PILLAR 3 DISCLOSURES

For the year ended 31 December 2018

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krbs, krbs.com, Kent Reliance Banking Services and Kent Reliance are trading names of OneSavings Bank plc.
Registered in England and Wales (Company number 7312896). Registered office: Reliance House, Sun Pier, Chatham, Kent, ME4 4ET.
OneSavings Bank plc is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority (registered number 530504).

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Overview

This document sets out the consolidated Pillar 3 disclosures of OneSavings Bank plc (OSB) and its subsidiaries included within the solo consolidated group (the Group) as at 31 December 2018. The disclosures have been prepared in accordance with the Capital Requirements Directive (CRD) and the Capital Requirements Regulation (CRR) together known as CRD IV, which came into force on 1 January 2014.

The Basel Committee on Banking Supervision introduced the Basel framework with the primary goal of promoting the safety and soundness of the financial system. The framework consists of the following three pillars of regulation:

- Pillar 1 defines minimum capital requirements for certain risks, including credit, market and operational risks;
- Pillar 2 sets out the supervisory review process; and
- Pillar 3 on market discipline specifies disclosure requirements, which allow market participants to assess key pieces of information on the firm's capital, risk exposures and risk assessment process.

The CRD was initially introduced on 1 January 2007, bringing in capital adequacy standards for banks and an associated EU-wide supervisory framework based on the Basel II Accord. The European Union (EU) implemented the Basel III proposals published in December 2010 through CRD IV, which is enforced in the UK by the Prudential Regulation Authority (PRA). Disclosure requirements under CRD IV as detailed in Part 8 of the CRR are designed to promote market discipline through the publication by banks of key information. These comprise risk exposures, risk management frameworks and risk management processes. CRD IV also made changes to rules on corporate governance, including remuneration, and introduced standardised regulatory reporting within the EU.

This document makes references to the Group's Annual Report and Accounts, which can be found at the company's website: www.osb.co.uk. All figures in these disclosures are consistent with the basis used for prudential regulatory reporting. The main differences in prudential regulatory reporting as compared to disclosures in the annual accounts are:

- Lending commitments for which capital is held are included.
- Amounts from non-solo consolidated subsidiaries are excluded.
- Differences in valuation methodology including derivatives and secured financing transactions.

Pillar 3 Disclosure Policy

The Group is supportive of the overarching objectives of Pillar 3 disclosures, which are to promote market discipline and improve comparability and consistency of disclosures. As a complement to supervisory efforts, these objectives help to encourage banks to assess risk, maintain capital and develop and maintain sound risk management systems and practices.

The Group's Pillar 3 disclosures set out its risk management objectives and policies covering:

- the strategies and processes to manage those risks;
- the structure and organisation of the relevant risk management function or other appropriate arrangements;
- the scope and nature of risk reporting and measurement systems; and
- the policies for hedging and mitigating risk, and the strategies and processes for monitoring the continuing effectiveness of hedges.

Materiality

The Group regards information as material in disclosures if its omission or misstatement would change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions. If the Group deems a certain disclosure to be immaterial, it may be omitted from the Pillar 3 disclosure.

Confidentiality

Information is considered as proprietary if its public disclosure would undermine the Group's competitive position. Proprietary information may include information on products or systems which, if shared with competitors, would render the Group's investments therein less valuable. Further, the Group must regard information as confidential if there are obligations to customers or other counterparty relationships binding the Group to confidentiality. In the event that any such information is omitted, the Group shall disclose such and explain the grounds of non-disclosure.

Verification

The information and figures contained in the Pillar 3 disclosure document have been subject to internal verification and are based on the financial statements and supporting schedules. Within the 2018 Pillar 3 disclosures there is additional reporting over what is presented in the statutory financial accounts and Common Reporting (COREP) which is submitted to the PRA. The additional disclosures over the statutory financial accounts include code staff aggregate remuneration for 2018, the table for disclosing the impact of the transitional rules from the current own funds capital to the final own funds capital under CRD IV (Appendix II - Own Funds), the main characteristics of capital instruments (Appendix III - Subordinated Debt Instruments), Asset Encumbrance (Appendix I - Disclosure on Asset Encumbrance), Leverage Ratio (Appendix IV) and disclosure on Liquidity Coverage Ratio (LCR) (Appendix V). The additional disclosures over the COREP are contained in the table illustrating the main features of capital instruments (Appendix III - Subordinated Debt Instruments).

Basis and frequency of disclosure

Pillar 3 disclosures will be made at least annually and more frequently if management determines that significant events justify such disclosures. The disclosures are made around the same time as publication of the Group's Annual Report and Accounts.

Media and location of publication

The Group's Pillar 3 disclosures are published on its website (www.osb.co.uk).

Management and Board sign-off

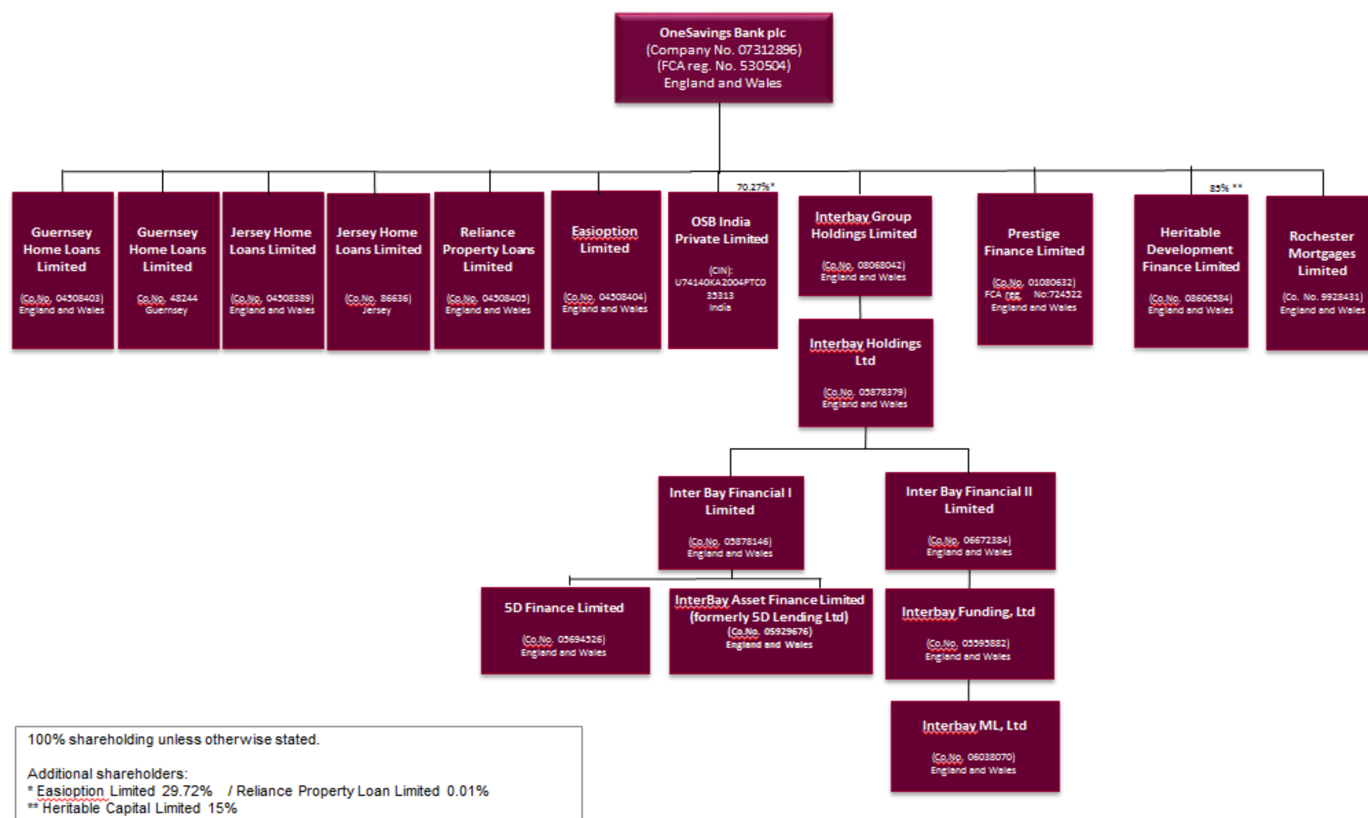
The Regulatory Governance Committee (a sub-committee of the Executive Committee (ExCo) and the Audit Committee are responsible for assessing and confirming the appropriateness of the Pillar 3 disclosures, including their verification and frequency. The disclosures must convey the Group's risk profile comprehensively to market participants as required under Part 8 of CRR.

