Experts in specialist lending

Annual Report and Accounts 2018

Contents

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, and a unique cost efficient operating model.

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

www.osb.co.uk

Key reads

Chief Executive Officer's statement

For more information go to page 14

Market review

For more information go to page 10

Our business model

For more information go to page 4

Chairman's statement

2018 was another successful year for OSB, as we continued to deliver growth in our chosen market segments.

This strong performance has enabled the Board to recommend a final dividend of 10.3 pence per share. If approved at the Annual General Meeting, this will take the full year dividend to 14.6 pence per share, an increase of 14% over 2017.

I am proud that we continue to make progress towards becoming our customers' favourite bank, improving our customer net promoter score from +62 to +63 for the year and we welcomed more than 40,000 new savers to our Kent Reliance franchise. In addition to our core lending segments, we identified and developed propositions in adjacent product areas and over time these will add some diversification to our balance sheet, as well as leverage the Group's core capabilities to grow our high quality secured lending portfolio.

Our relaunched Mission, Vision and Values (described in more detail on page 62) added focus to the efforts of our talented and dedicated people. I am particularly pleased to see this reflected in our entry into The Sunday Times Top 100 Best Companies to Work For, underpinned by a record 94% participation.

We added expertise to our Board and I am delighted to welcome Sarah Hedger as a Non-Executive Director of the Bank. Sarah brings a wealth of corporate finance experience and I look forward to working with her. I would also like to extend my personal thanks to Andrew Doman who stepped down from the Board in May 2018.

No chairman's report would be complete at the moment without highlighting the uncertain and inclement economic climate in which we operate, exacerbated by lack of clarity about the eventual Brexit outcome. However, I am confident that the combination of our engaged workforce, highly-focused executive team and committed Board will stand us in good stead. This, coupled with our focus on delivering value for our customers and a sensible approach to risk, means I am confident that OneSavings Bank will continue to deliver growth and strong returns for our owners.

David Weymouth
Non-Executive Chairman

Highlights

Gross new lending

+15%

2018: £3.0bn
2017: £2.6bn

Net loan book

+23%

2018: £9.0bn
2017: £7.3bn

Net interest margin

-12bps

2018: 304bps
2017: 316bps

Cost to income ratio

+1pp

2018: 28%
2017: 27%

Profit before tax

+10%

2018: £183.8m
2017: £167.7m

Underlying profit before tax

+15%

2018: £193.6m
2017: £167.7m

Basic EPS

+9%

2018: 55.5p
2017: 51.1p

Underlying basic EPS

+14%

2018: 58.5p
2017: 51.1p

Full year dividend per share

+14%

2018: 14.6p
2017: 12.8p

Fully-loaded Common Equity Tier 1 ratio

-0.4pp

2018: 13.3%
2017: 13.7%

For more information and definitions, see Key performance indicators on page 30.

Strategic report

OneSavings Bank's business model and 2018 operating and financial review

Key reads within this section:

Chief Executive's message
"Another excellent year for OneSavings Bank"

For more information go to page 14

Operating and financial review
"Delivering value for our stakeholders"

For more information go to page 24

Risk review
"Low and stable risk profile"

For more information go to page 36

Corporate responsibility report
"Putting customers at the heart of everything we do"

For more information go to page 52

Contents

Our business model

Our purpose is to enable our customers to achieve their personal and business goals by providing access to fair financial services.

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 and efficiency 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.

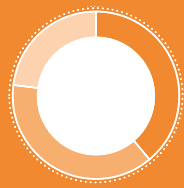
Financial
We have a strong CET1 ratio and proven capital generation capability to support significant loan book growth through profitability.

What we do

Attractive retail savings

Our key strengths
- Stable funding platform
- Customer focused
- Transparent, good value savings products

Our channels

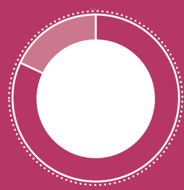


- Online 39%
- Direct 38%
- Branches 23%

Specialist lending business

Our key strengths
- Excellent loan performance
- Award-winning products
- Strong relationships with intermediaries

Our segments



- Buy-to-let/ SME lending 82%
- Residential 18%

Unique operating model

Our key strengths
- Integrated multi-brand approach
- Best-in-class customer service
- High employee retention rates
- OSBIndia

Cost to income ratio

- Ratio 28%

Underpinned by our core values

Stronger together

Aim high

Strategic priorities
- Provide a stable funding platform for the Bank to grow its loan book
- Maintain and build upon over 150 years of heritage in savings
- Deliver good and consistent value savings products

For more information go to page 18

Strategy in action
Customer satisfaction and retention
- Improved ISA transfer process leading to successful ISA season raising deposits at below our target cost of funds
- Increased bond retention to 95%[2] despite high profile competitor launches supported by significant marketing spend

Strategic priorities
- Be a leading specialist lender in our chosen markets
- Retain focus on bespoke and responsive underwriting
- Further deepen relationships and reputation for delivery with intermediaries

For more information go to page 18

Strategy in action
Exploring core and adjacent areas for growth
- Successfully launched InterBay asset finance targeting hard assets critical to businesses
- Successful pilot introduction of new residential product range

For more information go to page 21

Strategic priorities
- Deliver distribution, sales and risk processes under a coordinated structure
- Leverage our unique and cost efficient operating model
- Maintain an efficient, scalable and resilient infrastructure

For more information go to page 18

Strategy in action
OSBIndia – unique competitive advantage
- Excellent customer experience
- High customer Net Promoter Score
- Highly qualified and dedicated staff with market leading employee retention rate

For more information go to page 23

Take ownership

Create your future

For more information go to page 62

Outcomes and value creation

For shareholders

Underlying basic EPS[1]

58.5p

Dividend per share

14.6p

For customers

Customer NPS

+63

Customer retention[2]

95%

For intermediaries

Broker NPS

+28

For employees

Number of employees promoted in 2018

88

Number of learning events attended by employees in 2018

1,258

For communities

Sponsorship and donations

£260k

1. 25% of underlying profit after tax attributable to ordinary shareholders.
2. Retention is defined as average maturing fixed contractual retail deposits that remain with the Bank on their maturity date.

Our business model explained

Leveraging our unique business model to differentiate ourselves from competition, offering well-defined propositions in our chosen markets.

Attractive retail savings

Our retail savings brand

KentReliance

2018 balance by channel

Online	Direct	Branches
39%	38%	23%
2017: 36%	2017: 41%	2017: 23%

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.

Specialist lending business

Our Buy-to-Let/SME brands

KentReliance

InterBay Commercial

Heritable Development Finance

InterBay Asset Finance

2018 Buy-to-Let/SME

Net loans and advances	Gross new lending	Average book LTV at 31 December
£7.4bn	£2.8bn	70%
2017: £5.6bn	2017: £2.4bn	2017: 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.

Asset finance
We provide loans under hire purchase, leasing and refinancing arrangements to UK SMEs and small corporates to finance business-critical assets.

For further information about Buy-to-Let/SME segment, go to page 26.

Our residential mortgage brands

KentReliance Prestige Finance

2018 Residential mortgages

Net loans and advances	Gross new lending	Average book LTV at 31 December
£1.6bn	£0.3bn	56%
2017: £1.7bn	2017: £0.2bn	2017: 56%

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 further information about Residential segment, go to page 28.

Unique operating model

Our brand

osbIndia

OSBIndia ('OSBI') is a wholly-owned subsidiary based in Bangalore, India.

OSBI puts customer service at the heart of everything it does demonstrated by our excellent customer Net Promoter Score.

Various functions are supported by OSBI, including support services, operations, IT, finance and human resources.

We have a one team approach between the UK and India.

OSBI operates a fully paperless office – all data and processing are in the UK.

Relationships with our key stakeholders

Our vision is to become our customers' favourite bank; one that delivers its very best, challenges convention and opens doors that others can't.

Strong relationships with our stakeholders are fundamental to achieving this vision, and are central to the Bank's culture. We encourage effective and honest engagement from all of our people when dealing with stakeholders including customers, shareholders, business partners, colleagues, and the communities in which we operate.

Customers

We pride ourselves on delivering straightforward and transparent products and propositions to both our borrowers and our savers.

Our value 'Aim High' encourages us to keep our customers at the centre of everything we do. Every time a customer calls or interacts with the Bank we offer them the opportunity to let us know how we did. We listen to them and act upon what they tell us. Customer satisfaction is high and our customer Net Promoter Score increased to +63 which is testament to the outstanding customer service we provide.

We added over 40,000 new savings customers in the year and we pride ourselves on high retention rates for savings and borrowing customers.

"Our success depends on close relationships and effective engagement with our key stakeholders and upholding the values to which we operate.

Shareholders

OSB maintains an open dialogue with its shareholders and is recognised for its straightforward and uncomplicated approach.

Clear and comprehensive reporting is supported by the OSB Investor Relations team. Management is available for meetings with shareholders through investor roadshows, conferences and one to one meetings. These interactions provide us with direct feedback on the market and Bank-specific issues that interest our shareholders.

The Annual General Meeting is attended by the members of the Board and Management.

The Investor Relations team also maintains strong relationships with analysts and attends relevant conferences. In 2018, OSB met 130 individual investors.

The Group's results are available on our website at www.osb.co.uk/investors.

Intermediaries

Our straightforward lending proposition is based on our goal to make it easier for intermediaries to serve our borrowers. We continuously enhance relationships with our intermediaries through training and growing our team as the number of intermediaries grow. Our business development managers listen and work with intermediaries, making themselves available to discuss cases and helping to obtain swift and reliable decisions.

The OSB Sales team attended 170 intermediary events during 2018, interacting with brokers and keeping abreast of industry developments and intermediary requirements. The broker NPS score was +28 at the end of 2018.

Colleagues

Our experienced and dedicated colleagues work together to create a business in which we can all take pride and prosper. Our people are a key asset and our success depends on the talented individuals we employ.

In 2018, we reached a milestone of 1,000 employees across the UK and India. What our employees think is paramount to us and we regularly ask for their opinion in company-wide surveys. Responses from UK employees enabled us to enhance the working experience, resulting in the Bank being included for the first time in The Sunday Times 100 Best Companies to Work For in 2018. We take the same approach at OSBIndia, which was officially certified as a 'Great place to work' in 2018.

The Group also engages with employees via a new dedicated intranet site launched in 2018, regular newsletters and company-wide events, including the Mission, Vision and Values events, for more details, see page 62.

Communities

OSB cares about the communities in which it is based. Each year OSB engages with the people in the county of Kent taking part in a variety of charitable events and partnerships.

In 2018, the Bank raised £260,000 for its charity partners and our employees dedicated time in a variety of volunteering activities. OSBIndia is also heavily involved with the community local to the office in Bangalore, as well as in areas where there are critical needs. For more information on how the Group engages with the communities it operates in, see page 64.

For more information on how Directors engaged with our key stakeholders, see the Corporate Governance Report on page 72.

For more detail about OSB non-financial information regarding environmental, employees and social matters, respect for human rights, anti-corruption and anti-bribery matters, see the Corporate Responsibility Report on page 52.

Market review

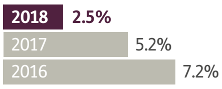
UK Buy-to-Let gross advances

£37.1bn

Source: UK Finance, New and outstanding Buy-to-Let mortgages, Feb 2019

UK average house price inflation

2.5%



Source: ONS, UK house price index, Dec 2018

The UK housing and mortgage market

In 2018, the housing market saw a continuation of trends seen in the previous year. Whilst political uncertainty surrounding Brexit has undoubtedly had some impact, the combination of affordability challenges and low housing supply also contributed to slowing levels of activity in some parts of the country. Price growth declined and even reversed in some parts of London and the South East, whilst in other parts of the country, house prices continued to grow, including in many of the UK's major cities. The record low mortgage rates in mainstream markets, as high street banks competed for market share, continued to support the market with low loan servicing costs but deposits required were still a barrier to entry for many. This drove the extension of the government's Help to Buy equity loan scheme.

Government policy and the intention to support home ownership and increase the supply of social housing has been positive, including lifting the borrowing cap for councils and the move to abolish stamp duty land tax for first-time buyers on properties worth up to £300,000. However, this activity was somewhat overshadowed by political uncertainty and noise surrounding Brexit. It is reasonable to expect increased support for building new homes and the housing market in general once clarity around the political landscape returns.

According to UK Finance, gross mortgage lending reached £269.3bn in 2018, up 3% compared to £260.4bn in 2017[1] with remortgage activity driving lending growth.

1. UK Finance, New mortgage lending by purpose of loan, 30 Jan 2019.

The UK savings market

The UK savings market continued to grow in 2018 with c. £64bn added in the year to reach a total of £1,671bn (2017: £1,607bn).[2]

The year also saw new competition entering the market offering attractive rates to savers, with existing banks taking note. Savings rates showed a gradual increase during 2018 with average one-year fixed rate bonds paying 1.45% in December 2018, up from an average of 1.16% at the start of the year. Average rates on no-notice accounts increased from 0.45% to 0.63% at the end of 2018, demonstrating that the Bank of England base rate rise to 0.75% in August 2018 had some effect on the wider savings market.[3]

Aside from the rate offered, two clear trends are emerging in the savings market:

- there are signs that customers are becoming more technologically aware and are choosing their savings providers based on service and convenience over their return, and some new entrants to the market are exploiting this opportunity. We expect this trend to continue, however;
- it has also been observed that traditional ways of interacting with savings customers, via branches, are regaining popularity.

Variable rate easy access products proved to be popular accounts for the industry in 2018, as customers sought flexibility and accessibility of their funds over higher returns, potentially reflecting the current macroeconomic uncertainty.

2. Bank of England, Monthly amounts outstanding of monetary financial institutions' sterling retail deposits from private sector (in sterling millions) seasonally adjusted, LPMB3SF, 20 Feb 2019.
3. Moneyfacts, UK Savings Trends Treasury Report, Dec 2018.

OneSavings Bank's lending markets

UK Buy-to-Let/specialist SME market

PRS broadly stable

The Private Rented Sector ('PRS') remained at approximately 4.5 million households in 2017–18, broadly stable for the last five years.[4] As has been well documented, the lack of growth is attributable to the political and regulatory interventions announced under the previous Conservative administration. These delivered the desired reduction in Buy-to-Let market growth. In the year, new Buy-to-Let lending of £37.1bn was up 4% on 2017 (£35.8bn), a figure that should be measured against the context of 2016's £40.6bn.[5] However, despite a softening of house price inflation, house prices are still generally up, and affordability measures have not eased, hence, the changes to Buy-to-Let taxation have arguably done little to achieve their primary political aim, of increasing levels of home ownership. Given this continuing context of a shortage of housing supply that keeps house prices relatively high and mortgage regulation and mortgage finance beyond the reach of many, the market for rental property is expected to remain strong.

This demand is, however, being met by a reducing number of landlords. The 'dinner party landlords' who flocked to the market in the period from approximately 2012–2015, have diminished, put off by, in particular, changes to personal taxation. This has left professional landlords, those whose primary income is obtained from their property portfolio, to pick up demand. The professional market, whilst not immune to the changes, has persisted because of the strong fundamentals which underpin it: sustained demand from tenants and the potential for long-term capital gains.

This long-term perspective drove a change in buying behaviour from professional landlords, in the form of significant growth in the market for long-term fixed mortgage rates. In a time of economic turmoil, these provide a degree of certainty as well as enable greater leverage under the PRA rules.

Borrowing through limited company structures also continues to be a feature of this market, with professional landlords continuing to mitigate the impact of income tax changes via this route. OSB is a respected lender within the specialist Buy-to-Let sector, with a strong reputation for limited company lending which has been beneficial to date and is expected to continue to be so.

4. English Housing Survey, Headline Report 2017–18, 31 Jan 2019.
5. UK Finance, New and outstanding buy-to-let mortgages, 19 Feb 2019.

Market review continued

Commercial

Resilience in UK yields

The UK commercial property market saw investment reduce in 2018 compared to 2017, although the total exceeded £55bn for the fifth consecutive year.[6] The uncertainty surrounding the UK's withdrawal from the EU continues to have an effect, with indications that some investment decisions are being delayed until a clear way forward has been agreed.

However, the UK remains an attractive investment proposition. Yields are high compared to much of Europe and Asia, while sterling is weak and interest rates are relatively low. As a result, overseas investments accounted for more than half of investments in 2018, an established trend that is expected to continue.[7]

Furthermore, high demand for offices in and around London, partly due to a lack of development opportunities, suggests that London may be more resilient to Brexit than initially thought.[8]

Research from Savills highlights increasing demand for industrial and warehouse properties which provide logistical support, usually for e-commerce. Also featured is the potential for commercial property growth in regions outside London and the South East, aided by stronger house prices and consumer confidence, together with a relative lack of supply.[8]

As in previous years, yields weakened across the retail property sector (except in prime central London), reflecting the rise of technology, changing consumer habits and a resulting lack of demand. This trend is not expected to change, but it may create opportunities for investors looking to repurpose vacant shops, creating a greater mix of uses and services.[8]

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 a robust understanding of customer requirements, can provide a service differential.

Residential development

Continued under-supply

The UK has experienced a long-term upward trend in real house prices, creating affordability problems as demand for housing outstripped both supply and real wage growth. Turnover in the second-hand housing market has fallen, resulting in reduced liquidity within this market.

The new-build market has also been adversely affected, especially in London, with some regions structurally reliant on the government's Help to Buy product, which will be restricted to first time buyers and be subject to regional caps from April 2021. The support required by the small and medium-sized developers who form our core audience for development finance will continue to increase.

Specialist residential lending

New initiatives gaining traction

OneSavings Bank's manual underwriting and individual case assessment model provides a strong platform for specialist residential lending. Customers with non-standard 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.

OneSavings Bank implemented a number of tactical product initiatives in this market in 2018. We are seeing encouraging results which we will build on in 2019.

6. Colliers International, UK Property Snapshot, Jan 2019.
7. CBRE Research, UK Real Estate Market Outlook 2019.
8. Savills, UK cross sector outlook, 8 Jan 2019.

Second charge lending

Controlled high standards

The second charge market saw approximately £1.07bn of gross new lending in 2018 (2017: £1.02bn).[9] This market continues to adjust to the changes in regulation that came into effect in March 2016 and the short-term outlook remains neutral; any significant increase in market size is considered unlikely.

2018 saw the first regulatory reviews of lending practice in the sector, leading to some lenders revising their risk appetite and lending practices. We expect further regulatory involvement in the broker market in the short term. This is expected to maintain the subdued outlook for this market.

As a regulated lender in other markets, OSB has always maintained high standards of conduct and prudential regulation so we do not see this having any material impact on our lending.

Funding lines

Strong pipeline

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 and securitisation/bond markets, high net worth investors and market-based/peer-to-peer platforms.

OSB is an active provider of secured funding lines to these specialty finance providers, 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.

9. FLA, Second charge mortgage market reports volumes up by 13% in December, 8 Feb 2019.

Chief Executive Officer's statement

Continued strong performance

> We are well-placed to continue to deliver attractive returns...

ANDY GOLDING
CHIEF EXECUTIVE

I am delighted to report another excellent year for OneSavings Bank ('OSB'). The Group achieved strong results as we worked together to deliver our vision of being our customers' favourite bank. Underlying basic earnings per share grew by 14% to 58.5 pence with underlying pre-tax profit up 15% to £193.6m. Our strategy continues to provide us with a platform to grow profitably and develop the business whilst we are ever mindful of the uncertain economic and political environment in which we are operating.

Our ability to raise and retain retail funds given the long-standing heritage of the Kent Reliance brand, track record of raising funds whenever needed and our leading retention rate of 95%, means we can safely and confidently fund the lending business we wish to write. The strength of our proposition continues to attract new customers. Our manual underwriting process, strong risk management and enhanced stress testing, including numerous Brexit scenarios, give us a deep understanding of the markets in which we operate.

We flex our lending in different business areas according to the opportunities present, always underpinned by appropriate prudence given the current uncharted political and economic environment. Whilst Brexit may impact certain business opportunities, our balance sheet remains strong, our core markets remain extremely attractive and we have a high-quality secured asset portfolio. Combined with an excellent funding franchise and customer proposition, this positions us well to continue to deliver value for our shareholders regardless of the uncertain macroeconomic backdrop.

Our customer franchises

An award-winning secured lender

The Group grew its loan book by 23% to £9.0bn in 2018 and, whilst maintaining its discipline on understanding and pricing for risk, delivered a strong net interest margin ('NIM') of 3.04% for the year. Our core Buy-to-Let business continues to grow as professional landlords recognise the strength of our proposition and enjoy the excellent levels of customer service that they receive.

New Buy-to-Let/SME mortgage origination increased to £2.8bn during 2018, reflecting our specialism and expertise in lending to limited companies and large portfolio landlords. We are particularly proud of our lending growth as it was achieved in the context of industry-wide gross Buy-to-Let advances increasing by 4% in the year to £37.1bn.[1] Our target market of professional/multi-property landlords accounted for 81% of completions for OSB by value during 2018, with a continued high proportion of professional landlords choosing to remortgage with us. This performance demonstrates the sustainable strength of our proposition, in particular our specialist, manual underwriting, as well as our deep and historic relationships with mortgage intermediaries.

We have seen significant growth in the commercial side of our Buy-to-Let/SME segment through the InterBay brand. We have used our strong understanding of this market to invest in products, service and innovation that have proved increasingly popular with commercial borrowers. We developed the proposition further following our successful entry into the bespoke bridging market and in August 2018, we successfully launched InterBay Asset Finance, with the first of its flexible asset finance deals funded in October. I am pleased with the success our commercial business is enjoying and the positive start for our asset finance business. As with all new business segments that we enter, we do so cautiously on a test, assess and grow basis.

Our more cyclical commercial businesses continued to perform strongly throughout 2018. The Bank's Heritable Development Finance business provides development finance to small and medium-sized residential developers operating in areas of the UK where demand for housing is consistently strong. We are delighted with the performance of the Heritable joint venture ('the JV') since it started lending in early 2014. We had the opportunity to acquire the JV partners' interest in 2019 and in doing so recognised an exceptional cost of £9.8m in 2018 in respect of this option. We are particularly pleased that we were able to retain the key individuals in the business going forward, whilst continuing to offer them the opportunity to lend alongside the Bank to align interests. We also saw controlled growth in 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.

As we flagged earlier in 2018, originations in the residential segment increased in 2018 with attractive opportunities in more complex prime and second charge markets. However new organic lending was more than offset by redemptions in the back book and acquired mortgages in run-off, contributing to the first charge

Statutory basic earnings per share

55.5p

+9%

2017: 51.1p

Dividend per share

14.6p

+14%

2017: 12.8p

...professional landlords recognise the strength of our proposition...

Chief Executive Officer's statement continued

gross loan book reducing marginally to £1,224m from £1,241m at the end of 2017. We piloted new specialist products in the residential segment in 2018 and are seeing encouraging results. Over the medium term, we see an opportunity to deliver attractive risk-adjusted returns from this new product range, particularly once we transition to IRB.

Our focus on new and existing customers means we are always investing in and improving our sales capability across our brands. We continued to gain recognition from mortgage customers and intermediaries, winning multiple awards during the year. I am particularly pleased that OSB won multiple awards including Best BDM Team, Best Specialist Lender and Best Buy-to-Let Lender, all from Mortgage Strategy Awards and Moneyfacts Best Specialist Mortgage Provider in 2018. In addition our Sales Director, Adrian Moloney, was awarded Business Leader: Complex Buy-to-Let Lender by British Specialist Lending Awards.

Through the Bank's mortgage product transfer scheme, Choices, we are consistently increasing the proportion of borrowers who choose a new product within three months of their initial product ending and this grew to around 69% by December 2018. This is driven by success in highlighting opportunities available to borrowers who might otherwise revert to standard variable rate ('SVR') and who should ensure that they are actively choosing appropriate mortgage pricing and features.

Sustainable funding with award-winning savings

Our stable and award winning retail funding franchise continues to support lending growth, with retail deposits up 21% to £8.1bn during the year. Over 40,000 new savings customers joined the Bank in 2018. Key to our vision is becoming our customers' favourite bank and we put our customers at the heart of everything we do. This is demonstrated by our market-leading 95% retention rate amongst customers with maturing fixed rate bonds and ISAs. The strength and fairness of our retail savings proposition, coupled with excellent customer service and high retention rates, allow the Bank to raise significant funds when required without needing to price at the very top of the best buy tables and provides a consistent and stable source of liquidity.

We continue to develop our savings proposition and following investment in a new ISA transfer management system, we had a particularly strong ISA season in 2018. We opened a record number of accounts, raising a significant amount of fixed term savings at a price below our target cost of funds, further demonstrating the value of the Bank's strong retail presence.

I am delighted that Kent Reliance was recognised by winning the Savings Account Provider of the Year from MoneyAge and was commended for Best No Notice Account Provider by Moneyfacts Awards in 2018. These awards are a testament to our savings proposition and to the outstanding customer service delivered by our staff.

The Bank remained predominantly retail funded in 2018, with a loan to deposit ratio for the year of 93%[2] delivering on our strategy to primarily fund our loan book using retail deposits. At the close of the Bank of England's Term Funding Scheme ('TFS') in February 2018, the Bank had drawdowns of £1.5bn. The TFS funding is repayable by the end of February 2022. Along with our proven ability to raise retail funds, the Bank was ready to re-commence its RMBS programme in Q4 2018, but market conditions and pricing were unattractive. In addition, the Bank participated in the Bank of England's Indexed Long-Term Repo scheme ('ILTR') with a total of £80m ILTR borrowings outstanding at the year end.

Leveraging and investing in our unique business model

The low cost to income ratio of 28% reflects our efficient and scalable operating platform. Through 2018 we invested significantly in future proofing the business by delivering regulatory projects, principally General Data Protection Regulation ('GDPR'), the Second Payment Services Directive ('PSD 2') and the ongoing project to deliver IRB. We also started upgrading our IT infrastructure, including customer platforms. This increased expenditure was partially offset by our continuous focus on finding efficiencies in the costs of running the Bank on a 'business as usual basis', through maintaining disciplined cost management, increased benefits of scale and leveraging our unique operating platform in India ('OSBI'). I am particularly pleased that finding these efficiencies reduced our management expense ratio to 0.84% from 0.86% in the prior year.

The Group's first generation IRB models were delivered on schedule in late 2016 and we ran them for the second year in 2018. We remain pleased with progress towards our IRB application and believe that the new calibrations, combined with the final IRB output floors outlined in Basel III, will be beneficial to the Bank's capital requirements.

OSBI undertakes a range of primary processing services at a significantly lower cost than an equivalent UK-based operation, whilst delivering consistently high quality service levels. I am especially pleased that we continue to achieve this whilst maintaining our focus on our customer-led vision, borne out by an increase in customer NPS to an outstanding +63 (2017: +62).

A strong and sustainable business

The Group continued to exercise strong diligence over loan and customer assessment. The loan loss ratio increased to 10bps in the year to 31 December 2018 (2017: 7bps), largely as we modelled the potential for a more severe impact from the outcome of the Brexit negotiations in our economic scenarios. Removing the impact of this additional scenario, the loan loss ratio was consistent with the prior year as we saw no deterioration in the credit quality of the book across our lending businesses. The modelling of more severe economic scenarios surrounding Brexit increased our focus on the resilience of our business model to House Price Index and commercial real estate risk and we continue to assess our lending appetites in relation to these risks.

Our front book of mortgages continues to demonstrate our excellent credit management. From more than 48,500 loans totalling £11bn of new organic originations since the Bank's creation in February 2011, we have only 206 cases of arrears over three months in duration, with an aggregate balance of £53.5m and an average loan to value ('LTV') of just 62%, reflecting the continued strength of the Bank's underwriting and lending criteria.

The weighted average LTV of the overall mortgage book remained low at 66% at the end of 2018, with an average LTV of 69% on new origination during the year.

The lower NIM of 3.04% (2017: 3.16%) reflects the changing mix of the loan book despite broadly stable asset pricing and wider average five year swap spreads, partially offset by a relatively favourable cost of retail funds and additional benefit from the Bank of England's Term Funding Scheme ('TFS'). The mix of the loan book continues to change with new origination forming a growing proportion of the total book, diluting the impact of loans originated or acquired several years ago when yields were exceptionally high. The favourable cost of retail funds was due primarily to the retail savings market not pricing in the full November 2017 and August 2018 Bank of England Base Rate rises. Five year fixed rate mortgages accounted for c. 56% of Buy-to-Let completions for our Kent Reliance brand in 2018, up from 43% in 2017.

Our achievements in 2018 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.

Looking forward to 2019

Despite the macroeconomic and political uncertainty surrounding the outcome of the negotiations of the UK's departure from the EU, trading conditions in our core markets remain positive and current application levels in our Buy-to-Let and commercial businesses are strong as we head into 2019 with a robust pipeline of new business.

Whilst OSB may be less directly affected by Brexit than companies which trade in the EU, we have considered and planned for the potential implications carefully, both strategically and operationally in expected and stressed conditions. The Board has commissioned a number of reviews from external experts and economic advisers to assist in this work. In our planning, we considered our own particular circumstances, including our location, regulatory environment, customer credit profiles, loan securities, location of our stakeholders, including key customers and suppliers, as well as our workforce. We have analysed the potential impact of a range of scenarios such as the effect of a 'no-deal' Brexit, including falling property prices, on loan loss provisions, including the Group's IFRS 9 impairment process, which are covered in the Risk review. We have also analysed the potential impact of various Brexit scenarios on different portfolio segments with a view to coordinating strategic actions across the credit risk lifecycle if a deterioration in the macroeconomic outlook were to occur. This same plan could be deployed should the Group observe credit profile deterioration post a 'no-deal' Brexit.

Outside our core Buy-to-Let market, we also see good opportunities in other segments of the lending market where we already have expertise and a platform to build on. In particular, we expect to grow further through our InterBay Commercial brand and we see more opportunities to grow our residential lending franchise in the medium to longer term. We will, however exercise caution and grow sensibly into new markets as we adjust to a potentially new economic outlook.

Following the statement released on 9 March 2019 confirming that Charter Court Financial Services and OneSavings Bank were in advanced discussions regarding a possible all-share combination of the two companies, we are today pleased to announce the recommended all-share combination of the two organisations. This statement and any future public documents relating to the possible combination will be placed on the Investors section of the OSB website at www.osb.co.uk. As such, we are not able to provide our usual extent of guidance for the financial year ahead.

We recognise the macroeconomic uncertainty caused by the Brexit negotiations, however, based on what we are currently seeing in our core markets and assuming current application levels continue, we would expect to deliver mid-teens net loan book growth in 2019. Based on current asset pricing, swap spreads and cost of funds, we would anticipate NIM for 2019 to be marginally lower than in 2018, due to the changing mix of the loan book, despite broadly stable asset pricing. Whilst we will continue to investment in the business for growth in 2019, as always, we will maintain a strong focus on cost efficiency and control as reflected in our cost to income and management expense ratios.

We start 2019 with a fully loaded CET1 ratio of 13.3% and a proven organic capital generation capability through profitability. Our dividend policy remains a payout ratio of at least 25% of underlying profit after taxation attributable to ordinary shareholders.

I believe that OneSavings Bank's customer-focused business model and the strength of both our lending and savings franchises, mean we are exceptionally well-placed to continue to generate attractive returns for our shareholders.

Andy Golding
Chief Executive Officer
14 March 2019

Our vision & values

Our vision is to become our customers' favourite bank; one that delivers its very best, challenges convention and opens doors that others can't.

Our values guide us to the success we are all striving towards – for ourselves and our customers.

Stronger together

Aim high

Take ownership

Create your future

For more information go to page 62.

1. UK Finance, New and outstanding buy-to-let mortgages, 19 Feb 2019.
2. Excluding the impact of TFS and ILTR drawdowns. The unadjusted ratio was 111% as at 31 December 2018 (2017: 109%).

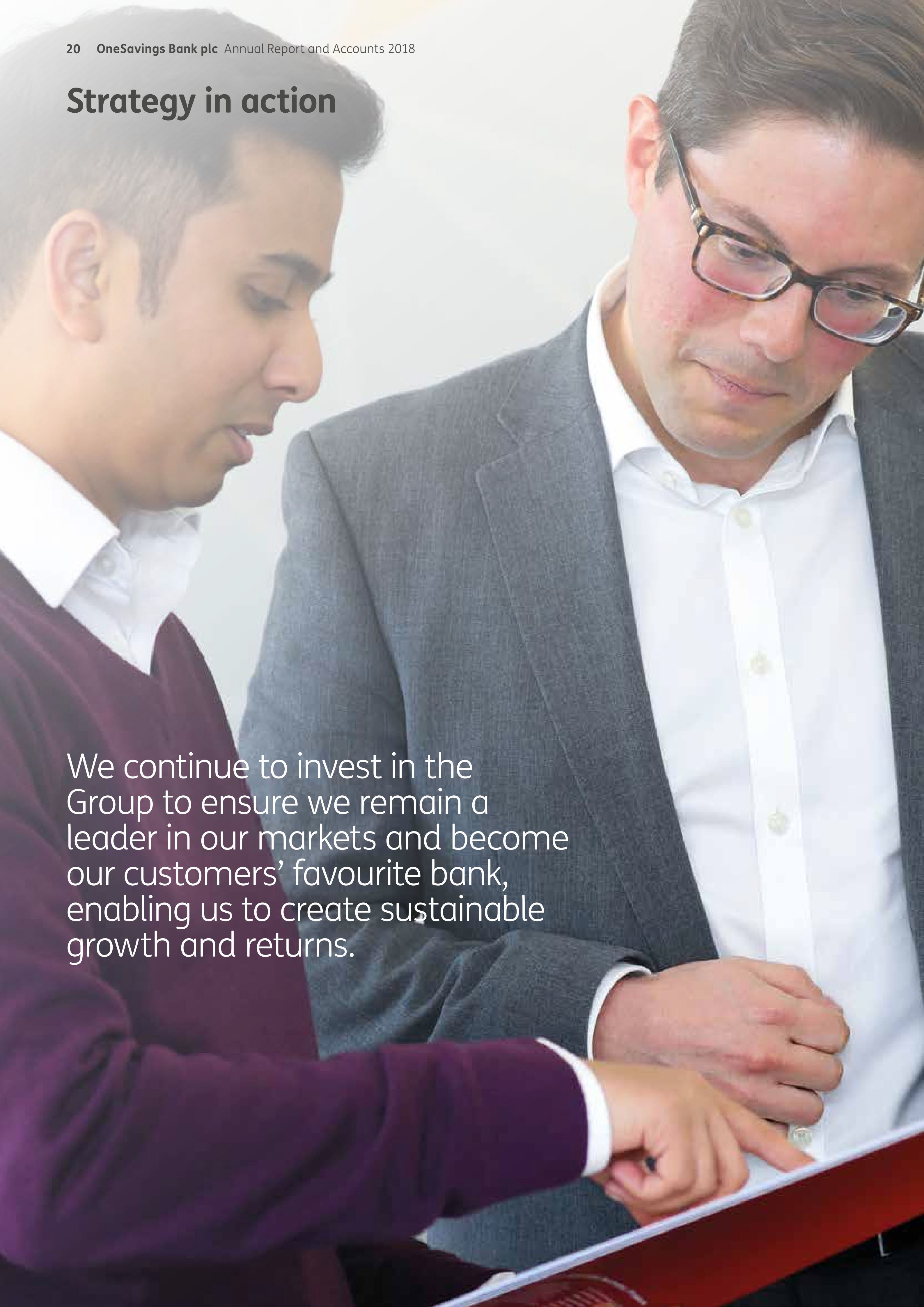
Strategic framework

Our vision is to become our customers' favourite bank; one that delivers its very best, challenges convention and opens doors that others can't.

Priorities	Our goals	2018 progress
Specialist lending business 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 15% to £2.8bn • £223m originations in commercial lending through our InterBay brand • Established InterBay Asset Finance business • Received multiple awards including Best Specialist Lender (Mortgage Strategy Awards) and Best Specialist Mortgage Provider (Moneyfacts Awards)
Specialist lending business Retain focus on bespoke and responsive underwriting	**High quality decisions protecting the business** • Skilled manual underwriting supported by clever technology • Deliver a 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 48,500 loans totalling £11.0bn originated since the Bank's creation in 2011 with only 206 cases of arrears over 3 months, with an aggregate balance of £53.5m and an average LTV of 62% • Transactional Credit Committee met twice a week in 2018 to assist with more complex or larger new mortgage applications
Specialist lending business Further deepen relationships and reputation for delivery with intermediaries	**Increase partner reach in response to demand** • Access to specialist products developed by listening to intermediary partners • Be accessible and available to intermediaries • One distribution model • Gain intermediary recognition for delivering sustainable proposition • Deliver bespoke solutions to meet intermediary and customer needs	• Choices programme had another successful year increasing retention rates in 2018 • Restructured relationship team to increase levels of engagement • Attended c. 170 intermediary events across our target geographies • Enhanced marketing and brand support for intermediaries • Published periodic market leading 'Buy-to-Let Britain' reports
Attractive retail savings 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 c.40,000 new savings customers • Achieved 95% customer retention • Received multiple awards for savings products including Savings Account Provider of the Year • Loan to deposit ratio of 93%[1] 1. Excluding impact of TFS and ILTR drawdowns.
Unique operating model Leverage unique and cost-efficient operating model	**Best in class customer service** • Customer service at the heart of everything that we do • Extend activity in OSBIndia, developing high quality areas of excellence • Deliver cost efficiencies through excellent process design and management	• Investments in training and process development contributed to enhanced customer NPS of +63 • Increased OSBI headcount by 20% to 440

Looking forward	Key risks	KPI
• Focus on organic growth in our target sub-sectors • Further develop commercial lending opportunities • Further enhance our proposition in residential lending in light of the opportunities under IRB • Build on the successful pilot into bridge finance and cautiously grow InterBay Asset Finance • Identify new market sub-sectors with high returns on a risk-adjusted basis	• Market conditions affecting long-term demand • Increased regulatory pressure • Continued political and economic uncertainty • New specialist lenders entering the market	**Net loan book £9.0bn** **+23%** 2018 £9.0bn 2017 £7.3bn 2016 £5.9bn
• 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	• Changing regulation for underwriting • More complex underwriting requirements • Difficulty in recruiting experienced staff • Increasing intermediary demands • Demands of ever-changing technology	**Loan loss ratio 10bps** **increased by 3bps** 2018 10bps 2017 7bps 2016 16bps
• 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	• Loss of key broker relationships • Competition reducing pricing below OSB's risk-adjusted return appetite • More complex underwriting requirements slowing the process	**Gross new lending £3.0bn** **+15%** 2018 £3.0bn 2017 £2.6bn 2016 £2.3bn
• 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	• Increased competition for retail funds • 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)	**Customer NPS +63** **increased by 1** 2018 +63 2017 +62 2016 +59
• Extend measurement by benchmarking to best in class • Introduce robotics technology and improve workflows to further enhance primary servicing • Increase change capacity through enhanced end-to-end project management capability	• 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	**Cost to income ratio 28%** **increased 1pp** 2018 28% 2017 27% 2016 27%

Strategy in action



We continue to invest in the Group to ensure we remain a leader in our markets and become our customers' favourite bank, enabling us to create sustainable growth and returns.

Be a leading specialist lender in our chosen markets

Leading lender in our chosen markets

Our key strengths

- Focus on specialist market sub-segments
- Bespoke underwriting
- Deep relationships with intermediaries

The market sub-segments we focus on are:

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

Bespoke underwriting
At OSB, we do not use automated or scorecard-based processes. All of our loans are underwritten by experienced and skilled underwriters, supported by technology to reduce the administrative burden on our underwriters and mortgage intermediaries. We take each loan on its own merit, responding quickly and flexibly to offer the best solution for each of our customers. 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 demonstrating our responsiveness to broker needs.

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-segments.

Gross new organic lending

+15%

2018: £3.0bn
2017: £2.6bn

Maintain and build upon over 150 years of heritage in savings

Customer satisfaction and retention

Our key strengths

- Customer focused
- Transparent, good value savings products

Customer retention

95%

2017: 90%

Stable retail savings platform
OSB's proposition for savers is simple; we offer consistently good value savings products to attract and retain a loyal customer base. 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, and existing customers benefit from loyalty rates.

We attracted over 40,000 new savings customers during 2018, and retained 95% of maturing fixed term deposit balances, demonstrating the strength of our long-term proposition.

> Provide access to customers through the channel of their choice.

Leverage unique and cost-efficient operating model

OSBIndia – unique competitive advantage

Focused on customers
Our customer service functions, based in our wholly-owned subsidiary OSBIndia, support our aim of putting customers first.

We reward our people based on the quality of service they provide to customers, further protecting our retail savings franchise and leading to high customer satisfaction with a customer NPS of +63.

