Regulatory Story

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OneSavings Bank PLC - OSB Preliminary Results for the year ended 31 Dec 2018
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OneSavings Bank plc
Preliminary results for the year ended 31 December 2018

Financial highlights

- Underlying profit before tax[1] increased 15% to £193.6m (2017: £167.7m)
- Loan book growth of 23% to £9.0bn (2017: £7.3bn) driven by 15% growth in gross originations to £3.0bn (2017: £2.6bn)
- Strong income growth alongside continued focus on cost discipline and efficiency delivered a strong cost to income ratio[2] of 28% (2017: 27%) and a management expense ratio of 0.84% (2017: 0.86%) despite planned investment in the business
- Net interest margin ('NIM')[3] remains strong at 304bps (2017: 316bps)
- Impairments remain low with a loan loss ratio[4] of 10bps (2017: 7bps) despite the addition of a 'no-deal' Brexit scenario in our IFRS 9 modelling
- Return on equity ('RoE')[5] remained strong at 26% (2017: 28%), with a Common Equity Tier 1 ('CET1') capital ratio of 13.3% (2017: 13.7%)
- Underlying basic earnings per share[6] grew 14% to 58.5 pence (2017: 51.1 pence)
- Recommended final dividend[7] of 10.3 pence per share giving a full year dividend of 14.6 pence per share, in line with our target dividend payout ratio
- Exceptional cost of £9.8m in respect of option to acquire the JV partners' interest in the Heritable residential development finance business

Andy Golding, CEO of OneSavings Bank, said:

"I am delighted that OneSavings Bank delivered excellent shareholder returns in 2018. Our core Buy-to-Let segment continued to grow, attracting our target professional landlords, and our commercial business is flourishing, reflected in strong new business volumes in the year. The Group's organic originations grew by 15%, supporting 15% growth in underlying profit before tax to £193.6m and an attractive return on equity of 26%.

I am particularly proud of our lending growth in the Buy-to-Let segment this year, which exceeded the overall market growth, due to the strength of our proposition and focus on professional landlords. Whilst the economic effect of Brexit may impact some business opportunities, OneSavings Bank is positioned well, with a strong balance sheet, an excellent track record in raising and retaining retail funds and a high-quality secured asset portfolio.

In 2019 the Bank took the opportunity to acquire our JV partners' interest in the Heritable residential development finance business, demonstrating our ability to deliver value through growing successful new business areas organically. I am particularly pleased that we were able to both retain the key individuals in the business going forward, and continue to offer them the opportunity to lend alongside the Bank.

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. As such, we are not able to provide our usual detailed guidance for the financial year ahead.

OSB entered 2019 with a strong pipeline and our core markets remain highly attractive. The strength of our lending franchise, driven by specialist underwriting, gives us confidence in continuing to deliver sustainable growth in our net loan book. Despite the uncertainty surrounding Brexit, based on application levels seen so far this year, we would expect to deliver mid-teens net loan book growth in 2019 at attractive margins, with NIM marginally lower than 2018, reflecting current asset pricing and the continued transition from back book to front. Whilst we will continue to invest 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.

OneSavings Bank is exceptionally well placed to continue to generate attractive returns for our shareholders regardless of potential political scenarios that may take place and we look to the future with confidence."

Key metrics

	2018	2017
Loan loss ratio[4] (bps)	**10**	7
Statutory profit before tax (£m)	**183.8**	167.7
Total assets (£bn)	**10.5**	8.6
Statutory basic EPS[8] (pence)	**55.5**	51.1
Loan to deposit ratio[9] (%)	**93**	92
3 months + arrears[10] (%)	**1.5**	1.2
Customer net promoter score	**+63**	+62

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Analyst presentation

A presentation for analysts will be held at 9:30am on Thursday 14 March at The Lincoln Centre, 18 Lincoln's Inn Fields, WC2A 3ED. The UK dial in number is +44 (0) 20 3003 2666 and the password is OneSavings Bank 18. The presentation will be webcast and available from 9:30am on the OneSavings Bank website at www.osb.co.uk in the Investors section. Registration is open immediately.