The Pillar 3 disclosures are approved by the Audit Committee and the Board of Directors.

Scope

The Group operates a number of lending subsidiaries for functional reasons rather than to effect risk transfer. Figure 1 illustrates the Group's structure.

Figure 1: Group Structure as at 31 December 2018



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

As at 31 December 2018 all subsidiaries are included within the solo consolidation with the exception of OSB India Private Limited and Rochester Mortgages Limited. There are no material differences in the basis of consolidation for accounting and prudential purposes.

Chief Risk Officer's report

Approach to Risk Management

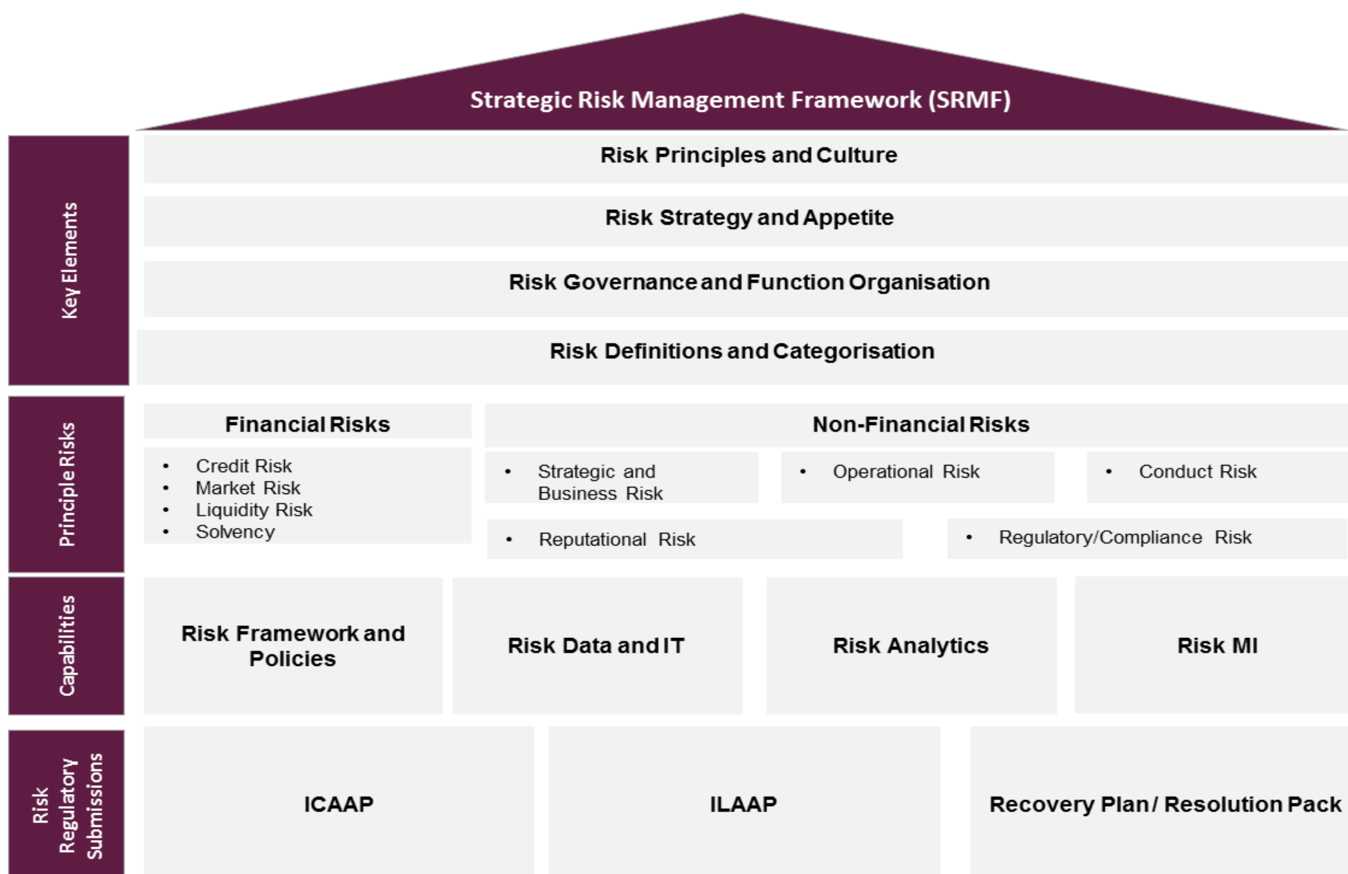
Ongoing risk identification, assessment, monitoring and reporting are the primary risk disciplines underpinning the Group's growth strategy and adherence to the prudential and conduct regulatory requirements. The Group's approach to risk management is outlined within the Strategic Risk Management Framework (SRMF).

The SRMF is the overarching framework which enables the Board and senior management to actively manage and optimise the risk-reward profile within the constraints of the Group risk appetite. The SRMF enables informed decisions to be taken in a timely manner by factoring the interests and expectations of the various stakeholders and to manage potential trade-offs within the context of the risk appetite. The SRMF articulates the Group's risk management principles, culture, policies and procedures and ensures that the Board, senior management and all key stakeholders have a consistent view of the Group's risk management practices and approach.

The SRMF is a structured approach to aligning the Board's overarching objectives against the risks assumed and the ongoing management of these risks. The SRMF enables the Board to articulate its expectations and tolerance in relation to the nature and level of risks it is willing to assume in pursuit of its strategic and business agenda.

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

Figure 2: Strategic Risk Management Framework



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

Key Modular Component 1: Risk Principles and Culture

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

The Risk Principles are:

- **Customer Outcomes:** Fair treatment and good customer outcomes are core business values which cannot be put at risk.

- **Proportionate and Scalable:** The approach to risk management needs to be commensurate with the complexity of the underlying risk profile and appropriately agile to respond to changing business and regulatory needs.

- **Actively Managed:** The risk profile needs to be actively managed within the Board approved risk appetite.

- **Comprehensive Coverage:** All risks and their underlying drivers impacting the Group's strategic, business, operational and regulatory objectives should be actively assessed, monitored and reported.

- **Segregation of Duties:** Risk taking, oversight and assurance responsibility to be organised in adherence to the 'three lines of defence' principle.

- **Integration and Usage:** Risk assessment should be a critical feature of decision making processes at all levels of the organisation.

- **Versatile and Progressive:** The approach to managing risks should be subject to continuous review and challenge to keep pace with emerging good practice and regulatory standards.

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

Key Modular Component 2: Risk Strategy and Appetite

Risk Strategy

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

The Group's Mission and Vision form the foundations to the risk strategy:

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

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

The Group's risk vision being: "right first time and central to our thinking".