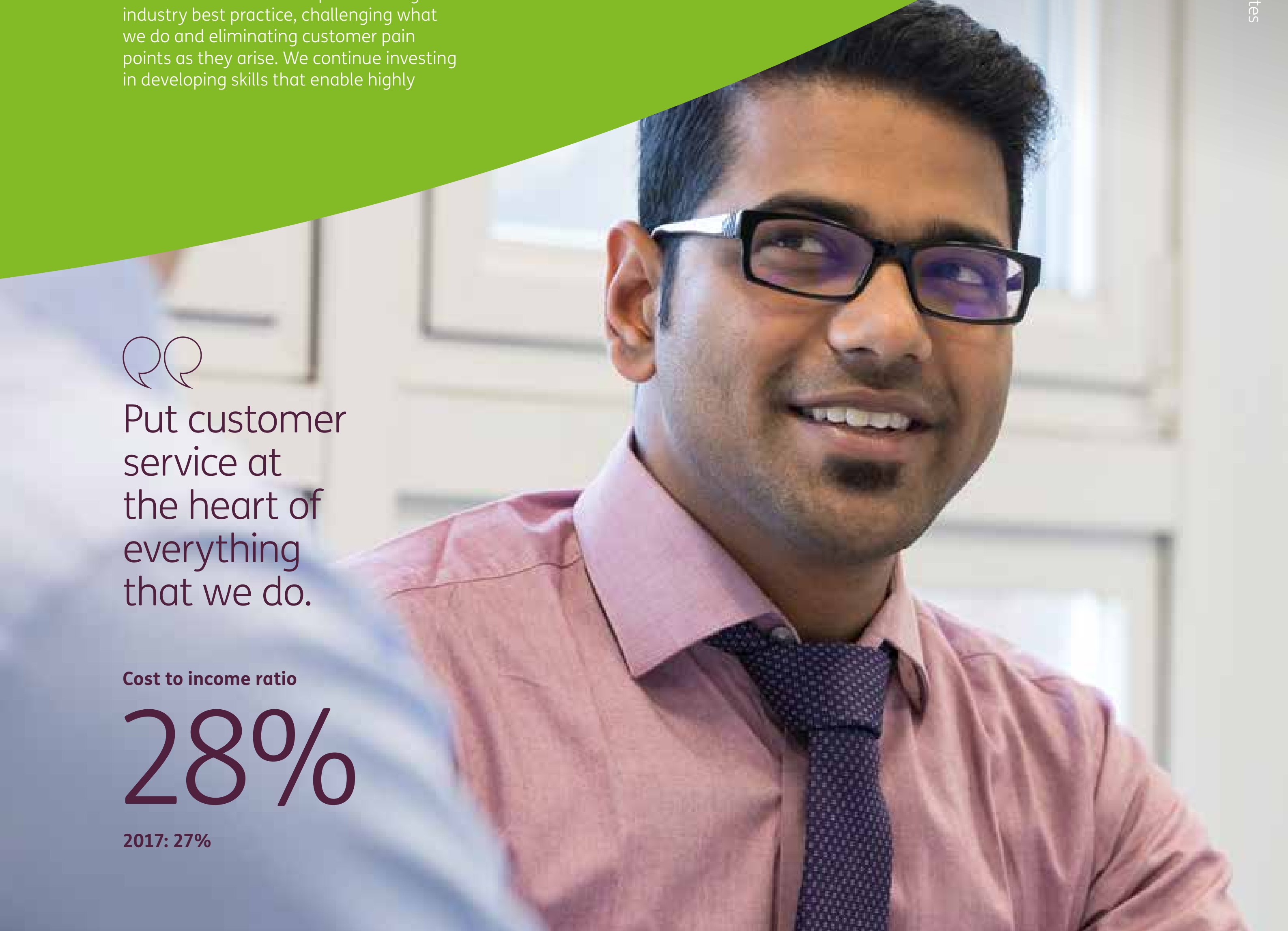
Focused on quality and cost discipline
At OSBI we employ highly talented and motivated employees at a competitive cost. We benchmark our processes against industry best practice, challenging what we do and eliminating customer pain points as they arise. We continue investing in developing skills that enable highly efficient service management, matching those to business needs both in India and the UK.

We are proud of our low employee turnover in India, with a remarkable 11% regretted attrition rate, substantially outperforming industry averages.

Investment in infrastructure and systems
We aim to deliver efficient, scalable and resilient infrastructure and invest in IT security, supported by market leading data security and resilience experts.

Our key strengths

- Excellent customer experience
- High customer NPS
- High employee retention rates



Put customer service at the heart of everything that we do.

Cost to income ratio

28%

2017: 27%

Operating and financial review

OneSavings Bank

Group overview

2018 was another year of exceptional performance, underpinned by organic originations of £3.0bn at attractive margins, strong risk management, cost efficiency and discipline.

Business highlights

2018 was a year of excellent performance for the Bank, further building on our strengths and creating a business that can withstand macroeconomic uncertainty and deliver value for all of our stakeholders. The Group wrote £3.0bn of gross organic originations in the year (2017: £2.6bn) at attractive margins despite continuing competition, especially for five year fixed rate Buy-to-Let products.

The strongest lending growth was achieved in our Buy-to-Let /SME segment which caters for our core audience of large professional landlords and also provides commercial, semi-commercial, bridging and more complex Buy-to-Let products via our InterBay brand. In the second half of 2018, the Group launched its InterBay Asset Finance business, funding its first deals in October 2018 and exceeding our lending targets. Overall, the Buy-to-Let/SME net loan book increased by 31% to £7.4bn as at 31 December 2018.

Organic origination in our residential segment also increased in the year to £0.3bn (2017: £0.2bn) as the specialist residential products launched in the second half of 2018 received a positive response from borrowers. However, the Residential net loan book decreased to £1.6bn, down 4% compared with 2017 year end as redemptions in the back book and acquired mortgages in run-off more than offset new lending.

Overall, the Group's net loan book was up 23%, reaching £9.0bn by the end of 2018, with Buy-to-Let/SME comprising 82% and Residential 18% of the total net loan book.

The Group remained predominantly retail funded during the year, with a loan to deposit ratio of 93%[1] as at 31 December 2018 (2017: 92%). Retail deposits were up 21% to £8.1bn for the year as we welcomed over 40,000 new retail customers and had a particularly successful ISA season. Our focus on providing fair and transparent savings products and outstanding customer service was reflected in a +63 customer net promoter score ('NPS') and retention rate of 95% for maturing fixed term bond and ISA balances in 2018 (2017: +62 and 90% respectively). Our business savings accounts were also popular with SMEs, with total deposits constituting just over 1% of the entire savings book, or £80m of the total balance as at 31 December 2018.

Case study

More than ticking boxes

David Morgan – Senior Legal Counsel – Group Data Protection Officer

2018 was a busy year for new regulation and this included a comprehensive programme at the Bank to meet the new General Data Protection Regulation ('GDPR') – the biggest change to UK data protection law in 20 years.

Multiple streams of work were required, ranging from the Bank's data governance framework, system modifications and procedures to deal with enhanced customer documentation.

Alongside this, a detailed programme of training and awareness was undertaken to ensure that staff understood the implications of the new regulation.

What most impressed me was the determined and collaborative way in which teams across the Group, with our external advisers, worked together to navigate the requirements and implement the changes. The result is that it's been more than just a tick-box exercise. The clear opportunity was, and remains, to continually enhance customer experience.

The Bank's Heritable Development Finance business provides development finance to small and medium-sized residential developers operating in areas of the UK where demand for housing is consistently strong. The business operates as a joint venture ('the JV') between the Bank and certain senior members of the Heritable team ('the JV partners'). In 2019, the Bank had the opportunity to acquire the JV partners' interest and recognised an exceptional cost of £9.8m in 2018 in respect of this option. The Bank was able to retain the senior members of the team in the business going forward, whilst continuing to offer them the opportunity to continue to lend alongside the Bank. The new revenue sharing arrangement is on more favourable terms for the Bank, reflecting the maturity of the business.

In 2018, OSB used the Bank of England's Indexed Long Term Repo scheme for the first time, complementing retail and TFS funding with £80.0m borrowing at base rate +15bps which was 90bps as at 31 December 2018. The borrowing is offered as a collateralised cash loan repayable in six months.

Profitable lending in the year allowed us to achieve an attractive return on equity of 26% for 2018 (2017: 28%).

The Group ended the year with a CET1 ratio of 13.3% (2017: 13.7%), demonstrating the strength of the capital generation capability of the business to support significant growth through profitability. The Group's total capital ratio of 15.8% and leverage ratio of 5.9% remained strong (2017: 16.9% and 6.0% respectively).

Financial overview

The Group reported strong profit growth in 2018. Statutory profit before taxation of £183.8m was 10% higher than in 2017 (2017: £167.7m). On an underlying basis, before the exceptional cost of £9.8m due to the Heritable option, profit before taxation increased by 15% to £193.6m (2017: £167.7m). This strong underlying profitability reflects the continued attractiveness of our lending and funding franchises and our efficient operating model.

Statutory basic earnings per share ('EPS') was 55.5 pence, up 9% from 51.1 pence in 2017 and underlying basic EPS strengthened to 58.5 pence (2017: 51.1p). Our focus on cost discipline and efficiency continued throughout 2018, helping to deliver a very strong cost to income ratio of 28% (2017: 27%) despite increased investment in the business and in meeting the growing cost of regulation.

The Board is recommending a final dividend of 10.3 pence per share, which together with the interim dividend of 4.3 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 and ILTR drawdowns. The unadjusted ratio was 111% as at 31 December 2018 (2017: 109%).

Operating and financial review continued

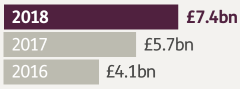
Buy-to-Let/SME

Gross loan book

£7,389.2m

+31%

2017: £5,654.1m

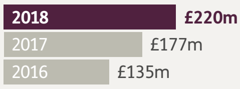


Net interest income

£220.0m

+24%

2017: £177.1m

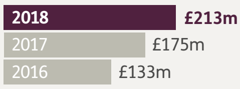


Contribution to profit

£213.3m

+22%

2017: £174.8m



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, secured funding lines to other lenders and asset finance.

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

	Group 31-Dec-2018 £m	Group 31-Dec-2017 £m
Buy-to-Let	**6,517.5**	5,033.8
Commercial	**547.8**	370.8
Residential development	**155.8**	143.9
Funding lines	**168.1**	104.5
Personal loans[1]	**–**	1.1
Total	**7,389.2**	5,654.1

In 2018, market-wide Buy-to-Let gross advances were £37.1bn, up 4% compared to £35.8bn in 2017.[2] The Group's market share of new Buy-to-Let mortgages remained flat in 2018 at approximately 6%.

It has been widely reported that a combination of tax and regulatory changes impacted the Buy-to-Let market, reducing lending levels from the post-crisis high of 2016. Whilst no further interventions have been announced since changes to affordability assessments were introduced in October 2017, the gradual reduction in personal tax relief continues and, as a result, any growth in overall lending levels is expected to be muted in the short term. This downward trend in new lending masks, however, a more subtle change, which has seen professional landlords persist, with the reduction therefore attributable to smaller amateur landlords. OSB has always targeted professional landlords, and it is the sustainable demand from this audience that has underpinned our continued growth when at face value, the Buy-to-Let market is facing various challenges. The systemic issues in the UK housing market remain largely untouched by the government, and it is reasonable to expect demand from tenants to continue as they are faced with ongoing challenges around house prices relative to incomes, and mortgage regulation that constrains lending. The opportunity for professional landlords is therefore expected to remain resilient for at least the medium term.

The prospect of the UK's exit from the European Union creates uncertainties for consumers. These uncertainties have led to some short-term fluctuations in house prices, including falls in some parts of London despite a national picture of price rises, albeit modest in scale. Our target audience is, however, focused on the long-term, and over this longer period, asset prices have consistently risen. This long-term view, alongside continuing tenant demand as referenced above, will maintain sector attractiveness for the professional investor.

The volume of the Group's new organic lending in this segment reached £2,769.7m in 2018, an increase of 15% from £2,413.7n in 2017. The segment gross loans were £7,389.2m, up 31% from £5,654.1m in 2017. The Buy-to-Let/SME net loan book represented 82% of total OSB net loans as at 31 December 2018.

Gross loans in the Buy-to-Let sub-segment increased by 29% to £6,517.5m (2017: £5,033.8m) in the year mostly due to continued activity from professional, multi-property and incorporated landlords and the withdrawal of amateur landlords. Professional landlords accounted for 81% of completions by value for OSB in 2018 (2017: 80%). The share of purchase applications that came from incorporated landlords continued to rise to 70% for our Kent Reliance brand in the year (2017: 69%) as borrowers mitigated reductions in yield resulting from recent changes to personal taxation.

A large proportion of Buy-to-Let lending comes from refinancing and in 2018, remortgages represented 58% of lending for our main Kent Reliance brand. Around 69% of existing borrowers chose a new product with the Group within three months of the original product ending. Many of our borrowers also chose to lock in the attractive mortgage rates for a longer period of time and five year fixed rate products represented 56% of completions for the Kent Reliance brand in 2018 (2017: 43%). The weighted average loan to value ('LTV') of the Buy-to-Let book was 70% with an average loan size of £260,000. The weighted average interest coverage ratio ('ICR') for Buy-to-Let origination during 2018 reduced to 171% (2017: 185%).

The InterBay commercial business, which offers commercial, semi-commercial, bridging and more complex Buy-to-Let mortgages had a very successful year with the commercial and semi-commercial gross loan book up 48% to £547.8m (2017: £370.8m). Initiatives introduced in the first half of 2018 included the launch of our bridging proposition and the expansion of our distribution network to reach a wider broker audience. As ever, these were supported by the Bank's core strengths in rapid and effective underwriting and our ability to deal with large and complex cases. In the second half of the year, InterBay Asset Finance was launched, funding its first deals in October 2018 and exceeding our lending targets. The weighted average LTV in this sub-segment remained low at 66% and the average loan size was £360,000 in 2018.

Our Heritable Development Finance business, which was set up as a joint venture with the Heritable team in late 2013, provides development finance to small and medium-sized residential developers operating in areas of the UK where demand for housing is consistently strong. New applications come primarily from a mixture of repeat business from the team's extensive existing relationships and from referrals. The business continued to grow in spite of new entrants to the market, as customers sought an experienced and prudent lender. In light of macroeconomic uncertainty, many experienced developers appear to have taken a cautious approach and therefore the number of potential schemes that withstand the business' stringent stress testing remains low.

The residential development funding gross loan book at the end of 2018 was £155.8m, with a further £90.3m committed (31 December 2017: £143.9m and £78.0m respectively). Gross advances during 2018 totalled £137.6m (2017: £123.7m).

In addition, the Bank continued to provide secured funding lines 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 2018 were £385.0m with total loans outstanding of £168.1m (31 December 2017: £303.0m and £104.5m respectively). During 2018, one facility was repaid and three new funding lines were added and credit approved limits increased by a further £47.0m across four existing funding lines. The pipeline remains robust, however, given the macroeconomic uncertainty, the Bank continues to adopt a cautious approach.

In the second half of 2018, the Group established its asset finance business under the InterBay brand targeting underserved markets where we can bring our expertise to the fore to generate attractive returns on a risk-adjusted basis. The first deals were funded in October, working with a small number of brokers and targeting predominantly UK SMEs and small corporates for whom the Group finances business-critical assets. The assets are mostly plant and machinery, construction equipment and commercial vehicles, all with an established inherent resale value. The gross carrying amount under finance leases was £7.2m as at 31 December 2018.

OSB's combined Buy-to-Let/SME net loan book grew by 31% in 2018 to £7,389.2m (2017: £5,654.1m) due to gross new lending in the year, partially offset by back book redemptions, and it is the Group's largest segment. Buy-to-Let/SME made a contribution to profit of £213.3m in 2018, up 22% compared to £174.8m in 2017, primarily due to the growth in new lending, partially offset by higher impairment losses of £5.7m (2017: £0.8m), due to the addition of a 'no-deal' Brexit downside economic scenario in our IFRS 9 modelling. Removing the impact of this additional scenario, loan loss provisions remained broadly flat year on year.

The Group remains highly focused on the quality of new lending as demonstrated by the average LTV in the Buy-to-Let/SME segment as at 31 December 2018 of 70% (31 December 2017: 69%) with only 0.6% of loans exceeding 90% LTV (31 December 2017: 0.7%). The average LTV for new Buy-to-Let/SME origination was 70% (2017: 70%).

1. The personal loan portfolio was disposed of in the year, for more information see note 6 to the financial statements.
2. UK Finance, New and outstanding buy-to-let mortgages, 19 Feb 2019.

Operating and financial review continued

Residential mortgages

Gross loan book

£1,616.0m

-3%

2017: £1,673.5m

Net interest income

£67.3m

-1%

2017: £68.3m

Contribution to profit

£60.7m

+3%

2017: £58.9m

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-segment: gross loans

	Group 31-Dec-2018 £m	Group 31-Dec-2017 £m
First charge	**1,223.9**	1,240.6
Second charge	**368.0**	415.3
Funding lines	**24.1**	17.6
Total	**1,616.0**	1,673.5

As at 31 December 2018, the Residential gross loan book was £1,616.0m, down 3% compared to the previous year (2017: £1,673.5m) with £280.1m of organic originations in the segment, up 15% from £243.9m in 2017.

The first charge gross loan book reduced to £1,223.9m from £1,240.6m in 2017 as a result of new organic lending being more than offset by redemptions in the back book and acquired mortgages in run-off.

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 lenders, as most favour automated decision-making over manual underwriting. In 2018, the Group made a tactical entry into the near-prime residential market. This market provides the Bank with a strategic opportunity as we pursue our internal ratings-based approach to risk weighting. 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 to refinance their first charge mortgage. Competitive pressure in the second charge market kept pricing low and we continued to manage our market share to ensure we appropriately price for risk. The second charge residential loan book had a gross value as at 31 December 2018 of £368.0m (2017: £415.3m).

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 to adopt a cautious approach in the more cyclical businesses given macroeconomic uncertainty. Total credit approved limits at 31 December 2018 were £51.8m with total loans outstanding of £24.1m (2017: £33.6m and £17.6m respectively). During 2018, the credit limit for one facility was increased by £20.0m and its maturity date extended.

OSB's total residential loan portfolio had a net carrying value of £1,605.1m as at 31 December 2018 (2017: £1,665.1m). The average LTV remained low at 56% (2017: 56%) with only 3% of loans by value with LTVs exceeding 90% (2017: 3%). The average LTV of new residential origination during 2018 was 68% (2017: 65%).

Residential mortgages made a contribution to Group profit of £60.7m in 2018, up 3% from £58.9m in 2017, reflecting slightly lower net interest income, more than offset by lower third party servicing fees, lower amortisation of the fair value adjustment on hedged assets relating to cancelled swaps and lower loan losses.

Case study

Creating our asset finance company

Jennifer Calver – Head of Operations, InterBay Asset Finance

Joining OSB in the summer of 2018 to launch the asset finance business was a great opportunity. My first few months were varied as we prepared for launch. Funding our first deals in October 2018 was an achievement for the whole team and now that we are up and running, no two days are alike. As the business levels increase, I am involved in recruiting for my team, developing processes and enhancing our systems and working practices.

The most rewarding part of it all however, has always been providing our customers with the best service possible by working with our colleagues across the Bank. We created InterBay Asset Finance business from the ground up and I am really excited to be part of this growing business.

YEAR ENDED 31-DEC-2018	BTL/SME £m	Residential mortgages £m	Total £m
BALANCES AT THE REPORTING DATE			
Gross loans and advances to customers	**7,389.2**	**1,616.0**	**9,005.2**
Provision for impairment losses on loans and advances	**(11.0)**	**(10.9)**	**(21.9)**
Loans and advances to customers	**7,378.2**	**1,605.1**	**8,983.3**
Risk weighted assets	**3,453.8**	**758.0**	**4,211.8**
PROFIT OR LOSS FOR THE YEAR			
Net interest income	**220.0**	**67.3**	**287.3**
Other expense	**(1.0)**	**(4.2)**	**(5.2)**
Total income	**219.0**	**63.1**	**282.1**
Impairment losses	**(5.7)**	**(2.4)**	**(8.1)**
Contribution to profit	**213.3**	**60.7**	**274.0**

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 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

Key performance indicators

KPI	Definition	2018 performance
1. Gross new lending Performance £3.0bn **+15%** **2018 £3.0bn** 2017 £2.6bn 2016 £2.3bn	This is defined as gross new organic lending before redemptions.	Gross new lending reflects growth in new origination, primarily in the BTL/SME segment.
2. Net interest margin Performance 304bps **-12bps** **2018 304bps** 2017 316bps 2016 316bps	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 down on prior year mostly due to a change in asset mix with an increasing proportion of lower-yielding front book mortgages diluting the higher-yielding back book and wider average five year swap spreads partially offset by a relatively favourable cost of retail funds.
3. Cost to income ratio Performance 28% **+1pp** **2018 28%** 2017 27% 2016 27%	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 of 28%, despite the additional costs of meeting regulatory requirements and investment in the business, continues to be market leading.
4. Underlying profit before tax Performance £193.6m **+15%** **2018 £193.6m** 2017 £167.7m 2016 £138.2m	This is defined as statutory profit before tax before exceptional items. See reconciliation of statutory profit to underlying profit in Alternative performance measures on page 33.	The increase reflects strong balance sheet growth, stable front book pricing, continued focus on cost discipline and efficiency, and low loan losses. Statutory profit before tax of £183.8m in 2018 increased by 10% compared to £167.7m in 2017.
5. Underlying basic EPS Performance 58.5 pence per share **+14%** **2018 58.5p** 2017 51.1p 2016 41.7p	This is defined as underlying profit attributable to ordinary shareholders, which is profit after taxation before exceptional items less the 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 33.	The strong growth is in line with the significant increase in underlying profitability of the Bank. On a statutory basis basic EPS increased to 55.5 pence per share in 2018 from 51.1 pence per share in 2017.

KPI	Definition	2018 performance
6. Return on equity Performance 26% **-2pp** 2018: 26% 2017: 28% 2016: 29%	This is defined as underlying profit after tax 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 tax, see reconciliation of statutory profit to underlying profit in Alternative performance measures on page 33.	Return on equity remained strong at 26% (2017: 28%) despite our strengthened capital position.
7. Dividend per share Performance 14.6 pence per share **+14%** 2018: 14.6p 2017: 12.8p 2016: 10.5p	This is defined as the sum of the recommended final dividend for 2018 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 10.3 pence per share in respect of 2018 at the Bank's AGM on 9 May 2019. This, together with the interim dividend of 4.3 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 2018, in line with the Bank's target dividend payout ratio.
8. CRD IV fully-loaded Common Equity Tier 1 capital ratio Performance 13.3% **-0.4pp** 2018: 13.3% 2017: 13.7% 2016: 13.3%	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 13.3% reflects the ability of the business to generate capital to support significant loan book growth through profitability.
9. Loan loss ratio Performance 10bps **+3bps** 2018: 10bps 2017: 7bps 2016: 16bps	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 loan loss ratio of 10bps for 2018 (2017: 7bps) is primarily due to the implementation of 'no-deal' Brexit scenario assumptions in the calculation of expected loan loss provisions. Removing the impact of the more severe Brexit scenario, the Group's loan loss ratio would have been c.6bps. The ratio also reflects the continued strong performance from the front book of loans. From more than 48,500 loans totalling £11bn of new organic originations since the Bank's creation in February 2011, we have only 206 cases of arrears over three months in duration, with an aggregate balance of £53.5m and average LTV of 62%.
10. Customer satisfaction – Net Promoter Score Performance +63 **+1** 2018: +63 2017: +62 2016: +59	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 customer NPS improved to an outstanding +63. 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 continue to deliver high levels of customer satisfaction.

Financial review

Summary profit or loss	Group 31-Dec-2018 £m	Group 31-Dec-2017 £m
Net interest income	**287.3**	245.4
Net losses on financial instruments	**(5.2)**	(6.3)
Net fees and commissions	**0.6**	0.5
External servicing fees	**(0.6)**	(1.5)
Administrative expenses[1]	**(79.6)**	(65.1)
FSCS and other regulatory provisions	**(0.8)**	(0.9)
Impairment losses	**(8.1)**	(4.4)
Exceptional cost–Heritable option	**(9.8)**	–
Profit before taxation	**183.8**	167.7
Profit after taxation	**140.3**	126.9
Underlying profit before taxation[2]	**193.6**	167.7
Underlying profit after taxation[2]	**147.5**	126.9
Key ratios		
Net interest margin[2]	**304bps**	316bps
Cost to income ratio[2]	**28%**	27%
Management expense ratio[3]	**0.84%**	0.86%
Loan loss ratio[2]	**0.10%**	0.07%
Basic EPS[2], pence per share	**55.5**	51.1
Underlying basic EPS[2], pence per share	**58.5**	51.1
Return on equity[2]	**26%**	28%
Dividend per share, pence per share	**14.6**	12.8
Extracts from the Statement of Financial Position	**£m**	£m
Loans and advances	**8,983.3**	7,306.0
Retail deposits	**8,071.9**	6,650.3
Total assets	**10,460.2**	8,589.1
Key ratios		
Liquidity ratio[4]	**14.5%**	15.2%
Common Equity Tier 1 ratio[5]	**13.3%**	13.7%
Total capital ratio	**15.8%**	16.9%
Leverage ratio	**5.9%**	6.0%

1. Including depreciation and amortisation.
2. See definition in Key performance indicators table on pages 30–31.
3. Administrative expenses including depreciation and amortisation as a percentage of average total assets.
4. Liquid assets as a percentage of funding liabilities.
5. Fully-loaded under Basel III/CRD IV.

Strong profit growth

The Group reported profit growth of 10% in 2018 with statutory profit before taxation of £183.8m (2017: £167.7m) including the exceptional cost of £9.8m relating to the Heritable option. On an underlying basis, before this exceptional item, the Bank recorded a 15% increase in underlying profit before taxation to £193.6m (2017: £167.7m) reflecting strong balance sheet growth supported by lending at attractive margins and our efficient cost base.

Profit after taxation in 2018 increased by 11% to £140.3m (2017: £126.9m) including the after tax exceptional cost of £7.2m for the Heritable option. On an underlying basis, profit after taxation increased by 16% to £147.5m (2017: £126.9m). The Group's effective tax rate was 23.7%[1] in 2018 (2017: 24.1%), 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 17% to £287.3m in 2018 (2017: £245.4m) reflecting the strong growth in the loan book and NIM of 304bps (2017: 316bps).

The lower NIM reflects the changing mix of the loan book despite broadly stable asset pricing and wider average five year swap spreads, partially offset by a relatively favourable cost of retail funds and additional benefit from the Bank of England's Term Funding Scheme ('TFS'). The mix of the loan book continues to change with new origination forming a growing proportion of the total book, diluting the impact of loans originated or acquired several years ago when yields were exceptionally high. The favourable cost of retail funds was due primarily to the retail savings market not pricing in the full November 2017 and August 2018 Bank of England Base Rate rises.

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 tax **Group 31-Dec-2018 £m**	Profit before tax Group 31-Dec-2017 £m	Profit after tax **Group 31-Dec-2018 £m**	Profit after tax Group 31-Dec-2017 £m
Statutory profit	**183.8**	167.7	**140.3**	126.9
Exceptional cost–Heritable option	**9.8**	–	**7.2**	–
Underlying profit	**193.6**	167.7	**147.5**	126.9

Statutory basic EPS of 55.5 pence per share (2017: 51.1 pence per share) is calculated by dividing profit attributable to ordinary shareholders of £135.6m (2017: £124.2m) which is profit after tax of £140.3m (2017: £126.9m) less coupons on equity PSBs, including the tax effect of £0.7m (2017: £0.7m) and coupons on AT1 securities, including the tax effect of £4.0m (2017: £2.0m) by the weighted average number of ordinary shares in issue during the year of 244.2m (2017: 243.2m).

Underlying basic EPS of 58.5 pence per share (2017: 51.1 pence per share) is calculated by dividing underlying profit attributable to ordinary shareholders of £142.8m (2017: £124.2m), which is underlying profit after tax of £147.5m (2017: £126.9m) less coupons on equity PSBs, including the tax effect of £0.7m (2017: £0.7m) and coupons on AT1 securities, including the tax effect of £4.0m (2017: £2.0m) by the weighted average number of ordinary shares in issue during the year of 244.2m (2017: 243.2m).

Losses on financial instruments

The fair value loss on financial instruments in 2018 of £5.2m (2017: £6.3m) includes a net loss of £0.3m from the Group's hedging activities (2017: £1.1m gain) and £4.6m amortisation of fair value adjustments on hedged assets relating to cancelled swaps (2017: £7.3m). 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 2018, the Group also made a £0.1m loss on disposal of the residual amount of the personal loan portfolio. For more detail, see note 6 to the financial statements.

Net fees and commission

Net fees and commission income of £0.6m (2017: £0.5m) comprises fees and commission receivable of £1.7m (2017: £1.5m) partially offset by commission expense of £1.1m (2017: £1.0m).

Fees and commissions receivable grew by £0.2m which is mostly attributable to an increase in InterBay application fees resulting from business growth.

Fees and commissions payable remained broadly flat in 2018 and related to branch agency fees and commissions paid to the Kent Reliance Provident Society for conducting member engagement activities for the Bank.

External servicing fees

External servicing fees decreased to £0.6m in 2018 (2017: £1.5m) due to the transfer of servicing for the majority of acquired first charge residential loan books to the Bank's operation in India during the year and the disposal of the remaining personal loans portfolio.

Efficient and scalable operating platform

Administrative expenses, including depreciation and amortisation, were up 22% to £79.6m in 2018 (2017: £65.1m), reflecting the growth in the loan book and increased spend incurred in delivering regulatory projects, principally General Data Protection Regulation ('GDPR'), the Second Payment Services Directive ('PSD2') and the ongoing project to deliver IRB. In addition, the Bank also commenced work on upgrading its customer platforms and made significant improvements to the IT infrastructure.

Despite the project spend, the Group's cost to income ratio of 28% and the management expense ratio of 0.84% remained strong (2017: 27% and 0.86% respectively) reflecting continuous focus on finding efficiencies in the costs of running the Bank on a 'business as usual basis' and use of its scalable low cost back office based in Bangalore, India.

FSCS and other regulatory provisions

Regulatory provisions expense remained stable at £0.8m (2017: £0.9m). This includes levies due to the Financial Services Compensation Scheme which continued to decrease in the year and other regulatory provisions on acquired books.

Financial review continued

Impairment losses
Since 1 January 2018 the Group has calculated expected credit loss provisions under IFRS 9. Impairment losses increased to £8.1m in 2018 (2017: £4.4m) representing 10bps on average gross loans and advances (2017: 7bps).

On adoption of IFRS 9, the Group utilised three macroeconomic scenarios (upside, base and downside) within expected credit loss calculations. Due to ongoing uncertainty relating to the UK's exit from the European Union, the Board deemed it appropriate to implement a fourth scenario of a disorderly 'no-deal' Brexit, which increased the Group's provision requirements.

Removing the impact of the additional Brexit scenario, the Group's loan loss ratio would have been c. 6bps.

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 48,500 loans totalling £11.0bn of new organic originations since the Bank's creation in February 2011, there were only 206 cases of arrears over three months or more as at 31 December 2018, with an aggregate value of just £53.5m and average LTV of 62%.

IFRS 9
The Group successfully implemented IFRS 9 as at 1 January 2018. The day 1 impact of implementation was an increase in impairment provisions of £3.6m.

The stage 3 provisions increase relates to a higher balance of loans which are in arrears greater than three months and the Group's IFRS 9 methodology, which includes a probation period before returning to a non-default status. Following a review, the Group also made changes to the threshold criteria for classification into stage 2 which resulted in an increased balance of loans in stage 2.

Exceptional items
The Heritable Development Finance business, which started lending in 2014, operates as a joint venture ('the JV') between the Bank and certain senior members of the Heritable team ('the JV partners'). Under the JV the parties agreed to co-operate in developing the business and to lend alongside each other, sharing revenues in accordance with a profit waterfall. The JV agreement also included a put/call option ('the Heritable option') over the JV partners' share of the business, exercisable from 2019, subject to certain conditions. During 2018, the conditions of exercise were met and an exceptional cost of £9.8m was recognised for the fair value of the option.

In 2019, the Heritable option was surrendered for a one-off payment of £9.8m and the Bank acquired the JV partners' interest in the business. At the same time a new revenue sharing arrangement was signed allowing the JV partner to continue to lend alongside the Bank

There were no exceptional items in 2017.

Dividend
The Board recommends a final dividend for 2018 of 10.3 pence per share. Together with the 2018 interim dividend of 4.3 pence per share, this represents 25% of underlying profit after taxation attributable to ordinary shareholders for 2018, in line with the Bank's target dividend payout ratio. The proposed final dividend will be paid on 15 May 2019, subject to approval at the AGM on 9 May 2019, with an ex-dividend date of 21 March 2019 and a record date of 22 March 2019.

Balance sheet growth
Net loans and advances grew by 23% in 2018 to £8,983.3m (31 December 2017: £7,306.0m) primarily due to an increase in new lending in our Buy-to-Let and commercial sub-segments.

Retail deposits and total assets grew by 21% and 22%, respectively in 2018 with the final drawings under the TFS funding of £250.0m in the first quarter of 2018, taking the balance under the scheme as at the year end to £1,502.9m (31 December 2017: £1,250.0m).

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 the drawing to repay the existing loans.

In 2018, the Group also took the opportunity to complement its retail and TFS funding by borrowing £80.0m under the Bank of England's Indexed Long-Term Repo scheme ('ILTR') at base rate +15bps which was 90bps as at 31 December 2018. The ILTR is an auction and the borrowings are offered as a collateralised cash loan repayable in six months.

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 2018, our liquidity coverage ratio of 224% (2017: 250%) was significantly in excess of the 2018 regulatory minimum of 100%, including drawings under the Bank of England TFS funding facilities. The Group's liquidity ratio as at 31 December 2018 was 14.5% (31 December 2017: 15.2%).

The Bank's retail savings franchise continued to provide the business with long-term sustainable funding for balance sheet growth as evidenced by the retention rate for maturing deposits of 95% and an exceptional level of customer satisfaction with a Net Promoter Score of +63.

Capital
The Bank's fully-loaded CET1 capital ratio under CRD IV remained robust at 13.3% as at 31 December 2018 (31 December 2017: 13.7%), demonstrating the strong organic capital generation capability of the business to support significant growth through profitability.

The Bank had a total capital ratio of 15.8% and a leverage ratio of 5.9% as at 31 December 2018 (31 December 2017: 16.9% and 6.0% respectively).

The Bank had a Pillar 2a requirement of 1.1% of risk-weighted assets as at 31 December 2018 (31 December 2017: 1.1%).

Cash flow statement

The Group's cash and cash equivalents increased by £158.3m during the year to £1,324.2m as at 31 December 2018.

During the year, the increase in the Group's loans and advances to customers of £1,689.5m was largely funded by £1,421.6m of deposits from retail customers and contributed to £85.1m of cash used in operating activities. The remaining funding came largely from the final drawdown under the TFS of £250.0m and £80.0m of funding under the Bank of England's Indexed Long-Term Repo scheme, which generated £289.0m of cash from financing activities. Cash used in investing activities was £45.6m, primarily driven by net purchases and maturities of investment securities of £40.0m.

In 2017, the Group replaced £524.6m of the 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.

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 £511.1m 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 £1,165.7m 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.

Summary cash flow statement	Group 31-Dec-2018 £m	Group 31-Dec-2017[2] £m
Profit before tax	**183.8**	167.7
Net cash generated/(used in):		
Operating activities	**(85.1)**	(511.1)
Investing activities	**(45.6)**	26.0
Financing activities	**289.0**	1,165.7
Net increase in cash and cash equivalents	**158.3**	680.6
Cash and cash equivalents at the beginning of the period	**1,165.9**	485.3
Cash and cash equivalents at the end of the period	**1,324.2**	1,165.9

1. Effective tax rate excludes £0.1m of adjustments relating to prior years.
2. The comparative information has been reclassified to include interest paid on bonds and subordinated debt, which was previously shown within operating activities, within financing activities.

Case study

Stronger together – bringing our values to life

Anita Hughes – Internal Communications Manager

2018 was a challenging and exciting year for the Internal Communications team, which included us supporting the launch of our new Mission, Vision and Values with colleagues across both the UK and India.

Our Mission, Vision and Values were designed using insight gathered from colleagues across all areas of the business, so when the time came to share them, it was important we did this in a meaningful way – by bringing everyone together, sharing real life stories, videos and creating activities that brought our values to life.

The response to our light-hearted teaser campaign and employee events was very positive; but it was a truly collective effort. We engaged the support of colleagues across the business to help create our campaign and embed it within our different locations, ensuring maximum impact, which as it turned out saw one of our new values already in action – stronger together!

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 enhance its risk identification and management capabilities to ensure ongoing compliance with emerging industry and regulatory standards.

By 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, the Group took appropriate and timely actions in response to the changing economic, business and regulatory environment.

The Group has maintained its focus on risk-based investment to enhance data governance and controls, and made good progress towards building Internal Ratings-Based Approach ('IRB') capabilities. The discipline associated with effective operational resilience has continued to be an important area of enhanced risk management. The Group has established effective and scalable operating models across all risk functions, which include leveraging its OSBI operations.

The Group delivered strong and profitable growth whilst maintaining a low and stable risk profile. The loan assets have continued to exhibit strong performance and the Group has maintained high quality capital and liquidity buffers to meet its current and future requirements.

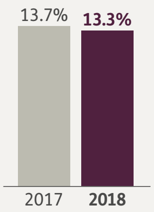
Ongoing stress testing demonstrates that the Group is resilient to extreme but plausible scenarios in the context of the ongoing uncertainty surrounding the economic, political and regulatory environment. In particular, the Group continues to actively monitor the developments relating to Brexit negotiations.

The Group has successfully managed its funding and liquidity profile post the withdrawal of the Term Funding Scheme by the Bank of England in February 2018.

The other key regulatory developments to which the Group is responding include the General Data Protection Regulation ('GDPR') and the Second Payment Services Directive ('PSD2'). The Group has appropriate systems and controls to comply with the requirements and these continue to be enhanced as the Group improves its capabilities.

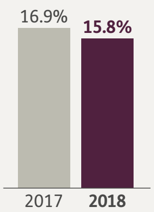
Key risk indicators | Commentary

CET1 ratio



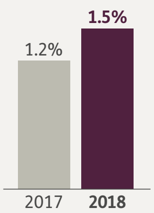
The Group's fully-loaded CET1 ratio remained well above regulatory minimums at 13.3% at the end of 2018 (2017: 13.7%).

Total capital ratio



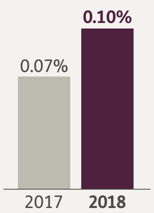
The Group's total capital ratio remained strong at 15.8% in 2018 (2017: 16.9%).

3+ months in arrears*



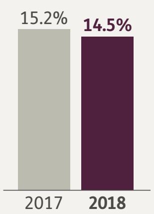
The percentage of loans more than three months in arrears was 1.5% in 2018 (2017: 1.2%).

Cost of risk



Impairments increased to 0.10% (2017: 0.07%) driven by changes to the IFRS 9 impairment approach, specifically the implementation of a fourth macroeconomic scenario, aligned to a disorderly 'no-deal' Brexit scenario, which increased the Group's provision requirements.

Liquidity ratio



The Group's liquidity ratio remained well above regulatory and risk appetite limits in 2018 finishing the year at 14.5% (2017: 15.2%).

The liquidity coverage ratio of 224% (2017: 250%) is significantly above the regulatory minimum of 100%.

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

High level key risk indicators

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

Key achievements in 2018

The Group continued to improve its risk appetite and stress testing procedures to identify, monitor and manage the risks associated with Brexit. In particular, the Group has leveraged its IRB and IFRS 9 models to assess capital and provision requirements across a range of macroeconomic and business scenarios.

Liquidity and funding forecasting procedures have further improved and the Group is fully prepared to access wholesale funding through securitisation at a commercially opportune time. The Group continues to make investment to further enhance its retail and SME funding propositions.

Good progress continues to be made on delivering a robust and compliant IRB programme. The IRB programme has been focused on the delivery of second generation IRB models, further embedding model governance and validation procedures and improved adherence to regulatory requirements.

Improvements have been made to the Group's data management and governance capabilities driven by the Group's strategic data management objectives. This initiative is designed to deliver integrated data controls, aggregation and reporting capabilities.

The Group established the core components of an effective and regulatory compliant operational resilience framework. The operational resilience framework ensures that all critical services and operations are supported by a resilient infrastructure of systems and processes which are subject to ongoing monitoring and testing. The Group has improved its procedures relating to business continuity planning and disaster recovery.

