
Past due but not impaired				
Less than three months	2.3	0.6	–	2.9
Three months to one year	1.8	1.1	–	2.9
One to five years	5.7	9.2	–	14.9
More than five years	165.1	56.5	–	221.6
	174.9	67.4	–	242.3
Impaired				
Less than three months	0.3	0.3	–	0.6
Three months to one year	0.2	1.0	–	1.2
One to five years	–	2.5	–	2.5
More than five years	9.3	23.7	–	33.0
	9.8	27.5	–	37.3

Geographical analysis by region
An analysis of loans by region is provided below:

Region	Group As at 31-Dec-17 £m	Group As at 31-Dec-17 %	Group As at 31-Dec-16 £m	Group As at 31-Dec-16 %
East Anglia	**236.4**	**3**	182.2	3
East Midlands	**249.6**	**4**	204.5	3
Greater London	**3,173.0**	**43**	2,543.1	43
Guernsey	**73.8**	**1**	93.4	2
Jersey	**225.1**	**3**	282.0	5
North East	**103.0**	**1**	90.3	2
North West	**347.9**	**5**	273.2	5
Northern Ireland	**16.9**	**–**	16.8	–
Scotland	**51.1**	**1**	56.1	1
South East	**1,591.7**	**22**	1,278.5	21
South West	**522.3**	**7**	380.6	6
Wales	**142.9**	**2**	114.7	2
West Midlands	**425.4**	**6**	308.6	5
Yorks and Humberside	**167.4**	**2**	130.8	2
Total mortgages before provisions	**7,326.5**	**100**	5,954.8	100
Personal loans	**1.1**		9.4	
Total loans before provisions	**7,327.6**		5,964.2	

Region	Bank As at 31-Dec-17 £m	Bank As at 31-Dec-17 %	Bank As at 31-Dec-16 £m	Bank As at 31-Dec-16 %
East Anglia	**212.4**	**4**	159.7	3
East Midlands	**203.8**	**3**	164.8	3
Greater London	**2,726.9**	**45**	2,234.3	46
North East	**86.3**	**1**	74.6	2
North West	**277.0**	**5**	228.4	5
Northern Ireland	**16.5**	**–**	16.4	–
Scotland	**50.3**	**1**	55.3	1
South East	**1,426.6**	**24**	1,161.7	24
South West	**439.1**	**7**	335.4	7
Wales	**126.1**	**2**	102.2	2
West Midlands	**374.6**	**6**	272.7	5
Yorks and Humberside	**125.8**	**2**	97.7	2
Total mortgages before provisions	**6,065.4**	**100**	4,903.2	100
Personal loans	**1.1**		9.4	
Total loans before provisions	**6,066.5**		4,912.6	

Credit risk – Loans and advances to credit institutions and investment securities
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 £710.7m (2016: £678.8m).

Notes to the Financial Statements continued

For the year ended 31 December 2017

37. Risk management continued

The following table presents the credit quality of the Group's assets exposed to credit risk. The Group mainly uses external credit ratings provided by Fitch, Moody's or Standard & Poor's.

	Group					
As at 31-Dec-17	**AAA £m**	**AA £m**	**A+ £m**	**A £m**	**Less than A rating £m**	**Total £m**
Bank of England[1]	**–**	**1,146.9**	**–**	**–**	**–**	**1,146.9**
Call accounts	**–**	**0.2**	**–**	**11.0**	**29.1**	**40.3**
Floating rate notes	**19.1**	**–**	**–**	**–**	**–**	**19.1**
Total	**19.1**	**1,147.1**	**–**	**11.0**	**29.1**	**1,206.3**
As at 31-Dec-16						
Bank of England[1]	–	401.0	–	–	–	401.0
Call accounts	–	1.5	0.5	4.4	10.4	16.8
Floating rate notes	29.1	–	–	–	–	29.1
Treasury bills	–	112.6	–	–	–	112.6
Total	29.1	515.1	0.5	4.4	10.4	559.5

	Bank					
As at 31-Dec-17	**AAA £m**	**AA £m**	**A+ £m**	**A £m**	**Less than A rating £m**	**Total £m**
Bank of England[1]	**–**	**1,146.9**	**–**	**–**	**–**	**1,146.9**
Call accounts	**–**	**0.2**	**–**	**11.0**	**21.2**	**32.4**
Floating rate notes	**19.1**	**–**	**–**	**–**	**–**	**19.1**
Total	**19.1**	**1,147.1**	**–**	**11.0**	**21.2**	**1,198.4**
As at 31-Dec-16						
Bank of England[1]	–	401.0	–	–	–	401.0
Call accounts	–	1.5	0.5	4.4	6.1	12.5
Floating rate notes	29.1	–	–	–	–	29.1
Treasury bills	–	112.6	–	–	–	112.6
Total	29.1	515.1	0.5	4.4	6.1	555.2

The below tables show the industry sector and asset class of the Group's loans and advances to credit institutions and investment securities:

	Group As at 31-Dec-17		Group As at 31-Dec-16	
	£m	**%**	£m	%
Bank of England[1]	**1,146.9**	**95**	401.0	72
Other banks	**40.3**	**3**	16.8	3
Central government	**–**	**–**	112.6	20
Supranationals	**19.1**	**2**	29.1	5
Total	**1,206.3**	**100**	559.5	100

	Bank As at 31-Dec-17		Bank As at 31-Dec-16	
	£m	**%**	£m	%
Bank of England[1]	**1,146.9**	**96**	401.0	73
Other banks	**32.4**	**3**	12.5	2
Central government	**–**	**–**	112.6	20
Supranationals	**19.1**	**1**	29.1	5
Total	**1,198.4**	**100**	555.2	100

1. Balances with the Bank of England include £10.0m (2016: £9.1m) held in the cash ratio deposit.

The below tables show the geographical exposure of the Group's loans and advances to credit institutions and investment securities:

	Group As at 31-Dec-17		Group As at 31-Dec-16	
	£m	**%**	£m	%
United Kingdom	**1,181.0**	**98**	525.6	94
Rest of Europe	**19.1**	**2**	29.1	5
Canada	**0.2**	**–**	1.5	–
India	**6.0**	**–**	3.3	1
Total	**1,206.3**	**100**	559.5	100

	Bank As at 31-Dec-17		Bank As at 31-Dec-16	
	£m	**%**	£m	%
United Kingdom	**1,179.1**	**98**	524.6	95
Rest of Europe	**19.1**	**2**	29.1	5
Canada	**0.2**	**–**	1.5	–
Total	**1,198.4**	**100**	555.2	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 has established a call account with the Bank of England and has access to its contingent liquidity facilities.