The risk vision is achieved through the following key components:

A Strategic Partner: On-going assessment and evaluation of risks arising from strategic and business decisions.

Scalable and Credible: An independent, appropriately resourced and technically competent risk function.

Cultivate a Risk Culture: Foster a culture of risk awareness across the Group and cultivate a sense of individual and collective responsibility at all levels.

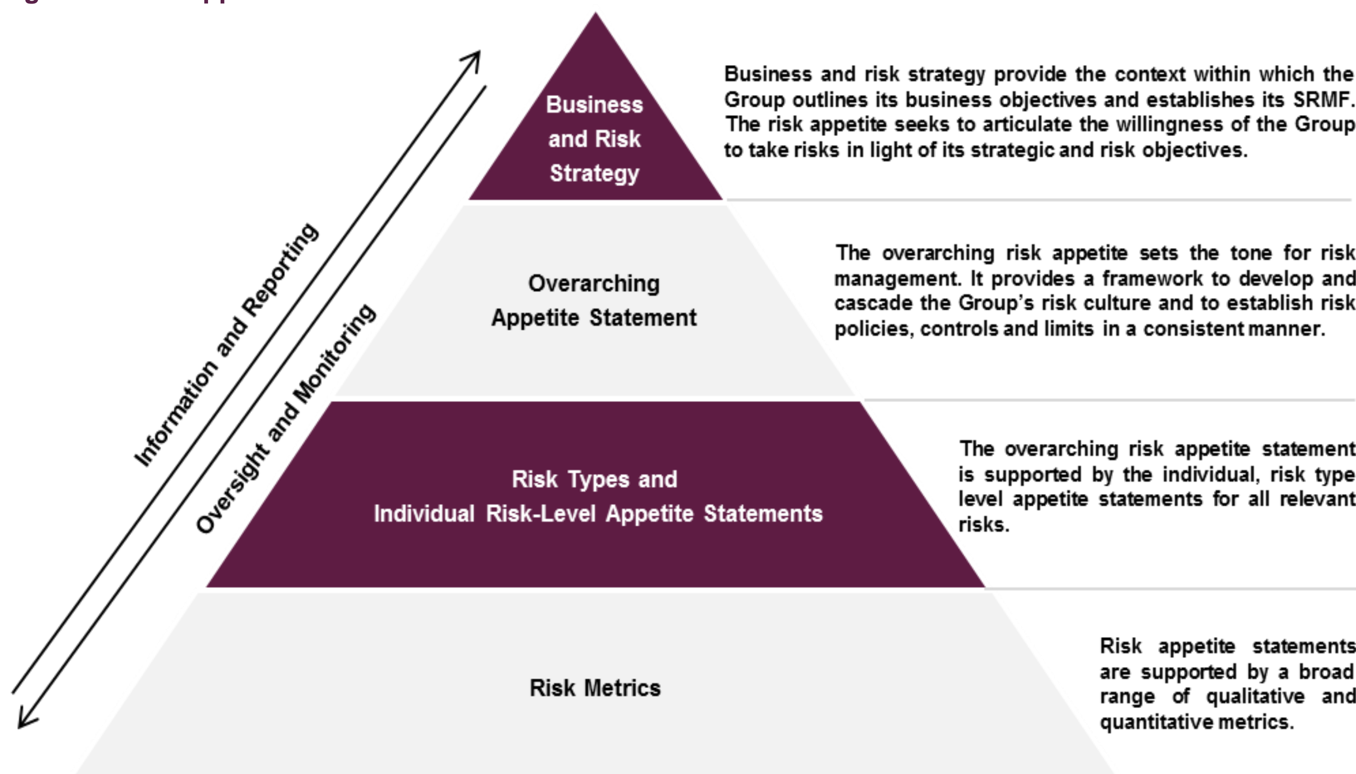
Risk Appetite

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

The risk appetite is calibrated to reflect the Group's strategic objectives, business operating plans, as well as external economic, business and regulatory constraints. In particular, the risk appetite is calibrated to ensure that the Bank continues to deliver against its strategic 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 by which the Board set 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 the approved thresholds. The Board and senior management actively monitor actual performance against Board approved management triggers and limits to respond in a timely manner to adverse trends and breaches.

Figure 3: Risk Appetite



Risk Appetite Statements

Overarching Risk Appetite Statement

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, supported by strong and high quality financial buffers. The highly efficient business operating model is an important source of competitive advantage. The Group also places significant importance on its strong conduct and compliance culture as an important driver of its overall success.

Business and Strategic Risk Appetite Statement

The Group does not intend to undertake any long to medium term strategic actions which could put at risk the Group's vision of being a leading specialist lender in its chosen markets, supported by a strong and dependable savings franchise.

The Group aims to also maintain a resilient and sustainable business operating model under normal and stressed market conditions. In particular, the business operating model should be able to sustain an extreme but plausible stress of a 1 in 20 intensity stress without breaching its key business performance indicators.

Reputational Risk Appetite Statement

The Group has a very low risk appetite for reputational risks. The Group will not conduct its business or engage with stakeholders in a manner that could adversely impact its reputation or franchise value.

The Group seeks to protect and enhance its reputation at all times through on-going identification and assessment of reputational risk events, active engagement with the Board, establishment of clear mitigating plans and actions, including communication actions and crisis management plans.

Credit Risk Appetite Statement

The Group seeks to maintain a high quality lending portfolio that generates adequate returns, in benign and stressed operating environments.

Market Risk Appetite Statement

The Group actively manages market risk arising from structural interest rate and foreign exchange rate exposures.

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 by dynamic hedging. The Board requirement is to maintain balance sheet and hedge positions sufficient to survive a range of severe but plausible stress scenarios for interest rate risk and basis risk. Historical data is used to calibrate the severity of the stress scenarios against the Group's overall risk appetite.

Liquidity and Funding Risk Appetite Statement

The Group will maintain sufficient liquidity to meet its liabilities as they fall due under normal and stressed business conditions; this will be achieved by maintaining a strong retail savings franchise, supported by a high quality liquid asset portfolio comprised of cash and readily-monetisable assets, and through access to pre-arranged secured funding facilities. The Board requirement to maintain balance sheet resources sufficient to survive a range of severe but plausible stress scenarios is interpreted in terms of the LCR and Liquidity Ratio.

Solvency Risk Appetite Statement

The Group seeks to ensure that it retains a sufficient level and quality of capital to satisfy its minimum regulatory requirements to cover its prudential risks and support its growth objectives. The Group's solvency risk appetite is constrained within the leverage ratio.

Operational Risk Appetite Statement

The Group aims to minimise operational risk arising from its ongoing business activities and operations and has no appetite for systemic operational failures which cause damage to its reputation, customers and financial performance.

Conduct Risk Appetite Statement

The Group aims to operate and conduct its business to the highest standards which ensure integrity and trust with respect to how the Group operates and manages its relationships with key stakeholders. In this respect the Group has no appetite to knowingly assume risks which may result in an unfair outcome for customers and/or cause disruption in the market segments in which it operates.

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 given its business operating model.

The Group acknowledges that regulatory rules and standards are subject to interpretation and subsequent translation into internal policies and procedures. The Group interprets requirements to ensure adherence with the intended purpose and spirit of the regulation whilst being cognisant of commercial considerations and good customer outcomes. To minimise regulatory risk, the Group proactively engages with its regulators, participates in industry forums and seeks external advice to validate its interpretations.