The launch of our asset finance business was subject to extensive review and development of appropriate policies, systems and controls to ensure that the underlying risks were fully understood and appropriately priced and managed.

The Group continued to make significant investment in people across the Risk and Compliance functions, ensuring that there is sufficient capacity and capability to ensure it is well positioned to deliver against its growth strategy.

Risk-based management information has been an important area of continued improvement across all risk types.

Priority areas for 2019

The Group has established a comprehensive and scalable risk management framework covering current and forward-looking risks. During 2019, the Group will further refine and embed its risk management capabilities in the context of changing economic, business and operating conditions. In particular, the Group has identified the following key areas to further improve its risk and compliance capabilities:

- Delivery of an enhanced and integrated data governance and controls framework which is integrated with the Group's risk, financial and regulatory reporting procedures.
- Integration of second generation IRB credit risk models with credit portfolio monitoring, stress testing and capital planning, risk appetite and risk-based pricing.
- Development of IRB waiver documentation demonstrating compliance with approval requirements.

The Board and senior management continue to provide appropriate oversight and direction to all risk and compliance 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

The Group views its capabilities to effectively identify, assess and manage its risk profile as critical to its growth strategy. The Group's approach to risk management is outlined within the Strategic Risk Management Framework ('SRMF').

The SRMF is the overarching framework which enables the Board and senior management to actively manage and optimise the risk profile within the constraints of the risk appetite. The SRMF also enables informed decisions to be taken in a timely manner by factoring the interests and expectations of key stakeholders.

The SRMF also provides a structured mechanism to align all components of an effective approach to risk management. The SRMF links overarching risk principles to day-to-day risk management activities.

Risk review continued

The modular construct of the SRMF provides for an agile approach to keeping pace with the evolving nature of the risk profile and underlying drivers. The SRMF and its core modular components are subject to periodic review and approval by the Board and its relevant Committees.

The key modules of the SRMF structure are as follows:

1: Risk principles and culture
2: Risk strategy and appetite
3: Risk governance and function organisation
4: Risk definitions and categorisation

Further detail on these modules is set out in the Group's Pillar 3 Disclosures.

The following diagrams outline the core components of the SRMF and the organisational arrangements to ensure that the Group operates in accordance with the requirements of the SRMF.

Strategic Risk Management Framework ('SRMF')

Key elements

Risk principles and culture
Risk strategy and appetite
Risk governance and function organisation
Risk definitions and categorisation

Principal risks

Financial risks	Non-financial risks	
Credit risk Market risk Liquidity risk Solvency risk	Strategic and business risk Reputational risk Compliance/regulatory risk	Operational risk Conduct risk

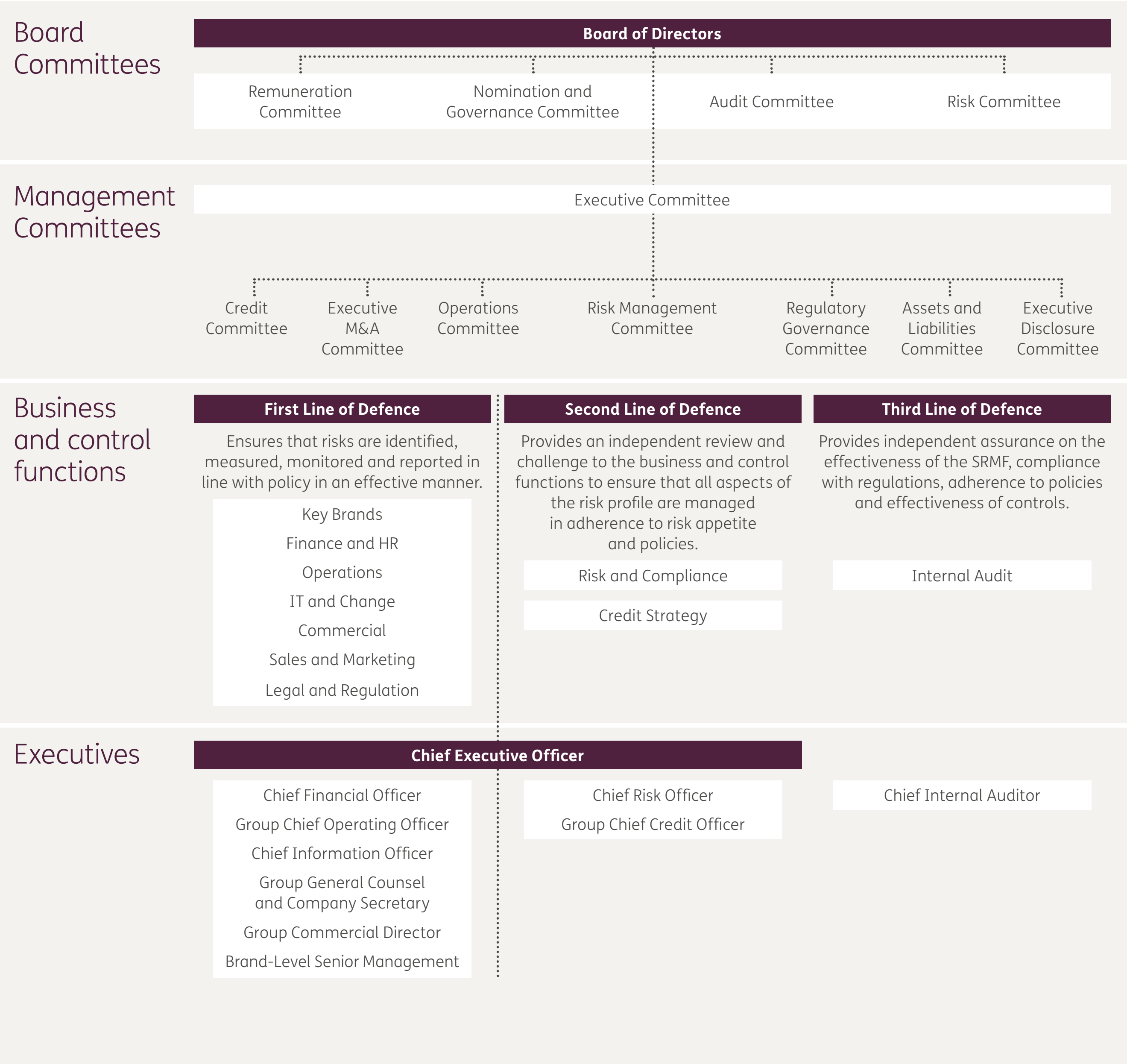
Capabilities

Risk framework and policies	Risk data and IT	Risk analytics	Risk MI

Risk regulatory submissions

ICAAP	ILAAP	Recovery Plan/ Resolution Pack

The OSB risk organisational structure is detailed below:



Risk review continued

Risk appetite

The Group aligns its strategic and business objectives with its risk appetite, enabling the Board and senior management to monitor the risk profile relative to its strategic and business performance objectives. Risk appetite is a critical mechanism through which the Board and senior management are able to identify adverse trends and respond to unexpected developments in a timely and considered manner.

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, risk appetite is calibrated to ensure that the Bank continues to deliver against its strategic and business objectives and maintains sufficient financial resource buffers to withstand plausible but extreme stresses. The primary objective of the risk appetite is to ensure that the Group's strategy and business operating model is sufficiently resilient.

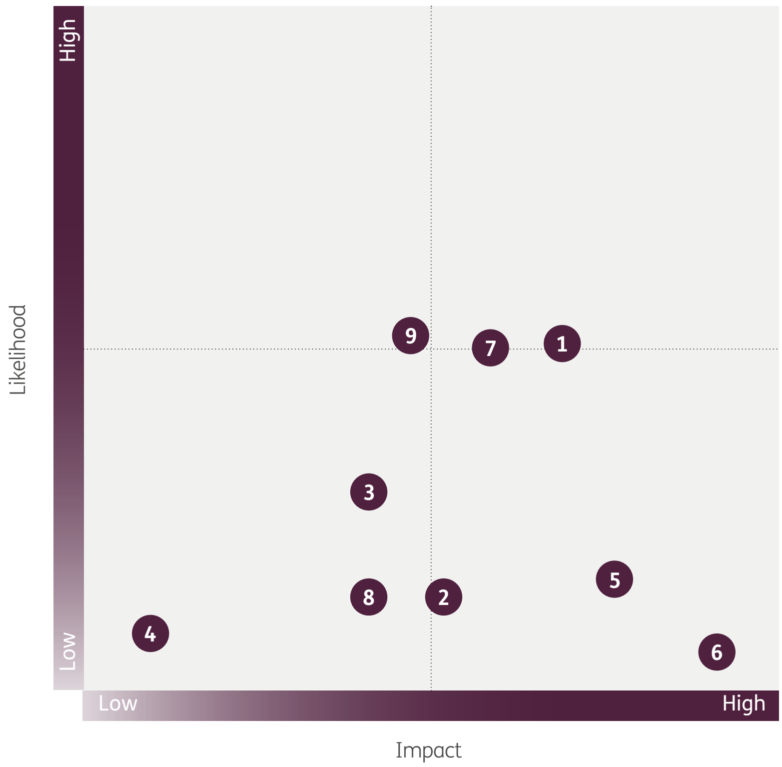
The risk appetite is calibrated using statistical analysis and stress testing to inform the process for setting management triggers and limits against key risk indicators. The calibration process is designed to ensure that timely and appropriate actions are taken to maintain the risk profile within approved thresholds. The Board and senior management actively monitor actual performance against approved management triggers and limits.

Overarching risk appetite statement

The Group aims to ensure that it is able to withstand a severe but plausible stress without breaching its key performance indicators and underlying risk limits. In particular, it should remain profitable and meet its prudential requirements under a 1 in 20 intensity stress (where applicable), by factoring for corrective management actions.

The Group 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 Group 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, with 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.

Current assessment of our principal risks



The Bank's principal risks are set out in the following heat map and in detail on pages 41 to 46.

1. Strategic and business risk
2. Reputational risk
3. Credit risk
4. Market risk
5. Liquidity and funding risk
6. Solvency risk
7. Operational risk
8. Conduct risk
9. Compliance/regulatory risk

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:

1 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
The Group's strategic and business risk appetite states that the Group does not intend to undertake any medium to long-term strategic actions that would put at risk its vision of being a leading specialist lender, backed by a strong and dependable savings 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.

Risk	Mitigation	Direction
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 its 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 new 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 the 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 vulnerability.	**Increased** The Group's strategic and business risk profile is impacted by the uncertainty surrounding Brexit negotiations and potential future changes to regulatory standards.
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 allow the Group to respond effectively to regulatory change.	**Increased** The level and sophistication of emerging regulatory requirements place increasing demands on the Group's operational capacity.

2 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
The Group does not knowingly conduct business or organise its operations to put its reputation and franchise value at risk.

Risk	Mitigation	Direction
Deterioration of reputation 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

3 Credit risk

Definition

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

Risk appetite statement
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 scenario.

Risk	Mitigation	Direction
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 in most cases 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 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.	**Increased** The economic outlook is uncertain with the final terms of Brexit to be confirmed. The likelihood of a 'no-deal' Brexit has increased.
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 minimise credit risk on most of its liquidity portfolio.

4 Market risk

Definition

Potential loss due to changes in market prices or values.

Risk appetite statement
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.

Risk	Mitigation	Direction
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 rates 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's Basis Risk exposure is measured on a monthly basis against a range of stress scenarios. Exposure is constrained by risk appetite with balance sheet strategy and hedging used to minimise mismatches.	**Unchanged** Product design and balance sheet strategy has enabled the Group to maintain the overall level of basis risk through the year.

5 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
The Group actively maintains stable and efficient access to liquidity and funding 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.

Risk	Mitigation	Direction
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 the OSB franchise.	The Group's funding strategy is focused on a highly stable retail deposit franchise. The large number of depositors and mix of easy access, one and two year term products, provides diversification, with a high proportion of balances covered by the FSCS and so at 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 Assets and Liabilities Committee (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.	**Unchanged** The Group's funding mix remained stable throughout the year.

Principal risks and uncertainties continued

6 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
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 leverage ratio related requirements. We manage our capital resources in a manner which avoids excessive leverage and allows us flexibility in raising capital.

Risk	Mitigation	Direction
Deterioration of capital ratios 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.	**Unchanged** The Group has maintained a prudent and stable CET1 capital and total capital position providing resilience against unexpected losses.

7 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
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.

Risk	Mitigation	Direction
Cyber/data security risk The risk of loss of customer or proprietary data as a result of malicious activities 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 continues to make enhancements to its defences with respect to IT security threats, it recognises that the threats to the industry continue to grow both in respect of volume and 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. Oversight is achieved via a Data Strategy programme, designed to ensure a consistency of approach and implementation.	**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.

7 Operational risk continued

Risk	Mitigation	Direction
Operational and IT resilience The inability of the Bank to maintain the provision of its high priority services in the event of a major incident impacting its IT infrastructure, facilities, people or the third parties on which it relies to provide those services.	The completion of all modules of the Operational Resilience programme has delivered a Group-wide approach in respect to planning and testing. The Bank has developed a thorough testing schedule intended to validate its response to a range of significant scenarios. In addition, a series of training and awareness activities are intended to increase the Bank's readiness to respond to an incident. A range of back-up technologies employed to provide real-time replication of 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 increased risk is primarily driven by the expanding scale of the Bank's operations and the continued evolution of cyber-based threats. However the Bank has invested significantly in its operational resilience frameworks, capabilities and testing to better address the emerging risks.
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.	Whilst the Bank adopts a risk-based approach to automation, it recognises that a number of manual processes remain, which have a proportionate level of controls associated with them.	**Unchanged** 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.

8 Conduct risk

Definition

The risk that the Group's behaviours or actions result in customer detriment or have a negative impact on the integrity of the market segments in which it operates.

Risk appetite statement
The Bank considers its culture and behaviours in ensuring the fair treatment of customers and in maintaining the integrity of the market segments 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.

Risk	Mitigation	Direction
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.	**Unchanged** Whilst this risk has remained low 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, 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 2018 the network/system threats continue to increase in both volume and sophistication.

Principal risks and uncertainties continued

9 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
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 to its business operating model.

Risk	Mitigation	Direction
Regulation changes Key compliance and regulatory changes that impacted the Bank include changes in the standardised approach to capital rules, implementation of an IRB floor and introduction of IFRS 9 accounting standard for computing impairment allowance requirements.	The Bank has an effective horizon scanning process to identify regulatory change. All significant regulatory initiatives are managed by structured programmes overseen by the Project and Change Management team and sponsored at Executive level. The Bank has proactively sought external expert opinions to support interpretation of the requirements and validation of its response, where required.	**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 Conduct Authority's Discussion Paper on Price Discrimination in the Cash Savings Market or HM Treasury's consultation on Breathing Space and Statutory Debt Repayment Plan 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 risk to be:

Emerging risk	Description	Mitigation action
Political and macroeconomic uncertainty.	As the outcome of Brexit remains unclear, 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 such as changes to house prices, interest rates and unemployment rates.	The Group 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 subsequently developed a suite of early warning indicators which are closely monitored to identify changes in the economic environment. The Group has no European operations outside of the UK and has minimal deposits from non-UK customers limiting its exposure to Brexit-related operational risks.

RISK PROFILE PERFORMANCE OVERVIEW

Credit risk

Credit profile performance

The Group's credit profile performed strongly in 2018, 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 loan portfolio composition continued to evolve with pre-2011 lending (prior to OneSavings Bank plc being established) continuing to run off. Legacy problem loans reduced further in 2018 from £8.6m to £5.6m, 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 2018, with no impairment recognised across either portfolio.

Strong Group originations performance was observed in 2018, 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 UK'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. From 48,500 loans which were underwritten post 2011, 206 loans are greater than three months in arrears, totalling £53.5m with a weighted average LTV of just 62%.

Strong credit risk management and continuing favourable economic conditions, supported the portfolio arrears rate of 1.5% as at 31 December 2018 (31 December 2017: 1.2%).

Segment	Measure	31-Dec-2018	31-Dec-2017	Variance	Commentary
BTL/SME	New origination average LTV	70%	70%	–	New lending average LTV remained stable
	Weighted average Interest Coverage Ratio for new lending	171%	185%	-14%	Resulting from a higher proportion of five year products and a rising base rate
Residential lending	New origination average LTV	68%	65%	+3%	Increase in new average LTV from new product mix
	Percentage of new residential lending with a loan to income (LTI) greater than 4.5	3.2%	3.2%	–	Remained stable year on year

Other key risk measures also performed strongly within the period:
- Gross exposure to commercial lending grew to £547.8m through the year with a weighted average LTV of 66%.
- Gross exposure to residential development finance remains low at £155.8m with a further £90.3m committed with a weighted average LTV of 35.2%.
- The Group has limited exposure to high LTV loans on properties worth more than £2m. In total only 6% 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 than 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.

Further information regarding forbearance can be found in note 39 to the financial statements.

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 low impairment performance for the full year to 31 December 2018.

Since 1 January 2018, the Group has been calculating expected credit loss provisions under an IFRS 9 approach, replacing the previous IAS 39 accounting standard.

Impairment losses totalled £8.1m during the full year to 31 December 2018 (2017: £4.4m) representing a loan loss ratio of 10bps (2017: 7bps). During 2018, the Group made a number of enhancements to its IFRS 9 impairment approach, including the implementation of a new probability of default model, enhancements to the Group's definition of default, cure criteria from stage 3 and the transfer criteria logic to move accounts from stage 1 to 2.

Principal risks and uncertainties continued

At the point of adoption of the IFRS 9 accounting standard the Group utilised three macroeconomic scenarios (upside, base and downside) within expected credit loss calculations. Due to ongoing uncertainty relating to Brexit, the Board deemed it appropriate to implement a fourth disorderly 'no-deal' Brexit scenario during December 2018, which increased the Group's provision requirements.

Removing the impact of this additional Brexit scenario, the loan loss ratio would have been c. 6bps.

Loan losses across the Buy-to-Let/SME segment increased during 2018, predominantly driven by the increased provision required post implementation of the Group's further downside disorderly 'no-deal' Brexit scenario. In addition, individually assessed provisions raised against a small number of high exposure new arrears cases and legacy problem loans within the period prior to resolution also contributed to the higher loan losses observed against this segment.

Across the Residential segment the stable loan to value profile and continued portfolio run down, predominantly driven by the run off of acquired and second charge originated mortgage portfolios, resulted in a lower loan loss ratio during the full year to 31 December 2018, versus the full year 2017.

The Group continues to closely monitor impairment coverage levels:

At 31 December 2018	Gross carrying amount (£m)	Provisions (£m)	Incurred loss remaining[1] (£m)	Coverage ratio[2]
Stage 1	8,286.8	4.3	–	**0.05%**
Stage 2	436.8	5.6	–	**1.28%**
Stage 3 (+ POCI)	281.6	11.8	7.2	**6.75%**
Undrawn loan facilities	–	0.2	–	**–**
Total	9,005.2	21.9	7.2	**0.32%**
At 1 January 2018 (post IFRS 9 transitional adjustment)				
Stage 1	6,782.5	7.8	–	**0.12%**
Stage 2	292.4	2.3	–	**0.79%**
Stage 3 (+ POCI)	252.7	15.1	7.9	**9.10%**
Undrawn loan facilities	–	–	–	**–**
Total	7,327.6	25.2	7.9	**0.45%**
At 1 January 2018 (IAS 39)				
Total	7,327.6	21.6	7.9	**0.40%**

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 is the total provisions plus incurred losses remaining versus gross loans and advances.

The total coverage ratio with respect to loans and advances to customers reduced to 0.33% from 0.40% as at 31 December 2017 (0.45% post IFRS 9 transitional adjustment) driven by the resolution of a number of significant individually assessed legacy problem loans. As these loans move to write off, the provision against the loans is released decreasing total book impairment.

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, 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.

The Bank's fully-loaded CET1 capital ratio under CRD IV remained robust at 13.3% as at 31 December 2018 (31 December 2017: 13.7%), demonstrating the strong organic capital generation capability of the business to support significant growth through profitability. The Bank had a total capital ratio of 15.8% and a leverage ratio of 5.9% as at 31 December 2018 (31 December 2017: 16.9% and 6.0% respectively).

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 continues to attract new retail savers and retain existing customers through loyalty-based product offerings.

In 2018, the Bank actively managed its liquidity and funding profile within the confines of its risk appetite as set out in the Internal Liquidity Adequacy Assessment Process ('ILAAP'). The Group's liquidity coverage ratio ('LCR') at 224% remains 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.

Transition away from LIBOR

The PRA and FCA have continued to encourage banks to transition away from using LIBOR as a benchmark in all operations before the end of 2021. Throughout the UK banking sector LIBOR remains a key benchmark and for each market impacted, solutions to this issue are progressing through various industry bodies.

In 2018, OSB set up an internal working group comprised of all of the key business lines that are involved with this change with strong oversight from the compliance and risk departments. Risk assessments are currently underway to ensure this process is managed in a measured and controlled manner.

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 2018, the Bank managed its interest rate risk exposure within its risk appetite limits.

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 CET1 capital, with exposure assessed and monitored monthly across a range of 'business as usual' and stressed scenarios.

Throughout 2018, 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 get 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 market segments 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 'to become our customers' favourite bank; one that delivers its very best, challenges convention and opens doors that others can't.'

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 market segments 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 position further through strong and sustainable financial performance.

Reputational risk
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.

The Bank monitors reputational risk through tracking media coverage, customer satisfaction scores, the share price and net promoter scores provided by brokers.

OSBIndia – a great place to work

OSBIndia is an integral part of the Group. We attract talented and dedicated employees who provide leading service both to the Bank's customers and to the rest of the Group. We were delighted to be certified as a 'Great place to work' in 2018. We work hard to ensure our vision and values are embedded in everything we do and this is reflected in the great culture that our employees love.

The benefits of being a great place to work go beyond providing a great service. Another business benefit is that our employee retention rates for 2018 are class leading. This has been confirmed and benchmarked against the best in the industry. Even against the biggest brands, we attract and retain great people, making us even more efficient.

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, macroeconomic outlook, market opportunity, the competitive landscape, and sensitivity of the financial plan to volumes, margin pressures and capital requirements
- The ongoing assessment of financial performance and prudential requirements through the use of scenario and sensitivity analysis covering this period, and
- It incorporates a forward-looking time period which captures business and economic uncertainty following the EU referendum outcome.

The Company is authorised by the PRA, and regulated by the FCA and the 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 41 to 46).

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 36 to 40). 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 an integral risk management discipline, used to assess the financial and operational resilience of the Group. The Group developed bespoke stress testing capabilities to assess the impact of extreme but plausible scenarios in the context of its principal risks impacting the primary strategic, financial and regulatory objectives. Stress test scenarios are identified in the context of the Bank's operating model, identified risks, business and economic outlook. The Group actively engages external experts to inform the process by which it develops business and economic stress scenarios. A broad range of stress scenarios have been analysed, including the economic impact of differing outcomes for the UK leaving the European Union, regulatory changes relating to lending into the UK housing sector, governmental housing policy shifts and scenarios prescribed by the Bank of England.

Stresses are applied to lending volumes, capital requirements, liquidity and funding mix, interest margins and credit and operational losses. Stress testing also supports key regulatory submissions such as the ICAAP, ILAAP and the Recovery Plan. The Group's stress testing activities generally test the viability of the Group over a five-year period.

The Group has identified a broad suite of credible management actions which can be implemented to manage and mitigate the impact of stress scenarios. These management actions are assessed under a range of scenarios varying in severity and duration. Management actions are evaluated based on speed of implementation, second order consequences and dependency on market conditions and counterparties. Management actions are used to inform capital, liquidity and recovery planning under stress conditions.

In addition, the Group identifies a range of catastrophic scenarios, which could result in the failure of its current business model. Business model failure scenarios (Reverse Stress Tests or 'RSTs') are primarily used to inform the Board and executive management of the outer limits of the Group's risk profile. RSTs play an important role in helping the Board and its executives assess the available recovery options to revive a failing business model. The RSTs exercise is based on analysing a range of scenarios, 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 Group has established a comprehensive operational resilience framework to actively assess the vulnerabilities and recoverability of its critical services. The Group also conducts regular business continuity and disaster recovery exercises.

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.

The UK's departure from the European Union without defined and agreed terms could have a significant impact on the economic and business outlook for the Group. To address this uncertainty the Group has develop a range of Brexit-related scenarios of varying severities and probabilities to inform its IFRS 9 and capital planning processes.

Corporate responsibility report

Operating sustainably and responsibly is integral to our business model and strategy.

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 them 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 2018
In 2018, 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: +63
- Employees – OSB was certified as one of the 100 Best Companies to Work for by The Sunday Times and OSBIndia as a Great Place to Work
- Communities – donated over £260,000 to community and charitable causes

Building on OneSavings Bank's long tradition of putting the customer at the heart of everything we do.

Focused on our customers

OneSavings Bank encourages a culture that aims to:

- Communicate and deal with each customer on an individual basis
- Act with consistency across all channels
- Promote 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
- Arrears, Repossessions and Forbearance Policy to ensure that handling of arrears and repossessions deliver fair and suitable outcomes based on the individual circumstances of the customer
- 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 96% in 2018.

Corporate responsibility report continued

Case study

Enhancing customer experience

Simon King – Bastion Development Team Lead

In the past year, the IT teams at OSB completed a number of major projects, one of which was the launch of a streamlined ISA transfer management system. Our core savings platform is administered and continuously upgraded by teams at OSB and we are always looking to add innovative solutions to enhance our customer experience. The improved ISA transfer system is an example of this and its success was shown through the particularly strong ISA season that we had in 2018.

The new savings platform was a result of months of work across various IT and Business teams using up to date technology, and showed how well we work together. The new system is a sleek and smooth process that allows OneSavings Bank's customers to transfer their Cash ISA accounts to us via a choice of routes: in branch, online or by post, and a process that once took a couple of weeks now completes in a few days.

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 to help the Bank 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.

Customer complaints

Whilst we concentrate on providing an excellent service, when things have gone wrong, we aim to put them 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.

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 2018 was an outstanding +63. In addition, we won numerous awards for being the best provider for a range of services from cash ISAs to Buy-to-Let mortgages.

Focused on our employees

The goal of making OSB the best workplace it can be was central to all employee activities undertaken throughout 2018. Our employees are our key asset. Their skills, expertise and enthusiasm are fundamental to achieving our strategic goals, and we continue to invest in training, development and employee engagement activities.

In 2017 we established the Talent Acquisition team to better assist the growing business and to provide bespoke support to hiring managers and by the end of 2018 we had four recruitment specialists. Throughout the year, around a quarter of new hires came via the Talent Acquisition team saving the business substantial recruitment fees. The team was shortlisted for the best Newcomer Award at the 2018 In-house Recruitment Awards winning the bronze award.

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 discriminatory or unnecessarily intrusive. This commitment to actively promote an environment where disabled candidates and employees are welcome was further strengthened in July 2018 when the Group achieved Disability Confident Employer (Level Two) status building on our initial success as Disability Confident Committed in 2017.

In 2018, we welcomed 165 new employees in the UK and 147 new employees in India and in August we reached a milestone of 1,000 employees for the Group. The InterBay Asset Finance business, which was launched in 2018 now employs a team of nine and operates from a new office in Fleet.

Training and development

Our employees are our key asset, and our approach to development is focused on encouraging staff to be the best they can be. Our People Development team provide learning and development opportunities for all employees, using a mix of internal and externally sourced content, which are delivered through a range of media, including workshop and digital formats. Highlights in 2018 saw the function deliver bespoke management development programmes, regulatory training, generic skills-based workshops and business change content to support operational and systemic training needs. In 2018, there were 995 attendees of 160 separate workshops or learning events delivered by the People Development Team in the UK and a further 263 OSB attendees at 97 other events delivered by external training providers. The completion rate for our mandatory regulatory training throughout the year was 96%, demonstrating the importance we continue to place on ensuring our employees are suitably aware of key requirements.

At OSBIndia ('OSBI'), we strive to make all those who join the Group feel welcome and be given as much training as possible to perform to their best ability. In 2018, new joiners undertook on average 120 hours of training. An initiative to improve and develop various managerial competencies and skills was also launched in the year, with a series of management development programmes for all managers in Bangalore.

The Group is also committed to supporting employees undertaking professional development and in 2018, 16 employees received financial support to pursue professional qualifications.

Since launching our Apprenticeship Scheme in late 2017, we have hired six apprentices who work in a number of different functions throughout the business. The scheme runs for two years and we hope it will lead to the start of many successful careers at OSB.

Talent management and leadership programmes

During the year, the Group again undertook a robust mapping exercise to identify the 2018 Primary Talent Group, who were exposed to a programme of talent management activities which aimed to aid their ongoing progression. The range of activities were enhanced from the previous year based on feedback received and the ever-evolving profile of a business leader. The programme provided a group-based stretch assignment, access to a Board level/Executive level mentor, career focused discussions, a psychometric profiling exercise and a bespoke workshop delivered via an external Business School. The Group considers this initiative as an integral part of retaining and developing our emerging talent; either as technical specialists or as potential leaders of the future.

The People Development function also delivered a Management Development programme, recognising the significant role our managers play in the delivery of outstanding customer service, staff engagement and delivery of the Group's business objectives. Divided into two phases, the first being a detailed and robust programme to support newly promoted or appointed line managers, providing them with the tools needed to become effective line managers; with the second phase being a development centre, designed to allow experienced managers to participate in a variety of exercises, encouraging the individuals to identify their development needs across a range of management behaviours and skills.

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 2018, we filled 22% of vacancies with internal candidates (49 out of 224).

OSB has a genuine desire to retain, support and develop its employee base. During 2018, 44 employees in the UK and 42 employees in India were formally promoted to a more senior grade. Our regretted attrition rate for 2018 was 9% for UK employees and a remarkable 11% for our employees in India, far exceeding industry averages.

Kent Reliance savings

WINNER
Savings Account Provider of the Year
MoneyAge Awards 2018

Best Business Access Account Provider
Savings Champion

COMMENDED
Best No Notice Account
Moneyfacts Awards 2018

Corporate responsibility report continued

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 99 to 105.

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 standard benefits offering includes pension contributions, permanent health insurance, private medical insurance, life cover, a holiday purchase scheme, interest-free season ticket loan and a cycle purchase scheme. In 2018, we conducted a benchmarking exercise to ensure that core benefits remained aligned with market practice. As a result, we increased standard annual leave allocations and discretionary bonus opportunities for all employees, up to our management. In addition, we launched Total Rewards Statements and a pension salary sacrifice scheme, with 53% of pension scheme members transitioning during the year. A significant number of OSB employees also participate in the Pennies from Heaven scheme, donating the small change from their monthly salary directly to the Bank's charity.

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 option price. The Group first launched its annual Sharesave Scheme in June 2014 and over 50% of employees are members of one of the schemes.

In 2018, 77 employees saw their 2015 Sharesave Scheme mature, with the total value of their respective individual plans increasing by over 80%.

Employee engagement

In October 2018, UK employees were invited, for the fourth time, to participate in the 2019 Sunday Times Best Companies Employee Engagement survey, which saw an outstanding 94% of employees submit their responses.

The results demonstrated an overall score increase of 2.1% and for the second year in a row, OSB achieved the One Star Accreditation Rating, signifying very good levels of workplace engagement. The continuous score improvement has seen the Bank included within The Sunday Times 100 Best Companies to Work For list for the first time and the improved results related primarily to proactive local engagement plans being created within all departments and the broader identification and implementation of initiatives by the Engagement Steering Group.

In addition, both UK and India employees took part, for the second time, in the Banking Standards Board survey, which aims to influence positive change throughout the banking sector with a participation rate of 81%. The survey provided an insight into employees' perceptions 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 showed an increase in all categories leading to OSB being ranked on average 13th out of 25 participating banks.

OSBI takes part in its own survey, run by the Great Place to Work Institute. In 2018, 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 to 75, up from 66 in 2016/2017, and it received the highest score in Pride, reflecting the strong brand and culture that has been created. 90% of our India colleagues participated in this year's survey.

GREAT PLACE TO WORK®
CERTIFIED
FEB 2018 - JAN 2019
INDIA

Employee awards

Mortgage Personality of the Year: Adrian Moloney
Mortgage Strategy Awards 2018

Provider: Underwriter – Craig Richardson
The British Specialist Lending Awards 2018

Business Leader: Commercial Finance Lender – Darrell Walker
The British Specialist Lending Awards 2018

Business Leader: Complex Buy-to-Let Lender – Adrian Moloney
The British Specialist Lending Awards 2018

In 2018, OSB partnered with specialist external consultants to design and launch the Group's Mission, Vision and Values. Through engaging employees and the executive team in discussion groups and interviews, the Group defined its mission, vision and the underpinning four core values. These were then launched to all employees via a number of all-day interactive sessions, hosted by the Executive Committee, the first event on this scale ever launched by OSB. The events were followed by a range of related actions that have assisted in embedding the new values and proactively driving positive cultural change throughout the business.

Employee recognition and awards

In 2018, the significant tenure of 55 employees who reached a 5, 10, 15, 20, 25 or 30 year milestone for employment with the Group were recognised through our Long Service Award programme. There were three employees who reached 30 years' service with the Group and our longest-serving employee has over 31 years' service to date.

Every quarter, employees are invited to nominate their colleagues as part of OSB's employee recognition scheme, which has now been aligned with our four values. Throughout 2018 there were 431 nominations made via the scheme from which 13 individual awards were presented.

The expertise of our employees was also recognised by the mortgage industry and in 2018 Adrian Moloney, Darrell Walker and Craig Richardson were recognised by The British Specialist Lending Awards in the categories of Complex Buy-to-Let, Commercial Finance Lender and Underwriter, respectively.

Health and safety

We have a duty of care to all of our employees, and a safe and healthy work environment is paramount at 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.

In 2018, the annual mandatory health and safety training was completed by all Group employees. This year, we also turned the display screen equipment assessment into a process that is more straightforward for our employees, more cost effective and a single Group-wide procedure. Finally, we undertook a full review of all of the Group's real estate in partnership with external consultants. The review demonstrated that all sites are compliant with statutory health and safety regulations and provided us with additional best practice improvements and recommendations which will be implemented in the future.

Kent Reliance for Intermediaries

WINNER
Best Specialist Lender

Best Business Development Managers Team

Best Buy-to-Let Lender
Mortgage Strategy Awards 2018

Best Specialist Mortgage Provider –
Moneyfacts Awards 2018

Best Specialist Lender
MoneyAge Awards 2018

Corporate responsibility report continued

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 2018, 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:

- Mental Health Awareness sessions were introduced and are available to all employees to help understand how stress symptoms, if left unaddressed, can develop into mental health problems.
- Attaining Disability Confident Employer (Level Two) status with further commitment from the Group to attract, employ, support and retain those with disabilities. As a holder of this accreditation, OSB is able to evidence that we get the right people for the business despite their considered barriers to employment due to disability, that we are retaining and developing our employees who have individual needs related to disability and that we are ensuring that disabled people, and those with long-term health conditions, have the opportunities to fulfil their potential and realise their aspirations within the Group.
- Each office location with over 100 employees now has a private employee room, which can be used both as a prayer room and a private space for breastfeeding mothers.
- We partnered with ShawTrust, a charity that specialises in helping people with barriers to secure employment. One of the outcomes of this partnership was a focus group with those with disabilities where we asked for advice on how to better attract and support talented people who may need additional help at work. The valuable insight from this partnership is being implemented by OSB to ensure the Group becomes a truly welcoming employer for those with disabilities.

OSB publishes its gender pay gap data in line with legislation that applies to all UK companies with more than 250 employees. The full publication is available on the Group's website: www.osb.co.uk.

OSB's median gender pay gap as at the snapshot date of 5 April 2018 was 44%, with the mean gap of 45.5%, these figures reducing from the 2017 reported figures of 46% and 47%, respectively. Whilst this signifies progression, reducing the gap further remains a long-term commitment for OSB and it will not be until the 2019 data is collated that we can establish the degree to which the specific activities that were identified and implemented in 2018 have helped to close our gap.

Fundamentally, OSB's gap relates to the structure of our workforce and reflects the fact that we have more men than women in senior roles and more female employees undertaking clerical roles. Whilst progress has been made in 2018 to positively impact both aspects of our workforce structure, we remain confident that our gap will continue to close and the level of attention that we pay to the salaries of male and female incumbents undertaking the same role provides us with comfort that we do not have an issue in respect of the equal pay.

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

- In 2018, we embedded the mandatory recruitment requirement to ensure that we interviewed at least one credible female candidate for senior roles and at least one credible male candidate for roles at junior levels. Our senior external recruitment activity in 2018 saw us hire an equal split in terms of gender and at more junior grades 40% of the vacancies were filled with male candidates. We firmly believe that our approach to seeking to interview credible male and female candidates is making a tangible difference and over the long-term will positively impact our gender pay gap.
- We made solid progress towards our commitment as a signatory of HM Treasury's Women in Finance Charter. By the end of 2018, we had 28% of all senior roles being undertaken by female employees, a solid progression towards our target of at least 30% of senior roles occupied by women by 2020.
- OSB's Women's Networking Forum had a very successful year. This group, which is focused on helping to identify and break down the barriers that prevent women from progressing within financial services, provided regular opportunity throughout the year for relevant discussions, guest speakers, development tips and encouragement regarding career progression.

In 2018, over 58% of our UK workforce was female, we had three female Directors (38% of the Board) and two female members of the Executive Committee (20%).

In our office in India, women constitute 41% of the total workforce.

	Male	Female
Number of Board Directors	5	3
Number of Directors of subsidiaries	16	1
Number of senior managers (not Directors)	45	23
All other employees[1]	462	525

1. Includes OSBI.

We have 10% 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.

The Group's second annual statement under the Modern Slavery Act 2015 was published on our website in June 2018. We reviewed relevant policies and we worked with an external supplier to increase the monitoring of risks in our supply chain. None of our suppliers are considered to be of higher risk. In addition, 100% of our suppliers received our new Vendor Code of Conduct informing them of our commitment to acting in an ethical and honest way. This year, all employees completed a more detailed module which built on last year's modern slavery learning, helping to increase awareness and understanding.

OSBIndia

OSBIndia is a wholly-owned subsidiary of the Group. OSBI operates from an office in Bangalore and currently employs 440 staff of which 41% are women. OSBI supports the Bank across various functions including Support Services, Operations, IT, Finance and Human Resources. We actively promote integration between our colleagues in the UK and India with frequent employee exchanges, transfers, overseas training, staff and management visits.

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.

OSBI is a holder of ISO 27001: 2018 certified which demonstrates high standards of information security. To that end, the business continuity site in Hyderabad, which was opened in 2017, became fully operational this year. OSBI prides itself on excellence in customer service and the ISO 9001: 2018 certified is a testament to meeting customer and regulatory requirements by providing outstanding customer service. In 2018, OSBI undertook a benchmarking exercise against industry peers and was noted as Class Leading in Customer Service by an independent consultant.

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 include 22 days of annual leave, 12 days' sick leave and cafeteria services.

Corporate responsibility report continued

Focused on the environment

2018 was yet another year when the Group took on initiatives, or advanced existing ones, to achieve its goal of becoming a greener organisation.

As an office-based financial services provider, we have a relatively low impact on the environment due to many improvements to the Group's real estate introduced over the years. The Group sources all of its energy from 'green' energy providers and we monitor and control the electricity and gas consumption to avoid unnecessary waste.

In addition to these improvements, we have policies in place that allow us to minimise our negative impact on the environment in which we operate. Our 'Zero to Landfill' waste policy means that all of our waste is either recycled, reused or sent to a dedicated Energy from Waste facility. We also consider the environmental impact on supply chain when buying from suppliers and our procurement policy actively incorporates these aspects when appointing new partners. Finally, secure print solutions were introduced in all offices which significantly lowered paper consumption.

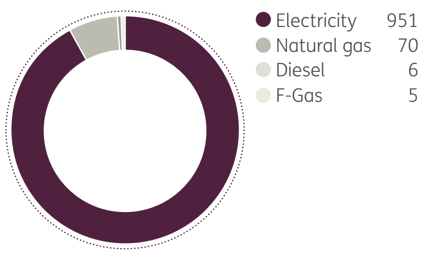
The Group is also committed to promoting awareness of environmental issues amongst our employees. The OSB Magazine frequently includes recycling tips and monthly green challenges which see positive uptake by the business. This year, we focused on reducing single use plastic consumption and installed recycling stations across all sites.