About OneSavings Bank plc

OneSavings Bank plc began trading as a bank on 1 February 2011 and was admitted to the main market of the London Stock Exchange in June 2014 (OSB.L). OSB joined the FTSE 250 index in June 2015. OSB is a specialist lending and retail savings group authorised by the Prudential Regulation Authority, part of the Bank of England, and regulated by the Financial Conduct Authority and Prudential Regulation Authority.

OSB primarily targets market sub-sectors that offer high growth potential and attractive risk-adjusted returns in which it can take a leading position and where it has established expertise, platforms and capabilities. These include private rented sector Buy-to-Let, commercial and semi-commercial mortgages, residential development finance, bespoke and specialist residential lending, secured funding lines and asset finance. OSB originates organically through specialist brokers and independent financial advisers. It is differentiated through its use of high skilled, bespoke underwriting and efficient operating model.

OSB is predominantly funded by retail savings originated through the long-established Kent Reliance name, which includes online and postal channels, as well as a network of branches in the South East of England. Diversification of funding is currently provided by access to a securitisation programme and the Term Funding Scheme.

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1. Before exceptional items of £9.8m (2017: £nil, see Alternative performance measures and Exceptional items in the Financial review for further details).
2. Administrative expenses, including depreciation and amortisation, as a percentage of total income.
3. Net interest income as a percentage of average interest bearing assets.
4. Impairment losses expressed as a percentage of average gross loans and advances.
5. Profit after tax excluding exceptional items after tax of £7.2m in 2018 (2017: £nil, see Alternative performance measures and Exceptional items in the Financial review for further details), and after deducting 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), as a percentage of average shareholders' equity (excluding equity PSBs of £22m and AT1 securities of £60m) of £547.8m in 2018 and £446.6m in 2017.
6. Underlying profit after taxation and after deducting coupons on equity PSBs, including tax effect of £0.7m (2017: £0.7m) and AT1 coupons, including tax effect of £4.0m (2017: £2.0m), divided by the weighted average number of ordinary shares in issue.
7. Representing 25% of underlying profit after tax attributable to ordinary shareholders. To be paid on 15 May 2019, subject to approval at the Annual General Meeting on 9 May 2019, with a record date of 22 March 2019. For 2017, the dividend of 9.3p per share represented a final two-thirds dividend.
8. Statutory profit after taxation divided by the weighted average number of ordinary shares in issue.
9. Excluding the impact of TFS and ILTR drawdowns. The unadjusted ratio was 111% as at 31 December 2018 (2017: 109%).
10. Portfolio arrears rate (excluding legacy problem loan book) of accounts for which there are missed or overdue payments by more than three months.

Non-IFRS performance measures

OneSavings Bank believes that the non-IFRS performance measures included in this document provide valuable information to the readers as they enable the reader to identify a more consistent basis for comparing the business' performance between financial periods, and provide more detail concerning the elements of performance which the Group is most directly able to influence or are relevant for an assessment of the Group. They also reflect an important aspect of the way in which operating targets are defined and performance is monitored by OneSavings Bank's Board. However, any non-IFRS performance measures in this document are not a substitute for IFRS measures and readers should consider the IFRS measures as well. Refer to Alternative performance measures in the Financial review for further details, reconciliations and calculations of non-IFRS performance measures included throughout this document, and the most directly comparable IFRS measures.

Important disclaimer

The financial information set out below does not constitute the company's statutory accounts for the years ended 31 December 2018 or 2017 but is derived from those accounts. Statutory accounts for 2017 have been delivered to the registrar of companies, and those for 2018 will be delivered in due course. The auditor has reported on those accounts; their reports were (i) unqualified, (ii) did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under section 498 (2) or (3) of the Companies Act 2006.

This document should be read in conjunction with the documents distributed by OneSavings Bank plc ('OSB') through the Regulatory News Service ('RNS').