The Compliance and Regulatory Risk Appetite Statement is supported by a subset of statements:

Regulatory Change Risk Appetite Statement

To minimise the risk of the Group failing to manage and respond to regulatory change the Group will design and maintain robust systems and controls to effectively identify, interpret and implement all regulatory change that impacts the Group.

Financial Crime Risk Appetite Statement

To minimise financial crime risk the Group will design and maintain robust systems and controls to identify, assess, manage and report any activity (internal or external in nature) which exposes the Group to financial crime risk in the form of money laundering, human trafficking, terrorist financing, sanctions breaches, bribery and corruption, and fraud. The Group recognises the need to continuously review its systems and controls to ensure they are aligned to the nature and scale of financial crime risk it is exposed on a current and forward looking basis.

Key Modular Component 3: Risk Governance and Function Organisation

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

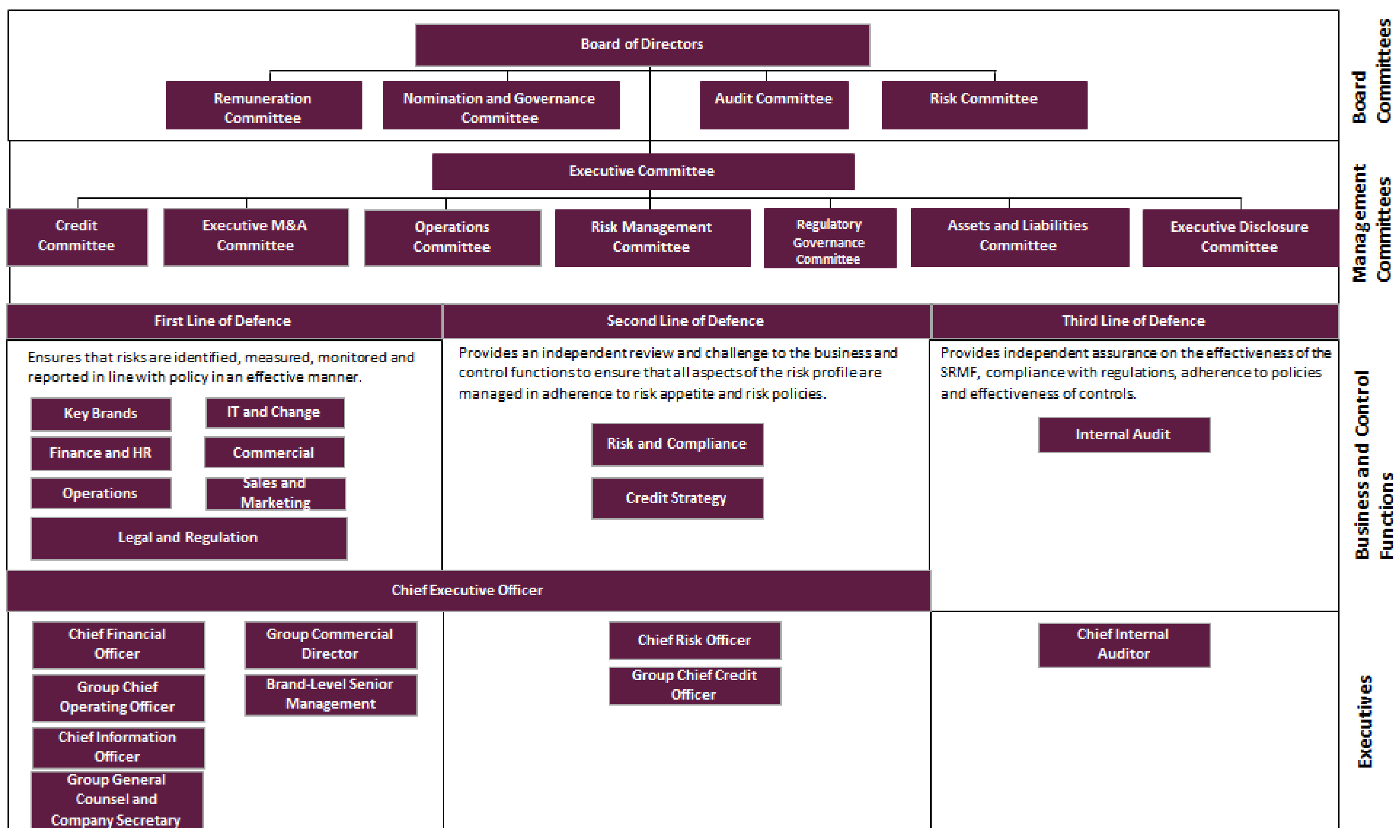
The Board has the ultimate responsibility for the oversight of the Group's risk profile and management framework and where it deems it appropriate, it delegates its authority to its nominated committees. The Board and its Committees are provided with appropriate and timely information relating to the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

The ExCo has day-to-day responsibility for managing the Group's risk profile within the parameters of the Board approved risk appetite. The ExCo discharges its risk control and oversight responsibilities through a number of management level risk committees covering all principal risks. The Chief Risk Officer (CRO) is the accountable executive responsible for establishing an effective risk management framework supported by appropriately organised Risk and Compliance functions. In discharging his duties, the CRO has dual reporting lines into the Group Chief Executive Officer (CEO) and the Chair of the Risk Committee. The CRO ensures that the risk function is appropriately resourced and capable of identifying, assessing and reporting all principal risks to which the Group is exposed.

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

The OSB risk organisational structure is detailed below:

Figure 4: Risk Governance and Organisational Structure



Key Modular Component 4: Risk Definitions and Categorisation

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

Figure 5: Risk Profile

Business model characteristics

- Specialist,and primarily secured lender to underserved sectors
- Desired levels of credit exposure to key segments (Buy-to-let/SME, residential)
- Potential for concentrations
- Also incurs exposure to potentially riskier sub-sectors (2nd charge, bridging and development finance)
- Manage infrastructure and operations to support its core business activities
- Performs activities to ensure regulatory compliance
- The Bank is subject to variations in the macroeconomic environment and movements in key variables (e.g. Gross Domestic Product (GDP), unemployment, interest rates)

Risk profile

Financial risks

Portfolio credit risk
The risk of losses due to one or more borrowers failing to meet all or part of their obligations towards the Bank. Credit risk also includes other elements such as pre-settlement and settlement risk, residual risk of credit risk mitigation and concentration risk.

Market risk (incl. IRRBB)
The risk of losses in on and off-balance sheet positions arising from adverse movements in market prices.

IRRBB - The current or prospective risk to both the earnings and capital, in respect of the banking book only, arising from adverse movements in interest rates. This risk arises when there is a mismatch between the risk profiles of Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL) and includes risks such as basis risk, yield curve risk etc.

Non-financial risks

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.

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

Operational risk
Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It includes legal risk but excludes strategic and reputational risk.

Conduct risk
Conduct risk as the risk that the firm's culture, organisation, behaviours and actions result in poor outcomes and detriment for customers and/or damage to consumer trust and integrity of the markets in which we operate.

Regulatory / compliance risk
The risk of failure due to non-adherence to provisions of the PRA handbook and all relevant prudential and conduct standards in the UK or non-compliance with reporting requirements or submission of incorrect information.

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

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

Risk Profile Performance Overview

Credit Risk

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 (BTL)/Small and Medium-sized Enterprises (SME) segment. Importantly, this lending was underwritten at sensible Loan to Value (LTV) levels, where tightened underwriting policy, following the United Kingdom's decision to leave the EU, 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 had been underwritten post-2011, 206 loans were 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 low portfolio arrears rate of 1.5% as at 31 December 2018 (31 December 2017: 1.2%).