Greenhouse gas emissions 2018

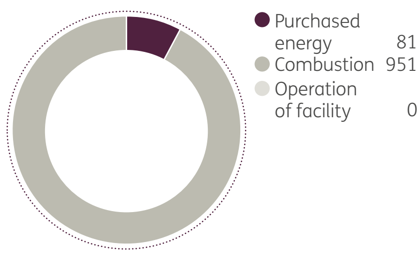
		Location-based method	Market-based method
Emission type	**Units**	**2018**	**2018**
Scope 1: Combustion	tCO_2e	76	N/A
Scope 1: Facility operation	tCO_2e	5	N/A
Total scope 1	**tCO_2e**	81	0
Scope 2: Purchased energy	tCO_2e	951	0
Scope 2: Purchased energy	MWh	2,180	1,025
Total scope 2	**tCO_2e**	951	0
Scope 3: Combustion	tCO_2e	N/A	N/A
Scope 3: Facility operation	tCO_2e	N/A	N/A
Total scope 3	**tCO_2e**	N/A	N/A
Total emissions	**tCO_2e**	**1,032**	**0**

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

Emissions breakdown by source (tCO_2e)



Emissions breakdown by category (tCO_2e)



Mandatory greenhouse gas report

Reporting scope

- The reporting period is 1/01/18 to 31/12/18, which was selected because it is the company's financial year.
- This report was compiled in line with the September 2009 DEFRA 'Guidance on how to measure and report your greenhouse gas emissions' which is based on the GHG Protocol.
- All measured emissions from activities which the organisation has financial control over are included unless otherwise stated in the exclusions statement, as required under The Companies Act 2006 (Strategic and Director's Reports) Regulations 2013.
- The intensity measurement of turnover was selected in order to compare emissions with company growth and for consistency, with similarly reporting businesses for review of the market position.
- Emissions factors used:

Fuel type	**Emissions conversion factor source**
UK electricity–location based (excluding transmission and distribution), UK gas, diesel, R410A, R32 and R22 F-gas	Department for Business, Energy and Industrial Strategy 2018
UK electricity–market based	SSE Green–100% renewable energy factsheet, opusenergy.com/our-energy-sources/, ssebusinessenergy.co.uk/help-and-advice/standard-fuel-mix/
Overseas electricity	http://www.carbon-calculator.org.uk/

Statement of exclusions

Scope 1 exclusions

- All company owned transport was excluded due to unavailability of data. OSB is putting processes in place to collate this for next year's report.

Scope 2 exclusions

- Scope 2 purchased electricity does not include the transmission and distribution element as this is owned by the supplier.
- Three sites have electricity use that is excluded as it is part of the service charge from the landlord and OSB have no visibility of consumption or an apportionment of the buildings' consumption. These are Fleet, InterBay and London, Heritable.
- The gas consumption for Prestige Finance was excluded as the meters were removed. The meters are still recorded as they are in the process of being closed down and final billed by the supplier.

Scope 3 exclusions

- No scope 3 emissions were included as they are voluntary.

Year on year emissions changes

- There are a total of three new sites in this year's report. Fleet is excluded as a landlord site and so has no impact on consumption. The other new sites are Newman Street and Canterbury (12–13) High St.
- The Maidstone branch moved location in November 2017, the old site (code 04189-10-05) is vacant and so has very low consumption. The new site is code 04189-10-18.
- F-gas recharges was much lower than last year.
- Natural gas emissions are lower than last year as the two meters at Prestige Finance were removed.

Estimation methods used

- Usage per day apportionment – total usage for period divided by days in period multiplied by missing days.
- Comparable site – client has advised of a site of a similar size and operation which should have a comparable level of consumption.
- Floor area apportioned – total usage for the year for whole floor area the meter serves divided by 100% multiplied by floor area the client occupies.
- Run time – standby fuel consumption from the generator specification sheets multiplied by run time.

Corporate responsibility report continued

Our new values

Our renewed company mission and values help us overcome the challenges we face and allow us to capitalise on the opportunities.

Our mission

To enable our customers to achieve their personal and business goals by providing access to fair financial solutions.

Our vision

To become our customers' favourite bank; one that delivers its very best, challenges convention and opens doors that others can't.

Our values

Our values will guide us to the success we're all striving towards – for ourselves and our customers.

Stronger together

We are OneTeam, working together to create a business in which we can all take pride and prosper. We work hard to build trust, respect and openness across the Company, pool our talents and energy when we need to, and pull together to challenge – and surpass – our competitors.

Take ownership

Each one of us bears responsibility for what we do, and for our share of the mission this Company sets itself every day. We help each other, show respect for each other and listen to what others have to say. And if there's a question to be asked or challenge to be faced, we don't look away.

Aim high

We need to set our bar high for our customers, be bold in our decision-making and dynamic in our actions on their behalf. They are the ones who know when we're going above and beyond. They can tell when they've been listened to. They remember the promises we keep. And, in even the smallest action or service, they sense the standards we set ourselves.

Create your future

Our bank is about making opportunities and taking opportunities. It's a place where each one of us can take control of our future – where we can all fulfil our need for personal growth and build a future for ourselves. So, seize the opportunities that come your way, and make the most of them to move forward in your career.

oneteam

OneSavings Bank has grown from 200 people in two sites to more than 1,000 across seven sites in the UK and in India.

So much of the work behind the renewed mission, vision and values was done to ensure that as a much larger business we can continue to work positively together, doing great things for our customers.

Our values have been cemented into the way we set our individual objectives as well as at a company level. Everyone in the Group has identified opportunities to develop themselves and the Bank all linking together to support great customer outcomes.

Total employees

1,000

Corporate responsibility report continued

Focused on our community

OneSavings Bank is proud of its strong links with the local community, especially through the Kent Reliance brand which has been synonymous with the county of Kent and a passionate supporter of its local community for over 150 years.

As one of the largest employers in the region, many of our employees live locally and therefore have a personal affinity with local causes and projects. Employees' views are actively sought in helping to decide where our support is best placed and feedback is shared throughout the business to boost active participation.

Our community strategy is built primarily around three key pillars consisting of volunteering, fundraising and community investment, all of which provide a platform for OneSavings Bank to share its vision and values.

In 2018, we implemented a revised community services programme that enabled employees to have a greater influence on the charities that matter to them. We continue to encourage an active "hands on" approach through fundraising and volunteering opportunities. Our volunteering activities have encouraged our employees to use their "Day to make a difference". This is a paid day, available to all employees, to help support any registered charity or community group. For example, the annual community-based campaign, "Project Kent", that Kent Reliance runs alongside the radio station kmfm, incorporates a whole week of volunteering opportunities for employees. Furthermore, if employees choose to undertake additional fundraising activities, the Bank will match any funds raised up to a specific amount.

During 2018, employees chose to support a variety of charities through their volunteering day, which included working at the central sorting warehouse for Demelza Children's Hospice, painting and decorating offices for the Young Lives Foundation as part of Project Kent and getting their hands dirty for a local Medway-based charity allotment scheme helping local school children to grow fruit and vegetables over the school holidays to tackle holiday hunger.

Overall, the Bank has contributed a total of £260,000 to community and charitable causes in 2018 through charity fundraisers, donations and additional support.

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.

In 2018, Kent Reliance branches continued to support Demelza as their local charity partner and marked the occasion with the launch of a dedicated Demelza Children's Account, whereby the charity receives an annual donation equivalent to an agreed percentage of the combined funds held across the associated accounts at the end of the year.

In 2018, £4,151 was raised primarily through the Kent Reliance branches and the annual charity donation arising from the Demelza Children's Account.

During 2018, 53 employees from across OneSavings Bank volunteered their time in the Demelza Warehouse, Maidstone, providing much needed additional support as the centre filters approximately five million items per year with most of this work supported by volunteers.

Kent Reliance also takes huge pride in raising money for Demelza through a range of annual fundraising events such as teddy bear picnics, bake sales and Halloween themed events.

Aside from straightforward fundraising, the branches also engage with the local community by offering the branch network as collection and promotion outlets for the charity.

Winston's Wish

During 2018, the Bank continued to support its nominated national charity, Winston's Wish, 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 for military families who have been bereaved.

The end of 2018 marked the end of its two year partnership but there was a silver lining as, in total, the Bank managed to raise over £26,000 for Winston's Wish, which included the sponsorship of their national support helpline on Christmas Eve.

Project Kent

Kent Reliance's Project Kent rolled into its second year, in partnership with the KM Media Group and led by its radio station kmfm. This community initiative was powered by nominations from local people who were asked to nominate a local charity or group which benefits the local community. The campaign was promoted via the Kent Reliance branches and nominations reached over 130 this year, a big increase on the previous year, as the annual project becomes more established. Following a lengthy judging process, "The Young Lives Foundation" was selected; a Maidstone based charity that helps improve the lives of disadvantaged young people across Kent. Their offices and meeting rooms were in a poor decorative state meaning they were not being used to their full potential.

A team of 50 OSB volunteers helped transform the downstairs area into a warm and friendly environment which included new display areas and new furniture, which resulted in an amazing transformation for its staff and young visitors.

Through the associated profile raising activity, the charity also benefited from a ripple effect with offers of additional fundraising, recruiting staff as adult mentors and increased awareness throughout the county that resulted in further offers of help from other local businesses.

Make Someone's Christmas

The Make Someone's Christmas campaign encourages listeners and readers of kmfm and the KM Media Group, and customers of Kent Reliance branches, to nominate those people they feel deserve an extra special treat during the festive season.

The 2018 campaign was very successful and achieved over 500 nominations which led to us helping ten special people in Kent in a variety of ways to ensure they enjoyed Christmas this year. As always, it was an extremely hard decision for the judging panel but the selected nominations really stood out.

The selected nominees included treating a special young person who made great efforts to look after the health of his eight year old best friend, by missing out on break times and calling for adult help if needed, a young carer who never put herself first and was trying to write her first book using an old typewriter which we swapped for a new laptop, and a young mum diagnosed with cancer who wanted to treat her family to a day out to thank them for their support. Each of the selected nominees was announced live on the radio during a two-week period and received a variety of prizes ranging from high street vouchers to a weekend away.

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 2018, the CSR Group agreed to support the areas of child welfare, education and healthcare.

Child welfare and education

OSBI has partnered with 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 and women and children belonging to vulnerable families. OSBI also hosted some events at SOS for employees to engage with the children, which was highly appreciated by both the children and employees.

Healthcare

OSBI is currently supporting HBS Hospital to provide dialysis sessions to 20 individuals who live below the poverty line. HBS Hospital is a non-profit hospital which provides critical healthcare to members of society who could otherwise not afford the care they need.

OSBI continued its support in maintaining the gardens at CV Raman General Hospital for the second year. Hospital staff and patients have appreciated the positive impact such a space has had on patients, their relatives and the hospital staff.

Looking forward to 2019

By partnering with national and local charities, we hope to offer employees the chance to make a difference both nationwide and closer to home. By focusing our efforts on our nominated charities, we hope to make a meaningful impact to our chosen charities, and to the lives of those that the charities help.

The OSB 2019 national charity partner, chosen by employees is My Shining Star: Children's Cancer Charity. This charity supports families through the financial hardship associated with childhood cancer.

Around 1,600 children are diagnosed with cancer in the UK every year. That means 1 in 500 children across the UK are diagnosed with cancer before they turn 14.

Families spend an extra £600 per month, on average, during their child's cancer treatment (mainly for transport, food and accommodation) and many fall into debt as a result, or families become separated as siblings of the child are left at home.

To learn more about My Shining Star, the services it provides, and the families it supports, visit its website: https://www.myshiningstaruk.co.uk/

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

Jason Elphick
Group General Counsel and Company Secretary
14 March 2019

Governance

How our Board
and Executive team
set the strategic
direction and
provide oversight
and control.

Key reads within this section:

Corporate Governance Report
"We are pleased to report full compliance"

For more information go to page 72

Risk Committee Report
"We continued to enhance and integrate the Strategic Risk Management Framework"

For more information go to page 87

Remuneration Report
"Extensive engagement with shareholders"

For more information go to page 90

Contents

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 and the Remuneration Committee.

Key skills
David has over 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. He served as a Non-Executive Director of Bank of Ireland (UK) plc. 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.

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. Andy currently holds a number of posts with industry institutions including membership of the UK Finance Executive Committee, the Building Societies Association's Council and the Financial Conduct Authority's Small Business Practitioners Panel. He is also a Director of the Building Societies Trust and has served as a Non-Executive Director for Northamptonshire NHS and Kreditech.

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 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 was involved with 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 and 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.

Sarah Hedger*
Non-Executive Director

Appointment
Sarah was appointed to the Board in February 2019.

Committee membership
None.

Key skills
Sarah has significant capital management and mergers and acquisitions experience in financial services. She is a qualified chartered accountant.

Experience & qualifications
Sarah held leadership positions at General Electric for 12 years in its Corporate, Aviation and Capital business development teams, leaving General Electric as Leader of Business Development and M&A for its global GE Capital division. Prior to General Electric, she worked at Lazard & Co., Limited for 11 years, leaving as Director, Corporate Finance. Sarah also spent five years as an auditor at PricewaterhouseCoopers. Sarah is an Independent Non-Executive Director of Balta Group NV, a Belgian company listed on Euronext.

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) and, since July 2018, of Nucleus Financial Group plc.

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. Mary spent 17 years at GE Capital, running a number of businesses including GE Fleet Services Europe and GE Equipment Finance.

Executive team (biographies)

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 and Funding, Head of Governance, Company Secretary and General Counsel Product, Regulation and Resolution.

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 its 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.

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.

Lisa Odendaal
Chief Internal Auditor

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 its 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.

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 practice. Hasan graduated from the London School of Economics with a MSc in Systems Design and Analysis and a BSc in Management.

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.

Richard Davis
Chief Information Officer

Experience & qualifications
Richard joined the Bank in 2013. Richard has worked in financial services for 20 years, 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.

Top row from left to right:
Clive Kornitzer; Jason Elphick; Lisa Odendaal; Richard Wilson.

Bottom row from left to right:
Jens Bech; Richard Davis; Hasan Kazmi.

Corporate Governance Report

The statement of corporate governance practices, including the Reports of Committees, set out on pages 72 to 108 and information incorporated by reference, constitutes the Corporate Governance Report of OneSavings Bank.

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

During 2018, the Company applied all of the main principles of the 2016 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 2018, and to report our full compliance throughout the year with the Code as updated in 2016.

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 2018, details of which are set out in the Report below. The review highlighted that the Board and its Committees continue to operate effectively. An externally facilitated Board evaluation will be undertaken during 2019.

Andrew Doman left the Board during 2018. I would like to thank him for his contribution towards the success of the Bank and I wish him well in all his future ventures. I would also like to welcome Sarah Hedger who joined the Board on 1 February 2019.

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 9 May 2019 at 11am.

David Weymouth
Non-Executive Chairman
14 March 2019

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, 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, 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 39. Each Committee has its own terms of reference which are reviewed at least annually. Details of each Committee's activities during 2018 are shown in the Nomination and Governance, Audit, Risk and Remuneration Committee reports on pages 80 to 105.

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 significant changes in accounting policies
- Ensuring maintenance of a sound system of internal control and risk management

Remuneration
- 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 it 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 82 to 86.

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 51.

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 and assists the Board in fostering a culture within the Group, which emphasises and demonstrates the benefits of a risk-based approach to internal control and management.

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 36 to 49. The Board has delegated authority to the Audit Committee 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 the Chief Internal Auditor 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 84.

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. Andrew Doman ceased to be a Director 10 May 2018. The Board currently consists of nine Directors; the Chairman, two Executive Directors and six independent Non-Executive Directors. The biographies of the Directors can be found on pages 68 to 69.

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 in the table below. The table also shows each Director's attendance at the Board and Committee meetings they were eligible to attend in 2018.

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

1. Appointed to the Remuneration Committee on 1 May 2018.
2. Retired from the Board on 10 May 2018.

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 Chair, to ensure that their views are recorded and taken into account during the meeting.

Key Board activities during the year included:

- Strategy – the Board convened a strategy away day in October 2018
- Risk monitoring and review
- Governance and compliance
- External affairs and competitor analysis
- Talent review/succession planning
- Annual, interim and quarterly reporting
- Customer/brand/product review
- Policy review and update
- Investment proposals
- Mission, Vision and Values

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 2018
Chairing the Board and general meetings of the Company.	The Chairman chaired all of the Board meetings held in 2018 and the 2018 AGM.
Setting the Board agenda and ensuring that adequate time is available for discussion of all agenda items.	The Chairman, in liaison with the Company Secretary, set 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 on changes in corporate governance and its application to the Company.
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, agreed the information to be distributed 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 ran the meetings in an open and constructive way, encouraging contribution from all Directors. He regularly met 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 received 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 80 and 81.
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 77.
Ensuring effective communication with shareholders and stakeholders.	The Chairman, along with the Board, and assisted by the Chief Executive Officer, Chief Financial Officer and Investor Relations team, agreed a programme of investor relations meetings. Details of meetings carried out during the year are shown on page 78.

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 Group's activities; he 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 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 70.

Executive Committee

The CEO chairs the Executive Committee ('ExCo'), whose members also include the Chief Financial Officer, Group Chief Operating Officer, Chief Risk Officer, Group General Counsel and Company Secretary, Group Commercial Director, Chief Information Officer, Group Chief Credit Officer and the Chief Internal Auditor. The ExCo is supported by a number of 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 to ensure consistency 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
- Mission, Vision and Values.

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. The independence of the Non-Executive Directors is reviewed continuously, including formal annual review.

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. The Directors' biographies can be found on pages 68 and 69.

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.

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 had 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.

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, 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.

Corporate Governance Report continued

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 distributed with accompanying detailed papers to the Board in advance of each Board and Committee meeting. These include reports from Executive Directors and other members of senior management. 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 76.

Board 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 2018, the internal review concluded that the Board, including its Committees, discharged 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 was satisfied that no individual or group of Directors dominated the discussions or had undue influence in the decision-making process. The review indicated that enhancements could be made to the induction and succession planning process which are being addressed. An externally facilitated Board evaluation will be undertaken during 2019.

Treasury operations

There are policies in place 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 applies to all employees of the Group and are benchmarked against industry standards. The Audit Committee is responsible for monitoring the Group's whistleblowing arrangements and the policy. Where concerns have been raised, a detailed report is provided on the investigation, actions taken, lessons learnt and changes made as a result. The Chair of the Audit Committee has overall responsibility for whistleblowing arrangements with oversight from the Board.

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

Relations with shareholders

Dialogue with shareholders

The Company has a dedicated Investor Relations function to liaise with institutional investors and analysts. Updates on investor relations activity and changes to the share register are regular items on the Board agenda.

An ongoing dialogue with the key stakeholders continued throughout the year on topics relating to the performance of the Group, including strategy and new developments. In 2018, the Company 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 130 meetings with individual existing and potential investors during 2018.

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 contact the Company through the Investor Relations function or the Company Secretariat.

Annual General Meeting
The AGM will be held at the offices of Addleshaw Goddard LLP, 60 Chiswell Street, London EC1Y 4AG on 9 May 2019 at 11am. The Chairs of each of the Committees of the Board will be present to answer questions put to them by shareholders. Due to unforeseen circumstances, the Chair of the Audit Committee was unable to attend the 2018 AGM. 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 five times during 2018.

The members of this Committee are David Weymouth, Chairman of the Board, myself (Rod Duke) and Mary McNamara.

We considered a number of items during 2018, with the main focus being on recruiting a Non-Executive Director with the appropriate skills to the Board. The Committee appointed Per Ardua[1] to assist with the recruitment process. We examined the revised UK Corporate Governance Code against our practices to ensure that we are compliant at the earliest opportunity. We also reviewed the Bank's progress in achieving the commitments set out in the Women in Finance Charter and various diversity initiatives.

Further details on areas considered by the Committee are provided below.

Rod Duke
Chair of the Nomination and Governance Committee and Senior Independent Director
14 March 2019

1. Per Ardua has no other connection with the Company.

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 2018, 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 as a member of the Remuneration Committee.

In addition, the Committee discussed and considered the size of the Board and its range of skills. It was determined that the Board would benefit from an additional Non-Executive Director and a job specification was drafted based on an audit of skills the Board currently possessed and those that would add even more value. The brief to Per Ardua was to include an equal number of male and female candidates. From the list presented to the Committee, three candidates were interviewed and the preferred candidate was chosen and recommended to the Board for appointment. As a result, the Board appointed Sarah Hedger to join the Board with effect from 1 February 2019.

Succession planning
The Committee considered both Board and Executive level succession planning during 2018, including ways in which skills could be developed. As a result Executives are regularly invited to attend Board and Committee meetings. The Committee also received updates on the performance of the wider employee population, particularly the 2018 Primary Talent Group.

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 workforce will include and make good use of differences in the skills, regional and industry experience, age, 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, where 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.

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 28% of senior management and 44% of our Board are female, placing us in the top 10 of the FTSE 250 for gender diversity. 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. The Group achieved Disability Confident Employer Level 2 status during 2018.

Further details relating to diversity and inclusion are set out on page 58.

Governance
The Committee reviewed changes in the regulatory landscape, particularly, the changes to the UK Corporate Governance Code.

Activities during 2018
In last year's report the Committee identified nine key priorities.

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

Objective	Action taken
Continue to focus on fulfilling our commitment to the Women in Finance Charter	A mandatory requirement was introduced that, for senior roles, at least one credible female candidate must be interviewed face to face.
Oversee the development and implementation of our action plan for Gender Pay Gap Reporting	The Committee reviewed the action plan for Gender Pay Gap Reporting.
Oversee a revised approach to cultural engagement within the Group	The Mission, Vision and Values was launched at an all-employee three-day event during September 2018.
Corporate governance reform	The Committee receives regular updates on corporate governance changes in the industry, including the steps being taken by the Bank to ensure compliance with any relevant changes.
Corporate purpose and sustainability	The Committee reviewed the Environmental Policy and the actions being taken to enable the Bank to continue to operate sustainably.
Board and Committee succession planning	The Committee reviewed the skills and mix of the Board and as a result a new Non-Executive Director has been appointed. The membership of Committees is periodically reviewed to ensure continuity.
Embedding diversity initiatives	The Bank has raised awareness of the various initiatives, which have been put in place to support diversity. Such initiatives relate to disabled facilities, mental health awareness workshops, the introduction of a Women's Networking Forum and unconscious bias training. Regular updates are provided to the Committee on the progress of diversity initiatives.
Board and Committee effectiveness	The Board and its Committees completed an internal effectiveness evaluation during the last quarter of 2018 with very positive results overall. An external evaluation of the Board and its Committees will be undertaken during 2019.
Oversee development of the talent pipeline	Members of the Committee met with the 2018 Primary Talent Group ('PTG') to understand the level of support provided to them and what other support would be beneficial. The Committee also received periodic reports of the activities undertaken by the PTG.

Priorities for 2019
The Committee's priorities for 2019 are:

- Consider the approach to Board and Executive succession planning, and the extent to which that planning incorporates a range of diversity criteria beyond gender diversity.
- Consider further training and development needs for Committee members.
- Provide oversight of how the Mission, Vision and Values are being embedded.
- Corporate governance reform.
- Embedding of diversity initiatives and reduction of the gender pay gap.
- External Board and Committee effectiveness review.
- Oversee progress with the Group's purpose and sustainability.
- Oversee the development of the talent pipeline.

Audit Committee Report

Dear Shareholder,
I am pleased to present the report of the Audit Committee for 2018. 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 completed a competitive tender process for the external audit of the Group from 2019, resulting in Deloitte LLP being selected as external auditor for the year ended 31 December 2019.

Membership and meetings
The Committee met five times in 2018. The members of the Committee, namely Graham Allatt, myself and Margaret Hassall are Independent Non-Executive Directors. As Chair of the Committee, I, Eric Anstee, have a wealth of recent and relevant financial and accounting experience in financial services and, taken as a whole, the Committee has an appropriate balance of skills, including recent and relevant financial experience.
In addition to members, standing invitations are extended to the Executive Directors, Chief Risk Officer, Chief Internal Auditor and Group Head of Compliance and Conduct Risk, 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.

Margaret Hassall joined the Committee at the beginning of the year and Andrew Doman left in May 2018.

The Company Secretary acts as Secretary to the Committee. The Chief Internal Auditor and the external auditor attended all meetings and also meet in private with the Committee; they also have regular contact with the Chair throughout the year. I discuss and agree the agenda with the Chief Financial Officer and Chief Internal Auditor in advance of each meeting and receive a full briefing on the key agenda items.

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

I would like to thank our outgoing auditor, KPMG LLP, for their service over the years and welcome our incoming external auditor, Deloitte LLP.

Eric Anstee
Chair of the Audit Committee
14 March 2019

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 is available to meet with the Company's investors on request, in accordance with the Financial Reporting Council's Stewardship Code.

Activities during 2018
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 2018 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 Expected Credit Losses
The Group conducts individual impairment assessments for high value loans (£0.5m) which are more than three months in arrears, estimating future cash flows, including the cost of obtaining and selling collateral, likely sale proceeds and any rental income prior to sale.

All assets without an individual impairment assessment are assessed under a modelled expected credit loss ('ECL') approach, which are unbiased and probability weighted using a number of macroeconomic scenarios. ECL is measured on either a 12 month (stage 1) or lifetime (stage 2) 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 (stage 3).

The modelled ECL calculation is a product of an individual loan's probability of default ('PD'), exposure at default ('EAD') and loss given default ('LGD'), discounted at the effective interest rate ('EIR'). The ECL drivers of PD, EAD and LGD are modelled at an account level.

Key estimates and assumptions which feed modelled ECL calculations relate to (1) macroeconomic scenarios which are probability weighted (2) significant increase in credit risk ('SICR') thresholds (3) forced sale discount rates (4) time to sale assumptions (5) propensity to go to possession given default rates ('PPD') (6) sale cost estimates (7) cure criteria utilised to transition accounts from stage 3 to stage 2 or 1.

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 expected credit loss calculations.

During the year, management implemented an enhanced probability of default model, which replaced one of four PD models utilised by the Group, enhanced the definition of default criteria to more closely align with industry and regulatory best practice and adjusted the Group's stage 3 cure criteria, whilst enhancing the significant increase in credit risk criteria. The Committee reviewed and challenged the appropriateness of these changes prior to implementation.

Throughout the year, the Committee reviewed proposed updates to the macroeconomic scenarios utilised within ECL calculations. In particular, the Committee debated management's proposals to include an additional no-deal disorderly Brexit macroeconomic scenario, to support the existing upside, base and other downside scenarios, and changes to the probability weightings attached to each scenario.

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 its 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 three members of the Committee were also members of the Risk Committee throughout 2018 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 compliance with IFRS 9: Financial Instruments, which became effective on 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 2018 parallel run and the proposed ongoing business as usual model as well as model governance, controls and procedures.

Loan book acquisition accounting and income recognition
Acquired loan books are initially recognised at fair value. 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 where performance varied from expectation. 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. In addition, the

Audit Committee Report continued

Committee reviewed sensitivity analysis on the potential impact of Brexit-related downside economic scenarios on future prepayment and default rates and expected cash flows. 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 ('ERCs'). Certain mortgage products offered by the Bank include significant directly-attributable net fee income, in particular Buy-to-Let, and/or those that 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. Prior to 2018, the Group prudently assumed no period on SVR before the borrower refinanced onto a new product or redeemed until a consistent behavioural trend could emerge following a new enhanced broker-led retention programme. At the 2018 year end, the Committee concluded that there was sufficient behavioural data to incorporate a period spent on SVR in the effective interest rate. This was based on a careful consideration of actual behavioural data post the enhanced programme and the potential impact of the economic and regulatory outlook and additional planned changes to the programme on future behaviour. The Committee also reviewed and challenged other assumptions used in the EIR calculations, in particular the redemption profile over which net fee income is spread and expected ERCs for fixed rate products. The Committee received and reviewed sensitivity analysis for key assumptions. 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.

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. 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.

In addition, the Committee reviewed the accounting treatment for the exceptional cost of fair valuing the option to acquire the JV partners' interest in the Heritable Development Finance business from our joint venture partners.

Fair, balanced and understandable
The Committee considered, on behalf of the Board, whether the 2018 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 Annual 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 Chief Internal Auditor and her team is supported by a panel of external accountancy firms who provide expert resource, when requested, on specific internal audits.

The primary role of Internal Audit is to help the Board and senior management to protect the Group's assets, reputation and sustainability. It assists the Group 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 2018. 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 actions have been completed. The Committee reviewed in detail high and medium findings within internal audit reports and monitored the associated management actions until closed.

The Committee carries out an annual review of the effectiveness of the Internal Audit function. In 2018 this was facilitated 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 2018, 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 Risk Assessment and Assurance Plan and received regular reports from the Group's Compliance function. 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 update, including: anti-bribery and corruption, data protection, data retention and record management, fraud, sanctions, whistleblowing and anti-money laundering and counter terrorist financing. The Committee received reports on fraud prevention arrangements, fraud incidents, whistleblowing and an annual report from the Group's Money Laundering Reporting Officer during the year.

The Committee also received regular updates on data governance and controls as the Group continued to enhance 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 has complied 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 no 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 put the external audit contract out for tender for its 2019 financial year. There are no restrictive contractual provisions limiting the Company's choice of auditor.

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 2017, 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, PricewaterhouseCoopers LLP and Deloitte LLP, in March 2018 to take through to a formal request for proposal ('RFP') process. As a result of the RFP process Deloitte LLP was selected as external auditor for the year ending 31 December 2019.

Effectiveness

The Committee assesses the effectiveness of the external audit function on an annual basis. In 2018, 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 throughout 2018.

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 86 for 2018) 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 and 2018 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 for non-audit services is taken in the context of its understanding of the Group, which can place it 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 preceding 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 2018, including 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 2018 Group annual audit services and subject to any single item above £100,000 being pre-agreed with the Committee Chair. The Committee regularly reviews a schedule of year-to-date non-audit services.

The fees paid to the external auditor in respect of non-audit services during 2018 totalled £135,000 representing 17% of 2018 Group audit services of £814,000 (2017: £151,000 representing 19% of 2017 Group audit services of £816,000) and are detailed in the table below.

	Group 2018 £'000	Group 2017 £'000
Fees payable to the Company's auditor for the audit of the Company's annual accounts	**626**	638
Fees payable to the Company's auditor and its associates for other services:		
Audit of the accounts of subsidiaries	**188**	178
Audit-related assurance services	**95**	96
Tax compliance services	**9**	8
Other assurance services	**31**	47

Audit Committee Report continued

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	OSBI tax audit required under the Indian Income Tax Act
Promoting, dealing in or underwriting shares in the Company	Such other activities as may be agreed by the Committee from time to time
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 or litigation support	
Internal audit services	
Tax services, including tax compliance and advice	
Services that play any part in the management or decision-making of the Company	
Remuneration services such as quantum of remuneration package or measurement criteria for a Director in key management position	
Restructuring services in relation to matters that are material to the financial statements	

Included within the audit of the Bank and Group accounts is £150k (2017: £165k) relating to the audit of IFRS 9. Other assurance services in 2018 include a review of data submitted to the Bank of England under the TFS and a review of the OSB India Private Limited financial statements as required by Indian income tax rules.

The Committee's assessment of the external auditor's independence in 2018 took into account the non-audit services provided during the year, and confirmations given by KPMG as to its continued independence at various stages in the year.

Training
The Committee undertook a significant amount of training during the year, including making extensive use of the Audit Committee Institute and training programmes run by the major accountancy firms. The members of the Committee attended seminars and update meetings held by the Financial Reporting Council. 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. In 2018, the assessment was facilitated using a survey completed by members of the Committee. The review concluded that the Committee operated effectively throughout 2018 with no significant improvements required.

Risk Committee Report

Dear Shareholder,
I am pleased to present the report of the Risk Committee.

The Risk Committee met seven times in 2018. The members of this Committee are myself (Graham Allat), Eric Anstee, Margaret Hassall, Mary McNamara and April Talintyre. 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 of them that they should not attend a particular meeting or discussion.

The Committee actively challenged the Group's performance against the Board approved risk appetite, ensuring appropriate and timely consideration was given to business, economic and regulatory factors impacting the Group's risk profile. The Committee maintained oversight of the Group's risk management framework to ensure that it remained fit for purpose to support the Group's strategic growth objectives.

The Committee assessed and recommended for approval by the Board key regulatory submissions including the Internal Capital Adequacy Assessment Process ('ICAAP'), the Group Recovery Plan and the Internal Liquidity Adequacy Assessment Process ('ILAAP'). In discharging this responsibility, the Committee focused on risk quantification techniques, underlying assumptions and the resulting risk assessment.

The Committee retains oversight of the strategic risk-based initiatives, including Internal Ratings-Based (IRB), operational resilience and data enhancement programme.

Further information on the role and activities of the Committee is provided in the following Report.

Graham Allatt
Chair of Risk Committee
14 March 2019

Responsibilities
The primary objective of the Committee is to support the Board in discharging its risk oversight and governance responsibilities. In particular, the Committee enables the Board to:

- Set a clear tone from the top in relation to a risk-based culture which fosters individual and collective accountability for risk management.
- Continuously review, challenge and recommend enhancements to the Group's risk management framework.
- Ensure adequacy of how the Group organises and resources its risk management and oversight functions across first and second line functions.
- Actively assess performance against risk appetite and challenge management to ensure that the Board's strategic, business and regulatory objectives are not put at unacceptable levels of risk.

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.

Risk Committee Report continued

Activity during 2018
In 2018, the Group continued to enhance and further integrate its Strategic Risk Management Framework (SRMF), which represents the overarching framework established to manage its risk profile in line with the Board strategy and risk appetite. The detailed overview of the SRMF is provided in the Group's Pillar 3 Disclosures. The key areas of the Committee's focus during 2018 are outlined below.

Risk appetite
The Committee played an active role is shaping and assessing the design of the Group's risk appetite in the context of economic and business outlook and uncertainties, the strategic growth agenda of the Group and regulatory developments. The Committee members held a focused risk appetite workshop in which risk appetite statements, risk metrics and guiding limits and triggers were discussed and challenged prior to recommendation to the Board for approval. The Committee sought independent business and economic insights to inform and validate the risk appetite. The Committee also ensured that the proposed risk appetite was subject to appropriate alignment to the Group's strategic agenda, business plans and stress testing capabilities.

The Committee also reviewed the Group's position against risk appetite across all principal risks and escalated issues to the Board where appropriate.

Credit risk
The Committee has monitored the performance of the Group loan book on aggregated and asset class sub-segment levels by assessing the key indicators of credit quality, security coverage, affordability and borrower risk profile. The Committee also assessed forward-looking credit risk indicators in the form of bureau data on customer credit scores, mover alerts and indebtedness, business and economic early warning indicators.

The Committee challenged and approved updates to policies including the Group Lending Policy, the Arrears, Repossessions and Forbearance Policies and the Loan Impairment Provisioning Policy. The Committee also exercised oversight over credit risk models and provided an appropriate level of challenge in relation to model construction and validation to ensure that the models are appropriate and robust. The Committee has also directed management on how to monitor model performance.

During 2018, the Committee oversaw and was involved in the Group making further developments to model governance, particularly in light of the IRB programme. 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 credit loss calculations. The Committee also assessed and approved the Group's provision adequacy levels throughout the year.

Market risk and liquidity risk
Market risk and liquidity risk are continually monitored by the Assets and Liabilities Committee ('ALCO') which reports to the 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 undertook an extensive assessment of the ILAAP prior to submission to the Board for approval. Key areas of Committee focus was in relation to scenarios, funding assumptions under stress and calibration of liquidity and funding risk appetites.

Solvency risk and 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 assessed the results of all the risk-based capital assessments and stress testing results before finally recommending the full ICAAP document to the Board for approval.

The Committee also reviewed and challenged the Group Capital Plan and monitored total capital and CET1 forecasts throughout the year ensuring risks were understood and managed appropriately.

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

Although there were operational incidents during the course of 2018, the Committee requested a detailed analysis of incidents to further understand any causes and trends. The Committee was satisfied that actions taken were 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 reviewed the Compliance and Financial Crime Target Operating Model. The Committee also assessed and recommended enhancements to the compliance and financial crime risk appetite before recommending it for approval by the Board.

Other risk types

The Committee reviewed the Group profiles of conduct risk, reputational risk and business and strategic risk against their respective risk appetites.

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 set of recovery options within its plan.

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
- Consider 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
- Challenge and endorse the Strategic Risk Management Framework
- Provide challenge and oversight to the ICAAP framework
- Monitor actual and forecast risk and regulatory capital positions
- Recommend changes to capital utilisation
- Provide challenge and oversight to the ILAAP framework
- Monitor the actual and forecast liquidity position
- Review reports on risk appetite thresholds, identify where a risk of a material breach of risk limits exists and ensure proposed actions are adequate
- Provide challenge and oversight to 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 2018 Directors' Remuneration Report which sets out details of Directors' remuneration in respect of 2018 and how we intend to implement the Policy in 2019.

Overview of 2018 performance
The Bank has continued to deliver strong financial and operational performance in 2018. Underlying pre-tax profits grew by 15% to £193.6m and the loan book grew by 23% to £9.0bn whilst delivering a strong net interest margin at 3.04% and cost to income ratio of 28%.

The financial growth was achieved whilst maintaining a strong focus on our customers and employees. Customer Net Promoter Score (NPS) was improved to an outstanding +63 and the 2018 employee engagement survey placed the Bank in the Sunday Times 100 Best Companies to Work For list.

The Bank has also developed its operations during the year including the launch of new specialist products in the residential segment and the launch of the InterBay Asset Finance business with the first deals being funded in October 2018.

Incentive outcomes for 2018
The 2018 Executive Bonus Scheme was based 90% on the Business Balanced Scorecard, which measures corporate performance against financial, customer, quality and staff metrics and 10% on personal objectives. Targets for each measure were set at the start of the year and were assessed by the Committee following the end of the financial year.

There was strong performance across the 2018 Scorecard with many of the maximum targets being met including those for profit, net loan book growth, customer NPS, levels of complaints, number of high severity operational incidents and employee engagement. There was, however, room for improvement under the employee and broker NPS metrics. Alongside the excellent performance against individual targets, the Committee determined that 91.75% and 91.25% of the bonus was earned by both the Chief Executive Officer and Chief Financial Officer respectively. Full details are set out on pages 100 to 103. As in previous years, 50% of this award will be deferred into shares for a three-year period.

The 2016 Award under the Performance Share Plan (PSP) will vest in March 2019 at 50% of maximum based on performance over the three-year performance period ending on 31 December 2018. Given the strong financial performance over this period, OSB has met the Earnings Per Share (EPS) growth target in full, however, given recent weakness in our share price (and the relatively high share price three years ago, from where our Total Shareholder Return (TSR) performance was based) the TSR element will lapse.

Overall the Committee is comfortable that there has been a clear and strong link between reward and performance and that discretion should not be exercised to adjust the incentive outcome.

Implementation of Policy in 2019

The Committee is comfortable that the current Policy is operating effectively and as such there are only minor changes to its proposed implementation in 2019.

The CEO's salary will be increased by 3.03% to £520,000 and the CFO's salary will be increased by 3.5% to £350,300. This is in line with the average salary increases provided to the wider employee population. There are no changes to pension or benefits.

The 2019 annual bonus will continue to be based 90% on the Business Balanced Scorecard (50% based on financial measures) and 10% on personal performance. The Committee has reviewed the metrics and these will largely remain the same, however the portion based on the Common Equity Tier One (CET1) ratio will be removed with a corresponding increase in weighting on the other financial metrics. Maintaining the CET1 ratio will continue to be a financial underpin to the payment of any bonus.

PSP awards of 150% of salary will be made to the Executive Directors in 2019 with performance being measured over the period to 31 December 2021 based on stock market out-performance (TSR, 40% weighting), EPS growth (40% weighting) and return on equity (ROE) (20% weighting). As for the 2018 Award, 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.

Given the current growth expectations as the Company matures, and in light of the prevailing market conditions, the EPS targets will require 5% p.a. growth for threshold vesting, rising to 10% p.a. for full vesting. This will be measured from the 2018 EPS which outperformed expectations. The TSR and ROE targets remain unchanged. The Committee is comfortable that these provide the appropriate stretch, taking into account the business plan, external operating environment and market expectations.

Consideration of shareholder views and response to the new UK Corporate Governance Code

The Committee undertook extensive engagement with shareholders during the review of the Policy in the lead-up to its approval at the 2018 AGM. We were pleased that shareholders were generally supportive with 83.71% voting in favour. However, we recognise that 16.29% of shareholders were not supportive. During 2018, the Committee has engaged with shareholders to understand their concerns, which related to the increase in the incentive opportunity last year. We will continue to ensure that the additional opportunity will be subject to appropriately stretching performance conditions.

The Committee has also considered the updated UK Corporate Governance Code (the Code) and updates to shareholder and proxy advisor guidelines and is taking steps to ensure that the practices at the Bank remain in line with best practice. The structure of our incentive policy is already in line with Code recommendations and we have broadened our clawback provisions and ensured that they remain fully enforceable. During the year we will review our policy for Directors' shareholding requirements, including post cessation of employment.