This document contains certain forward-looking statements, beliefs or opinions, including statements with respect to the business, strategy and plans of OSB and its current goals and expectations relating to its future financial condition, performance and results. Such forward-looking statements include, without limitation, those preceded by, followed by or that include the words 'targets', 'believes', 'estimates', 'expects', 'aims', 'intends', 'will', 'may', 'anticipates', 'projects', 'plans', 'forecasts', 'outlook', 'likely', 'guidance', 'trends', 'future', 'would', 'could', 'should' or similar expressions or negatives thereof. Statements that are not historical facts, including statements about OSB's, its directors' and/or management's beliefs and expectations, are forward-looking statements. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that may or may not occur in the future. Factors that could cause actual business, strategy, plans and/or results (including but not limited to the payment of dividends) to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements made by OSB or on its behalf include, but are not limited to: general economic and business conditions in the UK and internationally; market related trends and developments; fluctuations in exchange rates, stock markets, inflation, deflation, interest rates and currencies; policies of the Bank of England, the European Central Bank and other G8 central banks; the ability to access sufficient sources of capital, liquidity and funding when required; changes to OSB's credit ratings; the ability to derive cost savings; changing demographic developments, and changing customer behaviour, including consumer spending, saving and borrowing habits; changes in customer preferences; changes to borrower or counterparty credit quality; instability in the global financial markets, including Eurozone instability, the potential for countries to exit the European Union (the "EU") or the Eurozone, and the impact of any sovereign credit rating downgrade or other sovereign financial issues; technological changes and risks to cyber security; natural and other disasters, adverse weather and similar contingencies outside OSB's control; inadequate or failed internal or external processes, people and systems; terrorist acts and other acts of war or hostility and responses to those acts; geopolitical, pandemic or other such events; changes in laws, regulations, taxation, accounting standards or practices, including as a result of an exit by the UK from the EU; regulatory capital or liquidity requirements and similar contingencies outside OSB's control; the policies and actions of governmental or regulatory authorities in the UK, the EU or elsewhere including the implementation and interpretation of key legislation and regulation; the ability to attract and retain senior management and other employees; the extent of any future impairment charges or write-downs caused by, but not limited to, depressed asset valuations, market disruptions and illiquid markets; market relating trends and developments; exposure to regulatory scrutiny, legal proceedings, regulatory investigations or complaints; changes in competition and pricing environments; the inability to hedge certain risks economically; the adequacy of loss reserves; the actions of competitors, including non-bank financial services and lending companies; and the success of OSB in managing the risks of the foregoing.

No representation, warranty or assurance is made that any of these statements or forecasts will come to pass or that any forecast results will be achieved. Any forward-looking statements made in this document speak only as of the date they are made and it should not be assumed that they have been revised or updated in the light of new information of future events. Except as required by the Prudential Regulation Authority, the Financial Conduct Authority, the London Stock Exchange PLC or applicable law, OSB expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained in this document to reflect any change in OSB's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

The information, statements and opinions contained in this document and subsequent discussion do not constitute a public offer under any applicable law or an offer to sell any securities or financial instruments or any advice or recommendation with respect to such securities or financial instruments.

Chief Executive's Statement

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 demonstrating our ability to grow successful businesses organically. 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 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 recommence 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. We continued to 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, cost of funds and the changing mix of the loan book, we would anticipate NIM for 2019 to be marginally lower than in the prior year. Whilst we will continue to invest 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

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%).

Operating and financial review

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.

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 +15 bps which was 90 bps 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).

1. Excluding the impact of TFS and ILTR drawdowns. The unadjusted ratio was 111% as at 31 December 2018 (2017: 109%).

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.

Segmental review

The following tables show the Group's loans and advances, risk weighted assets and contribution to profit by segment.

31 December 2018, £m	BTL/SME	Residential	Total
Gross loans to customers	7,389.2	1,616.0	9,005.2
Provision for impairment losses	(11.0)	(10.9)	(21.9)
Net loans to customers	7,378.2	1,605.1	8,983.3
Risk weighted assets	3,453.8	758.0	4,211.8
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

31 December 2017, £m	BTL/SME	Residential	Total
Gross loans to customers	5,654.1	1,673.5	7,327.6
Provision for impairment losses	(13.2)	(8.4)	(21.6)
Net loans to customers	5,640.9	1,665.1	7,306.0
Risk weighted assets	2,642.8	705.7	3,348.5
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

Buy-to-Let/SME

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

1. The personal loan portfolio was disposed of in the year, for more information see note 6 to the financial statements.

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.