Segment	Measure	31-Dec-2018	31-Dec-2017	Variance	Commentary
BTL/SME	New origination average LTV	**70%**	70%	–	New lending average LTV remained stable
	Weighted average Interest Coverage Ratio for new lending	**171%**	185%	-14%	Resulting from a higher proportion of 5 year products and a rising base rate
Residential lending	New origination average LTV	**68%**	65%	+3%	Increase in new average LTV from new product mix
	Percentage of new residential lending with a loan to income (LTI) greater than 4.5	**3.2%**	3.2%	-	Remained stable year on year

Other key risk measures also performed strongly within the period:

- Gross exposure to semi-commercial lending grew to £547.9m through the year with a weighted average LTV of 66%.
- Gross exposure to residential development finance remains low at £155.9m with a further £85.3m 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 Group.

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

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

- Temporary switch to interest only: a temporary account change to assist customers through periods of financial difficulty where arrears do not accrue at the original contractual payment. Any arrears existing at the commencement of the arrangement are retained.
- Interest rate reduction: the Group may in certain circumstances, where the borrower meets the required eligibility criteria, transfer the mortgages to a lower contractual rate. Where this is a formal contractual change the borrower will be requested to obtain independent financial advice as part of the process.
- Loan term extension: a permanent account change for customers in financial distress where the overall term of the mortgage is extended, resulting in a lower contractual monthly payment.
- Payment holiday: a temporary account change to assist customers through periods of financial difficulty where arrears accrue at the original contractual payment. Any arrears existing at the commencement of the arrangement are retained.
- Voluntary assisted sale: a period of time is given to allow borrowers to sell the property and arrears accrue based on the contractual payment.
- Reduced monthly payments: a temporary arrangement for customers in financial distress. For example, a short term arrangement to pay less that the contractual payment. Arrears continue to accrue based on the contractual payment.
- Capitalisation of interest: arrears are added to the loan balance and are repaid over the remaining term of the facility or at maturity for interest only products. A new payment is calculated which will be higher than the previous payment.
- Full or partial debt forgiveness: where considered appropriate, the Group will consider writing off part of the debt. This may occur where the borrower has an agreed sale and there will be a shortfall in the amount required to redeem the Group's charge, in which case repayment of the shortfall may be agreed over a period of time subject to an affordability assessment or where possession has been taken by the Group, and on subsequent sale where there has been a shortfall loss.

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

Throughout 2018, the Group continued to observe low levels of accounts in forbearance.

Table 1: Forbearance measures undertaken during the financial year

Forbearance Type	Number of Accounts 2018	2018 Year End Balances £m	Number of Accounts 2017	2017 Year End Balances £m	2018 vs. 2017 variance number of accounts	2018 vs. 2017 variance of balances (£m)
Interest only switch	26.0	3.7	35.0	3.8	(9.0)	(0.1)
Interest rate reduction	5.0	0.8	0.0	0.0	5.0	0.8
Term extension	33.0	3.5	29.0	4.9	4.0	(1.4)
Payment holiday	31.0	0.6	50.0	1.5	(19.0)	(0.9)
Voluntary assisted sale	4.0	0.1	2.0	0.7	2.0	(0.6)
Payment concession (reduced monthly payments)	75.0	3.5	42.0	0.8	33.0	2.7
Capitalisation	0.0	0.0	0.0	0.0	0.0	0.0
Full or partial debt forgiveness	0.0	0.0	0.0	0.0	0.0	0.0
Total	**174.0**	**12.2**	**158.0**	**11.7**	**16.0**	**0.5**

Table 2: Analysis of forbearance measures undertaken in 2018 by loan type

Loan Type	Number of Accounts 2018	2018 Year End Balances £m	Number of Accounts 2017	2017 Year End Balances £m	2018 vs. 2017 variance number of accounts	2018 vs. 2017 variance of balances (£m)
First charge owner occupier	40.0	3.4	55.0	4.5	(15.0)	(1.1)
Second charge owner occupier	106.0	2.9	77.0	1.6	29.0	1.3
Buy to let	28.0	5.9	26.0	5.6	2.0	0.3
Commercial	0.0	0.0	0.0	0.0	0.0	0.0
Total	**174.0**	**12.2**	**158.0**	**11.7**	**16.0**	**0.5**

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 the Royal Institute of Chartered Surveyors (RICS).

Impairment Performance

Low arrears, sensible LTV's 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 the 1 January 2018 the Group has been calculating expected credit loss (ECL) provisions under an IFRS9 approach, replacing the previous IAS39 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 IFRS9 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 IFRS9 accounting standard, the Group utilised three macroeconomic scenarios (upside, base and downside) within ECL 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.

On an underlying basis, without the aforementioned enhancements made during the year, the loan loss ratio would have been c6bps, with the addition of the fourth scenario being the main driver of the increase.

Loan losses across the BTL/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 LTV profile and continued portfolio run down, predominantly driven by the run off of acquired and second charge originated mortgage portfolios resulted in lower loan loss ratios during the full year to 31 December 2018, versus the full year 2017.

The Group continues to closely monitor impairment coverage levels:

	Gross carrying amount (£m)	Provisions (£m)	Incurred loss remaining[1] (£m)	Coverage ratio[2]
At 31 December 2018				
Stage 1	8,286.8	4.3		0.05%
Stage 2	436.8	5.6		1.28%
Stage 3 (+ POCI)	281.6	11.8	7.2	6.75%
Undrawn loan facilities		0.2		
Total	9,005.2	21.9	7.2	**0.32%**
At 1 January 2018 (post IFRS 9 transitional adjustment)				
Stage 1	6,782.5	7.8		0.12%
Stage 2	292.4	2.3		0.79%
Stage 3 (+ POCI)	252.7	15.1	7.9	9.10%
Undrawn loan facilities				
Total	7,327.6	25.2	7.9	**0.45%**
At 1 January 2018 (IAS39)				
Total	7,327.6	21.6	7.9	**0.40%**

Notes:

- Incurred loss is the expected loss of the portfolio at the point of acquisition and is offset against the modelled future cash flows to derive the effective interest rate for the book. The incurred loss protection is therefore recognised over the life of the book against the unwind of any purchase discount or premium through interest income. Incurred loss remaining is this protection reduced by the cumulative losses observed since acquisition.
- Coverage ratio is the total provisions plus incurred losses remaining versus gross loans and advances.

The total coverage ratio with respect to loans and advances to customers reduced to 0.32% from 0.40% as at 31 December 2017 (0.45% post IFRS9 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 are released decreasing total book impairment.

Solvency Risk

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

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

The Group'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 Group had a total capital ratio of 15.8% and a leverage ratio of 5.4% as at 31 December 2018 (31 December 2017: 16.9% and 6.0% respectively).

Liquidity & Funding Risk

The Group 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 Group specific events. The Group's liquidity risk appetite has been calibrated to ensure that the Group 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 Group continues to attract new retail savers and retain existing customers through loyalty-based product offerings.

In 2018 the Group 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). It's LCR at 224% remains well above risk appetite and regulatory minimums.

Market Risk

The Group proactively manages its risk profile in respect of adverse movements in interest rates, foreign exchange rates and counterparty exposures. The Group 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 the Assets and Liabilities Committee (ALCO) and approved by the Board.

Interest Rate Risk

The Group 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 derivative 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 Group managed its interest rate risk exposure within its risk appetite limits.

Basis Risk

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

As with structural interest rate risk, capital allocation has been set in proportion to CET1 capital, with exposure assessed and monitored monthly across a range of 'business as usual' and stressed scenarios.

Throughout 2018, the Group 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 Group's reputation and any detrimental impact on financial performance. The Group 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 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 Group 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 Group's interpretation and response to new regulatory requirements reflects the Group's specific circumstances and its desire to give the best customer outcomes.