Consideration of employee policies and views

I am pleased to have been appointed as the Non-Executive Director representing the workforce on the Board. As a result, I regularly meet with employees, individually and through forums such as the 2018 Primary Talent Group and the Women's Networking Forum, to understand their views and report those to the Board.

The Committee oversaw a review of pay and benefits across the Group resulting in improvements in some salaries and bonus opportunity.

We have prepared and reported the CEO to employee pay ratio in line with the regulations and we will monitor its movement over time to ensure it is aligned with the performance of the CEO and the implementation of our Group remuneration policies.

Concluding remarks

I would like to thank Andrew Doman who stepped down as a member of the Committee when he left the Board in May 2018 and to thank David Weymouth for his contribution since joining the Committee in place of Andrew.

I look forward to your support for the resolution to approve the Remuneration Report at the 2019 AGM.

Mary McNamara
Chair of the Remuneration Committee
14 March 2019

Directors' Remuneration Report continued

Remuneration Policy

This section describes our Directors' Remuneration Policy, which was approved by shareholders at the AGM on 10 May 2018 and came into effect from that date.

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 undertook extensive engagement with shareholders during the review of the Policy in the lead up to its approval at the 2018 AGM. 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.

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 the 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 overleaf.	The maximum bonus opportunity is 150% of salary. The threshold level for payment is up to 25% for any measure.

Directors' Remuneration Report continued

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.
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.

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.

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 and 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. For the PSP, if events happen that cause it to determine that the targets are no longer appropriate, an amendment is required so they can achieve their original intended purpose and ensure 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 are coherent. 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 the annual bonus, with our corporate scorecard being used to assess bonus outcomes throughout the organisation, with measures weighted according to role, where relevant.

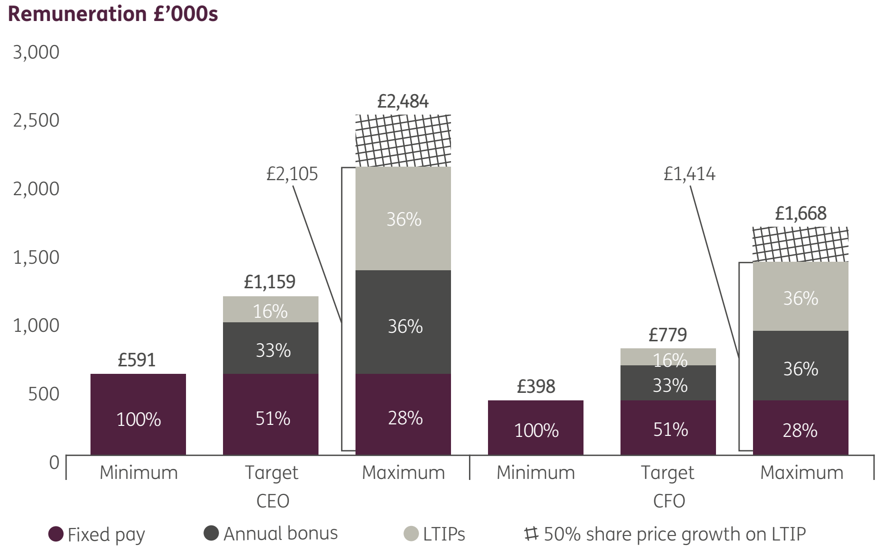
Overall, the Remuneration Policy for the Executive Directors is more heavily weighted towards performance-related pay than for other employees. In particular, performance-related long-term incentives are not provided outside of the most senior executive population as they are reserved for those considered 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 was launched for all employees. Executive Directors are eligible to participate in this plan on the same basis as other employees.

Directors' Remuneration Report continued

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 2019, 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 – 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). This scenario also shows the effect of a 50% increase in the share price for LTIP awards.

Other than as noted above, 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.

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 take into account and 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. This included 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 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.

Directors' Remuneration Report continued

THE REMUNERATION POLICY FOR THE CHAIRMAN AND NON-EXECUTIVE DIRECTORS

Element	Purpose and link to strategy	Operation	Maximum opportunity
Fees	To attract and retain a high-calibre Chairman and Non-Executive Directors by offering a market competitive fee level.	The Chairman and Non-Executive Directors are entitled to an annual fee, with supplementary fees payable 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 occasion 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.

2018 Annual Report on Remuneration

Introduction

This section sets out details of the remuneration received by Executive and Non-Executive Directors in respect of the financial year ended 31 December 2018. This Annual Report on Remuneration will, in conjunction with the Annual Statement of the Committee Chair on pages 90 to 91, be proposed for an advisory vote by shareholders at the forthcoming AGM to be held on 9 May 2019. Where required, data has been audited by KPMG LLP and this is indicated where applicable.

Membership

The Committee met six times during the year. Mary McNamara (Chair) and Rod Duke were members of the Committee throughout the year. Andrew Dolman was a member until he ceased to be a Director of the Company on 10 May 2018. David Weymouth, Chairman of the Board, subsequently became a member of the Committee. 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
  - Determining total individual remuneration (including salary increases, bonus opportunities and outcomes and LTIP awards)
  - Ensuring 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
- Approving the design of, and determining targets for, any performance-related pay schemes operated by the Company and approving 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 Material Risk takers 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:

- 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 2018 Directors' Remuneration Report
- Consider market trend and regulatory updates.

Advisers to the Committee

Korn Ferry provided independent advice to the Committee during 2018, having been appointed following a competitive tender process in 2017. The total fees paid to Korn Ferry in 2018 were £113,000.

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.

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

The Committee also receives input on senior executive remuneration from the Chief Financial Officer (CFO) and Group HR Director. 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' Remuneration Report continued

DIRECTORS' PAY OUTCOMES FOR 2018

Remuneration and fees payable for 2018 – (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 2018 and 31 December 2017.

Executive Directors	Year	Basic salary £'000	Taxable benefits[1] £'000	Pension £'000	Annual bonus paid[2] £'000	Amount bonus deferred[2] £'000	LTIP[3] £'000	Total £'000
Andy Golding	2018	501	21	65	347	347	293	1,574
	2017	480	19	62	208	208	637	1,614
April Talintyre	2018	336	16	44	232	232	207	1,067
	2017	324	14	42	138	138	450	1,106

1 Taxable benefits received include car allowance (CEO £20,000; CFO £15,000) and private medical cover.
2. 50% of bonus is payable in cash and 50% in shares deferred for three years.
3. The 2017 LTIP figure has been restated based on the share price on vesting of £3.72.

Total fees £'000	2017	2018
Chairman		
David Weymouth (from 1 September 2017)	83	**250**
Mike Fairey (until 10 May 2017)	69	**–**
Non-Executive Directors		
Graham Allatt	88	**89**
Eric Anstee	78	**83**
Andrew Doman (until 10 May 2018)	60	**22**
Rod Duke	138	**78**
Tim Hanford (paid to JC Flowers until 31 December 2017)	60	**–**
Margaret Hassall	60	**63**
Mary McNamara	70	**78**
Nathan Moss (until 31 May 2017)	25	**–**
Total	731	**663**

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: 2018 performance against the Business Balanced Scorecard (audited)

		Targets					
Category	Key performance indicator	Threshold (25%)	Budget (50%)	Max (100%)	Actual result	Outcome CEO (%)	Outcome CFO (%)
Financial (50%)	Underlying PBT	£172m	£176m	£184m	£193.6m	50	50
	All-in ROE	22.7%	23.7%	25.7%	26.0%		
	Cost to income ratio	31.6%	30.6%	28.6%	28.2%		
	Net loan book growth	17.4%	18.4%	20.4%	22.9%		
	CET1 ratio	<12%	12.0%	>13%	13.3%		
Customer (15%)	Customer satisfaction	35	40	50	63	12	12
	Broker satisfaction	27.5	30	35	28		
	Complaints	0.8%	0.5%	0.1%	0.1%		
Quality (15%)	Overdue actions	3	2	<1	2	11.25	11.25
	Arrears	1.25%	1%	0.50%	0.66%		
	High-severity incidents	4	3	1	1		
Staff (10%)	Diversity[1]	26%	27%	29%	28%	9	9
	Employee engagement[2]	3	4	6	6		
Personal (10%)	Vary by executive–see section below					9.5	9
Total						91.75	91.25

1. Diversity – based on the gender diversity of the senior leadership team.
2. Employee engagement – the employee engagement represents the number of categories which showed improvement versus the prior year.

2018 personal performance

The Executive Directors were allocated up to a maximum of 10% of their bonus based on their personal performance against agreed objectives.

The priorities for 2018 were identified in our 2017 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 objectives set at the start of the year and the Committee's assessment of performance against them are set out below:

	Objectives	Key achievements
CEO	Oversee the progression of all established 2018 strategic objectives in line with the operating plan and to the satisfaction of the Board.	Strong delivery of 2018 strategic objectives in line with the operating plan including launch of InterBay Asset Finance which funded its first deals in October 2018, acquisition of the JV partners' interest in the Heritable joint venture, oversight of GDPR, PSD 2 and IRB projects.
	Maintain strong relationships with regulators, ensuring ongoing and proactive communication.	Open and honest relationship with regulators maintained throughout 2018.
	Champion the design and implementation of the new Mission, Vision and Values and the associated activities that will assist in embedding these Group-wide and positively impacting on employee survey results.	Mission, Vision and Values successfully implemented with positive outcomes highlighted by the inclusion of the Bank in The Sunday Times 2018 Best Companies to Work For list and the report from the Banking Standards Board.
	Establish and maintain strong relationships with key investors, brokers and analysts, ensuring active and engaging ongoing communication, with a specific focus on the 'sell side'.	Relationships with key stakeholders strengthened by the outstanding performance on the investor roadshows during 2018.
CFO	Deliver all Board-approved BAU and strategic projects, with a particular focus on People, Data and MI.	Good progress made on these projects, which now have strong visibility at Management Committees and the Board.
	Successful implementation of new risk reporting systems.	Successful implementation using a phased approach throughout 2018.
	Enhance Opex reporting to improve tracking of projects and Board reporting.	Strong Opex reporting in place. A requirement for a procurement system in order to report on and control costs more effectively was identified in the year and a new purchase order system was selected. Implementation of the new system is on schedule to go live by the end of the first quarter of 2019.
	Strengthen relationships with shareholders and other stakeholders, including regulators and NEDs.	This is an area of strength and the focus for 2019 will be on relationships with the regulator and the new Non-Executive Director.
	Effective oversight of the management of the Bank's capital and funding.	A capital working group has been formed to enhance the capital management process with a dedicated resource to focus on regulatory policy and change management.

Based on this performance, the Committee determined that 9.5% and 9.0% of a possible 10% for the individual element of the bonus should be paid to the CEO and CFO respectively.

Long-term incentive plan

The 2016 LTIP award was granted on 17 March 2016 and measured performance over the three financial years to 31 December 2018. Awards will vest after publication of this report, based on the EPS and TSR performance, at 50% of maximum, as set out below.

Performance level	Percentage of that part of the award vesting	EPS element (50% of total award)	EPS performance	Vesting of EPS part	TSR (50% of total award)	TSR performance versus FTSE 250 constituents	Vesting of TSR part (50% of total award)
Below 'threshold'	0%	Less than 8% CAGR	19%	100%	Below median	7%	0%
'Threshold'	25%	8% CAGR	Above stretch		Median	Below median	
'Stretch'	100%	15% CAGR			Upper quartile		

Directors' Remuneration Report continued

The 2016 PSP awards will therefore vest as follows:

Executive Directors	Number of shares awarded	Number of shares due to vest	Value from share price increase[1]	Total value vesting £'000[2]
Andy Golding	162,055	81,027	88,238	293,240
April Talintyre	114,625	57,312	62,413	207,412

1. Value of share price increase based on a £2.53 share price at the time of grant of the award, to the three-month average share price of £3.6190 to 31 December 2018.
2. Value of shares based on a three-month average share price of £3.6190 to 31 December 2018. This value will be restated next year based on the actual share price on the date of vesting.

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 2017–2018		
	Salary	Taxable benefits	Annual bonus
CEO	4.4%	10.5%	66.8%
UK employees	5.8%	0.0%	9.6%

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 2013–2018:

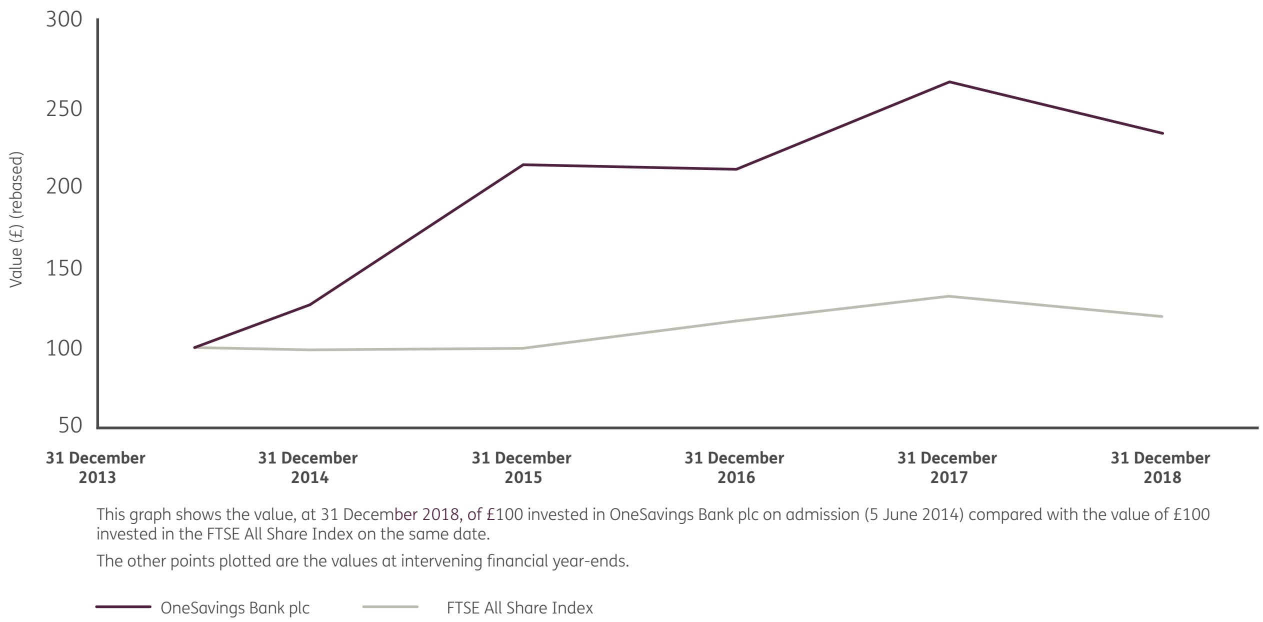
	2013	2014	2015	2016	2017	**2018**
Andy Golding						
Annual bonus (as a percentage of maximum opportunity)	92.5%	92.63%	93.00%	88.75%	85%	**91.75%**
LTIP vesting (as a percentage of maximum opportunity)	–	–	–	–	100%	**50%**
CEO single figure of remuneration (£'000)	518	777	848	910	1,614	**1,574**

Total shareholder return

The table below shows the total shareholder return (TSR) performance of the Company over the period from listing to 31 December 2018 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 2018, 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.

CEO pay ratios

The ratio of the CEO's single figure of total pay to employee pay is illustrated in the table below for 2017 and 2018. The median ratio has fallen from 46:1 in 2017 to 39:1 in 2018. This is as a result of a combination of factors including a decrease in the total paid to the CEO, positive changes to the Group's pay policy and changes in the employee population between 2017 and 2018.

2017		Basic Salary	Total	CEO Pay Ratio
Andy Golding		480	1,614	
Employee A	25th	22	26	62.1
Employee B	Median	30	35	46.1
Employee C	75th	53	65	24.8

2018		**Basic Salary**	**Total**	**CEO Pay Ratio**
Andy Golding		**501**	**1,574**	
Employee A	**25th**	**21.88**	**26.9**	**58.4**
Employee B	**Median**	**35.55**	**40**	**39.4**
Employee C	**75th**	**57.95**	**71.9**	**21.9**

Relative importance of the spend on employee 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.

	2017	**2018**
Total employee costs	£35.9m	**£43.6m**
Distributions to shareholders	£31.2m	**£35.7m**
Underlying profit before tax	£167.7m	**£193.6m**
Total employee costs v PBT	21.4%	**22.5%**
Average headcount	813	**989**
Average PBT per employee	£206,273	**£195,753**

OTHER DISCLOSURES RELATING TO 2018 EXECUTIVE REMUNERATION

Scheme interests awarded during the financial year

The table below shows the conditional share awards made to Executive Directors in 2018 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	Number of shares	Percentage of awards released for achieving threshold targets	End of performance period	Performance conditions (weighting)
Andy Golding	150%	£757,050	180,439	25%	31 December 2020	EPS (40%) TSR (40%) ROE (20%)
April Talintyre	150%	£507,690	121,005	25%	31 December 2020	EPS (40%) TSR (40%) ROE (20%)

1. The number of shares awarded was calculated using a share price of £4.1956 (the average mid-market quotation for the preceding five days before grant on 24 May 2018).
2. Performance conditions are (i) 40% TSR versus the FTSE 250 (25% vesting for median performance increasing to maximum vesting for upper quartile performance); (ii) 40% EPS (25% vesting for growth in EPS of 6% per annum increasing to maximum vesting for 12% per annum); and (iii) 20% ROE (25% vesting for average ROE of 20% increasing to maximum vesting for an average of 25%).

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 2018	Beneficially owned at 31 December 2018	Without performance conditions at 31 December 2018	Subject to performance conditions as at 31 December 2018	Shareholding requirement (percentage of basic salary)	Current shareholding (percentage of basic salary)[1]
Executive						
Andy Golding	1,100,000	680,429	174,462	486,038	250%	472% (Met)
April Talintyre	336,131	263,001	117,766	311,696	200%	272% (Met)
Non-Executive						
Eric Anstee	4,960	4,960				
Rod Duke	94,537	80,000				
Mary McNamara	22,350	22,350				
David Weymouth	13,178	13,178				

1. Shareholding based on the closing share price on 31 December 2018 – £3.50 and year end salaries.

Directors' Remuneration Report continued

External appointments
Andy Golding is a Director/Trustee of the Building Societies Trust Limited. He receives no remuneration for this position.

Andy Golding receives £10,000 per annum as a member of the Financial Conduct Authority's Small Business Practitioners Panel.

Payments to departing Directors
During the year, the Company did not make 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 2019
Base salary
The CEO 's and CFO's salaries will be increased by 3.03% and 3.5% respectively to £520,000 and £350,300 respectively. Benefits and pension provision will remain unchanged.

Annual bonus
The performance measures for the 2019 annual bonus have been set in line with 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	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 2019 Annual Report on Remuneration. The Committee may apply discretion to adjust the resultant bonus from the Business Balanced Scorecard if the result fails to reflect broader performance and the wider shareholder experience.

Similar to 2018, the maximum opportunity will be 150% of salary with half of any bonus earned deferred in shares for three years.

Performance Share Plan
PSP awards of 150% of salary will be made to the Executive Directors in 2019. Similar to the 2018 awards, the performance conditions will be EPS (40% weighting), relative TSR (40% weighting) and return on equity (20% weighting). 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 shares to cover tax charges). The performance targets are set out in the table below. The financial targets have been set taking into account the external market, shareholder expectations and expected business growth. Whilst the ROE targets remain the same as for the 2018 Awards, the EPS targets will require threshold EPS growth of 5% per annum, and full vesting at 10% per annum, over the period to 2021. The Committee is cognisant that on a percentage growth basis, these are lower than the targets for the 2018 Award of 6% to 12% per annum. However, they are measured from an EPS figure that is around 15% higher than last year so in absolute terms do represent significant growth above the EPS required to be achieved for the 2018 targets; the Committee is comfortable that they are appropriately stretching in light of the business plan and external consensus forecasts and no less challenging than the EPS range set for the 2018 awards.

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 5% CAGR	Below median	Below 20%	0%
'Threshold'	5% CAGR	Median	20%	25%
'Stretch'	10% CAGR	Upper quartile	25%	100%
	Pro rata vesting in between the above points			

Share ownership guidelines
The CEO and the CFO are 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 respectively. This is calculated on the basis of the value of beneficially owned shares plus the net of tax value of deferred bonus shares. Half of any vested share awards must be retained until the guideline is achieved. Based on the current share price, the CEO and CFO hold shares in excess of these levels.

Chairman and Non-Executive Director fees

The current Non-Executive Director fees are as follows:

Base fees	£'000
Chairman	250
Non-Executive Director	65
Additional fees	
Senior Independent Director	10
Nomination and Governance Committee Chair	10
Audit Committee Chair	20
Remuneration Committee Chair	20
Risk Committee Chair	20

Statement of voting at the Annual General Meeting

Shareholders were asked to approve the 2017 Annual Report on Remuneration and the 2018 Directors' Remuneration Policy at the 2018 AGM. The votes received were:

Resolution	Votes for	% of votes cast	Votes against	% of votes cast	Total votes cast	Votes withheld
To approve the 2017 Remuneration Report (2018 AGM)	202,260,789	99.44	1,129,179	0.56	203,389,968	1,071,307
To approve the 2018 Remuneration Policy (2018 AGM)	164,447,865	83.71	32,004,658	16.29	196,452,523	8,008,753

The Committee has continued to engage with shareholders and has written to shareholders who voted against the Remuneration Policy in 2018 to understand their rationale, which related to the increase in incentive opportunity. In response, the Committee will continue to ensure that incentives are subject to stretching performance conditions commensurate with the overall level of remuneration payable.

Approval

This report was approved by the Board of Directors, on the recommendation of the Remuneration Committee, on 14 March 2019 and signed on its behalf by:

Mary McNamara
Chair of the Remuneration Committee
14 March 2019

Directors' Report: Other Information

Share capital and rights attaching to shares

The Company had 244,487,537 ordinary shares of £0.01 each in issue as at 31 December 2018. 1,022,849 ordinary shares were issued during 2018, 159,407 at a price of £2.27, 860,756 at a price of £0.01 and 2,686 at a price of £1.34. Further details relating to share capital can be found in note 36.

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 2018 AGM, shareholders renewed the general authority for the Directors to allot up to £814,409 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 £293,187 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 24,432,250 ordinary shares. The Company did not repurchase any of its ordinary shares during 2018 (2017: none).

Employee share schemes

The details of the Company's employee share schemes are set out on pages 93 to 94 in the Remuneration Report.

Results and dividends

The results for the year are set out in the Statement of Profit or Loss on page 118. Our dividend policy for 2019 remains a pay-out ratio of at least 25% of underlying profit after taxation to ordinary shareholders. The Directors recommend the payment of a final dividend of 10.3 pence per share on 15 May 2019, subject to approval at the AGM on 9 May 2019, with an ex-dividend date of 21 March 2019 and a record date of 22 March 2019. This is in addition to the 2018 interim dividend of 4.3 pence per share paid during the year (2017: 12.8 pence total dividend).

Directors and Directors' interests

The names of Directors who served during the year can be found in the attendance chart on page 74.

Directors' interests in the shares of the Company are set out on page 103 in the Remuneration Report. None of the Directors had interests in shares of the Company greater than 0.6% of the ordinary shares in issue. There have been no changes to Directors' interests in shares since 31 December 2018.

Equal opportunities

The Group is committed to applying its Equality and Diversity Policy at all stages of recruitment and selection. Short-listing, 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 employee 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 60 in the Strategic report.

Political donations

Shareholder authority to make aggregate political donations not exceeding £50,000 was obtained at the 2018 AGM. Neither the Company nor any of its subsidiaries made any political donations this year.

Notifiable interests in share capital

At 31 December 2018, 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
Norges Bank	7,732,546	3.18
Merian Global Investors[1]	37,271,516	15.26
Standard Life Aberdeen plc	22,788,566	9.33

1. Formerly known as Old Mutual Global Investors.

There have been no notifications since 31 December 2018.

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 9 May 2019. The meeting will start at 11am with registration from 10.30am.

Other information

Likely future developments in the Group are contained in the Strategic Report on pages 2 to 65.

Information on financial instruments including financial risk management objectives and policies including the policy for hedging the exposure of the Group to price risk, credit risk, liquidity risk and cash flow risk can be found in the Risk Review of pages 36 to 49.

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, including stress scenarios relating to Brexit, 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 36 to 49.

Jason Elphick
Group General Counsel and Company Secretary
OneSavings Bank plc
Registered number: 07312896
14 March 2019

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 parent Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and parent Company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs 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 financial statements 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 their profit or loss 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 IFRSs 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 its 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.

Responsibility statement of the Directors in respect of the annual financial report

- 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/Directors' 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.

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; and
- they have taken all the steps they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Approved by the Board and signed on its behalf by:

Jason Elphick
Group General Counsel and Company Secretary
14 March 2019

Financial statements and notes

Group's financial statements and notes for the year ended 31 December 2018 and the report from the independent auditor.

Contents

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 Company") for the year ended 31 December 2018 which comprise the Consolidated Statement of 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 2018 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 first appointed as auditor on 28 May 2010. The period of total uninterrupted engagement is for the 9 financial years ended 31 December 2018. 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	£7.1 million (2017:£6.4 million) 4% (2017: 4%) of group profit before tax	
Coverage	100% (2017:100%) of group profit before tax	
Key audit matters		**vs 2017**
Other matter	The impact of uncertainties due to Britain exiting the European Union on our audit	**New matter**
Recurring risks	Loan impairment	▲
	Recognition of revenue on organic and acquired loans	◀▶

2. Key audit matters: including our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgment, 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 below the key audit matters 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.

The impact of uncertainties due to Britain exiting the European Union on our audit

Refer to Audit Committee report (page 83), Risk Review (pages 36 to 49) and the CEO's Report (pages 15 to 17).

The risk	Our response
Group and Parent **Unprecedented levels of uncertainty** All audits assess and challenge the reasonableness of estimates, in particular as described in loan impairment, recognition of revenue on originated and acquired loans, related disclosures and the appropriateness of the going concern basis of preparation of the annual accounts. All of these depend on assessments of the future economic environment and the Group's future prospects and performance. In addition, we are required to consider the other information presented in the Annual Report including the principal risks disclosure and the viability statement and to consider the directors' statement 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. Brexit is one of the most significant economic events for the UK and at the date of this report its effects are subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown.	We have developed a standardised firm-wide approach to the consideration of the uncertainties arising from Brexit in planning and performing our audits. Our procedures included: – **Our Brexit knowledge** – We considered the directors' assessment of Brexit-related sources of risk for the Group's business and financial resources compared with our own understanding of the risks. We considered the directors' plans to take action to mitigate the risks. – **Sensitivity analysis** – When addressing loan impairment and recognition of revenue on originated and acquired loans and other areas that depend on forecasts, we compared the directors' sensitivity analysis to our assessment of the full range of reasonably possible scenarios resulting from Brexit uncertainty – **Assessing transparency** – As well as assessing individual disclosures as part of our procedures on loan impairment and recognition of revenue on originated and acquired loans we considered all the Brexit related disclosures together, including those in the strategic report, comparing the overall picture against our understanding of the risks. **Our results** As reported under loan impairment and recognition of revenue on originated and acquired loans, we found the resulting estimates and related disclosures of sensitivity and disclosures in relation to going concern to be acceptable. However, no audit should be expected to predict the unknowable factors or all possible future implications for a Group and this is particularly the case in relation to Brexit.

KPMG

Loan impairment

Group – £21.9 million; 2017: £21.6 million
Parent – £16.1 million; 2017: £15.5 million
Refer to page 83 (Audit Committee Report), pages 125 to 127 (accounting policy) and pages 142 to 143 (financial disclosures).

The risk

Group and Parent
Subjective estimate
Credit risk is an area of significant estimate due to the assumptions involved and is further complicated by the adoption of IFRS 9, effective 1 January 2018. As a result we have assessed the risk relating to this estimate to have increased.

The expected credit loss ('ECL') relating to the Group and Parent's loan portfolios requires the directors to make significant judgments and assumptions over the recoverability of loans and receivables. Following the transition to IFRS 9 – Financial Instruments, the Group and Parent are required to determine the ECL using a three stage model:

i. For loans and advances to customers where the credit risk has not increased significantly since initial recognition, the loss allowance is calculated at an amount equal to 12 month expected credit losses;
ii. For loans and advances to customers where a significant increase in credit risk is considered to have occurred, the ECL is calculated based on expected losses over the loans behavioural life; and
iii. For loans and advances to customers that meet the Group and Parent's definition of default, the ECL is calculated based on expected losses over the loans behavioural life. Where applicable this is assessed on an individual basis.

For loans classified as either stage 1 or 2 and those in stage 3 that are not individually assessed, an assessment is performed on a modelled basis for impairment, with the key assumptions being:

- The definition of the significant increase in credit risk;
- The loan's probability of default ('PD') on either a 12 month or lifetime basis;
- The loan's loss given default ('LGD'); and
- The incorporation of forward economic guidance.

For loans classified as stage 3 that are individually assessed, an impairment assessment is required at an individual loan level, based on estimated future cash flows discounted to present value at the loans effective interest rate ('EIR'). There are a number of data inputs and assumptions including the cost of obtaining and selling potentially repossessed property, probable sale proceeds and any rental income prior to sale. For purchased or credit impaired ('POCI') loans held in stage 3, an assessment is performed on a portfolio basis, unless the loan satisfies the Group and Parent's definition of default.

There is a risk that the overall ECL is not reflective of the expected losses of a loan over its behavioural life. This may be due to the ECL calculation incorporating inappropriate assumptions and/or the Group and Parent's transfer criteria not effectively capturing a significant increase in credit risk.

Our response

Our audit procedures included:

- **Controls testing:** We performed end to end process walk-throughs to identify the key systems, applications and controls used in the ECL processes. We tested the relevant general IT and applications controls over key systems used in the ECL process.
- **Test of details:** We tested the completeness of the Group and Parent's watchlist. We performed credit file reviews over a risk assessed sample basis; and independently recalculated the probability weighted ECL for a sample of loans.
- **Historical comparisons:** We critically assessed the Group and Parent's assumptions in respect of significant increase in credit risk; likely collateral valuations, including timing of recovery; and the probability of possession given default by comparing them to the Group and Parent's historical experience. For the Group and Parent's probability of default models we assessed the reasonableness of the model predictions by comparing them against actual results.
- **Benchmarking assumptions:** We compared the Group and Parent's key assumptions on significant increase in credit risk; likely collateral valuations, including timing of recovery; probability of possession given default; and the probability weightings attached to each economic scenario to comparable peer group organisations.
- **Our sector experience:** We challenged the Group and Parent's key assumptions on significant increase in credit risk; the definition of default; likely collateral valuations, including timing of recovery; probability of default; probability of possession given default based on our knowledge of the Group and experience of the industry in which it operates.
- **Modelling expertise:** We involved our own economic specialists to assist us in assessing the appropriateness of the Group and Parent's methodology for determining the economic scenarios used and the probability weightings applied to them.
- **Sensitivity analysis:** We performed sensitivity analysis over the Group and Parent's key assumptions on significant increase in credit risk; likely collateral valuations, including timing of recovery; probability of possession given default; and the probability weightings attached to each economic scenario.
- **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the expected credit losses. As a part of this, we assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the key judgments and assumptions made was sufficiently clear.

Loan impairment (continued)

The effect of these matters is that, as part of our risk assessment, we determined that the impairment of loans and advances to customers has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole. Note 2 of the financial statements discloses the sensitivities estimated by the Group and Parent.

Disclosure quality
The disclosures regarding the Group and Parent's application of IFRS 9 are key to understanding the change from IAS 39 as well as explaining the key judgments and material inputs to the IFRS 9 ECL results.

Our results
We found the ECL provision recognised and the related disclosures to be acceptable (2017: acceptable).

Recognition of revenue on originated and acquired loans

Group – £407.9 million; 2017: £332.7 million
Refer to pages 83 to 84 (Audit Committee Report), page 123 (accounting policy) and page 132 (financial disclosures).

The risk

Group
Subjective Estimate
The recognition of revenue (interest receivable on loans and advances to customers under the effective interest rate ('EIR') method) requires management to apply judgment, with the most critical estimate being the loans' expected behavioural life.

Acquired loan portfolios
For the Group's acquired loan portfolios, the risk is that estimated future cash collections do not equal actual cash receipts. Given the nature of the acquired loan portfolios, estimation of future cash collections requires significant estimation in respect of the value and timing of expected future cash flows. 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.

Originated assets
The Group applies judgment in deciding which cash flows are spread on an EIR basis and assessing the expected life assumptions used to spread those cash flows.

The expected life assumptions utilise repayment profiles which represent when customers are expected to repay based on past customer behaviour and any qualitative factors management considered relevant to future customer trends.

Due to the relatively low levels of historical organic lending on certain tenors of longer fixed period lending, the Group has limited information available from which to assess trends in prepayment, redemption and product transfers. As a result there is increased subjectivity in these assumptions as detailed patterns of customer behaviour have not been clearly established from which to estimate expected customer behaviour.

The effect of these matters is that, as part of our risk assessment, we determined that the recognition of revenue on originated and acquired loans has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. Note 2 discloses the sensitivities estimated by the Group.

Our response

For originated loans our procedures included:
- **Methodology implementation:** We tested the consistency of methodology and application across the Group's loan portfolios.
- **Test of details:** We tested the accuracy of data inputs from the mortgage systems into the effective interest rate calculations, including interest rates, fees and product lives. We assessed the appropriateness of the Group's expected life assumptions on its various mortgage products with reference to historical customer repayment behaviour and any qualitative factors management considered relevant to future customer trends.
- **Sensitivity analysis:** We performed stress testing analysis on the key assumptions.
- **Independent re-performance:** We tested the mathematical accuracy of the calculations through re-performance.
- **Historical comparisons:** We considered whether any 'catch up' adjustments are required on portfolios where the repayment profile actual cash flow experience differs from that originally predicted. For those loans where catch up adjustments have been recorded, we assessed the appropriateness of the revised repayment profiles.

For acquired loans we also performed the following:
- **Control operations:** We visited each of the servicers for the mortgage books where these are 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 is appropriately captured in the models.

For both organic loans and acquired loans our procedures included:
- **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the level of subjective estimation that exists when determining revenue recognition on the Group's loan portfolios. In addition, we challenged whether the disclosure of the key estimates and assumptions made was sufficiently clear.

Our results
- We found the resulting revenue recognition on originated and acquired loans to be acceptable (2017: acceptable).

KPMG

3. Our application of materiality and an overview of the scope of our audit

Materiality

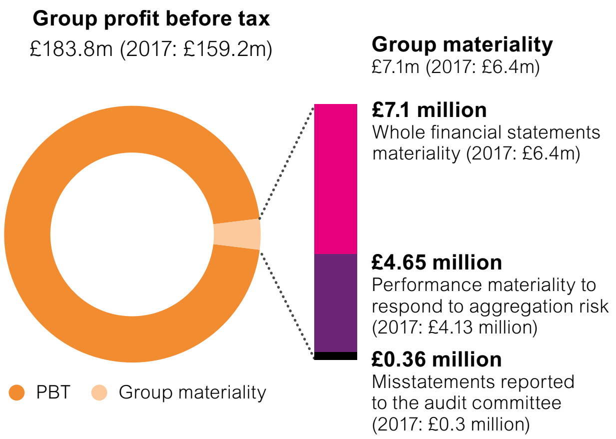
Materiality for the group financial statements as a whole was set at £7.1 million, determined with reference to a benchmark of group profit before tax, of which it represents 4% (2017: 4% of group profit before tax).

Materiality for the parent company financial statements as a whole was set at £5.3 million, determined with reference to a benchmark of company profit before tax, of which it represents 4%.

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.36 million, in addition to other identified misstatements that warranted reporting on qualitative grounds.

Scope – Group

In 2018, as in 2017, the Group audit team performed the audit of the Group as if it was a single aggregated set of financial information. 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.



4. We have nothing to report on going concern

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or the Group or to cease their operations, and as they have concluded that the Company's and the Group's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over their ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

Our responsibility is to conclude on the appropriateness of the Directors' conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the group or the company will continue in operation.

In our evaluation of the Directors' conclusions, we considered the inherent risks to the Group's and Company's business model and analysed how those risks might affect the Group's and Company's financial resources or ability to continue operations over the going concern period. The risks that we considered most likely to adversely affect the Group's and Company's available financial resources over this period was the impact of Brexit on the Group and Company's liquidity and capital resources.

- availability of funding and liquidity in the event of a market wide stress scenario including the impact of Brexit, and
- impact on regulatory capital requirements in the event of an economic slowdown or recession.

As these were risks that could potentially cast significant doubt on the Group's and the Company's ability to continue as a going concern, we considered sensitivities over the level of available financial resources indicated by the Group's financial forecasts taking account of reasonably possible (but not unrealistic) adverse effects that could arise from these risks individually and collectively and evaluated the achievability of the actions the Directors consider they would take to improve the position should the risks materialise.

Based on this work, we are required to report to you if:

- we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements.
- The related statement under the Listing Rules set out on page 107 is materially inconsistent with our audit knowledge.

We have nothing to report in these respects, and we did not identify going concern as a key audit matter.

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 Directors' 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 51 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 uncertainty 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.

Our work is limited to assessing these matters in the context of only the knowledge acquired during our financial statements audit. As we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made, the absence of anything to report on these statements is not a guarantee as to the Group's and Company's longer-term viability.

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 Statement does not properly disclose a departure from the eleven 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 Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 108, 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 or other irregularities (see below), 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.

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 annual accounts from our general commercial and sector experience, through discussion with the directors (as required by auditing standards), and from inspection of the Group's regulatory correspondence and discussed with the directors the policies and procedures regarding compliance with laws and regulations. We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit. The potential effect of these laws and regulations on the annual accounts varies considerably.

KPMG

Firstly, the Group is subject to laws and regulations that directly affect the annual accounts including financial reporting legislation (including related companies legislation, distributable profits legislation and taxation legislation), and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related annual account items.

Secondly, the Group is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the annual accounts, for instance through the imposition of fines or litigation or the loss of the Group's licence to operate. We identified the following areas as those most likely to have such an effect: regulatory capital and liquidity and certain aspects of company legislation recognising the financial and regulated nature of the Group's activities. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and inspection of regulatory and legal correspondence, if any.

These limited procedures did not identify actual or suspected non-compliance.

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the annual accounts, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the annual accounts, the less likely the inherently limited procedures required by auditing standards would identify it. In addition, 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. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

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
14 March 2019

Statement of Comprehensive Income
For the year ended 31 December 2018

	Notes	Group 2018 £m	Group 2017 £m
Interest receivable and similar income	3	**407.9**	332.7
Interest payable and similar charges	4	**(120.6)**	(87.3)
Net interest income		**287.3**	245.4
Fair value losses on financial instruments	5	**(5.1)**	(6.3)
Loss on sale of financial instruments	6	**(0.1)**	–
Fees and commissions receivable		**1.7**	1.5
Fees and commissions payable		**(1.1)**	(1.0)
External servicing fees		**(0.6)**	(1.5)
Total income		**282.1**	238.1
Administrative expenses	7	**(74.9)**	(61.6)
Depreciation and amortisation	25, 26	**(4.7)**	(3.5)
Impairment losses	21	**(8.1)**	(4.4)
FSCS and other regulatory provisions	33	**(0.8)**	(0.9)
Exceptional cost–Heritable option	10	**(9.8)**	–
Profit before taxation		**183.8**	167.7
Taxation	11	**(43.5)**	(40.8)
Profit for the year		**140.3**	126.9
Other comprehensive expense			
Items which may be reclassified to profit or loss:			
Fair value changes on financial instruments measured as FVOCI (2017: available-for-sale):			
Arising in the year		**(0.2)**	0.1
Revaluation of foreign operations		**(0.2)**	(0.3)
Other comprehensive expense		**(0.4)**	(0.2)
Total comprehensive income for the year		**139.9**	126.7
Dividend, pence per share	13	**14.6**	12.8
Earnings per share, pence per share			
Basic	12	**55.5**	51.1
Diluted	12	**55.0**	50.7

The above results are derived wholly from continuing operations.

The notes on pages 122 to 182 form part of these accounts.

The financial statements on pages 118 to 182 were approved by the Board of Directors on 14 March 2019.