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 27 to 33.

The Group also monitors a range of numeric triggers, defined in the contingency funding plan and recovery and resolution plan, 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 CRO, CEO, CFO and Head of Treasury.

Notes to the Financial Statements continued

For the year ended 31 December 2017

37. Risk management continued

Liquidity risk – contractual cash flows

The following tables provide an analysis of the Group's gross contractual cash flows, derived using interest rates and contractual maturities at the reporting date and excluding impacts of early payments or non-payments:

Group As at 31-Dec-17	Carrying amount £m	Gross inflow/ outflow £m	Up to 3 months £m	3–12 months £m	1–5 years £m	More than 5 years £m
Financial liability by type						
Amounts owed to retail depositors	**6,650.3**	**6,877.4**	**2,927.1**	**2,723.0**	**1,227.3**	**–**
Amounts owed to credit institutions and other customers	**1,276.0**	**1,296.5**	**1.9**	**29.5**	**1,265.1**	**–**
Derivative liabilities	**21.8**	**21.7**	**1.2**	**4.8**	**8.2**	**7.5**
Subordinated liabilities	**10.9**	**13.9**	**0.2**	**0.5**	**7.5**	**5.7**
Perpetual Subordinated Bonds	**15.3**	**19.4**	**0.4**	**0.4**	**3.6**	**15.0**
Total liabilities	**7,974.3**	**8,228.9**	**2,930.8**	**2,758.2**	**2,511.7**	**28.2**
Off balance sheet loan commitments	**530.2**	**530.2**	**530.2**	**–**	**–**	**–**
Financial asset by type						
Cash in hand	**0.5**	**0.5**	**0.5**	**–**	**–**	**–**
Loans and advances to credit institutions	**1,187.2**	**1,187.2**	**1,177.2**	**–**	**–**	**10.0**
Investment securities	**19.1**	**19.1**	**–**	**0.1**	**19.0**	**–**
Loans and advances to customers	**7,306.0**	**14,732.0**	**257.6**	**545.9**	**2,130.4**	**11,798.1**
Derivative assets	**6.1**	**6.1**	**–**	**(0.1)**	**6.2**	**–**
Total assets	**8,518.9**	**15,944.9**	**1,435.3**	**545.9**	**2,155.6**	**11,808.1**

Group As at 31-Dec-16	Carrying amount £m	Gross inflow/ outflow £m	Up to 3 months £m	3–12 months £m	1–5 years £m	More than 5 years £m
Financial liability by type						
Amounts owed to retail depositors	5,952.4	6,093.7	2,648.9	2,026.0	1,418.8	–
Amounts owed to credit institutions and other customers	105.7	106.6	4.6	0.2	101.8	–
Derivative liabilities	24.4	25.6	1.3	4.9	9.9	9.5
Subordinated liabilities	21.6	25.6	3.0	8.6	7.2	6.8
Perpetual Subordinated Bonds	15.3	19.4	0.4	0.4	3.6	15.0
Total liabilities	6,119.4	6,270.9	2,658.2	2,040.1	1,541.3	31.3
Off balance sheet loan commitments	365.4	365.4	365.4	–	–	–
Financial asset by type						
Cash in hand	0.4	0.4	0.4	–	–	–
Loans and advances to credit institutions	417.8	417.8	408.7	–	–	9.1
Investment securities	141.7	142.0	82.7	40.1	19.2	–
Loans and advances to customers	5,939.2	11,173.8	127.4	602.0	1,686.1	8,758.3
Derivative assets	1.8	2.0	0.6	1.0	0.4	–
Total assets	6,500.9	11,736.0	619.8	643.1	1,705.7	8,767.4

Bank As at 31-Dec-17	Carrying amount £m	Gross inflow/ outflow £m	Up to 3 months £m	3–12 months £m	1–5 years £m	More than 5 years £m
Financial liability by type						
Amounts owed to retail depositors	**6,650.3**	**6,877.4**	**2,927.1**	**2,723.0**	**1,227.3**	**–**
Amounts owed to credit institutions and other customers	**1,276.0**	**1,296.5**	**1.9**	**29.5**	**1,265.1**	**–**
Derivative liabilities	**21.8**	**21.7**	**1.2**	**4.8**	**8.2**	**7.5**
Subordinated liabilities	**10.9**	**13.9**	**0.2**	**0.5**	**7.5**	**5.7**
Perpetual Subordinated Bonds	**15.3**	**19.4**	**0.4**	**0.4**	**3.6**	**15.0**
Total liabilities	**7,974.3**	**8,228.9**	**2,930.8**	**2,758.2**	**2,511.7**	**28.2**
Off balance sheet loan commitments	**434.8**	**434.8**	**434.8**	**–**	**–**	**–**
Financial asset by type						
Cash in hand	**0.5**	**0.5**	**0.5**	**–**	**–**	**–**
Loans and advances to credit institutions	**1,179.3**	**1,179.3**	**1,169.3**	**–**	**–**	**10.0**
Investment securities	**19.1**	**19.1**	**–**	**0.1**	**19.0**	**–**
Loans and advances to customers	**6,051.0**	**12,668.8**	**203.1**	**411.8**	**1,649.1**	**10,404.8**
Derivative assets	**6.1**	**6.1**	**–**	**(0.1)**	**6.2**	**–**
Total assets	**7,256.0**	**13,873.8**	**1,372.9**	**411.8**	**1,674.3**	**10,414.8**