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

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

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

Strategic & Business Risk

The Board has clearly articulated the Group's strategic vision and business objectives supported by performance targets. The Group does not intend to undertake any medium to long term strategic actions which would put at risk the Group'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 Group has adopted a sustainable business model based on a focused approach to core niche markets where its experience and capabilities give it a clear competitive advantage.

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

Risk Based Submissions

The Group undertakes a comprehensive review of its current and projected risk profiles based on expected and stressed market and economic conditions. The two primary risk-based annual planning exercises are the Internal Capital Adequacy Assessment Process (ICAAP) and the ILAAP. The ICAAP informs the Board's and senior management's view on the level and quality of capital needed to meet the prudential and risk based capital requirements over the planning horizon under base and stress scenarios. The ICAAP is an integral input into the PRA's supervisory review process (SREP) and forms the basis upon which the Group's capital guidance is set. The ILAAP informs the Board's view on the Group's level and quality of liquidity buffer and liquidity management framework.

The Group also reviews and updates its Recovery Plan and its Resolution Pack on an annual basis. The Recovery Plan process is designed to ensure that the Group's Recovery Plan is credible and can be implemented in a time of stress. The Group's recovery options are assessed for feasibility and time to implementation under stressed conditions. The Group leverages its risk appetite and stress testing procedures to identify a suite of early warning indicators and triggers which inform the nature and type of recovery options which would be put in place.

The Group's Resolution Pack provides the regulatory authorities with information and analysis on the Group's businesses, organisation and structures to facilitate an orderly resolution should it become necessary.

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

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

Risk Appetite Statement	Risk	Mitigation and controls	Direction
The Group's strategic and business risk appetite states that the Group does not intend to undertake any long to medium-term strategic actions that	**Performance against targets** Performance against strategic and business targets does not meet stakeholder expectations.	Regular monitoring by the Board and the Executive Committee of business and financial performance against strategic agenda and risk appetite. The	**Increased** The Group's strategic and business operating environments are subject to on-going changes primarily driven by market

would put at risk its vision of being a leading specialist lender, backed by a strong and dependable saving franchise. The Group adopts a long-term sustainable business model which, while focused on niche sub-sectors, is capable of adapting to growth objectives and external developments.	This has the potential to damage the Group's franchise value and reputation.	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.	competition, economic outlook and regulation.
	Regulatory and economic environment The regulatory and economic environment is an important factor impacting the strategic and business risk profile. In particular, the new regulatory underwriting standards and tax changes impacting the BTL sector have resulted in a general slowdown in the sector.	The Group's robust underwriting standards and its focus on professional landlords have helped mitigate the impact of the regulatory changes and enabled the Group to continue to grow its share of the sector. The Group has continued to utilise and enhance its stress testing capabilities to assess and minimise potential areas of macroeconomic vulnerability.	**Increased** The Group's strategic and business risk profile is impacted by the uncertainty surrounding Brexit negotiations and potential future changes to regulatory standards.
	Regulatory requirements The potential for emerging regulatory requirements to increase the demands on the Group's operational capacity and increase the cost of compliance.	The Group continues to invest in its IT and data management capabilities to increase the ability to respond to regulatory change. A structured approach to change management and fully leveraging internal and external expertise allows the Group to respond effectively to regulatory change.	**Increased** The level and sophistication of emerging regulatory requirements place increasing demands on the Group's operational capacity.

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

Risk Appetite Statement	Risk	Mitigation and controls	Direction
The Group does not knowingly conduct business or organise its operations to put its	**Deterioration of reputation** Potential loss of trust and confidence that our	Culture and commitment to treating customers fairly and being open and transparent in	**Unchanged** The Group has increased the size and capabilities of its Risk and Compliance

reputation and franchise value at risk.	stakeholders place in us as a responsible and fair provider of financial services.	communication with key stakeholders. Established processes to proactively identify and manage potential sources of reputational risk.	function to ensure appropriate oversight and challenge to how the Group discharges its responsibilities to the various stakeholders.

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

Risk Appetite Statement	Risk	Mitigation and controls	Direction
The Group seeks to maintain a high quality lending portfolio that generates adequate returns, under normal and stressed periods. The portfolio is actively managed to operate within set criteria and limits based on profit volatility, focusing on key sectors, recoverable values, and affordability and exposure levels. The Group aims to continue to generate sufficient income and control credit losses to a level such that it remains profitable even when subjected to a credit portfolio stress of a 1 in 20 intensity stress scenario.	**Individual borrower defaults** Borrowers may encounter idiosyncratic problems in repaying their loans, for example loss of a job or execution problems with a development project. While most of the Group's lending is secured, some borrowers fail to maintain the value of the security.	All loans are extended only after thorough bespoke and expert underwriting to ensure ability and propensity of borrowers to repay and sufficient security in case of default. Should there be problems with a loan, the Collections and Recoveries team works with customers unable to meet their loan service obligations to reach a satisfactory conclusion while adhering to the principle of treating customers fairly. 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 economies of the specific project.	**Unchanged** The Group continues to observe strong and stable credit profile performance.

		The Group's Transactional Credit Committee actively reviews and approves larger or more complex mortgage applications.	
	Macroeconomic downturn A broad deterioration in the economy would adversely impact both the ability of borrowers to repay loans and the value of the Group's security. Credit losses would impact across the lending portfolio, so even if individual impacts were to be small, the aggregate impact on the Group could be significant.	The Group works within portfolio limits on LTV, affordability, name, sector and geographic concentration that are approved by Risk Committee and the Board. These are reviewed on a semi-annually basis. In addition, stress testing is performed to ensure the Group maintains sufficient capital to absorb losses in an economic downturn and continue to meet its regulatory requirements.	**Unchanged** Although the UK economy has remained stable during 2018, the economic outlook is uncertain with the final terms of BREXIT to be confirmed.
	Wholesale credit risk The Group has wholesale exposures both through call accounts used for transactional and liquidity purposes and through derivative exposures used for hedging.	The Group transacts only with high-quality wholesale counterparties. Derivative exposures include collateral agreements to mitigate credit exposures.	**Unchanged** The Group continues to utilise a reserve account with the Bank of England, enabling it to minimise credit risk on most of its liquidity portfolio.

Market risk
Definition - Potential loss due to changes in market prices or values.

Risk Appetite Statement	Risk	Mitigation and controls	Direction
The Group actively manages market risk arising from structural interest rate positions. The Group does not seek to take a significant interest rate position or a directional view on rates and it limits its mismatched and basis risk exposures.	**Interest rate risk** An adverse movement in the overall level of interest rates could lead to a loss in value due to mismatches in the duration of assets and liabilities.	The Group's Treasury department actively hedges to match the timing of cash flows from assets and liabilities.	**Unchanged** The Group continues to assess interest on a monthly basis ensuring that the interest rate risk exposure is limited in the current economic environment.
	Basis risk A divergence in market rates could lead to a loss in value, as assets and liabilities are linked to different rates.	The Group's basis risk exposure is measured on monthly basis against a range of stress scenarios. Exposure is constrained by risk appetite with balance sheet strategy and hedging used to minimise mismatches.	**Unchanged** Product design balance sheet strategy has enabled the Group to maintain the overall level of basis risk through the year.

Liquidity and funding risk
Definition - The risk that the Group will be unable to meet its financial obligations as they fall due.