Statement of Financial Position
As at 31 December 2018

	Note	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Assets					
Cash in hand		**0.4**	0.5	**0.4**	0.5
Loans and advances to credit institutions	15	**1,347.3**	1,187.2	**1,340.0**	1,179.3
Investment securities	16	**58.9**	19.1	**58.9**	19.1
Loans and advances to customers	17	**8,983.3**	7,306.0	**7,208.2**	6,051.0
Derivative assets	22	**11.7**	6.1	**11.7**	6.1
Fair value adjustments on hedged assets	23	**19.8**	31.9	**19.8**	31.9
Deferred taxation asset	27	**3.5**	5.1	**1.6**	2.5
Intangible assets	25	**7.8**	6.8	**7.1**	6.1
Property, plant and equipment	26	**21.8**	21.5	**15.6**	15.4
Investments in subsidiaries and intercompany loans	24	**–**	–	**1,900.7**	1,194.3
Other assets	28	**5.7**	4.9	**5.5**	4.7
Total assets		**10,460.2**	8,589.1	**10,569.5**	8,510.9
Liabilities					
Amounts owed to retail depositors	29	**8,071.9**	6,650.3	**8,071.9**	6,650.3
Amounts owed to credit institutions	30	**1,584.0**	1,250.3	**1,584.0**	1,250.3
Amounts owed to other customers	31	**32.9**	25.7	**32.9**	25.7
Derivative liabilities	22	**24.9**	21.8	**24.9**	21.8
Current taxation liability		**19.2**	18.3	**15.0**	14.8
Intercompany loans	24	**–**	–	**262.4**	31.2
Other liabilities	32	**18.7**	16.3	**14.7**	13.4
FSCS and other regulatory provisions	33	**1.8**	1.4	**1.8**	1.4
Subordinated liabilities	34	**10.8**	10.9	**10.8**	10.9
Perpetual subordinated bonds	35	**15.3**	15.3	**15.3**	15.3
		9,779.5	8,010.3	**10,033.7**	8,035.1
Equity					
Share capital	36	**2.4**	2.4	**2.4**	2.4
Share premium	36	**158.8**	158.4	**158.8**	158.4
Retained earnings		**439.6**	337.5	**297.0**	237.1
Other reserves	37	**79.9**	80.5	**77.6**	77.9
		680.7	578.8	**535.8**	475.8
Total equity and liabilities		**10,460.2**	8,589.1	**10,569.5**	8,510.9

The profit after tax for the year ended 31 December 2018 of OneSavings Bank plc as a Company was £96.2m (2017: £91.9m). As permitted by section 408 of the Companies Act 2006, no separate Statement of Comprehensive Income is presented in respect of the Company.

The notes on pages 122 to 182 form part of these accounts.

The financial statements on pages 118 to 182 were approved by the Board of Directors on 14 March 2019.

Andy Golding
Chief Executive Officer
14 March 2019

April Talintyre
Chief Financial Officer
14 March 2019

Company number: 07312896

Statement of Changes in Equity
For the year ended 31 December 2018

Group	Share capital £m	Share premium £m	Capital contribution £m	Transfer reserve £m	Foreign exchange reserve £m	FVOCI reserve £m	Available-for-sale reserve £m	Share-based payment reserve £m	Retained earnings £m	Equity bonds[1] £m	Total £m
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	–	–	–	–	–	–	–	–	(3.7)	–	(3.7)
Dividends paid	–	–	–	–	–	–	–	–	(27.0)	–	(27.0)
Other comprehensive income	–	–	–	–	(0.3)	–	0.1	–	–	–	(0.2)
Share-based payments	–	0.5	0.2	–	–	–	–	2.1	0.2	–	3.0
Additional Tier 1 securities issuance	–	–	–	–	–	–	–	–	(0.8)	60.0	59.2
Tax recognised in equity	–	–	–	–	–	–	–	1.0	1.2	–	2.2
At 31 December 2017	**2.4**	**158.4**	**6.4**	**(12.8)**	**(0.2)**	**–**	**0.1**	**5.0**	**337.5**	**82.0**	**578.8**
IFRS 9 transitional adjustment	**–**	**–**	**–**	**–**	**–**	**0.1**	**(0.1)**	**–**	**(3.6)**	**–**	**(3.6)**
Tax on IFRS 9	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**0.7**	**–**	**0.7**
Restated at 31 December 2017	**2.4**	**158.4**	**6.4**	**(12.8)**	**(0.2)**	**0.1**	**–**	**5.0**	**334.6**	**82.0**	**575.9**
Profit for the year	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**140.3**	**–**	**140.3**
Coupon paid on equity bonds	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(6.5)**	**–**	**(6.5)**
Dividends paid	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(33.2)**	**–**	**(33.2)**
Other comprehensive income	**–**	**–**	**–**	**–**	**(0.2)**	**(0.2)**	**–**	**–**	**–**	**–**	**(0.4)**
Share-based payments	**–**	**0.4**	**0.1**	**–**	**–**	**–**	**–**	**(0.3)**	**2.6**	**–**	**2.8**
Tax recognised in equity	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**1.8**	**–**	**1.8**
At 31 December 2018	**2.4**	**158.8**	**6.5**	**(12.8)**	**(0.4)**	**(0.1)**	**–**	**4.7**	**439.6**	**82.0**	**680.7**

Bank	Share capital £m	Share premium £m	Capital contribution £m	Transfer reserve £m	Foreign exchange reserve £m	FVOCI reserve £m	Available-for-sale reserve £m	Share-based payment reserve £m	Retained earnings £m	Equity bonds[1] £m	Total £m
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	–	–	–	–	–	–	–	–	(3.7)	–	(3.7)
Dividends paid	–	–	–	–	–	–	–	–	(27.0)	–	(27.0)
Other comprehensive income	–	–	–	–	–	–	0.1	–	–	–	0.1
Share-based payments	–	0.5	0.2	–	–	–	–	2.0	0.2	–	2.9
Additional Tier 1 securities issuance	–	–	–	–	–	–	–	–	(0.8)	60.0	59.2
Tax recognised in equity	–	–	–	–	–	–	–	1.0	1.2	–	2.2
At 31 December 2017	**2.4**	**158.4**	**6.1**	**(15.2)**	**–**	**–**	**0.1**	**4.9**	**237.1**	**82.0**	**475.8**
IFRS 9 transitional adjustment	**–**	**–**	**–**	**–**	**–**	**0.1**	**(0.1)**	**–**	**(1.3)**	**–**	**(1.3)**
Tax on IFRS 9	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**0.3**	**–**	**0.3**
Restated at 31 December 2017	**2.4**	**158.4**	**6.1**	**(15.2)**	**–**	**0.1**	**–**	**4.9**	**236.1**	**82.0**	**474.8**
Profit for the year	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**96.2**	**–**	**96.2**
Coupon paid on equity bonds	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(6.5)**	**–**	**(6.5)**
Dividends paid	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(33.2)**	**–**	**(33.2)**
Other comprehensive income	**–**	**–**	**–**	**–**	**–**	**(0.2)**	**–**	**–**	**–**	**–**	**(0.2)**
Share-based payments	**–**	**0.4**	**0.1**	**–**	**–**	**–**	**–**	**(0.2)**	**2.6**	**–**	**2.9**
Tax recognised in equity	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**1.8**	**–**	**1.8**
At 31 December 2018	**2.4**	**158.8**	**6.2**	**(15.2)**	**–**	**(0.1)**	**–**	**4.7**	**297.0**	**82.0**	**535.8**

1. Equity bonds comprise £22m of Perpetual Subordinated Bonds and £60m of Additional Tier 1 securities ('AT1 securities').

The reserves are further disclosed in note 37.

Statement of Cash Flows
For the year ended 31 December 2018

	Notes	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Cash flows from operating activities					
Profit before taxation		**183.8**	167.7	**129.6**	124.0
Adjustments for non-cash items	45	**32.7**	19.3	**31.1**	16.3
Changes in operating assets and liabilities	45	**(262.1)**	(655.0)	**(215.3)**	(623.1)
Cash used in operating activities		**(45.6)**	(468.0)	**(54.6)**	(482.8)
FSCS and other provisions paid		**(0.4)**	(1.0)	**(0.4)**	(1.0)
Net tax paid		**(39.1)**	(42.1)	**(30.3)**	(34.4)
Net cash used in operating activities		**(85.1)**	(511.1)	**(85.3)**	(518.2)
Cash flows from investing activities					
Maturity and sales of investment securities	16	**39.9**	40.0	**39.7**	40.0
Purchases of investment securities	16	**(79.9)**	–	**(79.7)**	–
Sales of financial instruments	6	**0.4**	–	**0.4**	–
Purchases of equipment and intangible assets	25, 26	**(6.0)**	(14.0)	**(5.2)**	(10.5)
Cash (used in)/generated from investing activities		**(45.6)**	26.0	**(44.8)**	29.5
Cash flows from financing activities					
Bank of England TFS drawdowns	30	**250.0**	1,149.0	**250.0**	1,149.0
Bank of England ILTR received	30	**80.0**	–	**80.0**	–
Interest paid on bonds and subordinated debt[1]		**(1.6)**	(1.8)	**(1.6)**	(1.8)
Coupon paid on equity bonds		**(6.5)**	(3.7)	**(6.5)**	(3.7)
Dividends paid	13	**(33.2)**	(27.0)	**(33.2)**	(27.0)
AT1 securities issuance net of costs	37	**–**	59.4	**–**	59.4
Proceeds from issuance of shares under employee SAYE schemes	36	**0.4**	0.5	**0.4**	0.5
Repayment of debt[2]	34	**(0.1)**	(10.7)	**(0.1)**	(10.7)
Cash generated from financing activities		**289.0**	1,165.7	**289.0**	1,165.7
Net increase in cash and cash equivalents		**158.3**	680.6	**158.9**	677.0
Cash and cash equivalents at the beginning of the year	14	**1,165.9**	485.3	**1,158.0**	481.0
Cash and cash equivalents at the end of the year	14	**1,324.2**	1,165.9	**1,316.9**	1,158.0
Movement in cash and cash equivalents		**158.3**	680.6	**158.9**	677.0

1. The comparative information has been reclassified to include interest paid on bonds and subordinated debt, which was previously shown within operating activities, within financing activities.
2. Repayment of debt comprises £0.1m of the 2022 LIBOR + 2% linked floating rate notes. 2017 comprised 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 2018

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 investment securities held at fair value through other comprehensive income ('FVOCI') and 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 Comprehensive Income 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. The stress scenarios include Brexit and Bank of England Term Funding Scheme ('TFS') repayments. 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 ('FX') 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')
- Residential mortgages.

The Group includes asset finance leases (a new business lending line developed internally with lending commencing in October 2018) and personal loans (sold in June 2018) within the BTL/SME segment.

The Group has applied the aggregation criteria of IFRS 8 for the segmental reporting in note 43 but has disclosed the risk management tables in note 39 at a sub-segment level to provide the user with granular level analysis of the Group's core lending business.

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. 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 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 FVOCI investment securities 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 in the period in which they are 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. The Group includes early redemption charges within the EIR.

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.

The Bank and its UK subsidiaries are in a group payment arrangement for corporation tax and show a net corporation tax liability and deferred tax asset accordingly.

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

j) Cash and cash equivalents
Cash and cash equivalents comprise cash, non-restricted balances with central banks and highly liquid financial assets with original maturities of less than three months 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.

Notes to the Financial Statements continued

For the year ended 31 December 2018

1. Accounting policies continued

Software is amortised on a straight line basis in profit or loss over its estimated useful life, which is generally 5 years. The Group reviews the amortisation period on an annual basis. If the expected useful life of assets is different from previous assessments, the amortisation period is changed accordingly.

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 financial instruments based on the business model and the contractual cash flow characteristics of the financial instruments. Under IFRS 9, the Group classifies financial assets into one of three measurement categories:

- **Amortised cost** – assets held in a business model to hold financial assets in order to collect contractual cash flows, where the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest ('SPPI') on the principal amount outstanding.
- **Fair value through other comprehensive income ('FVOCI')** – assets held in a business model which collects contractual cash flows and sells financial assets where the contractual terms of the financial assets give rise on specified dates to cash flows that are SPPI on the principal amount outstanding. The Group only measures investment securities under this category, which were previously classified as available-for-sale under IAS 39.
- **Fair value through profit or loss ('FVTPL')** – assets not measured at amortised cost or FVOCI. The Group only measures derivative assets under this category.

The 2017 comparatives are classified in accordance with IAS 39 and IAS 32 into the following categories:

- Loans and receivables
- Available-for-sale ('AFS')
- 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.

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
- 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.

iii. Derecognition
The Group derecognises financial assets when the contractual rights to the cash flows expire or the Group transfers substantially all the risks and rewards of ownership of the financial asset. 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.

The forbearance measures offered by the Group are considered a modification event as the contractual cash flows are renegotiated or otherwise modified. The Group considers the renegotiated or modified cash flows are not wholly different from the contractual cash flows, and does not consider forbearance measures to give rise to a derecognition event.

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.

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 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. 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
During 2018 the Group used the IFRS 9 three stage expected credit loss ('ECL') approach for measuring impairment. The three impairment stages under IFRS 9 are as follows:
- **Stage 1** – entities are required to recognise a 12 month ECL allowance where there is no significant increase in credit risk ('SICR') since initial recognition.
- **Stage 2** – a lifetime loss allowance is held for assets where a SICR is 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.

During 2017 the Group used IAS 39 specific and collective provisioning basis for measuring impairment.

The Group measures impairment through the use of individual and modelled assessments.

Individual assessment
The Group's provisioning process requires individual assessment for loans over £0.5m which are more than three months in arrears, have LPA receivers appointed, the property is taken into 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.

Notes to the Financial Statements continued

For the year ended 31 December 2018

1. Accounting policies continued

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.

If the present value of estimated future cash flows discounted at the original EIR is less than the carrying value of the loan, a 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 provision is recognised.

The Group applies its IFRS 9 (2017: IAS 39) models to all loans with no individually assessed provision.

2018 IFRS 9 modelled impairment

Measurement of ECL

The assessment of credit risk and the estimation of ECL are unbiased and probability weighted. ECL is measured on either a 12 month (stage 1) or lifetime basis depending on whether a SICR has occurred since initial recognition (stage 2) or where an account meets the Group's definition of default (stage 3).

The ECL calculation is a product of an individual loan's probability of default ('PD'), exposure at default ('EAD') and loss given default ('LGD') discounted at the effective interest rate ('EIR'). 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.

Significant increase in credit risk (movement to stage 2)

The Group's transfer criteria determine what constitutes a SICR, 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.

IFRS 9 includes a rebuttable presumption that if an account is more than 30 days past due it has experienced a SICR. The Group considers more than 30 days past due to be an appropriate back stop measure and therefore has not rebutted this presumption.

The Group's Risk function constantly monitors the ongoing appropriateness of the transfer criteria, where any proposed amendments are reviewed and approved by the Group's Management Committees and the Risk and Audit Committees at least semi-annually or more frequently if required.

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 uses 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 include:

- The rebuttable presumption that more than 90 days past due is an indicator of default. The Group has not rebutted this presumption and therefore deems more than 90 days past due as an indicator of default. This also ensures alignment between the Group's Internal Ratings Based ('IRB') models and the Basel/Regulatory definition of default.
- The Group has also deemed it appropriate to classify accounts that have moved into an unlikeliness to pay position, which includes forbearance, repossession and interest-only term expiry.

A borrower will move out of stage 3 when their credit risk improves such that they no longer meet the 90 days past due and unlikeliness to pay criteria and following this have completed an internally approved probation period. The borrower will move to stage 1 or stage 2 dependent on whether the SICR applies.

Forward-looking macroeconomic scenarios

IFRS 9 requires firms to consider the risk of default and expected credit loss taking into consideration expectations of economic changes that are deemed to be reasonably possible.

The Group uses a bespoke macroeconomic model to determine the most significant factors which may influence the likelihood of an exposure defaulting in the future. The macroeconomic factors relate to the HPI, unemployment and the Bank of England Base Rate.

The Group has derived an approach for factoring probability weighted macroeconomic forecasts into ECL calculations, adjusting PD and LGD estimates. An account's lifetime PD is impacted by the probability weighted macroeconomic scenario and therefore impacts whether an account meets the Group's SICR transfer criteria moving the exposure between stage 1 and stage 2. 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. During 2018, a fourth scenario was introduced relating specifically to a disorderly 'no-deal' Brexit outcome.

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 to set the Group's credit risk appetite thresholds and limits.

Expected life

IFRS 9 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.

Purchased or originated credit impaired ('POCI')

Acquired loans that meet OSB's definition of default (90 days past due or an unlikeliness to pay position) 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 no longer meets the definition of default post acquisition. The Group does not originate credit impaired loans.

2017 IAS 39 modelled impairment

All loans which have not been individually assessed are subsequently assessed for impairment collectively, with each loan being assigned a one year PD and a LGD generally consistent with the requirements of the 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.

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 (e.g. 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 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 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.

Notes to the Financial Statements continued

For the year ended 31 December 2018

1. Accounting policies continued

Loans and advances over which the Group transfers its rights to the collateral thereon to the Bank of England under the TFS and Indexed Long-Term Repo ('ILTR') 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 classifies TFS and ILTR as amortised cost under IFRS 9 Financial Instruments.

Loans and receivables also contain the Group's asset finance lease lending. Finance leases are initially measured at an amount equal to the net investment in the lease, using the interest rate implicit in the finance lease. Initial direct costs are included in the initial measurement of the net investment in the lease and reduce the amount of income recognised over the lease term. Finance income is recognised over the lease term, based on a pattern reflecting a constant periodic rate of return on the net investment in the lease.

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 FVOCI (2017: AFS). These are held at fair value with movements taken to other comprehensive income and accumulated in the FVOCI (2017: 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.

p) Deposits and subordinated liabilities

Deposits 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 and ILTR 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 and ILTR is recorded in amounts owed to credit institutions. Interest is accrued over the life of the agreements on an EIR basis.

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 IFRS 9 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 life of the agreement using the EIR method.

r) Derivative financial instruments

The Group uses derivative financial instruments (interest rate swaps) to manage its exposure to the interest rate risk. In accordance with its treasury policy, the Group does not hold or issue derivative financial instruments for proprietary 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 classified as assets when their fair value is positive and as liabilities when their fair value is negative. If a derivative is cancelled, it is derecognised from the Statement of Financial Position.

The Group is party to a limited number of options and warrants. These are recognised as a derivative financial instruments as applicable where a trigger event takes place and the fair value of the option or warrant can be reliably measured.

s) Hedge accounting

The Group has chosen to continue to apply the hedge accounting requirements of IAS 39 instead of the requirements in Chapter 6 of IFRS 9. The Group uses fair value hedge accounting for a portfolio hedge of interest rate risk (IAS 39 – AG 114).

Portfolio hedge accounting allows for hedge effectiveness testing and accounting over an entire portfolio of derivatives. 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 applies fair value portfolio hedge accounting to its fixed rate portfolio of mortgages and saving accounts. The hedged portfolio is analysed into repricing time periods based on expected repricing dates, utilising the ALCO approved prepayment curve. Interest rate swaps are designated against the repricing time periods to establish the hedge relationship. Hedge effectiveness is calculated as a percentage of the fair value movement of the interest rate swap against the fair value movement of the hedged item over the period tested.

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.

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. The accumulated amount in profit or loss is subsequently amortised 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 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 expected income or cost generated from the hedged assets or liabilities. Each reporting period the expectation is compared to actual with an accelerated run off applied where the two diverge by more than set parameters.

t) 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.

u) 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.

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

w) Share-based payments
In accordance with IFRS 2 Share-based payments, equity-settled 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 award 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 Sharesave Schemes is determined using a Black-Scholes 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 options or 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 options and awards.

Notes to the Financial Statements continued

For the year ended 31 December 2018

1. Accounting policies continued

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 2018 and 2017 reporting dates.

y) Adoption of new standards

In 2018 the Group adopted the classification and measurement and expected credit loss of financial instruments under IFRS 9 and revenue recognition principles of IFRS 15, together with amendments to existing standards that were endorsed for adoption by the EU and mandatory for annual reporting periods beginning on or after 1 January 2018.

The Group has applied IFRS 15 retrospectively in accordance with IFRS 15 C3(b). There were no cumulative effects of initially applying IFRS 15 to be recognised as an adjustment to the opening balance of retained earnings.

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 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. The adoption of IFRS 16 in respect of rented properties is expected to have a c. £3.9m effect on the Statement of Financial Position, as the Group recognises a right-of-use asset and lease liability of this amount. The Group will recognise the interest paid on the lease liability within the financing activities section of the 2019 Statement of Cash Flows. The Group will use its internal cost of funding excluding the impact of TFS funding in discounting future cash flows to derive the right-of-use assets. The adoption of IFRS 16 will have a negligible impact on the Group's capital.

- The Group will apply the changes to IAS 12 Income taxes from annual improvements to IFRS Standards 2015–2017 cycle effective from 1 January 2019. The changes will require the Group to recognise the tax consequences of payments on financial instruments classified as equity in the Statement of Comprehensive Income. This will result in c. £1.8m of tax on interest paid on equity PSBs and AT1 securities which is currently recognised directly in equity being recognised in profit or loss.

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.

Judgements

The Group has made the following judgments in applying the accounting policies:

(i) Loan book impairments

Significant increase in credit risk for classification in 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. The 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. Setting the appropriate thresholds to determine what is a 'significant' increase is a key area of judgement.

Probation period for classification from Stage 3 into Stage 1 or 2

The Group has set a minimum probation period which an account must undergo before returning to non-defaulted status. While supported by analysis of re-default rates, the probation period is set judgementally to ensure that only a limited number of accounts default soon after returning to a non-defaulted status, whilst also allowing permanent cures to return to non-default without excessive delay.

(ii) IFRS 9 classification

The Group has applied judgement in determining whether the contractual terms of a financial asset give rise on specified dates to cash flows that are SPPI on the principal amount outstanding when applying the classification criteria of IFRS 9. The main area of judgement is over the Group's loans and advances to customers which have been accounted for under amortised cost.

Estimates

The Group has made the following estimates in applying the accounting policies:

(i) Loan book impairments

This section provides details of the critical accounting estimates which underpin loan impairment calculations. Less significant estimates are not disclosed.

Individual impairment

Assessments for individually significant loans involve significant estimates 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 estimation 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 using the Group's IFRS 9 impairment models (2017: IAS 39 collective basis).

Modelled impairment

Modelled provision assessments are also subject to estimation uncertainty, underpinned by a number of estimates being made by management which are utilised within impairment calculations. Key areas of estimation within modelled provisioning calculations include those regarding the PD, the LGD and forward-looking macroeconomic scenarios.

Probability of Default models

The Group developed a number of PD models to assess the likelihood of a 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. A 10% relative worsening of modelled PDs (e.g. a 1.0% PD increasing to 1.1% PD) would drive an increase in total provisions by £0.7m as at 31 December 2018 under IFRS 9 approach (2017: £0.4m under IAS 39 approach).

Loss Given Default model

The Group developed a single LGD model, which includes a number of estimated inputs including propensity to go to possession given default ('PPD'), forced sale discount ('FSD'), time to sale ('TTS') and sale cost estimates. PPD and FSD parameters are segmented by loan type, with the LGD further segmented by LTV. The LGD is sensitive to the application of the HPI. As at 31 December 2018 a 10% fall in house prices would result in an incremental £11.0m (2017: £5.0m) of provision being required. The sensitivity increase year on year is primarily driven by the transition from IAS 39 to IFRS 9.

Forward-looking macroeconomic scenarios

The forward-looking macroeconomic scenarios affect both the PD and LGD estimates. Therefore the expected credit losses calculations are sensitive to both the scenarios utilised and their associated probability weightings.

As the Group does not have an in-house economics function it 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. Due to the current uncertainty regarding Brexit negotiations the choice of scenarios and weightings are subject to a significant degree of estimation. To address the economic uncertainty, during 2018 a fourth scenario was introduced relating specifically to a disorderly 'no-deal' Brexit outcome. As at 31 December 2018 an additional 10% of weighting attributed to this fourth scenario would result in an incremental £4.3m of provision being required. If a 100% probability weighting was applied to the severe 'no-deal' Brexit scenario, which was aligned to the Bank of England scenario published on 28 November 2018, an incremental £40.9m of provision would have been required as at 31 December 2018. This scenario includes a peak 30% fall in HPI, unemployment rates rising to 7.5% and base rates increasing to 5.25%.

IAS 39 Collective impairment

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.

(ii) Loan book acquisition accounting and income recognition

Acquired loan books are initially recognised at fair value. Significant estimation 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 cumulative prepayment rate ('CPR') and cumulative default rate ('CDR') 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.

Incurred losses at acquisition are calculated using the Group's modelled provision assessment (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 updated with a reset gain or loss taken. 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 calculated at acquisition to derive a new carrying value, with changes taken to profit or loss as interest income. The Group recognised a gain of £2.0m in 2018 as a result of resetting cash flows on acquired mortgage books (2017: loss of £0.3m). A 10% increase/decrease in prepayment cash flow performance to date across the acquired books would result in a reset gain/loss of c. £0.7m in 2018 (2017: £0.8m).

(iii) Effective interest rate on organic lending

A number of estimates 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.

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2. Judgements in applying accounting policies and critical accounting estimates continued

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. The Group estimates 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.

A 10% increase/decrease in the rate of prepayments term for 2018 new originations would decrease/increase interest income for 2018 by c. £0.3m (2017: c. £0.1m).

Estimation 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. Prior to 2018, the Group prudently assumed no period on SVR, before borrowers refinance on to a new product or redeem, as it waited for a stable trend to emerge following the automation of the broker-led Choices programme in late 2016. Behavioural data on two year products was available in 2018, and was used as the basis for assuming a period on SVR for both 2018 and prior year origination. Estimates were used to assess how further planned enhancements to and automation of the Choices programme and the potential for changes in regulation might impact future behaviour. No SVR period is recognised on three and five year products.

A three month longer/shorter period on SVR reflected within the EIR for 2018 originations would increase/decrease interest income in 2018 by c. £0.1m (2017: c. £0.4/£0.3m). A three month longer/shorter period on SVR for loans outstanding at the year end, assessed by discounting back the additional future cash flows, would increase/decrease interest income in 2018 by c. £0.9m/£0.3m.

3. Interest receivable and similar income

	Group 2018 £m	Group 2017 £m
At amortised cost:		
On BTL/SME mortgages[1]	**318.3**	245.4
On Residential mortgages[1]	**89.8**	93.7
On investment securities	**0.3**	0.1
On other liquid assets	**7.6**	2.0
At fair value through profit or loss:		
Net expense on derivative financial instruments–lending activities	**(8.1)**	(8.5)
	407.9	332.7

1. The comparative information for Residential mortgages has been reclassified following a change in allocation, with an additional £1.9m of interest income disclosed compared to the previously reported balance. This has decreased the BTL/SME mortgages interest income by £1.9m.

4. Interest payable and similar charges

	Group 2018 £m	Group 2017 £m
On retail deposits	**109.6**	86.1
On Bank of England borrowings	**8.7**	2.9
On Perpetual Subordinated Bonds	**0.9**	0.9
On subordinated liabilities	**0.7**	0.9
On wholesale borrowings	**0.4**	0.2
Net expense/(income) on derivative financial instruments–savings activities	**0.3**	(3.7)
	120.6	87.3

5. Fair value losses on financial instruments

	Group 2018 £m	Group 2017 £m
Fair value changes in hedged assets	**11.0**	(8.7)
Hedging of assets	**(13.8)**	10.0
Fair value changes in hedged liabilities	**(0.3)**	2.9
Hedging of liabilities	**0.4**	(3.1)
Ineffective portion of hedges	**(2.7)**	1.1
Net gains on unmatched swaps	**2.4**	–
Amortisation of fair value adjustments on hedged assets	**(4.6)**	(7.3)
Debit and credit valuation adjustment	**(0.2)**	(0.1)
	(5.1)	(6.3)

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 amortisation includes £3.0m (2017: £4.8m) of accelerated unwind due to faster run-off on the long-dated fixed rate mortgages compared to the run-off profile at cancellation date.

6. Loss on sales of financial instruments

During the year the Group disposed of its final portion of the personal loan portfolio. The Group sold personal loans with a gross value of £0.9m for proceeds of £0.4m. After removing loan loss provisions of £0.3m and recovering servicing costs of £0.1m, the Group made a £0.1m loss on disposal.

7. Administrative expenses

	Group 2018 £m	Group 2017 £m
Staff costs	**43.6**	35.9
Facilities costs	**3.3**	2.4
Marketing costs	**3.2**	2.7
Support costs	**9.2**	8.4
Professional fees	**7.7**	5.0
Other costs[1]	**7.9**	7.2
	74.9	61.6

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 2018 £'000	Group 2017 £'000
Fees payable to the Company's auditor for the audit of the Company's annual accounts	**626**	638
Fees payable to the Company's auditor and its associates for other services:		
Audit of the accounts of subsidiaries	**188**	178
Audit-related assurance services	**95**	96
Tax compliance services	**9**	8
Other assurance services	**31**	47

Included within the audit of the Bank and Group accounts is £150k (2017: £165k) relating to the audit of IFRS 9. Other assurance services in 2018 include a review of data submitted to the Bank of England under the TFS and a review of the OSB India Private Limited financial statements as required by Indian income tax rules.

Staff costs comprise the following categories:

	Group 2018 £m	Group 2017 £m
Salaries, incentive pay and other benefits	**36.0**	28.9
Share-based payments	**2.5**	2.4
Social security costs	**3.4**	3.3
Other pension costs	**1.7**	1.3
	43.6	35.9

The average number of people employed by the Group (including Executive Directors) during the year was 989 (2017: 813), analysed below:

	Group 2018	Group 2017
Operations	**510**	442
Support functions	**479**	371
	989	813

Notes to the Financial Statements continued

For the year ended 31 December 2018

8. Directors' emoluments and transactions

	Bank 2018 £'000	Bank 2017 £'000
Directors' emoluments[1]	**2,116**	1,914
Payments in respect of personal pension plans	**109**	104
Gains made on the exercise of share options[2]	**–**	17
	2,225	2,035

1. Directors' emoluments comprise salary costs, Non-Executive Directors' 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 £579k (2017: £346k) 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 £1,265k (2017: £895k) using a share price of £4.20 (2017: £4.08) (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 2018 or 2017.

There were no outstanding loans granted in the ordinary course of business to Directors and their connected persons as at 31 December 2018 and 2017.

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 awards 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 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. The Group's IPO awards were fully vested by the end of 2018.

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, 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 2018 £m	Group 2017 £m
IPO Share Award expensed in the year	**0.1**	0.3
Sharesave Scheme	**0.3**	0.2
Deferred Share Bonus Plan	**1.1**	0.9
Performance Share Plan	**1.0**	1.0
	2.5	2.4

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 2018	**652,198**	**732,341**	**2.60**	**1,186,762**	**1,589,030**
Granted	**–**	**313,443**	**3.35**	**376,231**	**708,146**
Exercised	**(652,198)**	**(162,093)**	**2.25**	**(301,575)**	**(559,179)**
Forfeited	**–**	**(42,062)**	**2.86**	**(2,706)**	**–**
At 31 December 2018	**–**	**841,629**	**2.93**	**1,258,712**	**1,737,997**
Exercisable at:					
31 December 2018	**–**	**2,861**	**3.15**	**–**	**–**

	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:					
31 December 2017	–	–	–	–	–

For the share-based awards granted during the year, the weighted average grant date fair value was 399 pence (2017: 383 pence).

The weighted average market price at exercise for IPO Share Awards exercised in the year was 408 pence (2017: nil).

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For the year ended 31 December 2018

9. Share-based payments continued

The range of exercise prices and weighted average remaining contractual life of outstanding awards are as follows:

Exercise price	2018 Number	2018 Weighted average remaining contractual life (years)	2017 Number	2017 Weighted average remaining contractual life (years)
IPO share awards				
Nil	–	–	652,198	0.4
Sharesave Scheme				
134–335 pence	**841,629**	**2.1**	732,341	2.1
Deferred Share Bonus Plan				
Nil	**1,258,712**	**1.3**	1,186,762	1.4
Performance Share Plan				
Nil	**1,737,997**	**1.4**	1,589,030	1.2
	3,838,338	**1.5**	4,160,331	1.3

The grant date fair values of options/awards under the Group's share-based payment schemes are determined using a Black-Scholes model. The share price at the grant date for all schemes is adjusted for the impact of dividends as the options/awards do not carry automatic rights to dividends. The valuation of share options/awards is based on the following input assumptions:

- Expected volatility – for Sharesave volatility is based on a benchmark of the FTSE 350 diversified financials whilst for DSBP and PSP plans volatility is based on the Bank's share price volatility.
- Attrition rate – based on the attrition rate of all UK employees and updated annually for the DSBP and PSP awards.
- Dividend yield – based on the average dividend yield across external analysts' reports for the quarter prior to scheme grant date.

Sharesave Scheme

	2018		2017		2016		2015		2014	
Contractual life, years	**3**	**5**	3	5	3	5	3	5	3	5
Share price at issue, £	**4.19**	**4.19**	3.93	3.93	3.00	3.00	2.84	2.84	1.68	1.68
Exercise price, £	**3.35**	**3.35**	3.15	3.15	2.40	2.40	2.27	2.27	1.34	1.34
Expected volatility, %	**16.1**	**16.5**	18.0	17.3	18.4	20.1	16.6	19.4	20.0	20.0
Dividend yield, %	**4.4**	**4.4**	4.1	4.1	4.6	4.6	3.6	3.6	3.0	3.0
Grant date fair value, £	**0.40**	**0.43**	0.75	0.70	0.10	0.15	0.75	0.79	0.31	0.34

Deferred Share Bonus Plan

	2018	2017		2016	2015
Contractual life, years	**3**	3	5	3	3
Mid-market share price, £	**3.80**	4.04	4.04	3.09	2.51
Expected volatility, %	**33.8**	63.7	63.7	43.9	35.5
Attrition rate, %	**9.7**	11.8	11.8	12.0	11.1
Dividend yield, %	**4.6**	4.0	4.0	4.6	3.7
Grant date fair value, £	**3.34**	3.61	3.37	2.71	2.26

Performance Share Plan

	2018	2017	2016	2015
Contractual life, years	**3**	3	3	3
Mid-market share price, £	**4.11**	4.04	3.09	2.51
Expected volatility, %	**29.1**	63.7	43.9	35.5
Attrition rate, %	**9.7**	11.8	12.0	11.1
Dividend yield, %	**4.6**	4.0	4.6	3.7
Vesting rate–growth, %	**55.0**	75.0	79.0	100.0
Vesting rate–TSR, %	**54.0**	60.0	60.0	60.0
Grant date fair value, £	**3.61**	3.61	2.71	2.26

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.

IPO Share Awards

The grant date fair value of the IPO Share Awards was the issue price of £1.70 as they are in the form of nil price awards 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 (2017: nil) per annum. This is lower than the overall expected employee attrition rate as nil attrition was assumed for certain Senior Managers who received larger awards. All IPO Share Awards were fully vested at 31 December 2018.

10. Exceptional cost – Heritable option

The Heritable Development Finance business operates as a joint venture ('JV') between the Bank and certain senior members of the Heritable team ('the JV partners'). Under the JV, the parties agreed to co-operate in developing the business and lend alongside each other, sharing revenues in accordance with a profit waterfall. The JV agreement also includes a put/call option over the JV partners' share of the business, exercisable from 2019, subject to certain conditions. During 2018, the conditions of exercise were met and an exceptional cost of £9.8m was recognised for the fair value of the option.

Subsequent to the year end, the option was surrendered for a one off payment of £9.8m and the Bank acquired the JV partners' interest in the business. At the same time, a new revenue sharing arrangement was signed allowing the JV partners to continue to lend alongside the Bank.

11. Taxation

	Group 2018 £m	Group 2017 £m
Corporation taxation	**(42.8)**	(41.5)
Deferred taxation	**(0.7)**	0.7
Total taxation	**(43.5)**	(40.8)

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:

	2018 £m	2017 £m
Profit before taxation	**183.8**	167.7
Profit multiplied by the weighted average rate of corporation taxation in the UK during 2018 of 19.00% (2017: 19.25%)	**(34.9)**	(32.3)
Bank surcharge	**(8.6)**	(8.3)
Taxation effects of:		
Expenses not deductible for taxation purposes	**0.1**	(0.2)
Adjustments in respect of earlier years	**0.1**	(0.4)
Tax adjustments in respect of share-based payments	**0.2**	0.3
Impact of tax losses carried forward	**–**	0.2
Timing differences on capital items	**(0.4)**	(0.1)
Total taxation charge	**(43.5)**	(40.8)

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.

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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 coupons 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 2018 £m	Group 2017 £m
Profit for the year	**140.3**	126.9
Adjustments:		
Coupons on PSBs and AT1 securities classified as equity	**(6.5)**	(3.7)
Tax on coupons	**1.8**	1.0
Profit attributable to ordinary shareholders	**135.6**	124.2
Exceptional items:		
Exceptional cost–Heritable option	**9.8**	–
Tax on above	**(2.6)**	–
Underlying profit attributable to ordinary shareholders	**142.8**	124.2

	Group 2018	Group 2017
Weighted average number of shares, millions		
Basic	**244.2**	243.2
Diluted	**246.2**	245.1
Earnings per share, pence per share		
Basic	**55.5**	51.1
Diluted	**55.0**	50.7
Underlying earnings per share, pence per share		
Basic	**58.5**	51.1
Diluted	**58.0**	50.7

13. Dividends

During the year, the Bank paid the following dividends:

	Bank 2018		Bank 2017	
	£m	Pence per share	£m	Pence per share
Final dividend for the prior year	**22.7**	**9.3**	18.5	7.6
Interim dividend for the current year	**10.5**	**4.3**	8.5	3.5
	33.2		27.0	

A summary of the Bank's distributable reserves from which dividends can be paid are shown below:

	Bank 2018 £m	Bank 2017 £m
Net assets	**535.8**	475.8
Less:		
– Share capital	**(2.4)**	(2.4)
– Share premium	**(158.8)**	(158.4)
– Other non-distributable reserves[1]	**(88.1)**	(93.1)
– Unrealised gains[2]	**(19.8)**	(31.9)
Distributable reserves	**266.7**	190.0

1. Other non-distributable reserves include the capital contribution, equity bonds and FVOCI reserve.
2. Unrealised gains relate to the Bank's fair value adjustments on hedged assets.

The Directors propose a final dividend of 10.3 pence per share (2017: 9.3 pence) payable on 15 May 2019 with an ex-dividend date of 21 March 2019 and a record date of 22 March 2019. This dividend is not reflected in these financial statements as it is subject to approval by shareholders at the AGM on 9 May 2019. Together with the interim dividend of 4.3 pence (2017: 3.5 pence), the total dividend for 2018 is 14.6 pence (2017: 12.8 pence) per share.

14. Cash and cash equivalents

	Group 2018 £m	Group 2017 £m	**Bank 2018 £m**	Bank 2017 £m
Cash in hand	**0.4**	0.5	**0.4**	0.5
Unencumbered loans and advances to credit institutions	**1,323.8**	1,165.4	**1,316.5**	1,157.5
	1,324.2	1,165.9	**1,316.9**	1,158.0

15. Loans and advances to credit institutions

	Group 2018 £m	Group 2017 £m	**Bank 2018 £m**	Bank 2017 £m
Unencumbered:				
Bank of England call account	**1,295.2**	1,136.9	**1,295.2**	1,136.9
Call accounts	**28.6**	24.5	**21.3**	20.6
Term deposits	**–**	4.0	**–**	–
Encumbered:				
Bank of England cash ratio deposit	**20.0**	10.0	**20.0**	10.0
Swap margin given	**3.5**	11.8	**3.5**	11.8
	1,347.3	1,187.2	**1,340.0**	1,179.3

16. Investment securities

	Group and Bank 2018 £m	Group and Bank 2017 £m
UK and EU Sovereign debt	**58.9**	19.1
	58.9	19.1

The Group had no investment securities sold under repos at the 2018 and 2017 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 FVOCI.