Bank As at 31-Dec-16	Carrying amount £m	Gross inflow/ outflow £m	Up to 3 months £m	3–12 months £m	1–5 years £m	More than 5 years £m
Financial liability by type						
Amounts owed to retail depositors	5,952.4	6,093.7	2,648.9	2,026.0	1,418.8	–
Amounts owed to credit institutions and other customers	105.7	106.6	4.6	0.2	101.8	–
Derivative liabilities	24.4	25.6	1.3	4.9	9.9	9.5
Subordinated liabilities	21.6	25.6	3.0	8.6	7.2	6.8
Perpetual Subordinated Bonds	15.3	19.4	0.4	0.4	3.6	15.0
Total liabilities	6,119.4	6,270.9	2,658.2	2,040.1	1,541.3	31.3
Off balance sheet loan commitments	297.2	297.2	297.2	–	–	–
Financial asset by type						
Cash in hand	0.4	0.4	0.4	–	–	–
Loans and advances to credit institutions	413.5	413.5	404.4	–	–	9.1
Investment securities	141.7	142.0	82.7	40.1	19.2	–
Loans and advances to customers	4,893.5	9,439.1	93.1	505.7	1,295.9	7,544.4
Derivative assets	1.8	2.0	0.6	1.0	0.4	–
Total assets	5,450.9	9,997.0	581.2	546.8	1,315.5	7,553.5

The actual repayment profile of retail deposits may differ from the analysis above due to the option of early withdrawal with a penalty.

The actual repayment profile of loans and advances to customers may differ from the analysis above since many mortgage loans are repaid early.

Notes to the Financial Statements continued
For the year ended 31 December 2017

37. Risk management continued
Liquidity risk – asset encumbrance
Asset encumbrance levels are monitored monthly at ALCO. The following tables provide an analysis of the Group's encumbered and unencumbered assets:

	Group As at 31-Dec-17				
	Encumbered		Unencumbered		
	Pledged as collateral £m	Other[1] £m	Available as collateral £m	Other[2] £m	Total £m
Cash in hand	–	–	0.5	–	0.5
Loans and advances to credit institutions	11.8	10.0	1,136.9	28.5	1,187.2
Investment securities	–	–	19.1	–	19.1
Loans and advances to customers	2,303.2	28.9	–	4,973.9	7,306.0
Derivative assets	–	–	–	6.1	6.1
Non-financial assets	–	–	–	70.2	70.2
	2,315.0	38.9	1,156.5	5,078.7	8,589.1

	Group As at 31-Dec-16				
	Encumbered		Unencumbered		
	Pledged as collateral £m	Other[1] £m	Available as collateral £m	Other[2] £m	Total £m
Cash in hand	–	–	0.4	–	0.4
Loans and advances to credit institutions	6.4	9.1	391.9	10.4	417.8
Investment securities	–	–	141.7	–	141.7
Loans and advances to customers	1,413.9	32.0	–	4,493.3	5,939.2
Derivative assets	–	–	–	1.8	1.8
Non-financial assets	–	–	–	80.0	80.0
	1,420.3	41.1	534.0	4,585.5	6,580.9

	Bank As at 31-Dec-17				
	Encumbered		Unencumbered		
	Pledged as collateral £m	Other[1] £m	Available as collateral £m	Other[2] £m	Total £m
Cash in hand	–	–	0.5	–	0.5
Loans and advances to credit institutions	11.8	10.0	1,136.9	20.6	1,179.3
Investment securities	–	–	19.1	–	19.1
Loans and advances to customers	2,303.2	28.9	–	3,718.9	6,051.0
Derivative assets	–	–	–	6.1	6.1
Non-financial assets	–	–	–	1,254.9	1,254.9
	2,315.0	38.9	1,156.5	5,000.5	8,510.9

	Bank As at 31-Dec-16				
	Encumbered		Unencumbered		
	Pledged as collateral £m	Other[1] £m	Available as collateral £m	Other[2] £m	Total £m
Cash in hand	–	–	0.4	–	0.4
Loans and advances to credit institutions	6.4	9.1	391.8	6.2	413.5
Investment securities	–	–	141.7	–	141.7
Loans and advances to customers	1,413.9	32.0	–	3,447.6	4,893.5
Derivative assets	–	–	–	1.8	1.8
Non-financial assets	–	–	–	1,049.5	1,049.5
	1,420.3	41.1	533.9	4,505.1	6,500.4

1. Represents assets that are not pledged but that the Group believes it is restricted from using to secure funding for legal or other reasons.
2. Represents assets that are not restricted for use as collateral, but the Group treats as available as collateral once they are readily available to secure funding in the normal course of business.

Liquidity risk – liquidity reserves
The following tables analyse the Group's liquidity reserves:

	Group As at 31-Dec-17		Group As at 31-Dec-16	
	Carrying amount £m	Fair value £m	Carrying amount £m	Fair value £m
Unencumbered balances with central banks	**1,136.9**	**1,136.9**	391.9	391.9
Unencumbered cash and balances with other banks	**28.5**	**28.5**	10.4	10.4
Other cash and cash equivalents	**0.5**	**0.5**	0.4	0.4
Unencumbered investment securities	**19.1**	**19.1**	141.7	141.7
Off balance sheet securities under FLS	**–**	**–**	524.6	524.6
	1,185.0	**1,185.0**	1,069.0	1,069.0

	Bank As at 31-Dec-17		Bank As at 31-Dec-16	
	Carrying amount £m	Fair value £m	Carrying amount £m	Fair value £m
Unencumbered balances with central banks	**1,136.9**	**1,136.9**	391.8	391.8
Unencumbered cash and balances with other banks	**20.6**	**20.6**	6.2	6.2
Other cash and cash equivalents	**0.4**	**0.4**	0.4	0.4
Unencumbered investment securities	**19.1**	**19.1**	141.7	141.7
Off balance sheet securities under FLS	**–**	**–**	524.6	524.6
	1,177.0	**1,177.0**	1,064.7	1,064.7

Market risk
Market risk is the risk of an adverse change in the Group's 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.