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 £7,378.2m (2017: £5,640.9m) 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. UK Finance, New and outstanding buy-to-let mortgages, 19 Feb 2019.

Residential mortgages

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

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

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.

Financial review

Summary Profit or Loss	Group 31/12/2018 £m	Group 31/12/2017 £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 page 1.
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.

Alternative performance measures

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

Reconciliation of statutory profit to underlying profit

	Profit before taxation		Profit after taxation	
	Group 31-Dec-2018 £m	Group 31-Dec-2017 £m	Group 31-Dec-2018 £m	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).

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.

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 ('PSD 2') 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 ('FSCS') which continued to decrease in the year and other regulatory provisions on acquired books.

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 partners 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 +15 bps which was 90 bps 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/(decrease) 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.

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.

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 above 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.

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.

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.

Risk appetite statements

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.

Strategic and business 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.

Reputational risk appetite statement

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

Credit 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.

Market 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.

Liquidity and funding 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.

Solvency 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.

Operational 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.

Conduct 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.

Compliance and regulatory 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 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%).

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.

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 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 CET 1 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.

Principal risks and uncertainties

Strategic and business risk

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

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.

Mitigation

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.

Direction: 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.

Mitigation

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.

Direction: 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.

Mitigation

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.

Direction: increased

The level and sophistication of emerging regulatory requirements place increasing demands on the Group's operational capacity.

Reputational risk

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.

Deterioration of reputation

Potential loss of trust and confidence that our stakeholders place in us as a responsible and fair provider of financial services.

Mitigation

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.

Direction: 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.

Credit risk

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

Individual borrower defaults

Borrowers may encounter idiosyncratic problems in repaying their loans, for example, 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.

Mitigation

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.

Direction: 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.

Mitigation

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.

Direction: 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.

Mitigation

The Group transacts only with high quality wholesale counterparties. Derivative exposures include collateral agreements to mitigate credit exposures.

Direction: 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.

Market risk

Potential loss due to changes in market prices or values.

Interest rate risk

An adverse movement in the overall level of interest rates could lead to a loss in value due to mismatches in the duration of assets and liabilities.

Mitigation

The Group's Treasury department actively hedges to match the timing of cash flows from assets and liabilities.

Direction: 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.

Mitigation

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.

Direction: unchanged

Product design and balance sheet strategy has enabled the Group to maintain the overall level of basis risk through the year.

Liquidity and funding risk

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

Retail funding stress

As the Group is primarily funded by retail deposits, a retail run could put it in a position where it could not meet its financial obligations.

Increased competition for retail savings driving up funding costs, adversely impacting retention levels and wider damage to the OSB franchise.

Mitigation

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.

Direction: unchanged

The Group's funding mix remained stable throughout the year.

Solvency risk

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

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.

Mitigation

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.

Direction: unchanged

The Group has maintained a prudent and stable CET1 capital and total capital position providing resilience against unexpected losses.

Operational risk

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

Cyber/data security risk

The risk of loss of customer or proprietary data as a result of malicious activities or through ineffective data management.

Mitigation

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.

Direction: 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.

Direction: 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.

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.

Mitigation

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.

Direction: 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.

Mitigation

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.

Direction: 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.

Conduct risk

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.

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.

Mitigation

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.

Direction: 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.

Mitigation

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.

Direction: unchanged

Despite a number of additional controls being introduced in 2018 the network/system threats continue to increase in both volume and sophistication.

Compliance and regulatory risk

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

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.

Mitigation

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.

Direction : 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.

Mitigation

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.

Direction: increased

The regulatory environment has tightened and this is likely to continue, exposing the Group to increased risk.

Emerging 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:

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.

Mitigation

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.

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 above.

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 above). 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.

Directors' responsibility statement

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

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 below form part of these accounts.

The financial statements 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 below form part of these accounts.

The financial statements were approved by the Board of Directors on 14 March 2019.

Andy Golding
Chief Executive Officer

April Talintyre
Chief Financial Officer

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**

Statement of Changes in Equity continued

For the year ended 31 December 2018

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.