Risk Appetite Statement	Risk	Mitigation and controls	Direction
The Group actively manages 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 (LAB) so as to withstand market and idiosyncratic liquidity-related stresses.	**Retail funding stress** As the Group is primarily funded by retail deposits, a retail run could put it in a position where it could not meet its financial obligations. Increased competition for retail savings driving up funding costs, adversely impacting retention levels and wider damage to the OSB franchise.	The Group's funding strategy is focused on a highly stable retail deposit franchise. The large number of depositors and mix of easy access, one and two year term products, provides diversification, with a high proportion of balances covered by the Financial Services Compensation Scheme (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 ALCO. Finally, the Group has prepositioned mortgage collateral with the Bank of England which allows it to consider other alternative funding sources to ensure it is not solely reliant on retail savings.	**Unchanged** The Group's funding mix has remained stable throughout the year.

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

Risk Appetite Statement	Risk	Mitigation and controls	Direction
OSB seeks to ensure that it is able to meet its Board level capital buffer requirements under a 1 in 20 stress scenario. The Group's solvency risk appetite is constrained within leverage ratio related requirements. We manage our capital resources in a manner which avoids excessive leverage and allows us flexibility in raising capital.	**Deterioration of capital ratios** Key risks to solvency arise from balance sheet growth and unexpected losses which can result in the Group's capital requirements increasing or capital resources being depleted such that it no longer meets the solvency ratios as mandated by the PRA and Board risk appetite. The regulatory capital regime is subject to change and could lead to increases in the level and quality of capital that the Group needs to hold to meet regulatory requirements.	Currently the Group operates from a strong capital position and has a consistent record of strong profitability. The Group 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 Group also holds prudent levels of capital buffers based on CRD IV requirements and expected balance sheet growth. The Group engages actively with regulators, industry bodies, and advisers to keep abreast of potential changes and provide feedback through the consultation process.	**Unchanged** The Group has maintained a prudent and stable CET1 capital and total capital position providing resilience against unexpected losses.

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

Risk Appetite Statement	Risk	Mitigation and controls	Direction
The Group's operational processes, systems and controls are designed to minimise disruption to customers, damage to the Group's reputation and any detrimental impact on financial performance. The Group actively promotes the continual evolution of its operating environment through the identification, evaluation and mitigation of risks, whilst recognising that the complete elimination of operational risk is not possible.	**Cyber/data security risk** The risk of a loss of customer or proprietary data as a result of theft or through ineffective data management.	A series of tools designed to identify and prevent network / system intrusions are deployed across the Group. The effectiveness of the controls is overseen by a dedicated IT Security Governance Committee, with specialist IT Security staff employed by the Group.	**Increased** Whilst the Group 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 to the volume and the level of sophistication.

	Data risk The use of inaccurate, incomplete or outdated data may result in a range of risks impacting risk management and reporting services.	The Group continues to invest in and enhance its data management architecture, systems, governance and controls. Oversight is achieved via a Data Strategy Programme, designed to ensure a consistency of approach and implementation.	**Increased** The increase in data risk has been primarily driven by the increased scale of operations and the multiple sources from which data is derived.
	Operational resilience The inability of the Group to maintain the provision of its high priority services in the event of a major incident impacting its IT infrastructure, facilities, people or the third parties on which it relies to provide those services.	The completion of all modules of the Operational Resilience Programme has delivered a Group-wide approach in respect to planning and testing. The Group 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 Group's readiness to respond to an incident. A range of back-up technologies employed to provide real-time replication on various critical systems while disaster recovery capabilities are tested annually. Real-time system performance monitoring established and a dedicated testing team in place.	**Increased** The increased risk is primarily driven by the expanding scale of the Group's operations and the continued evolution of cyber based threats. However, the Group has invested significantly in its operational resilience frameworks, capabilities and testing to better address the emerging risks.

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

Risk Appetite Statement	Risk	Mitigation and controls	Direction
The Group considers its culture and behaviours in ensuring the fair treatment of customers and in maintaining the integrity of the markets in which it operates a fundamental part of its strategy and a key driver to sustainable profitability and growth. The Group does not tolerate	**Product suitability** Whilst the Group's originates relatively simple products, there remains a risk that (primarily legacy) products may be deemed to be unfit for their original purpose in line with the current regulatory definitions.	The Group has a strategic commitment to provide simple, customer-focused products. In addition a Product Governance framework is established to oversee both the origination of new products and to revisit the ongoing suitability of the existing product suite.	**Unchanged** Whilst this risk has remained low as a result of increased awareness and dedicated oversight, the Group remains aware of the changes to the regulatory environment and their possible impact on product suitability.

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.			
	Data protection The risk that customer data is accessed inappropriately either as a consequence of network / system intrusion or through operational errors in the management of the data.	In addition to a series of network / system controls, the Group performs extensive root cause analysis of any data leaks in order to ensure that the appropriate mitigating actions are taken.	**Unchanged** Despite a number of additional controls being introduced in 2018, the network / system threats continue to increase in both volume and sophistication.

Compliance and regulatory risk

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

Risk Appetite Statement	Risk	Mitigation and controls	Direction
The Group views ongoing conformance with regulatory rules and standards across all the jurisdictions in which it operates as a critical facet of its risk culture. The Group does not knowingly accept compliance risk which could result in regulatory sanctions, financial loss or damage to its reputation. The Group will not tolerate any systemic failure to comply with applicable laws, regulations or codes of conduct relevant to its business operating model.	**Regulation changes** Key compliance and regulatory changes that impacted the Group include changes in the standardised approach to capital rules, implementation of an internal ratings based (IRB) floor and Introduction of IFRS9 Accounting Standards for computing impairment allowance requirements.	The Group 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 management level. The Group has proactively sought external expert opinions to support interpretation of the requirements and validation of its response, where required.	**Increased** The Group has historically responded effectively to regulatory changes, however the level and sophisticated 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	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	**Increased** The regulatory environment has tightened and this is likely to continue, exposing the Group to increased risk.

	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.	culture means that current practice may not have to change significantly to meet new conduct regulations.	

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

Emerging Risks	Description	Mitigation Action
Political and Macro-Economic Uncertainty	As the outcome of Brexit remains unclear, there is an increased likelihood of a period of macroeconomic uncertainty. The Group's lending activity is solely focused in the United Kingdom and, as such, will be impacted by any risks emerging from changes in the macroeconomic environment such as changes to house prices, interest rates and unemployment rates.	The Group has implemented robust monitoring processes and via various stress testing activity (i.e. risk appetite, ICAAP) understands how the Group performs over a variety of macroeconomic stress scenarios and has subsequently developed a suite of early warning indicators which are closely monitored to identify changes in the economic environment. 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.

Key achievements during 2018

The Group has 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 term funding markets 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 its second generation IRB models, further embedding of its 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. The initiative is designed to deliver integrated data controls, aggregation and reporting capabilities.

The Group has 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 on-going monitoring and testing. The Group has improved its procedures related to business continuity planning and disaster recovery.

The launch of the Interbay 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 risk profiles. 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 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.

The Board of Directors

The role and structure of the Board

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

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

The Board operates in accordance with the Company's Articles of Association (the Articles) and its own written terms of reference. The Board has established a number of Committees as indicated in the table on page 33. Each Committee has its own terms of reference which are reviewed at least annually.

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

Strategy and management
- Overall strategy of the Group
- Approval of long term objectives
- Approval of annual operating and capital expenditure budgets
- Review of performance against strategy and objectives

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

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

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

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

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

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

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

Board Committees

The Board has delegated specific areas of oversight and control to the Committees set out below. Each committee has Board-approved terms of reference, which are reviewed at least annually. The Board Committees and a summary of their terms of reference are listed in Table 3.