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. Exposure is mitigated on a continuous basis through the use of derivatives and reserve allocations within limits set by the ALCO and the Board (1.5% of CET1 as at 31 December 2017).

The Group measures interest rate risk using 14 different interest rate curve shift scenarios designed to emulate a full range of market movements. These 14 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. After taking into account the derivatives entered into by the Group, the maximum loss under these scenarios as at 31 December 2017 would have been £3.2m (2016: £1.9m) and the maximum gain £1.2m (2016: £2.1m). Against a parallel interest rate increase of 2%, the impact would have been a £2.8m loss (2016: £3.9m gain) in profit or loss.

The interest rate sensitivity is impacted by behavioural assumptions used by the Group, the most significant of which are prepayments and reserve allocations. Expected prepayments are modelled based on historical analysis and current market rates. The reserve allocation strategy is approved by Risk Committee and set to reflect the current balance sheet and future plans.

There is no material difference between the interest rate risk profile for the Group and that for the Bank.

Foreign exchange rate risk
The Group has limited exposure to foreign exchange risk in respect of its Indian operations. A 5% movement in exchange rates would result in £0.1m (2016: £0.1m) effect in profit or loss and £0.3m (2016: £0.2m) in equity.

The Bank is not exposed to foreign exchange risk since all its assets and liabilities are denominated in Pounds Sterling.

Structured entities
The Group had no structured entities as at 31 December 2017 and as at 31 December 2016.

Notes to the Financial Statements continued

For the year ended 31 December 2017

38. Financial instruments and fair values

i. Financial assets and financial liabilities

The following tables summarise the classification and carrying value of the Group's financial assets and financial liabilities:

		Group As at 31-Dec-17				
	Note	Fair value through profit or loss £m	Available-for-sale £m	Loans and receivables £m	Amortised cost £m	Total carrying amount £m
Assets						
Cash in hand		–	–	0.5	–	0.5
Loans and advances to credit institutions	15	–	–	1,187.2	–	1,187.2
Investment securities	16	–	19.1	–	–	19.1
Loans and advances to customers	17	–	–	7,306.0	–	7,306.0
Derivative assets	20	6.1	–	–	–	6.1
		6.1	19.1	8,493.7	–	8,518.9
Liabilities						
Amounts owed to retail depositors	27	–	–	–	6,650.3	6,650.3
Amounts owed to credit institutions	28	–	–	–	1,250.3	1,250.3
Amounts owed to other customers	29	–	–	–	25.7	25.7
Derivative liabilities	20	21.8	–	–	–	21.8
Subordinated liabilities	32	–	–	–	10.9	10.9
Perpetual Subordinated Bonds	33	–	–	–	15.3	15.3
		21.8	–	–	7,952.5	7,974.3

		Group As at 31-Dec-16				
	Note	Fair value through profit or loss £m	Available-for-sale £m	Loans and receivables £m	Amortised cost £m	Total carrying amount £m
Assets						
Cash in hand		–	–	0.4	–	0.4
Loans and advances to credit institutions	15	–	–	417.8	–	417.8
Investment securities	16	–	141.7	–	–	141.7
Loans and advances to customers	17	–	–	5,939.2	–	5,939.2
Derivative assets	20	1.8	–	–	–	1.8
		1.8	141.7	6,357.4	–	6,500.9
Liabilities						
Amounts owed to retail depositors	27	–	–	–	5,952.4	5,952.4
Amounts owed to credit institutions	28	–	–	–	101.7	101.7
Amounts owed to other customers	29	–	–	–	4.0	4.0
Derivative liabilities	20	24.4	–	–	–	24.4
Subordinated liabilities	32	–	–	–	21.6	21.6
Perpetual Subordinated Bonds	33	–	–	–	15.3	15.3
		24.4	–	–	6,095.0	6,119.4

	Note	Bank As at 31-Dec-17 Fair value through profit or loss £m	Available-for-sale £m	Loans and receivables £m	Amortised cost £m	Total carrying amount £m
Assets						
Cash in hand		–	–	0.5	–	0.5
Loans and advances to credit institutions	15	–	–	1,179.3	–	1,179.3
Investment securities	16	–	19.1	–	–	19.1
Loans and advances to customers	17	–	–	6,051.0	–	6,051.0
Derivative assets	20	6.1	–	–	–	6.1
		6.1	19.1	7,230.8	–	7,256.0
Liabilities						
Amounts owed to retail depositors	27	–	–	–	6,650.3	6,650.3
Amounts owed to credit institutions	28	–	–	–	1,250.3	1,250.3
Amounts owed to other customers	29	–	–	–	25.7	25.7
Derivative liabilities	20	21.8	–	–	–	21.8
Subordinated liabilities	32	–	–	–	10.9	10.9
Perpetual Subordinated Bonds	33	–	–	–	15.3	15.3
		21.8	–	–	7,952.5	7,974.3

	Note	Bank As at 31-Dec-16 Fair value through profit or loss £m	Available-for-sale £m	Loans and receivables £m	Amortised cost £m	Total carrying amount £m
Assets						
Cash in hand		–	–	0.4	–	0.4
Loans and advances to credit institutions	15	–	–	413.5	–	413.5
Investment securities	16	–	141.7	–	–	141.7
Loans and advances to customers	17	–	–	4,893.5	–	4,893.5
Derivative assets	20	1.8	–	–	–	1.8
		1.8	141.7	5,307.4	–	5,450.9
Liabilities						
Amounts owed to retail depositors	27	–	–	–	5,952.4	5,952.4
Amounts owed to credit institutions	28	–	–	–	101.7	101.7
Amounts owed to other customers	29	–	–	–	4.0	4.0
Derivative liabilities	20	24.4	–	–	–	24.4
Subordinated liabilities	32	–	–	–	21.6	21.6
Perpetual Subordinated Bonds	33	–	–	–	15.3	15.3
		24.4	–	–	6,095.0	6,119.4

The Group has no financial assets nor financial liabilities classified as held for trading or held to maturity.