Movements during the year of investment securities are analysed as follows:

	Group and Bank 2018 £m	Group and Bank 2017 £m
At 1 January	**19.1**	141.7
Additions	**79.9**	–
Disposals and maturities	**(39.9)**	(122.7)
Changes in fair value	**(0.2)**	0.1
At 31 December	**58.9**	19.1

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For the year ended 31 December 2018

17. Loans and advances to customers

	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Loans and advances (see note 18)	**8,998.0**	7,327.6	**7,224.3**	6,066.5
Finance leases (see note 19)	**7.2**	–	**–**	–
	9,005.2	7,327.6	**7,224.3**	6,066.5
Less: Expected credit losses (see note 20)	**(21.9)**	(21.6)	**(16.1)**	(15.5)
	8,983.3	7,306.0	**7,208.2**	6,051.0

18. Loans and advances

	2018			2017		
Group	BTL/SME £m	Residential £m	Total £m	BTL/SME £m	Residential £m	Total £m
Gross carrying amount						
Stage 1	**7,032.1**	**1,247.5**	**8,279.6**	–	–	–
Stage 2	**247.6**	**189.2**	**436.8**	–	–	–
Stage 3	**102.0**	**123.4**	**225.4**	–	–	–
Stage 3 (POCI)	**0.3**	**55.9**	**56.2**	–	–	–
IAS 39	**–**	**–**	**–**	5,654.1	1,673.5	7,327.6
	7,382.0	**1,616.0**	**8,998.0**	5,654.1	1,673.5	7,327.6
Bank						
Gross carrying amount						
Stage 1	**5,528.8**	**1,128.2**	**6,657.0**	–	–	–
Stage 2	**166.6**	**180.0**	**346.6**	–	–	–
Stage 3	**70.6**	**94.2**	**164.8**	–	–	–
Stage 3 (POCI)	**–**	**55.9**	**55.9**	–	–	–
IAS 39	**–**	**–**	**–**	4,588.7	1,477.8	6,066.5
	5,766.0	**1,458.3**	**7,224.3**	4,588.7	1,477.8	6,066.5

At 31 December 2018, mortgages with a carrying value of £2,629.7m (2017: £2,303.2m) were pledged with the Bank of England under the asset purchase facility, TFS. The Group considers these loans to be encumbered.

At 31 December 2018, mortgages with a carrying value of £216.3m (2017: nil) were pledged with the Bank of England under the ILTR facility. The Group considers these loans to be encumbered.

Included within loans and advances to customers are mortgages totalling £16.0m (2017: £28.9m) retained by the Group, who acts as master servicer for securitisation vehicles, to comply with the EU risk retention requirements. The Group considers these loans to be encumbered.

The tables opposite show the movement in loans and advances to customers by IFRS 9 stage during the year.

Group	Stage 1 £m	Stage 2 £m	Stage 3 £m	Stage 3 (POCI) £m	IAS 39 £m	Total £m
At 31 December 2017	–	–	–	–	7,327.6	7,327.6
IFRS 9 transitional adjustment	6,782.5	292.4	183.0	69.7	(7,327.6)	–
Restated at 31 December 2017	6,782.5	292.4	183.0	69.7	–	7,327.6
Originations[1]	3,043.4	–	–	–	–	3,043.4
Repayments and write-offs[2]	(1,265.3)	(50.8)	(43.4)	(13.5)	–	(1,373.0)
Transfers:						
– To Stage 1	170.5	(150.0)	(20.5)	–	–	–
– To Stage 2	(353.8)	375.1	(21.3)	–	–	–
– To Stage 3	(97.7)	(29.9)	127.6	–	–	–
At 31 December 2018	8,279.6	436.8	225.4	56.2	–	8,998.0

Bank	Stage 1 £m	Stage 2 £m	Stage 3 £m	Stage 3 (POCI) £m	IAS 39 £m	Total £m
At 31 December 2017	–	–	–	–	6,065.5	6,065.5
IFRS 9 transitional adjustment	5,679.0	185.8	131.6	69.1	(6,065.5)	–
Restated at 31 December 2017	5,679.0	185.8	131.6	69.1	–	6,065.5
Originations[1]	2,276.2	–	–	–	–	2,276.2
Repayments and write-offs[2]	(1,049.4)	(28.7)	(26.1)	(13.2)	–	(1,117.4)
Transfers:						
– To Stage 1	101.0	(83.6)	(17.4)	–	–	–
– To Stage 2	(279.0)	297.5	(18.5)	–	–	–
– To Stage 3	(70.8)	(24.4)	95.2	–	–	–
At 31 December 2018	6,657.0	346.6	164.8	55.9	–	7,224.3

1. Originations include further advances and drawdowns on existing commitments.
2. Repayments and write-offs include customer redemptions.

The Group did not purchase any mortgage books during 2018 (2017: nil).

19. Finance leases

The Group commenced asset finance lending in October 2018 through an existing subsidiary in the Group, InterBay Asset Finance Limited (formerly 5D Lending Ltd).

	Group 2018 £m	Group 2017 £m
Net investment in finance leases, receivable		
Less than one year	2.2	–
Between one and five years	4.9	–
More than 5 years	0.1	–
	7.2	–

The Group has recognised £0.1m of ECLs on finance leases as at 31 December 2018 (2017: nil). These are included within BTL/SME in note 20.

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20. Expected credit loss

The Group's ECL by segment and IFRS 9 stage is shown below:

	2018			2017		
	BTL/SME £m	Residential £m	Total £m	BTL/SME £m	Residential £m	Total £m
Group						
Stage 1	**3.0**	**1.3**	**4.3**	–	–	–
Stage 2	**2.1**	**3.5**	**5.6**	–	–	–
Stage 3	**5.7**	**4.5**	**10.2**	–	–	–
Stage 3 (POCI)	**–**	**1.6**	**1.6**	–	–	–
Undrawn loan facilities	**0.2**	**–**	**0.2**	–	–	–
IAS 39	**–**	**–**	**–**	13.2	8.4	21.6
	11.0	**10.9**	**21.9**	13.2	8.4	21.6
Bank						
Stage 1	**2.3**	**1.1**	**3.4**	–	–	–
Stage 2	**1.3**	**3.4**	**4.7**	–	–	–
Stage 3	**3.8**	**2.4**	**6.2**	–	–	–
Stage 3 (POCI)	**–**	**1.6**	**1.6**	–	–	–
Undrawn loan facilities	**0.2**	**–**	**0.2**	–	–	–
IAS 39	**–**	**–**	**–**	9.4	6.1	15.5
	7.6	**8.5**	**16.1**	9.4	6.1	15.5

The tables below show the movement in the ECL by IFRS 9 stage during the year. ECLs on originations reflect the IFRS 9 stage of loans originated during the year as at 31 December and not the date of origination. Remeasurement of loss allowance relates to existing loans which did not redeem during the year and includes the impact of loans moving between IFRS 9 stages.

Group	Stage 1 £m	Stage 2 £m	Stage 3 £m	Stage 3 (POCI) £m	IAS 39 Impairments £m	Total £m
At 31 December 2017	–	–	–	–	21.6	21.6
IFRS 9 transitional adjustment	**7.8**	**2.3**	**13.3**	**1.8**	**(21.6)**	**3.6**
Restated at 31 December 2017	**7.8**	**2.3**	**13.3**	**1.8**	**–**	**25.2**
Originations	**2.1**	**–**	**–**	**–**	**–**	**2.1**
Repayments and write-offs	**(0.3)**	**(0.2)**	**(7.0)**	**(0.2)**	**–**	**(7.7)**
Remeasurement of loss allowance	**(6.1)**	**6.9**	**4.0**	**–**	**–**	**4.8**
Transfers:						
– To Stage 1	**1.4**	**(0.8)**	**(0.6)**	**–**	**–**	**–**
– To Stage 2	**(0.8)**	**1.3**	**(0.5)**	**–**	**–**	**–**
– To Stage 3	**(5.8)**	**(0.4)**	**6.2**	**–**	**–**	**–**
– To Stage 3 (POCI)	**–**	**–**	**–**	**–**	**–**	**–**
Changes in assumptions and model parameters	**6.2**	**(3.5)**	**(5.2)**	**–**	**–**	**(2.5)**
At 31 December 2018	**4.5**	**5.6**	**10.2**	**1.6**	**–**	**21.9**

Bank	Stage 1 £m	Stage 2 £m	Stage 3 £m	Stage 3 (POCI) £m	IAS 39 Impairments £m	Total £m
At 31 December 2017	–	–	–	–	15.5	15.5
IFRS 9 transitional adjustment	**5.1**	**1.4**	**8.6**	**1.8**	**(15.5)**	**1.4**
Restated at 31 December 2017	**5.1**	**1.4**	**8.6**	**1.8**	**–**	**16.9**
Originations	**1.8**	**–**	**–**	**–**	**–**	**1.8**
Repayments and write-offs	**(0.1)**	**(0.1)**	**(4.1)**	**(0.2)**	**–**	**(4.5)**
Remeasurement of loss allowance	**(1.7)**	**6.8**	**1.6**	**–**	**–**	**6.7**
Transfers:						
– To Stage 1	**0.9**	**(0.4)**	**(0.5)**	**–**	**–**	**–**
– To Stage 2	**(0.6)**	**1.0**	**(0.4)**	**–**	**–**	**–**
– To Stage 3	**(4.4)**	**(0.3)**	**4.7**	**–**	**–**	**–**
– To Stage 3 (POCI)	**–**	**–**	**–**	**–**	**–**	**–**
Changes in assumptions and model parameters	**2.6**	**(3.7)**	**(3.7)**	**–**	**–**	**(4.8)**
At 31 December 2018	**3.6**	**4.7**	**6.2**	**1.6**	**–**	**16.1**

The table below shows the movement in the 2017 impairment provisions as measured under the IAS 39 model of specific and collective provisions:

Specific	Group £m	Bank £m
At 1 January 2017	23.4	17.7
Write-offs in year	(7.8)	(5.7)
Charge for the year net of recoveries	4.0	1.8
At 31 December 2017	19.6	13.8
Collective		
At 1 January 2017	1.6	1.4
Charge for the year net of recoveries	0.4	0.3
At 31 December 2017	2.0	1.7
Total		
At 1 January 2017	25.0	19.1
Write-offs in year	(7.8)	(5.7)
Charge for the year net of recoveries	4.4	2.1
At 31 December 2017	21.6	15.5

21. Impairment losses

	Group 2018 £m	Group 2017 £m
Write-offs in year	**11.1**	7.8
Disposals	**0.3**	–
Decrease in provision	**(3.3)**	(3.4)
	8.1	4.4

22. 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 amount 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**
At 31 December 2018					
Derivative assets:					
Interest rate risk hedging	**11.7**	**11.7**	**(10.3)**	**(1.0)**	**0.4**
Derivative liabilities:					
Interest rate risk hedging	**(15.1)**	**(15.1)**	**10.3**	**3.5**	**(1.3)**
Heritable option[1]	**(9.8)**	**(9.8)**	**–**	**–**	**(9.8)**
	(24.9)	**(24.9)**	**10.3**	**3.5**	**(11.1)**
At 31 December 2017					
Derivative assets:					
Interest rate risk hedging	6.1	6.1	(5.9)	(0.2)	–
Derivative liabilities:					
Interest rate risk hedging	(21.8)	(21.8)	5.9	11.8	(4.1)

1. The Group has a put/call option over Heritable Capital ('HCL') as part of the development finance joint venture, as further discussed in note 10.

Included within derivative liabilities is £3.0m (2017: £4.6m) of derivative contracts not covered by master netting agreements and therefore no cash collateral has been paid.

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22. Derivatives continued

The table below profiles the timing of nominal amounts for interest rate risk hedging derivatives based on contractual maturity:

Group and Bank	Total nominal £m	Less than 3 months £m	3–12 months £m	1–5 years £m	More than 5 years £m
At 31 December 2018					
Derivative assets	**1,999.0**	**106.0**	**330.0**	**1,563.0**	**–**
Derivative liabilities	**4,532.2**	**195.0**	**2,090.0**	**1,966.2**	**281.0**
	6,531.2	**301.0**	**2,420.0**	**3,529.2**	**281.0**
At 31 December 2017					
Derivative assets	1,636.1	151.1	702.0	783.0	–
Derivative liabilities	2,493.9	129.0	1,359.7	871.2	134.0
	4,130.0	280.1	2,061.7	1,654.2	134.0

The Group and Bank has 206 (2017: 169) derivative contracts with an average fixed rate of 1.23% (2017: 1.20%).

23. Fair value adjustments on hedged items

	Group and Bank 2018 £m	Group and Bank 2017 £m
Hedged assets		
Current hedge relationships	**2.5**	15.9
Cancelled hedge relationships	**17.3**	16.0
	19.8	31.9
Hedged liabilities		
Current hedge relationships	**–**	–

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 2018 £m	Group and Bank 2017 £m
At 1 January	**16.0**	23.3
New cancellations[1]	**5.9**	–
Amortisation (see note 5)	**(4.6)**	(7.3)
At 31 December	**17.3**	16.0

1. Following an update of the fixed prepayment curve assumptions, a long dated swap effective prior to the update was cancelled with the designated hedge moved to cancelled hedge relationships to be amortised over the original life of the swap.

24. 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:

	Shares in subsidiary undertakings £m	Intercompany loans receivable £m	Intercompany loans payable £m	Total £m
At 1 January 2017	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 2017	1.8	1,192.5	(31.2)	1,163.1
Additions	**–**	**782.4**	**(231.4)**	**551.0**
Repayments	**–**	**(76.0)**	**0.2**	**(75.8)**
At 31 December 2018	**1.8**	**1,898.9**	**(262.4)**	**1,638.3**

A list of the Bank's direct and indirect subsidiaries is shown below:

2018

Direct investments	Class of shares	Activity	Ownership	Charged by/(to) the Bank during the year £m	Balance due to/(by) the Bank £m
Easioption Limited	Ordinary	Holding company	**100%**	**–**	**0.5**
Guernsey Home Loans Limited	Ordinary	Mortgage provider	**100%**	**(0.3)**	**13.0**
Guernsey Home Loans Limited (Guernsey)	Ordinary	Mortgage provider	**100%**	**(0.8)**	**36.8**
Heritable Development Finance Limited[1]	Ordinary	Mortgage originator and servicer	**85%**	**1.5**	**(0.8)**
Interbay Group Holdings Limited	Ordinary	Holding company	**100%**	**–**	**–**
Jersey Home Loans Limited	Ordinary	Mortgage provider	**100%**	**(0.1)**	**2.0**
Jersey Home Loans Limited (Jersey)	Ordinary	Mortgage provider	**100%**	**(3.3)**	**152.3**
OSB India Private Limited[2]	Ordinary	Back office processing	**100%**	**6.8**	**5.7**
Prestige Finance Limited	Ordinary	Mortgage originator and servicer	**100%**	**2.7**	**(1.2)**
Reliance Property Loans Limited	Ordinary	Mortgage provider	**100%**	**(0.1)**	**3.8**
Rochester Mortgages Limited	Ordinary	Mortgage provider	**100%**	**–**	**–**
Indirect investments					
Inter Bay Financial I Limited	Ordinary	Holding company	**100%**	**(0.3)**	**20.1**
Inter Bay Financial II Limited	Ordinary	Holding company	**100%**	**(0.2)**	**6.8**
Interbay Funding, Ltd	Ordinary	Mortgage servicer	**100%**	**2.1**	**(260.3)**
Interbay ML, Ltd	Ordinary	Mortgage provider	**100%**	**(19.3)**	**1,651.2**
InterBay Holdings Ltd	Ordinary	Holding company	**100%**	**–**	**–**
5D Finance Limited	Ordinary	Mortgage servicer	**100%**	**–**	**0.4**
InterBay Asset Finance Limited (formerly: 5D Lending Ltd)[3]	Ordinary	Asset finance and mortgage provider	**100%**	**(0.1)**	**6.2**
				(11.4)	**1,636.5**

1. Heritable Development Finance Limited is a business development partnership with HCL. 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, 29.72% by Easioption Limited and 0.001% by Reliance Property Loans Limited.
3. The Group launched its new asset finance business in 5D Lending Ltd during 2018 and renamed the subsidiary to InterBay Asset Finance Limited.

2017

Direct investments	Class of shares	Activity	Ownership	Charged by/(to) the Bank during the year £m	Balance due to/(by) the Bank £m
Easioption Limited	Ordinary	Holding company	100%	–	0.5
Guernsey Home Loans Limited	Ordinary	Mortgage provider	100%	(0.3)	17.5
Guernsey Home Loans Limited (Guernsey)	Ordinary	Mortgage provider	100%	(1.0)	46.6
Heritable Development Finance Limited	Ordinary	Mortgage originator and servicer	85%	1.9	(0.9)
Interbay Group Holdings Limited	Ordinary	Holding company	100%	–	–
Jersey Home Loans Limited	Ordinary	Mortgage provider	100%	(0.1)	3.2
Jersey Home Loans Limited (Jersey)	Ordinary	Mortgage provider	100%	(4.3)	201.4
OSB India Private Limited	Ordinary	Back office processing	100%	5.4	5.9
Prestige Finance Limited	Ordinary	Mortgage originator and servicer	100%	3.2	(1.3)
Reliance Property Loans Limited	Ordinary	Mortgage provider	100%	(0.1)	4.1
Rochester Mortgages Limited	Ordinary	Mortgage provider	100%	–	–
Indirect investments					
Inter Bay Financial I Limited	Ordinary	Holding company	100%	(0.3)	19.8
Inter Bay Financial II Limited	Ordinary	Holding company	100%	(0.2)	17.7
Interbay Funding, Ltd	Ordinary	Mortgage servicer	100%	–	(28.9)
Interbay ML, Ltd	Ordinary	Mortgage provider	100%	(10.2)	875.6
InterBay Holdings Ltd	Ordinary	Holding company	100%	–	–
5D Finance Limited	Ordinary	Mortgage servicer	100%	–	0.2
5D Lending Ltd	Ordinary	Mortgage provider	100%	–	(0.1)
				(6.0)	1,161.3

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24. Investments in subsidiaries, intercompany loans and transactions with related parties continued

All entities have the same registered address as the Company, except the following:

- Guernsey Home Loans Limited (Guernsey) – 1st floor, Tudor House, Le Bordage, St Peter Port, Guernsey, GY1 1DB
- Jersey Home Loans Limited (Jersey) – 26 New Street, St Helier, Jersey, JE2 3RA
- OSB India Private Limited – Salarpuria Magnificia, 9th & 10th floor, 78 Old Madras Road, Bangalore, India, 560016

All of the above investments are reviewed annually for impairment. Based on management's assessment of the future cash flows of each entity and the support of the Bank, 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 was charged for services provided by KRPS amounting to £0.2m (2017: £0.3m).

All related party transactions were made on terms equivalent to those that prevail in arms 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 the Directors. Directors' remuneration is disclosed in note 8 and in the Annual Report on Remuneration.

No loans were issued to related parties during 2018 (2017: nil).

Key management personnel and connected persons held deposits with the Group of £1.7m (2017: £1.5m).

25. Intangible assets

Intangible assets consist of computer software. There were no capitalised costs related to the internal development of software during the period.

	Group £m	Bank £m
Cost		
At 1 January 2017	8.5	6.8
Additions	4.2	3.9
Disposals and write-offs	(0.3)	(0.3)
At 31 December 2017	12.4	10.4
Additions	**3.5**	**3.2**
Disposals and write-offs[1]	**(2.3)**	**(1.5)**
At 31 December 2018	**13.6**	**12.1**
Amortisation		
At 1 January 2017	3.8	2.7
Charged in year	1.8	1.6
At 31 December 2017	5.6	4.3
Charged in year	**2.5**	**2.2**
Disposals and write-offs[1]	**(2.3)**	**(1.5)**
At 31 December 2018	**5.8**	**5.0**
Net book value		
At 31 December 2018	**7.8**	**7.1**
At 31 December 2017	6.8	6.1

1. During the year the Group and Bank wrote-off fully depreciated assets.

26. Property, plant and equipment

Group	Freehold land and buildings £m	Leasehold improvements £m	Equipment and fixtures £m	Total £m
Cost				
At 1 January 2017	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 2017	16.2	0.6	9.9	26.7
Additions	**–**	**0.3**	**2.5**	**2.8**
Disposals and write-offs[1]	**–**	**–**	**(1.3)**	**(1.3)**
Foreign exchange difference	**(0.2)**	**–**	**(0.1)**	**(0.3)**
At 31 December 2018	**16.0**	**0.9**	**11.0**	**27.9**
Depreciation				
At 1 January 2017	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 2017	0.6	0.2	4.4	5.2
Charged in year	**0.2**	**0.1**	**1.9**	**2.2**
Disposals and write-offs[1]	**–**	**–**	**(1.3)**	**(1.3)**
At 31 December 2018	**0.8**	**0.3**	**5.0**	**6.1**
Net book value				
At 31 December 2018	**15.2**	**0.6**	**6.0**	**21.8**
At 31 December 2017	**15.6**	**0.4**	**5.5**	**21.5**

1. During the year the Group wrote-off fully depreciated assets.

Bank	Freehold land and buildings £m	Leasehold improvements £m	Equipment and fixtures £m	Total £m
Cost				
At 1 January 2017	6.4	0.5	5.7	12.6
Additions	5.1	0.1	1.7	6.9
At 31 December 2017	11.5	0.6	7.4	19.5
Additions	**–**	**0.1**	**1.8**	**1.9**
Disposals and write-offs[1]	**–**	**–**	**(1.0)**	**(1.0)**
At 31 December 2018	**11.5**	**0.7**	**8.2**	**20.4**
Depreciation				
At 1 January 2017	0.4	0.1	2.2	2.7
Charged in year	0.2	0.1	1.1	1.4
At 31 December 2017	0.6	0.2	3.3	4.1
Charged in year	**0.1**	**0.1**	**1.5**	**1.7**
Disposals and write-offs[1]	**–**	**–**	**(1.0)**	**(1.0)**
At 31 December 2018	**0.7**	**0.3**	**3.8**	**4.8**
Net book value				
At 31 December 2018	**10.8**	**0.4**	**4.4**	**15.6**
At 31 December 2017	**10.9**	**0.4**	**4.1**	**15.4**

1. During the year the Bank wrote-off fully depreciated assets.

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27. Deferred taxation asset

	Group				
	Losses carried forward £m	Accelerated depreciation £m	Share-based payments £m	IFRS 9 transitional adjustments £m	Total £m
At 1 January 2017	2.3	0.1	1.0	–	3.4
Profit or loss credit	0.2	–	0.5	–	0.7
Tax taken directly to equity	–	–	1.0	–	1.0
At 31 December 2017	2.5	0.1	2.5	–	5.1
IFRS 9 transitional adjustments	**–**	**–**	**–**	**0.7**	**0.7**
Restated at 31 December 2017	**2.5**	**0.1**	**2.5**	**0.7**	**5.8**
Profit or loss credit	**(1.1)**	**(0.2)**	**0.6**	**–**	**(0.7)**
Transferred to corporation tax liability	**–**	**–**	**(1.6)**	**–**	**(1.6)**
At 31 December 2018	**1.4**	**(0.1)**	**1.5**	**0.7**	**3.5**

	Bank				
	Losses carried forward £m	Accelerated depreciation £m	Share-based payments £m	IFRS 9 transitional adjustments £m	Total £m
At 1 January 2017	–	–	0.8	–	0.8
Profit or loss credit	–	–	0.7	–	0.7
Tax taken directly to equity	–	–	1.0	–	1.0
At 31 December 2017	–	–	2.5	–	2.5
IFRS 9 transitional adjustments	**–**	**–**	**–**	**0.3**	**0.3**
Restated at 31 December 2017	**–**	**–**	**2.5**	**0.3**	**2.8**
Profit or loss credit	**–**	**(0.2)**	**0.6**	**–**	**0.4**
Transferred to corporation tax liability	**–**	**–**	**(1.6)**	**–**	**(1.6)**
At 31 December 2018	**–**	**(0.2)**	**1.5**	**0.3**	**1.6**

The deferred tax has been calculated using the relevant rates for the expected periods of utilisation.

As at 31 December 2018, the Group had £3.5m (2017: £3.5m) 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.

28. Other assets

	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Prepayments	**2.3**	1.9	**2.1**	1.7
Other assets	**3.4**	3.0	**3.4**	3.0
	5.7	4.9	**5.5**	4.7

29. Amounts owed to retail depositors

	Group and Bank 2018 £m	Group and Bank 2017 £m
Fixed rate deposits	**5,155.5**	4,305.6
Variable rate deposits	**2,916.4**	2,344.7
	8,071.9	6,650.3

30. Amounts owed to credit institutions

	Group and Bank 2018 £m	Group and Bank 2017 £m
Bank of England TFS	**1,502.9**	1,250.0
Bank of England ILTR	**80.1**	–
Swap margin received	**1.0**	0.3
	1,584.0	1,250.3

Bank of England TFS includes £250.0m of cash movement and £2.9m of non-cash accrued interest.

Bank of England ILTR includes £80.0m of cash movement and £0.1m of non-cash accrued interest.

31. Amounts owed to other customers

	Group and Bank 2018 £m	Group and Bank 2017 £m
Fixed rate deposits	**32.9**	25.7

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32. Other liabilities

	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Falling due within one year:				
Accruals	**11.0**	10.9	**9.5**	9.0
Deferred income	**2.0**	0.9	**0.9**	0.8
Other creditors	**5.7**	4.5	**4.3**	3.6
	18.7	16.3	**14.7**	13.4

33. 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 for single account holders and £170,000 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 2018 will be recognised in 2019. The FSCS balance at the reporting date relates to the levy from previous years.

The Group has reviewed its current exposure to Payment Protection Insurance ('PPI') claims and has maintained a provision of £0.4m as at 31 December 2018 (2017: £0.4m). The Group will reassess the provision once the FCA deadline for PPI claims of 29 August 2019 has passed. The Group has increased its provision for FCA conduct rules exposures and has recognised a provision of £1.3m (2017: £0.5m) to cover potential future claims.

An analysis of the Group and Bank's FSCS and other provisions is presented below:

Group and Bank	FSCS 2018 £m	Other regulatory provisions 2018 £m	Total 2018 £m	FSCS 2017 £m	Other regulatory provisions 2017 £m	Total 2017 £m
At 1 January	**0.5**	**0.9**	**1.4**	1.4	0.1	1.5
Paid during the year	**(0.3)**	**(0.1)**	**(0.4)**	(1.0)	–	(1.0)
(Credit)/charge	**(0.1)**	**0.9**	**0.8**	0.1	0.8	0.9
At 31 December	**0.1**	**1.7**	**1.8**	0.5	0.9	1.4

34. Subordinated liabilities

	Group and Bank 2018 £m	Group and Bank 2017 £m
At 1 January	**10.9**	21.6
Repayment of debt at maturity	**(0.1)**	(10.7)
At 31 December	**10.8**	10.9

The Group's outstanding subordinated liabilities are summarised below:

	Group and Bank 2018 £m	Group and Bank 2017 £m
Linked to LIBOR:		
Floating rate subordinated loans 2022 (LIBOR + 5%)	**0.3**	0.3
Floating rate subordinated loans 2022 (LIBOR + 2%)	**0.3**	0.4
Fixed rate:		
Subordinated liabilities 2024 (6.45%)[1]	**5.1**	5.1
Subordinated liabilities 2024 (7.45%)	**5.1**	5.1
	10.8	10.9

1. The Group has the option to call the £5.0m second tranche of the subordinated debt on 27 September 2019.

The fixed rate subordinated liabilities are repayable at the dates stated or earlier, in full, at the option of the Group with the prior consent of the PRA. All subordinated liabilities are denominated in Pounds 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.

35. Perpetual Subordinated Bonds

	Group and Bank 2018 £m	Group and Bank 2017 £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% until the next reset date on 27 August 2019.

36. 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 plans	382,597	–	0.5
At 31 December 2017	243,464,688	2.4	158.4
Shares issued under OSB employee share plans	**1,022,849**	**–**	**0.4**
At 31 December 2018	**244,487,537**	**2.4**	**158.8**

37. 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.

FVOCI reserve (2017: AFS reserve)

The FVOCI reserve debit of £0.1m (2017: credit of £0.1m) 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 35, 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 is 4.5991% until the next reset date on 7 March 2021.

AT1 securities

On 25 May 2017 OSB issued £60.0m of Fixed Rate Resetting Perpetual Subordinated Contingent Convertible Securities ('AT1 securities') that qualify as Additional Tier 1 capital under the Capital Requirements Directive and Regulation ('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 related to the AT1 securities issuance are recognised directly in equity within retained earnings together with the related tax.

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38. Financial commitments and guarantees

a) As at 31 December 2018, the Group's contracted or anticipated capital expenditure commitments not provided for amounted to £0.2m (2017: £0.3m). 2018 consists of refurbishment and fixture costs for the relocation of the InterBay office. 2017 consisted of branch refurbishment costs.

b) The Group's minimum lease commitments under operating leases are summarised in the table below:

	Group 2018 £m	Group 2017 £m	**Bank 2018 £m**	Bank 2017 £m
Land and buildings: due within:				
One year	**0.7**	0.5	**0.5**	0.3
Two to five years	**2.3**	1.0	**1.5**	0.8
More than five years	**1.5**	–	**0.5**	–
	4.5	1.5	**2.5**	1.1

c) Undrawn loan facilities:

	Group 2018 £m	Group 2017 £m	**Bank 2018 £m**	Bank 2017 £m
BTL/SME mortgages	**622.8**	485.9	**406.0**	390.5
Residential mortgages	**81.8**	44.3	**81.8**	44.3
Asset Finance	**6.1**	–	**–**	–
	710.7	530.2	**487.8**	434.8

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 2018 (2017: nil).

39. 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.

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 market rates.

The PRA and FCA have continued to encourage banks to transition away from using LIBOR as a benchmark in all operations before the end of 2021. Throughout the UK banking sector LIBOR remains a key benchmark and for each market impacted solutions to this issue are progressing through various industry bodies.

In 2018 the Group set up an internal working group comprised of all of the key business lines that are involved with this change with strong oversight from the compliance and risk departments. Risk assessments are currently underway to ensure this process is managed in a measured and controlled fashion.

Types of risk
The principal financial risks to which the Group is exposed are credit, liquidity and market risks, the latter comprising interest and exchange rate risk. In addition to financial risks, the Group is exposed to various other risks, most notably operational, conduct and regulatory, which are covered in the Risk review on pages 41 to 46.

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 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 tables show the Group's maximum exposure to credit risk and the impact of collateral held as security, capped at the gross exposure amount, by impairment stage. Capped collateral excludes the impact of forced sale discounts and costs to sell.

	Group 2018		Group 2017	
	Gross carrying amount £m	**Capped collateral held £m**	Gross carrying amount £m	Capped collateral held £m
Stage 1	**8,286.8**	**8,274.5**	–	–
Stage 2	**436.8**	**436.8**	–	–
Stage 3	**225.4**	**224.2**	–	–
Stage 3 (POCI)	**56.2**	**56.1**	–	–
IAS 39	**–**	**–**	7,327.6	7,313.5
	9,005.2	**8,991.6**	7,327.6	7,313.5

	Bank 2018		Bank 2017	
	Gross carrying amount £m	**Capped collateral held £m**	Gross carrying amount £m	Capped collateral held £m
Stage 1	**6,657.0**	**6,653.2**	–	–
Stage 2	**346.6**	**346.5**	–	–
Stage 3	**164.8**	**164.7**	–	–
Stage 3 (POCI)	**55.9**	**55.8**	–	–
IAS 39	**–**	**–**	6,065.4	6,053.6
	7,224.3	**7,220.2**	6,065.4	6,053.6

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39. Risk management continued

The Group's collateral held in relation to BTL/SME and Residential first and second charge mortgage loans is property, based in the UK and the Channel Islands. The Group's collateral held in relation to funding lines is predominantly property. The Group's personal loan portfolio, which was sold in June 2018, was unsecured.

The Group uses indexed loan-to-value ('LTV') ratios to assess the quality of the uncapped collateral held. Property values are updated to reflect changes in the HPI. A breakdown of loans and advances to customers by indexed LTV is as follows:

LTV analysis by band for all loans:

	2018			
Group	**BTL/SME £m**	**Residential £m**	**Total £m**	**%**
Band				
0%–50%	**935.8**	**784.4**	**1,720.2**	**19**
50%–60%	**1,105.9**	**249.7**	**1,355.6**	**15**
60%–70%	**2,021.4**	**194.1**	**2,215.5**	**25**
70%–80%	**2,864.5**	**177.3**	**3,041.8**	**34**
80%–90%	**414.1**	**162.2**	**576.3**	**6**
90%–100%	**32.9**	**32.3**	**65.2**	**1**
>100%	**14.6**	**16.0**	**30.6**	**–**
Total mortgages before provisions	**7,389.2**	**1,616.0**	**9,005.2**	**100**

	2017			
Group	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

	2018			
Bank	**BTL/SME £m**	**Residential £m**	**Total £m**	**%**
Band				
0%–50%	**738.6**	**717.6**	**1,456.2**	**20**
50%–60%	**882.4**	**219.5**	**1,101.9**	**15**
60%–70%	**1,547.3**	**168.3**	**1,715.6**	**24**
70%–80%	**2,201.9**	**158.3**	**2,360.2**	**33**
80%–90%	**368.1**	**156.5**	**524.6**	**7**
90%–100%	**27.7**	**26.9**	**54.6**	**1**
>100%	**–**	**11.2**	**11.2**	**–**
Total mortgages before provisions	**5,766.0**	**1,458.3**	**7,224.3**	**100**

Bank	2017 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

LTV analysis by band for BTL/SME:

Group	**2018** Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Band					
0%–50%	**663.9**	**71.2**	**108.7**	**92.0**	**935.8**
50%–60%	**964.8**	**72.2**	**38.8**	**30.1**	**1,105.9**
60%–70%	**1,843.9**	**163.1**	**7.3**	**7.1**	**2,021.4**
70%–80%	**2,617.1**	**233.5**	**–**	**13.9**	**2,864.5**
80%–90%	**408.3**	**4.8**	**1.0**	**–**	**414.1**
90%–100%	**7.5**	**0.4**	**–**	**25.0**	**32.9**
>100%	**12.0**	**2.6**	**–**	**–**	**14.6**
Total mortgages before provisions	**6,517.5**	**547.8**	**155.8**	**168.1**	**7,389.2**

Group	2017 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

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39. Risk management continued

Bank	2018 Buy-to-Let £m	2018 Commercial £m	2018 Residential development £m	2018 Funding lines £m	2018 Total £m
Band					
0%–50%	**532.5**	**5.4**	**108.7**	**92.0**	**738.6**
50%–60%	**810.9**	**2.6**	**38.8**	**30.1**	**882.4**
60%–70%	**1,527.0**	**5.9**	**7.3**	**7.1**	**1,547.3**
70%–80%	**2,180.6**	**7.4**	**–**	**13.9**	**2,201.9**
80%–90%	**367.0**	**0.1**	**1.0**	**–**	**368.1**
90%–100%	**2.7**	**–**	**–**	**25.0**	**27.7**
>100%	**–**	**–**	**–**	**–**	**–**
Total mortgages before provisions	**5,420.7**	**21.4**	**155.8**	**168.1**	**5,766.0**

Bank	2017 Buy-to-Let £m	2017 Commercial £m	2017 Residential development £m	2017 Funding lines £m	2017 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

LTV analysis by band for Residential mortgages:

Group	2018 First charge £m	2018 Second charge £m	2018 Funding lines £m	2018 Total £m
Band				
0%–50%	**651.9**	**123.2**	**9.3**	**784.4**
50%–60%	**160.9**	**81.8**	**7.0**	**249.7**
60%–70%	**117.2**	**74.3**	**2.6**	**194.1**
70%–80%	**125.2**	**48.3**	**3.8**	**177.3**
80%–90%	**137.1**	**24.4**	**0.7**	**162.2**
90%–100%	**25.1**	**6.8**	**0.4**	**32.3**
>100%	**6.5**	**9.2**	**0.3**	**16.0**
Total mortgages before provisions	**1,223.9**	**368.0**	**24.1**	**1,616.0**

Group	2017 First charge £m	2017 Second charge £m	2017 Funding lines £m	2017 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

Bank	2018 First charge £m	Second charge £m	Funding lines £m	Total £m
Band				
0%–50%	**585.1**	**123.2**	**9.3**	**717.6**
50%–60%	**130.7**	**81.8**	**7.0**	**219.5**
60%–70%	**91.4**	**74.3**	**2.6**	**168.3**
70%–80%	**106.2**	**48.3**	**3.8**	**158.3**
80%–90%	**131.4**	**24.4**	**0.7**	**156.5**
90%–100%	**19.7**	**6.8**	**0.4**	**26.9**
>100%	**1.7**	**9.2**	**0.3**	**11.2**
Total mortgages before provisions	**1,066.2**	**368.0**	**24.1**	**1,458.3**

Bank	2017 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

Notes to the Financial Statements continued

For the year ended 31 December 2018

39. Risk management continued

Analysis of mortgage portfolio by arrears and collateral held

The tables below provide further information on collateral, capped at the value of each individual mortgage, over the mortgage portfolio by payment due status and IFRS 9 stage. The 2017 comparatives are disclosed by IAS 39 impairment stage, where impaired is defined as loans with a specific provision against them.

	Group 2018		Bank 2018	
	Loan balance £m	Capped collateral £m	Loan balance £m	Capped collateral £m
Stage 1				
Not past due	8,225.3	8,213.3	6,603.2	6,599.4
Past due < 1 month	61.5	61.2	53.8	53.8
	8,286.8	8,274.5	6,657.0	6,653.2
Stage 2				
Not past due	241.9	241.9	162.6	162.5
Past due < 1 month	124.9	124.9	117.9	117.9
Past due 1 to 3 months	70.0	70.0	66.1	66.1
	436.8	436.8	346.6	346.5
Stage 3				
Not past due	67.8	67.2	32.2	32.1
Past due < 1 month	16.2	16.2	11.4	11.4
Past due 1 to 3 months	30.4	30.4	27.2	27.2
Past due 3 to 6 months	57.2	57.2	54.7	54.7
Past due 6 to 12 months	32.0	31.9	24.7	24.7
Past due over 12 months	13.9	13.6	9.4	9.4
Possessions	7.9	7.7	5.2	5.2
	225.4	224.2	164.8	164.7
Stage 3 (POCI)				
Not past due	18.6	18.6	18.5	18.5
Past due < 1 month	6.7	6.6	6.5	6.4
Past due 1 to 3 months	6.6	6.6	6.6	6.6
Past due 3 to 6 months	7.4	7.4	7.4	7.4
Past due 6 to 12 months	7.7	7.7	7.7	7.7
Past due over 12 months	9.2	9.2	9.2	9.2
	56.2	56.1	55.9	55.8
Total loans before provisions	9,005.2	8,991.6	7,224.3	7,220.2

	Group 2017		Bank 2017	
	Loan balance £m	Capped collateral £m	Loan balance £m	Capped collateral £m
Not impaired:				
Not past due	6,792.9	6,784.8	5,613.8	5,606.5
Past due < 1 month	307.1	307.1	267.7	267.6
Past due 1 to 3 months	102.0	101.9	87.2	87.1
Past due 3 to 6 months	20.9	20.9	19.8	19.8
Past due 6 to 12 months	14.1	14.1	12.9	12.9
Past due over 12 months	7.6	7.6	6.3	6.3
Possessions[1]	0.5	0.5	0.5	0.5
	7,245.1	7,236.9	6,008.2	6,000.7
Impaired[2]:				
Not past due	12.3	7.7	7.0	2.7
Past due < 1 month	0.8	0.8	0.5	0.5
Past due 1 to 3 months	2.2	2.1	–	–
Past due 3 to 6 months	23.7	23.7	20.8	20.8
Past due 6 to 12 months	16.3	16.3	12.4	12.4
Past due over 12 months	14.5	14.4	12.1	12.1
Possessions	11.6	11.6	4.4	4.4
	81.4	76.6	57.2	52.9
Total mortgages before provisions	7,326.5	7,313.5	6,065.4	6,053.6
Personal loans	1.1		1.1	
Total loans before provisions	7,327.6		6,066.5	

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 2018

39. Risk management continued

Analysis of mortgage portfolio by arrears for BTL/SME

Group	2018 Buy-to-Let £m	2018 Commercial £m	2018 Residential development £m	2018 Funding lines £m	2018 Total £m
Stage 1					
Not past due	6,193.4	501.7	155.8	168.1	7,019.0
Past due < 1 month	18.5	1.8	–	–	20.3
	6,211.9	503.5	155.8	168.1	7,039.3
Stage 2					
Not past due	102.8	39.1	–	–	141.9
Past due < 1 month	74.7	1.0	–	–	75.7
Past due 1 to 3 months	29.3	0.7	–	–	30.0
	206.8	40.8	–	–	247.6
Stage 3					
Not past due	40.6	2.5	–	–	43.1
Past due < 1 month	3.3	0.4	–	–	3.7
Past due 1 to 3 months	12.0	0.1	–	–	12.1
Past due 3 to 6 months	24.5	0.1	–	–	24.6
Past due 6 to 12 months	10.9	0.1	–	–	11.0
Past due over 12 months	3.1	–	–	–	3.1
Possessions	4.4	–	–	–	4.4
	98.8	3.2	–	–	102.0
Stage 3 (POCI)					
Not past due	–	0.1	–	–	0.1
Past due < 1 month	–	0.2	–	–	0.2
	–	0.3	–	–	0.3
Total loans before provisions	6,517.5	547.8	155.8	168.1	7,389.2

Group	2017 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
	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 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

Bank	2018 Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Stage 1					
Not past due	**5,170.6**	**17.8**	**155.8**	**168.1**	**5,512.3**
Past due < 1 month	**16.2**	**0.3**	**–**	**–**	**16.5**
	5,186.8	**18.1**	**155.8**	**168.1**	**5,528.8**
Stage 2					
Not past due	**63.3**	**1.7**	**–**	**–**	**65.0**
Past due < 1 month	**71.3**	**1.0**	**–**	**–**	**72.3**
Past due 1 to 3 months	**29.3**	**–**	**–**	**–**	**29.3**
	163.9	**2.7**	**–**	**–**	**166.6**
Stage 3					
Not past due	**17.9**	**0.4**	**–**	**–**	**18.3**
Past due < 1 month	**2.6**	**–**	**–**	**–**	**2.6**
Past due 1 to 3 months	**11.0**	**0.1**	**–**	**–**	**11.1**
Past due 3 to 6 months	**24.4**	**0.1**	**–**	**–**	**24.5**
Past due 6 to 12 months	**7.4**	**–**	**–**	**–**	**7.4**
Past due over 12 months	**2.3**	**–**	**–**	**–**	**2.3**
Possessions	**4.4**	**–**	**–**	**–**	**4.4**
	70.0	**0.6**	**–**	**–**	**70.6**
Total loans before provisions	**5,420.7**	**21.4**	**155.8**	**168.1**	**5,766.0**

Notes to the Financial Statements continued

For the year ended 31 December 2018

39. Risk management continued

	2017				
Bank	Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
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
	4,293.6	23.2	143.9	104.5	4,565.2
Impaired:					
Not past due	2.4	4.2	–	–	6.6
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

Analysis of mortgage portfolio by arrears for Residential mortgages

	2018			
Group	**First charge £m**	**Second charge £m**	**Funding lines £m**	**Total £m**
Stage 1				
Not past due	**906.6**	**275.6**	**24.1**	**1,206.3**
Past due < 1 month	**32.5**	**8.7**	**–**	**41.2**
	939.1	**284.3**	**24.1**	**1,247.5**
Stage 2				
Not past due	**80.8**	**19.2**	**–**	**100.0**
Past due < 1 month	**43.2**	**6.0**	**–**	**49.2**
Past due 1 to 3 months	**32.7**	**7.3**	**–**	**40.0**
	156.7	**32.5**	**–**	**189.2**
Stage 3				
Not past due	**22.2**	**2.5**	**–**	**24.7**
Past due < 1 month	**10.2**	**2.3**	**–**	**12.5**
Past due 1 to 3 months	**13.0**	**5.3**	**–**	**18.3**
Past due 3 to 6 months	**23.8**	**8.8**	**–**	**32.6**
Past due 6 to 12 months	**16.9**	**4.1**	**–**	**21.0**
Past due over 12 months	**8.8**	**2.0**	**–**	**10.8**
Possessions	**3.5**	**–**	**–**	**3.5**
	98.4	**25.0**	**–**	**123.4**
Stage 3 (POCI)				
Not past due	**12.1**	**6.4**	**–**	**18.5**
Past due < 1 month	**4.4**	**2.1**	**–**	**6.5**
Past due 1 to 3 months	**4.1**	**2.5**	**–**	**6.6**
Past due 3 to 6 months	**3.5**	**3.9**	**–**	**7.4**
Past due 6 to 12 months	**3.4**	**4.3**	**–**	**7.7**
Past due over 12 months	**2.2**	**7.0**	**–**	**9.2**
	29.7	**26.2**	**–**	**55.9**
Total loans before provisions	**1,223.9**	**368.0**	**24.1**	**1,616.0**

Group	2017 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[1]	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

1. Mortgages with properties in possession are not considered impaired if the fair value of collateral exceeds the value of debt.