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 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.

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 specific provision is recognised for the difference. Such loans are classified as impaired. If the present value of the estimated future cash flows exceeds the carrying value no specific provision is recognised.

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 House Price Index ('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.

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.

1. Accounting policies (continued)

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.

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.

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

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).

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

	2018		2017	
Exercise price	**Number**	**Weighted average remaining contractual life (years)**	Number	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.

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	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

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 below show the movement in loans and advances to customers by IFRS 9 stage during the year, based on the following assumptions:

Group	**Stage 1**	**Stage 2**	**Stage 3**	**Stage 3 (POCI)**	**IAS 39**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£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**	**Stage 2**	**Stage 3**	**Stage 3 (POCI)**	**IAS 39**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£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 purchased 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	Group 2017
	£m	£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.

20. Expected credit loss

The Group's ECL by segment and IFRS 9 stage is shown below:

	2018			2017		
Group	**BTL/SME**	**Residential**	**Total**	BTL/SME	Residential	Total
	£m	**£m**	**£m**	£m	£m	£m
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**	**Stage 2**	**Stage 3**	**Stage 3 (POCI)**	**IAS 39 Impairments**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£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**	**Stage 2**	**Stage 3**	**Stage 3 (POCI)**	**IAS 39 Impairments**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£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 Limited ('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.

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				**Charged by/(to) the Bank during the year**	**Balance due to/(by) the Bank**
Direct investments	**Class of shares**	**Activity**	**Ownership**	**£m**	**£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				Charged by/(to) the Bank during the year	Balance due to/(by) the Bank
Direct investments	Class of shares	Activity	Ownership	£m	£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

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.

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	Group	**Bank**	Bank
	2018	2017	**2018**	2017
	£m	£m	**£m**	£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	Group and Bank
	2018	2017
	£m	£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	Group and Bank
	2018	2017
	£m	£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	Group and Bank
	2018	2017
	£m	£m
Fixed rate deposits	**32.9**	25.7

32. Other liabilities

	Group	Group	**Bank**	Bank
	2018	2017	**2018**	2017
	£m	£m	**£m**	£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.

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.

Credit risk

Credit risk is the risk that unexpected losses may arise as a result of the Group's borrowers or market counterparties failing to meet their obligations to repay.

The Group has adopted the Standardised Approach for assessment of credit risk capital requirements. This approach considers risk weightings as defined under Basel II and Basel III principles.

The classes of financial instruments to which the Group is most exposed are loans and advances to customers, loans and advances to credit institutions, cash in the Bank of England call account, call and current accounts with other credit institutions and investment securities. The maximum credit risk exposure equals the total carrying amount of the above categories plus off-balance sheet undrawn mortgage facilities.

Credit risk - loans and advances to customers

Credit risk associated with mortgage lending is largely driven by the housing market and level of unemployment. A recession and/or high interest rates could cause pressure within the market, resulting in rising levels of arrears and repossessions.

All loan applications are assessed with reference to the Group's lending policy. Changes to the policy are approved by the Board, with mandates set for the approval of loan applications.

The Credit Committee and the Assets and Liabilities Committee ('ALCO') regularly monitor lending activity, taking appropriate actions to reprice products and adjust lending criteria in order to control risk and manage exposure. Where necessary and appropriate, changes to the lending policy are recommended to the Risk Committee and the Board.

The following 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

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			
	BTL/SME	**Residential**	**Total**	
Bank	**£m**	**£m**	**£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**

	2017			
	BTL/SME	Residential	Total	
Bank	£m	£m	£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:

	2018				
	Buy-to-Let	**Commercial**	**Residential development**	**Funding lines**	**Total**
Group	**£m**	**£m**	**£m**	**£m**	**£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**

	2017				
	Buy-to-Let	Commercial	Residential development	Funding lines	Total
Group	£m	£m	£m	£m	£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

	2018				
	Buy-to-Let	**Commercial**	**Residential development**	**Funding lines**	**Total**
Bank	**£m**	**£m**	**£m**	**£m**	**£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**