Notes to the Financial Statements continued
For the year ended 31 December 2017

38. Financial instruments and fair values continued
ii. Fair values
The following tables summarise the carrying value and estimated fair value of financial instruments not measured at fair value in the statement of financial position:

	Group As at 31-Dec-17		Group As at 31-Dec-16	
	Carrying value £m	Estimated fair value £m	Carrying value £m	Estimated fair value £m
Assets				
Cash in hand	**0.5**	**0.5**	0.4	0.4
Loans and advances to credit institutions	**1,187.2**	**1,187.2**	417.8	417.8
Loans and advances to customers	**7,306.0**	**7,715.4**	5,939.2	6,259.1
	8,493.7	**8,903.1**	6,357.4	6,677.3
Liabilities				
Amounts owed to retail depositors	**6,650.3**	**6,684.0**	5,952.4	5,992.4
Amounts owed to credit institutions	**1,250.3**	**1,250.3**	101.7	101.7
Amounts owed to other customers	**25.7**	**25.7**	4.0	4.0
Subordinated liabilities	**10.9**	**11.1**	21.6	24.0
Perpetual Subordinated Bonds	**15.3**	**15.3**	15.3	14.4
	7,952.5	**7,986.4**	6,095.0	6,136.5

	Bank As at 31-Dec-17		Bank As at 31-Dec-16	
	Carrying value £m	Estimated fair value £m	Carrying value £m	Estimated fair value £m
Assets				
Cash in hand	**0.5**	**0.5**	0.4	0.4
Loans and advances to credit institutions	**1,179.3**	**1,179.3**	413.5	413.5
Loans and advances to customers	**6,051.0**	**6,408.4**	4,893.5	5,167.7
	7,230.8	**7,588.2**	5,307.4	5,581.6
Liabilities				
Amounts owed to retail depositors	**6,650.3**	**6,684.0**	5,952.4	5,992.4
Amounts owed to credit institutions	**1,250.3**	**1,250.3**	101.7	101.7
Amounts owed to other customers	**25.7**	**25.7**	4.0	4.0
Subordinated liabilities	**10.9**	**11.1**	21.6	24.0
Perpetual Subordinated Bonds	**15.3**	**15.3**	15.3	14.4
	7,952.5	**7,986.4**	6,095.0	6,136.5

The fair values in this table are estimated using the valuation techniques below. The estimated fair value is stated as at 31 December and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of each financial instrument.

Cash in hand
This represents physical cash across the Group's branch network where fair value is considered to be equal to carrying value.

Loans and advances to credit institutions
This mainly represents the Group's working capital current accounts and call accounts with central governments and other banks with an original maturity of less than three months. Fair value is not considered to be materially different to carrying value.

Loans and advances to customers
This mainly represents secured mortgage lending to customers. The fair value of fixed rate and tracker mortgages have been estimated by using system generated calculations based on known cash flow dates and interest rates and expected future interest rates extrapolated from an input zero coupon 24 point yield curve. The interest rate on variable rate mortgages is considered to be equal to current market product rates and as such fair value is estimated to be equal to carrying value.

Amounts owed to retail depositors
The fair value of fixed rate retail deposits has been estimated using system generated calculations based on known cash flow dates and interest rates and expected future interest rates extrapolated from a input zero coupon 24 point yield curve. Retail deposits at variable rates and deposits payable on demand are considered to be at current market rates and as such fair value is estimated to be equal to carrying value.

Amounts owed to credit institutions
This mainly represents amounts drawn down under the Bank of England TFS. Fair value is considered to be equal to carrying value.

Amounts owed to other customers
This represents fixed rate saving products to corporations and local authorities with original maturities greater than three months. The fair value is estimated using system generated calculations based on known cash flow dates and interest rates and expected future interest rates extrapolated from an input zero coupon 24 point yield curve.

Subordinated liabilities and Perpetual Subordinated Bonds
The fair value of subordinated liabilities is estimated using system generated calculations based on known cash flow dates and interest rates and expected future interest rates extrapolated from an input zero coupon 24 point yield curve. The PSBs are listed on the London Stock Exchange with fair value being the quoted market price at the reporting date.

iii. Fair value classification
The following tables provide an analysis of financial assets and financial liabilities measured at fair value on the statement of financial position grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

Group and Bank As at 31-Dec-17	**Carrying amount £m**	**Principal amount £m**	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Financial assets						
Investment securities	**19.1**	**19.0**	**19.1**	**–**	**–**	**19.1**
Derivative assets	**6.1**	**1,636.1**	**–**	**6.1**	**–**	**6.1**
	25.2	**1,655.1**	**19.1**	**6.1**	**–**	**25.2**
Financial liabilities						
Derivative liabilities	**21.8**	**(2,493.9)**	**–**	**21.8**	**–**	**21.8**

Group and Bank As at 31-Dec-16	Carrying amount £m	Principal amount £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets						
Investment securities	141.7	141.6	141.7	–	–	141.7
Derivative assets	1.8	2,267.1	–	1.8	–	1.8
	143.5	2,408.7	141.7	1.8	–	143.5
Financial liabilities						
Derivative liabilities	24.4	(612.4)	–	24.4	–	24.4

Level 1: Fair values that are based entirely on quoted market prices (unadjusted) in an actively traded market for identical assets and liabilities that the Group has the ability to access. Valuation adjustments and block discounts are not applied to level 1 instruments. Since valuations are based on readily available observable market prices, this makes them most reliable, reduces the need for management judgement and estimation and also reduces the uncertainty associated with determining fair values.