Bank	2018 First charge £m	Second charge £m	Funding lines £m	Total £m
Stage 1				
Not past due	**791.2**	**275.6**	**24.1**	**1,090.9**
Past due < 1 month	**28.6**	**8.7**	**–**	**37.3**
	819.8	**284.3**	**24.1**	**1,128.2**
Stage 2				
Not past due	**78.4**	**19.2**	**–**	**97.6**
Past due < 1 month	**39.6**	**6.0**	**–**	**45.6**
Past due 1 to 3 months	**29.5**	**7.3**	**–**	**36.8**
	147.5	**32.5**	**–**	**180.0**
Stage 3				
Not past due	**11.4**	**2.5**	**–**	**13.9**
Past due < 1 month	**6.5**	**2.3**	**–**	**8.8**
Past due 1 to 3 months	**10.8**	**5.3**	**–**	**16.1**
Past due 3 to 6 months	**21.4**	**8.8**	**–**	**30.2**
Past due 6 to 12 months	**13.2**	**4.1**	**–**	**17.3**
Past due over 12 months	**5.1**	**2.0**	**–**	**7.1**
Possessions	**0.8**	**–**	**–**	**0.8**
	69.2	**25.0**	**–**	**94.2**
Stage 3 (POCI)				
Not past due	**12.1**	**6.4**	**–**	**18.5**
Past due < 1 month	**4.4**	**2.1**	**–**	**6.5**
Past due 1 to 3 months	**4.1**	**2.5**	**–**	**6.6**
Past due 3 to 6 months	**3.5**	**3.9**	**–**	**7.4**
Past due 6 to 12 months	**3.4**	**4.3**	**–**	**7.7**
Past due over 12 months	**2.2**	**7.0**	**–**	**9.2**
	29.7	**26.2**	**–**	**55.9**
Total loans before provisions	**1,066.2**	**368.0**	**24.1**	**1,458.3**

Notes to the Financial Statements continued

For the year ended 31 December 2018

39. Risk management continued

Bank	2017 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[1]	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

1. Mortgages with properties in possession are not considered impaired if the fair value of collateral exceeds the value of debt.

Forbearance measures undertaken

The Group has a range of options available where borrowers experience financial difficulties which impact their ability to service their financial commitments under the loan agreement. These are explained in the Principal risks and uncertainties on pages 41 to 46.

A summary of the forbearance measures undertaken during the year is shown below:

Forbearance type	Number of accounts 2018	At 31 December 2018 £m	Number of accounts 2017	At 31 December 2017 £m
Interest-only switch	**26**	**3.7**	35	3.8
Interest rate reduction	**5**	**0.8**	–	–
Term extension	**33**	**3.5**	29	4.9
Payment holiday	**31**	**0.6**	50	1.5
Voluntary assisted sale	**4**	**0.1**	2	0.7
Payment concession (reduced monthly payments)	**75**	**3.5**	42	0.8
Total	**174**	**12.2**	158	11.7

Loan type	Number of accounts 2018	At 31 December 2018 £m	Number of accounts 2017	At 31 December 2017 £m
First charge owner occupier	**40**	**3.4**	55	4.5
Second charge owner occupier	**106**	**2.9**	77	1.6
Buy-to-Let	**28**	**5.9**	26	5.6
Total	**174**	**12.2**	158	11.7

Geographical analysis by region
An analysis of loans by region is provided below:

Region	Group 2018 £m	Group 2018 %	Group 2017 £m	Group 2017 %
East Anglia	**316.4**	**4**	236.4	3
East Midlands	**325.4**	**4**	249.6	4
Greater London	**3,965.5**	**43**	3,173.0	43
Guernsey	**61.7**	**1**	73.8	1
Jersey	**176.0**	**2**	225.1	3
North East	**115.6**	**1**	103.0	1
North West	**447.6**	**5**	347.9	5
Northern Ireland	**14.6**	**–**	16.9	–
Scotland	**45.2**	**1**	51.1	1
South East	**1,955.1**	**22**	1,591.7	22
South West	**634.2**	**7**	522.3	7
Wales	**187.1**	**2**	142.9	2
West Midlands	**557.5**	**6**	425.4	6
Yorks and Humberside	**203.3**	**2**	167.4	2
Total mortgages before provisions	**9,005.2**	**100**	7,326.5	100
Personal loans	**–**		1.1	
Total loans before provisions	**9,005.2**		7,327.6	

Region	Bank 2018 £m	Bank 2018 %	Bank 2017 £m	Bank 2017 %
East Anglia	**267.3**	**4**	212.4	4
East Midlands	**245.5**	**3**	203.8	3
Greater London	**3,270.7**	**45**	2,726.9	45
North East	**94.7**	**1**	86.3	1
North West	**346.9**	**5**	277.0	5
Northern Ireland	**14.4**	**–**	16.5	–
Scotland	**44.0**	**1**	50.3	1
South East	**1,667.9**	**24**	1,426.6	24
South West	**515.5**	**7**	439.1	7
Wales	**151.3**	**2**	126.1	2
West Midlands	**454.9**	**6**	374.6	6
Yorks and Humberside	**151.2**	**2**	125.8	2
Total mortgages before provisions	**7,224.3**	**100**	6,065.4	100
Personal loans	**–**		1.1	
Total loans before provisions	**7,224.3**		6,066.5	

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. 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 £1,296.1m (2017: £710.7m).

Notes to the Financial Statements continued

For the year ended 31 December 2018

39. Risk management continued

The following table presents the credit quality of Group's assets exposed to credit risk. The Group mainly uses external credit ratings provided by Fitch, Moody's or Standard & Poor's.

	Group					
2018	**AAA £m**	**AA £m**	**A+ £m**	**A £m**	**Less than A rating £m**	**Total £m**
Bank of England[1]	**–**	**1,315.2**	**–**	**–**	**–**	**1,315.2**
Call accounts	**–**	**–**	**0.7**	**24.7**	**6.7**	**32.1**
Floating rate notes	**19.1**	**–**	**–**	**–**	**–**	**19.1**
Treasury bills	**–**	**39.8**	**–**	**–**	**–**	**39.8**
Total	**19.1**	**1,355.0**	**0.7**	**24.7**	**6.7**	**1,406.2**
2017						
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

	Bank					
2018	**AAA £m**	**AA £m**	**A+ £m**	**A £m**	**Less than A rating £m**	**Total £m**
Bank of England[1]	**–**	**1,315.2**	**–**	**–**	**–**	**1,315.2**
Call accounts	**–**	**–**	**0.7**	**24.1**	**–**	**24.8**
Floating rate notes	**19.1**	**–**	**–**	**–**	**–**	**19.1**
Treasury bills	**–**	**39.8**	**–**	**–**	**–**	**39.8**
Total	**19.1**	**1,355.0**	**0.7**	**24.1**	**–**	**1398.9**
2017						
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

1. Balances with the Bank of England include £20.0m (2017: £10.0m) held in the cash ratio deposit.

The below tables show the industry sector and asset class of the Group's loans and advances to credit institutions and investment securities:

	Group 2018		Group 2017	
	£m	**%**	£m	%
Bank of England[1]	**1,315.2**	**94**	1,146.9	95
Other banks	**32.1**	**2**	40.3	3
Central government	**39.8**	**3**	–	–
Supranationals	**19.1**	**1**	19.1	2
Total	**1,406.2**	**100**	1,206.3	100

	Bank 2018		Bank 2017	
	£m	**%**	£m	%
Bank of England[1]	**1,315.2**	**94**	1,146.9	96
Other banks	**24.8**	**2**	32.4	3
Central government	**39.8**	**3**	–	–
Supranationals	**19.1**	**1**	19.1	1
Total	**1,398.9**	**100**	1,198.4	100

1. Balances with the Bank of England include £20.0m (2017: £10.0m) 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 2018		Group 2017	
	£m	%	£m	%
United Kingdom	**1,380.5**	**98**	1,181.0	98
Rest of Europe	**19.1**	**2**	19.1	2
Canada	**–**	**–**	0.2	–
India	**6.6**	**–**	6.0	–
Total	**1,406.2**	**100**	1,206.3	100

	Bank 2018		Bank 2017	
	£m	%	£m	%
United Kingdom	**1,379.8**	**99**	1,179.1	98
Rest of Europe	**19.1**	**1**	19.1	2
Canada	**–**	**–**	0.2	–
Total	**1,398.9**	**100**	1,198.4	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 ALCO, with day-to-day management delegated to treasury as detailed in the treasury policy. 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 below.

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 the Head of Treasury.

The tables below provide a contractual maturity analysis of the Group's financial assets and liabilities:

Group 2018	Carrying amount £m	On demand £m	Less than 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	**8,071.9**	**2,538.2**	**880.6**	**3,008.3**	**1,644.8**	**–**
Amounts owed to credit institutions	**1,584.0**	**1.0**	**40.1**	**40.0**	**1,502.9**	**–**
Amounts owed to other customers	**32.9**	**–**	**10.5**	**22.4**	**–**	**–**
Derivative liabilities	**24.9**	**–**	**0.1**	**11.3**	**7.0**	**6.5**
Subordinated liabilities	**10.8**	**–**	**0.2**	**0.1**	**0.5**	**10.0**
Perpetual Subordinated Bonds	**15.3**	**–**	**0.3**	**–**	**–**	**15.0**
Total liabilities	**9,739.8**	**2,539.2**	**931.8**	**3,082.1**	**3,155.2**	**31.5**
Financial asset by type						
Cash in hand	**0.4**	**0.4**	**–**	**–**	**–**	**–**
Loans and advances to credit institutions	**1,347.3**	**1,327.3**	**–**	**–**	**–**	**20.0**
Investment securities	**58.9**	**–**	**–**	**58.9**	**–**	**–**
Loans and advances to customers	**8,983.3**	**–**	**176.0**	**270.4**	**522.9**	**8,014.0**
Derivative assets	**11.7**	**–**	**–**	**–**	**11.7**	**–**
Total assets	**10,401.6**	**1,327.7**	**176.0**	**329.3**	**534.6**	**8,034.0**

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39. Risk management continued

Group 2017	Carrying amount £m	On demand £m	Less than 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	2,051.8	862.0	2,590.7	1,145.8	–
Amounts owed to credit institutions	1,250.3	0.3	–	–	1,250.0	–
Amounts owed to other customers	25.7	–	0.5	25.2	–	–
Derivative liabilities	21.8	–	0.1	1.6	4.7	15.4
Subordinated liabilities	10.9	–	0.2	0.1	0.6	10.0
Perpetual Subordinated Bonds	15.3	–	0.3	–	–	15.0
Total liabilities	7,974.3	2,052.1	863.1	2,617.6	2,401.1	40.4
Financial asset by type						
Cash in hand	0.5	0.5	–	–	–	–
Loans and advances to credit institutions	1,187.2	1,177.2	–	–	–	10.0
Investment securities	19.1	–	–	–	19.1	–
Loans and advances to customers	7,306.0	–	139.0	224.2	307.7	6,635.1
Derivative assets	6.1	–	–	0.2	5.9	–
Total assets	8,518.9	1,177.7	139.0	224.4	332.7	6,645.1

Bank 2018	**Carrying amount £m**	**On demand £m**	**Less than 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	**8,071.9**	**2,538.2**	**880.6**	**3,008.3**	**1,644.8**	**–**
Amounts owed to credit institutions	**1,584.0**	**1.0**	**40.1**	**40.0**	**1,502.9**	**–**
Amounts owed to other customers	**32.9**	**–**	**10.5**	**22.4**	**–**	**–**
Derivative liabilities	**24.9**	**–**	**0.1**	**11.3**	**7.0**	**6.5**
Subordinated liabilities	**10.8**	**–**	**0.2**	**0.1**	**0.5**	**10.0**
Perpetual Subordinated Bonds	**15.3**	**–**	**0.3**	**–**	**–**	**15.0**
Total liabilities	**9,739.8**	**2,539.2**	**931.8**	**3,082.1**	**3,155.2**	**31.5**
Financial asset by type						
Cash in hand	**0.4**	**0.4**	**–**	**–**	**–**	**–**
Loans and advances to credit institutions	**1,340.0**	**1,320.0**	**–**	**–**	**–**	**20.0**
Investment securities	**58.9**	**–**	**–**	**58.9**	**–**	**–**
Loans and advances to customers	**7,208.2**	**–**	**131.8**	**165.1**	**232.4**	**6,678.9**
Derivative assets	**11.7**	**–**	**–**	**–**	**11.7**	**–**
Total assets	**8,619.2**	**1,320.4**	**131.8**	**224.0**	**244.1**	**6,698.9**

Bank 2017	Carrying amount £m	On demand £m	Less than 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	2,051.8	862.0	2,590.7	1,145.8	–
Amounts owed to credit institutions	1,250.3	0.3	–	–	1,250.0	–
Amounts owed to other customers	25.7	–	0.5	25.2	–	–
Derivative liabilities	21.8	–	0.1	1.6	4.7	15.4
Subordinated liabilities	10.9	–	0.2	0.1	0.6	10.0
Perpetual Subordinated Bonds	15.3	–	0.3	–	–	15.0
Total liabilities	7,974.3	2,052.1	863.1	2,617.6	2,401.1	40.4
Financial asset by type						
Cash in hand	0.5	0.5	–	–	–	–
Loans and advances to credit institutions	1,179.3	1,169.3	–	–	–	10.0
Investment securities	19.1	–	–	–	19.1	–
Loans and advances to customers	6,051.0	–	118.7	158.4	150.6	5,623.3
Derivative assets	6.1	–	–	0.2	5.9	–
Total assets	7,256.0	1,169.8	118.7	158.6	175.6	5,633.3

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 2018	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	8,071.9	8,479.5	3,433.0	3,236.7	1,809.8	–
Amounts owed to credit institutions and other customers	1,616.9	1,646.2	54.5	71.2	1,520.5	–
Derivative liabilities	24.9	27.1	3.3	15.6	5.0	3.2
Subordinated liabilities	10.8	15.0	0.3	0.4	3.6	10.7
Perpetual Subordinated Bonds	15.3	19.4	0.4	0.4	3.6	15.0
Total liabilities	9,739.8	10,187.2	3,491.5	3,324.3	3,342.5	28.9
Off balance sheet loan commitments	710.7	710.7	710.7	–	–	–
Financial asset by type						
Cash in hand	0.4	0.4	0.4	–	–	–
Loans and advances to credit institutions	1,347.3	1,347.3	1,327.3	–	–	20.0
Investment securities	58.9	59.0	–	59.0	–	–
Loans and advances to customers	8,983.3	18,311.2	183.6	841.5	2,649.6	14,636.5
Derivative assets	11.7	12.2	0.4	1.0	10.8	–
Total assets	10,401.6	19,730.1	1,511.7	901.5	2,660.4	14,656.5
Cumulative liquidity gap			(1,979.8)	(4,402.6)	(5,084.7)	9,542.9

Group 2017	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
Cumulative liquidity gap			(1,495.5)	(3,707.8)	(4,063.9)	7,716.0

Notes to the Financial Statements continued

For the year ended 31 December 2018

39. Risk management continued

Bank 2018	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	8,071.9	8,479.5	3,433.0	3,236.7	1,809.8	–
Amounts owed to credit institutions and other customers	1,616.9	1,646.2	54.5	71.2	1,520.5	–
Derivative liabilities	24.9	27.1	3.3	15.6	5.0	3.2
Subordinated liabilities	10.8	15.0	0.3	0.4	3.6	10.7
Perpetual Subordinated Bonds	15.3	19.4	0.4	0.4	3.6	15.0
Total liabilities	9,739.8	10,187.2	3,491.5	3,324.3	3,342.5	28.9
Off balance sheet loan commitments	487.8	487.8	487.8	–	–	–
Financial asset by type						
Cash in hand	0.4	0.4	0.4	–	–	–
Loans and advances to credit institutions	1,340.0	1,340.1	1,320.1	–	–	20.0
Investment securities	58.9	59.0	–	59.0	–	–
Loans and advances to customers	7,208.2	15,496.7	107.3	647.8	1,931.3	12,810.3
Derivative assets	11.7	12.2	0.4	1.0	10.8	–
Total assets	8,619.2	16,908.4	1,428.2	707.8	1,942.1	12,830.3
Cumulative liquidity gap			(2,063.3)	(4,679.8)	(6,080.2)	6,721.2

Bank 2017	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
Cumulative liquidity gap			(1,557.9)	(3,904.3)	(4,741.7)	5,644.9

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 prior to the contractual end date.

Liquidity risk – asset encumbrance
Asset encumbrance levels are monitored by ALCO. The following tables provide an analysis of the Group's encumbered and unencumbered assets:

	Group 2018				
	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	**3.5**	**20.0**	**1,295.2**	**28.6**	**1,347.3**
Investment securities	**–**	**–**	**58.9**	**–**	**58.9**
Loans and advances to customers	**2,846.0**	**16.0**	**–**	**6,121.3**	**8,983.3**
Derivative assets	**–**	**–**	**–**	**11.7**	**11.7**
Non-financial assets	**–**	**–**	**–**	**58.6**	**58.6**
	2,849.5	**36.0**	**1,354.5**	**6,220.2**	**10,460.2**

	Group 2017				
	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

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.

	Bank 2018				
	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	**3.5**	**20.0**	**1,295.2**	**21.3**	**1,340.0**
Investment securities	**–**	**–**	**58.9**	**–**	**58.9**
Loans and advances to customers	**2,846.0**	**16.0**	**–**	**4,346.2**	**7,208.2**
Derivative assets	**–**	**–**	**–**	**11.7**	**11.7**
Non-financial assets	**–**	**–**	**–**	**1,950.3**	**1,950.3**
	2,849.5	**36.0**	**1,354.5**	**6,329.5**	**10,569.5**

	Bank 2017				
	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

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.

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39. Risk management continued

Liquidity risk – liquidity reserves

The tables below analyse the Group's liquidity reserves, where carrying value is considered to be equal to fair value:

	Group 2018 £m	Group 2017 £m
Unencumbered balances with central banks	**1,295.2**	1,136.9
Unencumbered cash and balances with other banks	**28.6**	28.5
Other cash and cash equivalents	**0.4**	0.5
Unencumbered investment securities	**58.9**	19.1
	1,383.1	1,185.0

	Bank 2018 £m	Bank 2017 £m
Unencumbered balances with central banks	**1,295.2**	1,136.9
Unencumbered cash and balances with other banks	**21.3**	20.6
Other cash and cash equivalents	**0.4**	0.4
Unencumbered investment securities	**58.9**	19.1
	1,375.8	1,177.0

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 of loss from adverse movement in the overall level of interest rates. It arises from mismatches in the timing of repricing of assets and liabilities, both on and off balance sheet. 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. Exposure is mitigated on a continuous basis through the use of derivatives and reserve allocations.

The Group measures interest rate risk using the impact of 14 different interest rate curve shift scenarios on the Group's economic value of equity. These 14 scenarios are defined by ALCO and are based on three 'shapes' of curve movement (shift, twist and flex). Historical data is used to calibrate the severity of the scenarios to the Group's risk appetite. The Board has set a limit on interest risk exposure of 2.25% of CET1 as at 31 December 2018 (2017: 1.5%). In addition, the regulatory scenario of an unfloored parallel shift of 200bps in both directions is applied. After taking into account the derivatives entered into by the Group, the maximum decrease under these scenarios as at 31 December 2018 would have been £5.6m (2017: £3.2m) and the maximum increase £1.8m (2017: £1.2m). Against a parallel interest rate increase of 2%, the impact would have been a decrease of £9.3m (2017: £2.8m decrease). In Q1 2019 the scenarios have been updated to fully incorporate the EBA guidance on the management of interest rate risk published in July 2018.

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 ALCO 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.

The Group is also exposed to basis risk. Basis risk is the risk of loss from an adverse divergence in interest rates. It arises where assets and liabilities reprice from different variable rate indices. These indices may be market rates (e.g. Bank Base Rate or LIBOR) or administered (e.g. the Group's SVR, other discretionary variable rates, or that received on call accounts with other banks).

The Group measures basis risk using the impact of five scenarios on net interest income over a one year period including movements such as diverging Base and LIBOR rates. Historical data is used to calibrate the severity of the scenarios to the Group's risk appetite. The Board has set a limit on basis risk exposure of 2.25% of CET1 as at 31 December 2018. As at 31 December 2018 the Group's assets and liabilities were broadly matched under the basis risk scenarios and comfortably within limits.

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 £0.3m (2017: £0.2m) effect in profit or loss and £0.3m (2017: £0.3m) 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 2018 and as at 31 December 2017.

40. 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:

		2018			
Group	Note	**Fair value through profit or loss £m**	**FVOCI £m**	**Amortised cost £m**	**Total carrying amount £m**
Assets					
Cash in hand		**–**	**–**	**0.4**	**0.4**
Loans and advances to credit institutions	15	**–**	**–**	**1,347.3**	**1,347.3**
Investment securities	16	**–**	**58.9**	**–**	**58.9**
Loans and advances to customers	17	**–**	**–**	**8,983.3**	**8,983.3**
Derivative assets	22	**11.7**	**–**	**–**	**11.7**
		11.7	**58.9**	**10,331.0**	**10,401.6**
Liabilities					
Amounts owed to retail depositors	29	**–**	**–**	**8,071.9**	**8,071.9**
Amounts owed to credit institutions	30	**–**	**–**	**1,584.0**	**1,584.0**
Amounts owed to other customers	31	**–**	**–**	**32.9**	**32.9**
Derivative liabilities	22	**24.9**	**–**	**–**	**24.9**
Subordinated liabilities	34	**–**	**–**	**10.8**	**10.8**
Perpetual Subordinated Bonds	35	**–**	**–**	**15.3**	**15.3**
		24.9	**–**	**9,714.9**	**9,739.8**

		2017				
Group	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	22	6.1	–	–	–	6.1
		6.1	19.1	8,493.7	–	8,518.9
Liabilities						
Amounts owed to retail depositors	29	–	–	–	6,650.3	6,650.3
Amounts owed to credit institutions	30	–	–	–	1,250.3	1,250.3
Amounts owed to other customers	31	–	–	–	25.7	25.7
Derivative liabilities	22	21.8	–	–	–	21.8
Subordinated liabilities	34	–	–	–	10.9	10.9
Perpetual Subordinated Bonds	35	–	–	–	15.3	15.3
		21.8	–	–	7,952.5	7,974.3

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40. Financial instruments and fair values continued

Bank	Note	2018 Fair value through profit or loss £m	2018 FVOCI £m	2018 Amortised cost £m	2018 Total carrying amount £m
Assets					
Cash in hand		–	–	0.4	0.4
Loans and advances to credit institutions	15	–	–	1,340.0	1,340.0
Investment securities	16	–	58.9	–	58.9
Loans and advances to customers	17	–	–	7,208.2	7,208.2
Derivative assets	22	11.7	–	–	11.7
		11.7	58.9	8,548.6	8,619.2
Liabilities					
Amounts owed to retail depositors	29	–	–	8,071.9	8,071.9
Amounts owed to credit institutions	30	–	–	1,584.0	1,584.0
Amounts owed to other customers	31	–	–	32.9	32.9
Derivative liabilities	22	24.9	–	–	24.9
Subordinated liabilities	34	–	–	10.8	10.8
Perpetual Subordinated Bonds	35	–	–	15.3	15.3
		24.9	–	9,714.9	9,739.8

Bank	Note	2017 Fair value through profit or loss £m	2017 Available-for-sale £m	2017 Loans and receivables £m	2017 Amortised cost £m	2017 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	22	6.1	–	–	–	6.1
		6.1	19.1	7,230.8	–	7,256.0
Liabilities						
Amounts owed to retail depositors	29	–	–	–	6,650.3	6,650.3
Amounts owed to credit institutions	30	–	–	–	1,250.3	1,250.3
Amounts owed to other customers	31	–	–	–	25.7	25.7
Derivative liabilities	22	21.8	–	–	–	21.8
Subordinated liabilities	34	–	–	–	10.9	10.9
Perpetual Subordinated Bonds	35	–	–	–	15.3	15.3
		21.8	–	–	7,952.5	7,974.3

The Group has no financial assets nor financial liabilities classified as held for trading or held to maturity.

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 2018		Group 2017	
	Carrying value £m	**Estimated fair value £m**	Carrying value £m	Estimated fair value £m
Assets				
Cash in hand	**0.4**	**0.4**	0.5	0.5
Loans and advances to credit institutions	**1,347.3**	**1,347.3**	1,187.2	1,187.2
Loans and advances to customers	**8,983.3**	**9,151.1**	7,306.0	7,715.4
	10,331.0	**10,498.8**	8,493.7	8,903.1
Liabilities				
Amounts owed to retail depositors	**8,071.9**	**8,097.5**	6,650.3	6,684.0
Amounts owed to credit institutions	**1,584.0**	**1,584.0**	1,250.3	1,250.3
Amounts owed to other customers	**32.9**	**32.9**	25.7	25.7
Subordinated liabilities	**10.8**	**10.8**	10.9	11.1
Perpetual Subordinated Bonds	**15.3**	**14.3**	15.3	15.3
	9,714.9	**9,739.5**	7,952.5	7,986.4

	Bank 2018		Bank 2017	
	Carrying value £m	**Estimated fair value £m**	Carrying value £m	Estimated fair value £m
Assets				
Cash in hand	**0.4**	**0.4**	0.5	0.5
Loans and advances to credit institutions	**1,340.0**	**1,340.0**	1,179.3	1,179.3
Loans and advances to customers	**7,208.2**	**7,340.1**	6,051.0	6,408.4
	8,548.6	**8,680.5**	7,230.8	7,588.2
Liabilities				
Amounts owed to retail depositors	**8,071.9**	**8,097.5**	6,650.3	6,684.0
Amounts owed to credit institutions	**1,584.0**	**1,584.0**	1,250.3	1,250.3
Amounts owed to other customers	**32.9**	**32.9**	25.7	25.7
Subordinated liabilities	**10.8**	**10.8**	10.9	11.1
Perpetual Subordinated Bonds	**15.3**	**14.3**	15.3	15.3
	9,714.9	**9,739.5**	7,952.5	7,986.4

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 mortgages has been estimated by discounting future cash flows at current market rates of interest. Future cash flows include the impact of expected credit losses. 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 by discounting future cash flows at current market rates of interest. 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.

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40. Financial instruments and fair values continued

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 by discounting future cash flows at current market rates of interest.

Subordinated liabilities and Perpetual Subordinated Bonds

The fair value of subordinated liabilities is estimated by discounting future cash flows at current market rates of interest. 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 in 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 2018	Carrying amount £m	Principal amount £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets						
Investment securities	**58.9**	**59.0**	**58.9**	**–**	**–**	**58.9**
Derivative assets	**11.7**	**1,999.0**	**–**	**11.7**	**–**	**11.7**
	70.6	**2,058.0**	**58.9**	**11.7**	**–**	**70.6**
Financial liabilities						
Derivative liabilities	**24.9**	**(4,532.2)**	**–**	**24.9**	**–**	**24.9**

Group and Bank 2017						
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

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 no 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.

The following table provides an analysis of financial assets and financial liabilities not measured at fair value in the Statement of Financial Position grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

Group 2018	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	**0.4**	**0.4**	**–**	**0.4**	**–**	**0.4**
Loans and advances to credit institutions	**1,347.3**	**1,346.9**	**–**	**1,347.3**	**–**	**1,347.3**
Loans and advances to customers	**8,983.3**	**9,121.4**	**–**	**4,195.3**	**4,955.8**	**9,151.1**
	10,331.0	**10,468.7**	**–**	**5,543.0**	**4,955.8**	**10,498.8**
Financial liabilities						
Amounts owed to retail depositors	**8,071.9**	**8,019.7**	**–**	**2,916.4**	**5,181.1**	**8,097.5**
Amounts owed to credit institutions	**1,584.0**	**1,581.0**	**–**	**1,584.0**	**–**	**1,584.0**
Amounts owed to other customers	**32.9**	**32.8**	**–**	**–**	**32.9**	**32.9**
Subordinated liabilities	**10.8**	**10.6**	**–**	**10.8**	**–**	**10.8**
Perpetual Subordinated Bonds	**15.3**	**15.0**	**14.3**	**–**	**–**	**14.3**
	9,714.9	**9,659.1**	**14.3**	**4,511.2**	**5,214.0**	**9,739.5**
Group 2017						
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

Bank 2018	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	**0.4**	**0.4**	**–**	**0.4**	**–**	**0.4**
Loans and advances to credit institutions	**1,340.0**	**1,339.7**	**–**	**1,340.0**	**–**	**1,340.0**
Loans and advances to customers	**7,208.2**	**7,337.6**	**–**	**3,123.7**	**4,216.4**	**7,340.1**
	8,548.6	**8,677.7**	**–**	**4,464.1**	**4,216.4**	**8,680.5**
Financial liabilities						
Amounts owed to retail depositors	**8,071.9**	**8,019.7**	**–**	**2,916.0**	**5,181.1**	**8,097.5**
Amounts owed to credit institutions	**1,584.0**	**1,581.0**	**–**	**1,584.0**	**–**	**1,584.0**
Amounts owed to other customers	**32.9**	**32.8**	**–**	**–**	**32.9**	**32.9**
Subordinated liabilities	**10.8**	**10.6**	**–**	**10.8**	**–**	**10.8**
Perpetual Subordinated Bonds	**15.3**	**15.0**	**14.3**	**–**	**–**	**14.3**
	9,714.9	**9,659.1**	**14.3**	**4,511.2**	**5,214.0**	**9,739.5**

Notes to the Financial Statements continued

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40. Financial instruments and fair values continued

Bank 2017	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

41. 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 £1.7m (2017: £1.3m).

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 2018 the liability to remaining members is £2k (31 December 2017: £2k) matched by Scheme assets.

42. 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.

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 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 Pillar 1 capital information is presented below:

	(Unaudited) 2018 £m	(Unaudited) 2017 £m
Common Equity Tier 1 capital		
Called up share capital	**2.4**	2.4
Share premium, capital contribution and share-based payment reserve	**170.0**	169.8
Retained earnings	**439.6**	337.5
Transfer reserve	**(12.8)**	(12.8)
Other reserves	**(0.5)**	(0.1)
Total equity excluding equity bonds	**598.7**	496.8
Foreseeable dividends	**(25.2)**	(22.6)
Solo consolidation adjustments[1]	**(5.4)**	(4.8)
IFRS 9 transitional adjustment[2]	**2.7**	–
Deductions from Common Equity Tier 1 capital		
Prudent valuation adjustment[3]	**(0.1)**	–
Intangible assets	**(7.7)**	(6.8)
Deferred tax asset	**(1.4)**	(2.5)
Common Equity Tier 1 capital	**561.6**	460.1
Additional tier 1 capital		
AT1 securities	**60.0**	60.0
Total tier 1 capital	**621.6**	520.1
Tier 2 capital		
Subordinated debt and PSBs	**47.4**	47.7
Collective provisions	**–**	2.0
Deductions from tier 2 capital	**(3.3)**	(2.5)
Total tier 2 capital	**44.1**	47.2
Total regulatory capital	**665.7**	567.3
Risk weighted assets (unaudited)	**4,211.8**	3,348.5

1. The Bank has solo consolidation waivers for most of its subsidiaries. The equity for unconsolidated entities has been removed from CET1.
2. The regulatory capital includes a £2.7m add-back under IFRS 9 transitional arrangements. This represents 95% of the IFRS 9 transitional adjustment booked directly to retained earnings of £2.9m. The full impact of IFRS 9, if applied, would reduce total regulatory capital to £663.0m.
3. The Group has adopted the simplified approach under the Prudent Valuation rules, recognising a deduction equal to 0.1% of fair value assets and liabilities.

The movement in CET1 during the year was as follows:

	(Unaudited) 2018 £m	(Unaudited) 2017 £m
At 1 January	**460.1**	365.6
Movement in retained earnings	**102.1**	96.8
Share premium from Sharesave Scheme vesting	**0.4**	0.5
Movement in other reserves	**(0.6)**	3.1
Movement in foreseeable dividends	**(2.6)**	(4.1)
Movement in solo consolidation adjustment	**(0.6)**	0.5
IFRS 9 transitional adjustment	**2.7**	–
Movement in prudent valuation adjustment	**(0.1)**	–
Net increase in intangible assets	**(0.9)**	(2.1)
Movement in deferred tax asset for carried forward losses	**1.1**	(0.2)
At 31 December	**561.6**	460.1

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43. Operating segments

The Group distinguishes two segments within its operations.

1. **BTL/SME;** secured lending on property for investment and commercial purposes. This segment also includes the Group's new asset finance business and personal loan portfolio (disposed of during 2018), 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:

2018	BTL/SME £m	Residential mortgages £m	Total £m
Balances at the reporting date			
Gross loans and advances to customers	**7,389.2**	**1,616.0**	**9,005.2**
Provision for impairment losses on loans and advances	**(11.0)**	**(10.9)**	**(21.9)**
Loans and advances to customers	**7,378.2**	**1,605.1**	**8,983.3**
Capital expenditure	**5.2**	**1.1**	**6.3**
Profit or loss for the year			
Net interest income	**220.0**	**67.3**	**287.3**
Other expense	**(1.0)**	**(4.2)**	**(5.2)**
Total income	**219.0**	**63.1**	**282.1**
Impairment losses	**(5.7)**	**(2.4)**	**(8.1)**
Contribution to profit	**213.3**	**60.7**	**274.0**
Operating expenses			**(79.6)**
FSCS and other provisions			**(0.8)**
Exceptional cost–Heritable option			**(9.8)**
Profit before taxation			**183.8**
Taxation			**(43.5)**
Profit for the year			**140.3**

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
Capital expenditure	11.0	3.3	14.3
Profit or loss for the year			
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

44. 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 InterBay Asset Finance Limited (formerly: 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 Limited (Guernsey) and Jersey Home Loans Limited (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 with no permanent establishments in Guernsey or Jersey.

Other disclosures required by the CBCR directive are provided below:

2018	UK	India	Consolidation[2]	Total
Average number of employees	**588**	**401**	**–**	**989**
Turnover[1], £m	**281.7**	**7.2**	**(6.8)**	**282.1**
Profit/(loss) before tax, £m	**183.4**	**1.1**	**(0.7)**	**183.8**
Corporation tax paid, £m	**38.9**	**0.2**	**–**	**39.1**

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

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.

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44. Country by country reporting continued

The tables below reconcile tax charged and tax paid during the year.

2018	UK £m	India £m	Total £m
Tax charge	**43.3**	**0.2**	**43.5**
Effects of:			
Other timing differences	**(0.8)**	**–**	**(0.8)**
Tax outside of profit or loss	**(3.4)**	**–**	**(3.4)**
Prior year tax paid during the year	**19.5**	**–**	**19.5**
Current year tax to be paid after the reporting date	**(19.7)**	**–**	**(19.7)**
Tax paid	**38.9**	**0.2**	**39.1**

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

45. Adjustments for non-cash items and changes in operating assets and liabilities

	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Adjustments for non-cash items:				
Depreciation and amortisation	**4.7**	3.5	**4.0**	3.0
Interest on subordinated liabilities	**0.7**	0.9	**0.7**	0.9
Interest on Perpetual Subordinated Bonds	**0.9**	0.9	**0.9**	0.9
Impairment charge on loans	**8.1**	4.4	**7.1**	2.0
Loss on sale of financial instruments	**0.1**	–	**0.1**	–
FSCS and other regulatory provisions	**0.8**	0.9	**0.8**	0.9
Fair value losses on financial instruments	**5.1**	6.3	**5.1**	6.3
Share-based payments	**2.5**	2.4	**2.6**	2.3
Exceptional cost–Heritable option	**9.8**	–	**9.8**	–
Total adjustments for non-cash items	**32.7**	19.3	**31.1**	16.3
Changes in operating assets and liabilities:				
Increase in loans and advances to credit institutions	**(1.7)**	(6.3)	**(1.7)**	(6.3)
Increase in loans to customers	**(1,689.5)**	(1,371.2)	**(1,166.1)**	(1,159.5)
Increase in intercompany balances	**–**	–	**(475.2)**	(181.0)
Increase in retail deposits	**1,421.6**	697.9	**1,421.6**	697.9
Net increase/(decrease) in other assets	**(0.8)**	7.0	**(0.8)**	(0.9)
Net decrease in derivatives and hedged items	**(5.3)**	(0.1)	**(5.3)**	(0.1)
Net increase in credit institutions and other customers' deposits	**10.9**	21.3	**10.9**	21.3
Net increase/(decrease) in other liabilities	**2.9**	(3.3)	**1.3**	5.5
Exchange differences on working capital	**(0.2)**	(0.3)	**–**	–
Total changes in operating assets and liabilities	**(262.1)**	(655.0)	**(215.3)**	(623.1)

46. Events after the reporting date

On 9 March 2019, a statement was released confirming that Charter Court Financial Services and OneSavings Bank are in advanced discussions regarding a possible all-share combination of the two companies. This statement and any future public documents relating to the possible combination will be placed on the Investor Relations section of the OSB website at www.osb.co.uk.

In 2019, the Heritable option was surrendered for a one-off payment of £9.8m and the Bank acquired the JV partners' interest in the business. At the same time a new revenue sharing arrangement was signed allowing the JV partner to continue to lend alongside the Bank.

47. Controlling party

As at 31 December 2018 there was no controlling party of OSB.

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