	2017				
Bank	Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Band					
0% - 50%	466.8	6.5	88.3	25.5	587.1
50% - 60%	686.3	2.1	42.8	14.2	745.4
60% - 70%	1,204.4	6.3	8.9	39.6	1,259.2
70% - 80%	1,607.9	8.2	3.9	11.2	1,631.2
80% - 90%	319.5	0.1	-	13.5	333.1
90% - 100%	9.9	-	-	0.5	10.4
>100%	17.0	4.2	-	-	21.2
Total mortgages before provisions	4,311.8	27.4	143.9	104.5	4,587.6
Personal loans					1.1
Total loans before provisions					4,588.7

LTV analysis by band for Residential mortgages:

	2018			
Group	**First charge £m**	**Second charge £m**	**Funding lines £m**	**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**

	2017			
Group	First charge £m	Second charge £m	Funding lines £m	Total £m
Band				
0% - 50%	647.1	150.2	11.0	808.3
50% - 60%	163.3	94.2	3.1	260.6
60% - 70%	147.9	78.4	2.0	228.3
70% - 80%	136.1	47.2	1.2	184.5
80% - 90%	116.4	21.6	0.2	138.2
90% - 100%	22.2	9.3	0.1	31.6
>100%	7.6	14.4	-	22.0
Total mortgages before provisions	1,240.6	415.3	17.6	1,673.5

	2018			
Bank	**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**

	2017			
Bank	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

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.

Analysis of mortgage portfolio by arrears for BTL/SME

	2018				
Group	**Buy-to-Let £m**	**Commercial £m**	**Residential development £m**	**Funding lines £m**	**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**

	2017				
Group	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 1 to 3 months	-	-	-	-	-
Past due 3 to 6 months	9.1	-	-	-	9.1
Past due 6 to 12 months	4.0	0.4	-	-	4.4
Past due over 12 months	1.6	0.1	-	-	1.7
Possessions	7.8	0.7	-	-	8.5
	27.1	5.8	-	-	32.9
Total mortgages before provisions	5,033.8	370.8	143.9	104.5	5,653.0
Personal loans					1.1
Total loans before provisions					5,654.1

	2018				
Bank	**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**

	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 < 1 month	-	-	-	-	-

Past due 1 to 3 months	-	-	-	-	-
Past due 3 to 6 months	7.6	-	-	-	7.6
Past due 6 to 12 months	3.0	-	-	-	3.0
Past due over 12 months	0.9	-	-	-	0.9
Possessions	4.3	-	-	-	4.3
	18.2	4.2	-	-	22.4
Total mortgages before provisions	4,311.8	27.4	143.9	104.5	4,587.6
Personal loans					1.1
Total loans before provisions					4,588.7

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**

	2017			
Group	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	**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**

	2017			
Bank	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.

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:

	Group 2018		Group 2017	
Region	**£m**	**%**	£m	%
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	

	Bank 2018		Bank 2017	
Region	**£m**	**%**	£m	%
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).

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					
	AAA	**AA**	**A+**	**A**	**Less than A rating**	**Total**
2018	**£m**	**£m**	**£m**	**£m**	**£m**	**£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					
	AAA	**AA**	**A+**	**A**	**Less than A rating**	**Total**
2018	**£m**	**£m**	**£m**	**£m**	**£m**	**£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**	**-**	**1,398.9**
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**

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

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**

	2017				
	Encumbered		Unencumbered		
	Pledged as collateral	Other¹	Available as collateral	Other²	Total
	£m	£m	£m	£m	£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.

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

	Note					
		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

		2018			
Bank	**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	**-**	**-**	**1,340.0**	**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**

		2017				
Bank	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	-	-	1,179.3	-	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.

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:

			Estimated fair value			
Group 2018	**Carrying amount £m**	**Principal amount £m**	**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**
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

			Estimated fair value			
Bank	**Carrying amount**	**Principal amount**	**Level 1**	**Level 2**	**Level 3**	**Total**
2018	**£m**	**£m**	**£m**	**£m**	**£m**	**£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**	**-**	**2,916.4**	**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**
2017						
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 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

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	Commercial banking
		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	
	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.

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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