Level 2: Fair values that are based on one or more quoted prices in markets that are not active or for which all significant inputs are taken from directly or indirectly 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.

Level 3: Fair values for which any one or more significant input is not based on observable market data and the unobservable inputs have a significant effect on the instruments fair value. Valuation models that employ significant unobservable inputs require a higher degree of management judgement and estimation in determining the fair value. Management judgement and estimation are usually required for the selection of the appropriate valuation model to be used, determination of expected future cash flows on the financial instruments being valued, determination of the probability of counterparty default and prepayments, determination of expected volatilities and correlations and the selection of appropriate discount rates.

Investment securities
The fair values of UK treasury bills and supranational bonds are based on quoted bid prices in active markets.

Notes to the Financial Statements continued

For the year ended 31 December 2017

38. Financial instruments and fair values continued

Derivatives

The Group uses LIBOR curves to value its derivatives; however, using OIS curves would not materially change their value.
The fair value of the Group's derivative financial instruments incorporates CVA and DVA. The DVA and CVA take into account the respective credit ratings of the Bank and counterparty and whether the derivative is collateralised or not. In considering which similar instruments to use, management takes into account the sensitivity of the instrument to changes in market rates and the credit quality of the instrument.

The following table provides an analysis of financial assets and financial liabilities not measured at fair value on the statement of financial position grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

Group As at 31-Dec-17	Carrying amount £m	Principal amount £m	Estimated fair value Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets						
Cash in hand	**0.5**	**0.5**	**–**	**0.5**	**–**	**0.5**
Loans and advances to credit institutions	**1,187.2**	**1,187.2**	**–**	**1,187.2**	**–**	**1,187.2**
Loans and advances to customers	**7,306.0**	**7,441.9**	**–**	**2,788.8**	**4,926.6**	**7,715.4**
	8,493.7	**8,629.6**	**–**	**3,976.5**	**4,926.6**	**8,903.1**
Financial liabilities						
Amounts owed to retail depositors	**6,650.3**	**6,610.1**	**–**	**2,474.4**	**4,209.6**	**6,684.0**
Amounts owed to credit institutions	**1,250.3**	**1,250.3**	**–**	**1,250.3**	**–**	**1,250.3**
Amounts owed to other customers	**25.7**	**25.5**	**–**	**–**	**25.7**	**25.7**
Subordinated liabilities	**10.9**	**10.7**	**–**	**11.1**	**–**	**11.1**
Perpetual Subordinated Bonds	**15.3**	**15.0**	**15.3**	**–**	**–**	**15.3**
	7,952.5	**7,911.6**	**15.3**	**3,735.8**	**4,235.3**	**7,986.4**

Group As at 31-Dec-16	Carrying amount £m	Principal amount £m	Estimated fair value (Restated) Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets						
Cash in hand	0.4	0.4	–	0.4	–	0.4
Loans and advances to credit institutions	417.8	417.8	–	417.8	–	417.8
Loans and advances to customers[1]	5,939.2	6,069.4	–	2,508.4	3,750.7	6,259.1
	6,357.4	6,487.6	–	2,926.6	3,750.7	6,677.3
Financial liabilities						
Amounts owed to retail depositors[1]	5,952.4	5,906.5	–	2,275.9	3,716.5	5,992.4
Amounts owed to credit institutions	101.7	101.6	–	101.7	–	101.7
Amounts owed to other customers[1]	4.0	4.0	–	–	4.0	4.0
Subordinated liabilities	21.6	20.7	–	24.0	–	24.0
Perpetual Subordinated Bonds[2]	15.3	15.0	14.4	–	–	14.4
	6,095.0	6,047.8	14.4	2,401.6	3,720.5	6,136.5

1. The fair values for prior year comparatives have been reclassified to disclose the different valuation techniques used when assessing fair value is equal to carrying value (Level 2) and where system generated calculations are used to estimate fair value (Level 3).
2. The fair value for prior year comparatives for PSBs has been restated to use quoted market prices.

Bank As at 31-Dec-17	Carrying amount £m	Principal amount £m	Estimated fair value Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets						
Cash in hand	**0.5**	**0.5**	**–**	**0.5**	**–**	**0.5**
Loans and advances to credit institutions	**1,179.3**	**1,179.3**	**–**	**1,179.3**	**–**	**1,179.3**
Loans and advances to customers	**6,051.0**	**6,177.1**	**–**	**2,653.3**	**3,755.1**	**6,408.4**
	7,230.8	**7,356.9**	**–**	**3,833.1**	**3,755.1**	**7,588.2**
Financial liabilities						
Amounts owed to retail depositors	**6,650.3**	**6,610.1**	**–**	**2,474.4**	**4,209.6**	**6,684.0**
Amounts owed to credit institutions	**1,250.3**	**1,250.3**	**–**	**1,250.3**	**–**	**1,250.3**
Amounts owed to other customers	**25.7**	**25.5**	**–**	**–**	**25.7**	**25.7**
Subordinated liabilities	**10.9**	**10.7**	**–**	**11.1**	**–**	**11.1**
Perpetual Subordinated Bonds	**15.3**	**15.0**	**15.3**	**–**	**–**	**15.3**
	7,952.5	**7,911.6**	**15.3**	**3,735.8**	**4,235.3**	**7,986.4**

Bank As at 31-Dec-16	Carrying amount £m	Principal amount £m	Estimated fair value (Restated) Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets						
Cash in hand	0.4	0.4	–	0.4	–	0.4
Loans and advances to credit institutions	413.5	413.5	–	413.5	–	413.5
Loans and advances to customers[1]	4,893.5	5,015.0	–	2,370.8	2,796.9	5,167.7
	5,307.4	5,428.9	–	2,784.7	2,796.9	5,581.6
Financial liabilities						
Amounts owed to retail depositors[1]	5,952.4	5,906.5	–	2,275.9	3,716.5	5,992.4
Amounts owed to credit institutions	101.7	101.6	–	101.7	–	101.7
Amounts owed to other customers[1]	4.0	4.0	–	–	4.0	4.0
Subordinated liabilities	21.6	20.7	–	24.0	–	24.0
Perpetual Subordinated Bonds[2]	15.3	15.0	14.4	–	–	14.4
	6,095.0	6,047.8	14.4	2,401.6	3,720.5	6,136.5

1. The fair values for prior year comparatives have been reclassified to disclose the different valuation techniques used when assessing fair value is equal to carrying value (Level 2) and where system generated calculations are used to estimate fair value (Level 3).
2. The fair value for prior year comparatives for PSBs has been restated to use quoted market prices.

39. 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 £1.3m (2016: £1.1m).

Defined benefit scheme

Kent Reliance Building Society (the 'Society') 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 for 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 2017, the liability to remaining members is £2k (31 December 2016: £2k) matched by Scheme assets.

40. Capital management

The Group's prime objectives in relation to the management of capital are to provide a sufficient capital base to cover business risks and support future business development. The Group is compliant with the requirements set out by the PRA, the Group's primary prudential supervisor.

Capital management is based on the three 'pillars' of Basel II. Under Pillar 1, the Group calculates its minimum capital requirements based on 8% of risk weighted assets. The PRA then applies a multiplier to this amount to cover risks under Pillar 2 of Basel II and generates an individual capital guidance ('ICG'). The Group manages and reports its capital on a solo consolidated basis and hence the Bank's capital position is not disclosed separately.

Notes to the Financial Statements continued

For the year ended 31 December 2017

40. Capital management continued

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.

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.

The ultimate responsibility for capital adequacy rests with the Board of Directors. The Group's ALCO, which consists of the CEO, CFO 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 Group 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, forecasts and strategic plans with initiatives being executed against this plan.

The Group's regulatory capital consists of the sum of the following elements:

- Tier 1 capital comprises of CET1 capital and Additional Tier 1 ('AT1') capital, calculated on a solo consolidation basis. The CET1 capital is made up of share capital, share premium, retained earnings (net of foreseeable dividends), capital contribution reserve, share-based payment reserve, transfer reserve, foreign exchange reserve and AFS reserve. The AT1 capital is made up of issued AT1 securities. Deductions from Tier 1 capital are intangible assets and deferred tax assets subject to future profitability.
- Tier 2 capital comprises of PSBs, dated subordinated debt and general credit risk adjustments. The dated subordinated debt is reduced for amortisation when within five years of maturity or under the Capital Requirements Regulation ('CRR') grandfathering rules.

The Group's Pillar 1 capital information is presented below:

	As at 31-Dec-17 £m	As at 31-Dec-16 £m
Common equity tier 1 capital		
Called up share capital	**2.4**	2.4
Share premium, capital contribution and share-based payment reserve	**169.8**	166.0
Retained earnings	**337.5**	240.7
Transfer reserve	**(12.8)**	(12.8)
Other reserves	**(0.1)**	0.1
Total equity excluding equity bonds	**496.8**	396.4
Foreseeable dividends	**(22.6)**	(18.5)
Solo consolidation adjustments[1]	**(4.8)**	(5.3)
Deductions from common equity tier 1 capital		
Intangible assets	**(6.8)**	(4.7)
Deferred tax asset	**(2.5)**	(2.3)
Common equity tier 1 capital	**460.1**	365.6
Additional tier 1 capital		
AT1 securities	**60.0**	–
Total tier 1 capital	**520.1**	365.6
Tier 2 capital		
Subordinated debt and PSBs	**47.7**	48.5
Collective provisions	**2.0**	1.6
Deductions from tier 2 capital	**(2.5)**	(2.0)
Total tier 2 capital	**47.2**	48.1
Total regulatory capital	**567.3**	413.7
Risk weighted assets (unaudited)	**3,348.5**	2,743.0

1. The Bank has solo consolidation waivers for most of its subsidiaries. The equity for unconsolidated entities has been removed from CET1.

41. Operating segments

From 1 January 2017, the Group distinguishes two segments within its operations (see note 1e for additional information):

1. BTL/SME; secured lending on property for investment and commercial purposes, and
2. Residential mortgages; lending to customers who live in their own homes, secured either via first or second charges against the residential home.

The financial position and results of operations of the above segments are summarised below:

Year ended 31-Dec-17	BTL/SME £m	Residential mortgages £m	Total £m
Balances at the reporting date			
Gross loans and advances to customers	5,654.1	1,673.5	7,327.6
Provision for impairment losses on loans and advances	(13.2)	(8.4)	(21.6)
Loans and advances to customers	5,640.9	1,665.1	7,306.0
Capital expenditure	11.0	3.3	14.3
Profit or loss for the period			
Net interest income	177.1	68.3	245.4
Other expense	(1.5)	(5.8)	(7.3)
Total income	175.6	62.5	238.1
Impairment losses	(0.8)	(3.6)	(4.4)
Contribution to profit	174.8	58.9	233.7
Operating expenses			(65.1)
FSCS and other provisions			(0.9)
Profit before taxation			167.7
Taxation			(40.8)
Profit for the year			126.9

Year ended 31-Dec-16	BTL/SME £m	Residential mortgages £m	Total £m
Balances at the reporting date			
Gross loans and advances to customers	4,104.3	1,859.9	5,964.2
Provision for impairment losses on loans and advances	(17.2)	(7.8)	(25.0)
Loans and advances to customers	4,087.1	1,852.1	5,939.2
Capital expenditure	5.3	2.4	7.7
Profit or loss for the period			
Net interest income	135.2	71.4	206.6
Other expense	(0.5)	(4.7)	(5.2)
Total income	134.7	66.7	201.4
Impairment losses	(1.8)	(7.2)	(9.0)
Contribution to profit	132.9	59.5	192.4
Operating expenses			(53.7)
FSCS and other provisions			(0.5)
Exceptional items			24.9
Profit before taxation			163.1
Taxation			(42.2)
Profit for the year			120.9

Notes to the Financial Statements continued

For the year ended 31 December 2017

42. Country by country reporting

Country by Country Reporting ('CBCR') was introduced through Article 89 of CRD IV, aimed at the banking and capital markets industry.

From 1 January 2015, 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; and
f) any public subsidies received.

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.

The name, nature of activities and geographic location of the Group's companies are presented below:

Jurisdiction	Country	Name	Activities
UK[1]	England	OneSavings Bank plc Easioption Limited Guernsey Home Loans Limited Heritable Development Finance Limited Interbay Group Holdings Limited Jersey Home Loans Limited Prestige Finance Limited Reliance Property Loans Limited Rochester Mortgages Limited 5D Finance Limited 5D Lending Ltd Interbay Funding, Ltd Inter Bay Financial I Limited Inter Bay Financial II Limited Interbay Holdings Ltd Interbay ML, Ltd	Commercial banking
	Guernsey	Guernsey Home Loans Limited	
	Jersey	Jersey Home Loans Limited	
India	India	OSB India Private Limited	Back office processing

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 are managed and controlled in the UK and have no permanent establishment in Guernsey or Jersey.

Other disclosures required by the CBCR directive are provided below:

2017	**UK**	**India**	**Consolidation**[2]	**Total**
Average number of employees	**483**	**330**	**–**	**813**
Turnover[1], £m	**238.0**	**5.4**	**(5.3)**	**238.1**
Profit/(loss) before tax, £m	**167.5**	**1.0**	**(0.8)**	**167.7**
Corporation tax paid, £m	**41.8**	**0.3**	**–**	**42.1**

2016	UK	India	Consolidation[2]	Total
Average number of employees	431	243	–	674
Turnover[1], £m	201.2	3.9	(3.7)	201.4
Profit/(loss) before tax, £m	162.9	1.0	(0.8)	163.1
Corporation tax paid, £m	29.4	0.2	–	29.6

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.

The tables below reconcile tax charged and tax paid during the year.

2017	UK £m	India £m	Total £m
Tax charge	**40.5**	**0.3**	**40.8**
Effects of:			
Other timing differences	**0.8**	**–**	**0.8**
Tax outside of profit or loss	**(1.2)**	**–**	**(1.2)**
Prior year tax paid during the year	**22.3**	**–**	**22.3**
Current year tax to be paid after the reporting date	**(20.6)**	**–**	**(20.6)**
Tax paid	**41.8**	**0.3**	**42.1**

2016	UK £m	India £m	Total £m
Tax charge	41.9	0.3	42.2
Effects of:			
Other timing differences	0.2	–	0.2
Tax outside of profit or loss	(0.3)	–	(0.3)
Prior year tax paid during the year	9.2	–	9.2
Current year tax to be paid after the reporting date	(21.6)	(0.1)	(21.7)
Tax paid	29.4	0.2	29.6

43. Events after the reporting date

There are no material events after the reporting date.

44. Controlling party

As at 31 December 2017, there was no controlling party of OSB. During 2017, OSB Holdco Limited reduced its interest in the Company and as at the balance sheet date no longer held a controlling interest. The Company maintained the Relationship Agreement with OSB Holdco Limited during 2017, as set out on page 69. OSB Holdco Limited is a company controlled by funds advised by J.C. Flowers & Co. LLC.

Glossary

AGM	Annual General Meeting
ALCO	Assets and Liabilities Committee
AT1	Additional Tier 1 Capital
BoE	Bank of England
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CRD IV	Capital Requirement Directive and Regulation
CRO	Chief Risk Officer
DSBP	Deferred Share Bonus Plan
EIR	Effective Interest Rate
EPS	Earnings Per Share
EU	European Union
FCA	Financial Conduct Authority
FLS	Funding for Lending Scheme
FRC	Financial Reporting Council
FSCS	Financial Services Compensation Scheme
FTSE	Financial Times Stock Exchange
HMRC	Her Majesty Revenue and Customs
HPI	House Price Inflation
HR	Human Resources
IAS	International Accounting Standards
ICAAP	Internal Capital Adequacy Assessment Process
ICR	Interest Coverage Ratio
IFRS	International Financial Reporting Standards
ILAAP	Individual Liquidity Adequacy Assessment Process
IPO	Initial Public Offering
IRB	Internal Ratings-Based Approach Bank
ISA	Individual Savings Account
KRPS	Kent Reliance Provident Society
LCR	Liquidity Coverage Ratio
LIBOR	London Inter Bank Offered Rate
LTIP	Long-Term Incentive Plan
LTV	Loan to value
MI	Management Information
NIM	Net Interest Margin
NPS	Net Promoter Score
ONS	Office for National Statistics
PRA	Prudential Regulatory Authority
PRS	Private Rented Sector
PSBs	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
SDLT	Stamp Duty Land Tax
SID	Senior Independent Director
SME	Small Medium Enterprises
SRMF	Strategic Risk Management Framework
TFS	Term Funding Scheme

Company information

Registered office and head office
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Registered in England no: 07312896
www.osb.co.uk

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Private shareholders are welcome to contact the Company Secretary if they have any questions or concerns they wish to be raised with the Board.

Savings Bank

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OneSavings Bank plc

ANNUAL REPORT AND ACCOUNTS **2017**