Table 3: Board Committees

Subcommittee	Objectives
Audit Committee	• Assist the Board in overseeing the system of internal control and external financial reporting across the Group • Ensure the external and internal audit arrangements are appropriate and effective • Ensure that fraud prevention and whistleblowing arrangements are established • Ensure that the annual report and accounts, related internal control disclosures, and any other publicly available financial information are reviewed and scrutinised
Nomination and Governance Committee	• Lead the process for Board appointments • Ensure the Board and its Committees have an appropriate balance of skills, experience, availability, independence, and knowledge of the Group to enable them to discharge their respective responsibilities effectively • Oversight of corporate governance arrangements and sustainability
Remuneration Committee	• Advise the Board on developing policy on executive remuneration • Fix the remuneration packages of individual directors and members of the Executive Team
Risk Committee	• Oversight of the Group's risk appetite, risk monitoring, and capital and liquidity management • Ensure the compliance arrangements are appropriate and effective • Provide oversight and advice to the Board on current risk exposures and future risk strategy • Assist the Board to foster a culture within the Group that emphasises and demonstrates the benefits of a risk-based approach to internal control and management of the Group • Approve lending up to 20% of CET1 capital at the connection level • Approve asset purchases and secured funding lines up to £80m investment with Risk Weighted Assets (RWA) not exceeding £50m at any point under a base case scenario

The Business

Executive Committee

The CEO chairs the Executive Committee (Exco), whose other members are the Chief Financial Officer (CFO), the Group Chief Operating Officer, Chief Risk Officer (CRO), Group General Counsel and Company Secretary, Group Commercial Director, Chief Information Officer, Group Chief Credit Officer and Chief Internal Auditor. The ExCo is supported by Management Committees.

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

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

The ExCo's activities during the year included:

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

Management Committees

Table 4: Management Committees

Committee	Main objectives and responsibilities
Assets and Liabilities Committee (ALCO)	• Reports to ExCo • Ensure the Treasury Function is operating effectively and in accordance with the Interest Rate Risk in the Banking Book Policy • Assess the exposure of the Group to movements in interest rates and establish a strategy for managing and containing such risks • Review the limit report and highlight any departure or threat of departure from agreed limits • Monitor the net interest margin
Credit Committee	• Reports to ExCo and monitored by Risk Committee • Review, assess, and recommend to Risk Committee proposed changes to Lending Policy, Arrears, Repossession and Forbearance Policy • Approval of certain lending decisions as required by Lending Policy • Monitoring adherence to Lending Policy • Review of credit risk exposure in lending portfolio, including arrears • Review, assess, and approve recovery strategies • Review, assess, and recommend to the Audit Committee any changes to the Group Loan Impairment Provisioning Policy • Oversight of calculation of specific and collective provisions • Identifying and recommending improvements to systems and controls for the

	management of credit risk • Monitor conduct risk considerations in lending activity • Review staff loans annually
Operations Committee	• Oversee operational management of business • Provide operational inputs into larger projects • Structure and manage smaller operational projects • Oversee Indian Operations
Risk Management Committee (RMC)	• Review legal risk register to ensure risk remains within the Board stated risk appetite, agree mitigation plans and monitor progress against those plans • Propose and regularly review the implementation and effectiveness of the operational risk policy and statement of operational risk appetite • Propose and regularly review the implementation and effectiveness of the Group's conduct risk policy and statement of conduct risk appetite
Regulatory Governance Committee	• Revising approaches, treatments and management subjective decisions on regulatory reporting practice • Act as Project Change Governance Committee for changing reports, reporting processes and approval for spends
Executive M&A Committee (EMAC)	• Reviewing and assessing potential inorganic commercial opportunities • Providing oversight of transactions post-completion including the integration of acquired businesses and assets until the operation of these are business as usual.
Executive Disclosure Committee	• Determine in accordance with the Disclosure Policy and Market Abuse Regulation whether specified information is inside information which requires disclosure to the market • Reviewing scheduled and ad-hoc announcements to market • Keeping accurate records of evaluations and decisions around inside information including any decision to delay disclosure • Monitoring business activity and incidents and reporting any matters deemed sufficiently material to the Board

Risk and Compliance

Risk and Compliance are independent of the business by virtue of their reporting lines. These include a direct line to the Board and a direct line to the ExCo. Their role is to review, approve and test the risks and control systems designed by management.

Risk and Compliance work with the executives to ensure general risks and regulatory risks respectively are identified, assessed, prioritised, owned, recorded, reported and mitigated by the business. They provide independent challenge to help identify gaps in the risk and control system. These are reported to the ExCo, the Risk Committee and the Board and recorded on the tracking systems with timescales for action, nominated owners, and regular reports on progress to the Risk and Audit Committees.

Risk and Compliance also provide regular Management Information (MI) on the risks being run by the business, including credit risk, liquidity risk, and operational risk. This MI is provided to the appropriate executive subcommittee, the Risk Committee, and the Board. Risk and Compliance also use the insights gained in the collection and reporting of this information to advise the business on its management of risks.

The CRO also provides assurance to the Board through regular reports which assess strategic risks as well as business risks.

The CRO's responsibilities include ensuring that all key business risks are appropriately considered, with allocated business owners responsible for taking remedial action to mitigate shortcomings. The CRO is also responsible for ensuring the PRA's requirements are met. The CRO facilitates action and provides regular reporting to the ExCo and the Board. Assurance is provided that risks are controlled through the Risk Committee.

The CRO's role also includes ensuring that Financial Conduct Authority (FCA) requirements are met and all relevant legislation is complied with. A compliance risk assessment is carried out annually and informs the prioritisation of compliance activities, resourcing and plans for the year, including compliance monitoring, review and assessment activity.

Internal Audit

Internal Audit operates as the third line of defence within the Group’s three lines of defence risk management framework. The Chief Internal Auditor’s primary role is to help the Board and Executives to protect the Group’s assets, reputation and sustainability. Internal Audit will:

- assess whether significant risks have been identified and reported appropriately to the Board and Executive management;
- provide a view of the design and operation of key controls to determine whether they are effective at mitigating risk; and
- challenge management to improve the effectiveness of governance, risk management and internal control.

It assists the Group in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of the risk management, control, and governance processes.

The internal audit activity is established by the Board of Directors, who has delegated authority to the Audit Committee to oversee the activities of the internal audit function.

The Chief Internal Auditor’s primary reporting line is to the Chair of the Audit Committee with a secondary reporting line to the CEO.

Capital Resources

Table 5 summarises the composition of regulatory capital resources as of 31 December 2018. Details on the Group's leverage ratio are presented in Appendix IV - Leverage Ratio. The Group complied with all externally imposed capital requirements to which it is subject for the years ended December 2018 and December 2017.

Table 5: Capital resources

	Group 2018	Group 2017
	£m	£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	(5.4)	(4.8)
IFRS 9 transitional adjustment	2.7	-
Deductions from common equity tier 1 capital		
Prudent valuation adjustment	(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**

Additional information on the main features of the Group's Tier 2 Subordinated Debt instruments can be found in Appendix III - Subordinated Debt Instruments.

The Group's Recovery Plan discusses options for raising capital in a stress situation, some of which (e.g. reduction in new business origination) are considered as management actions in the analysis of the capital planning buffer in the Group's ICAAP while others (e.g. sale of portions of the business) are reserved for more severe situations that are outside the scope of the ICAAP.

All the Perpetual Subordinated Bonds (PSBs), Subordinated Liabilities and Bonds are issued by OSB. Table 6 shows the terms of PSBs, Subordinated Liabilities and Bonds are detailed below:

Table 6: PSBs, Subordinated Liabilities and Bonds

	Group 2018 £m	**Group 2017 £m**
Subordinated liabilities		
Linked to LIBOR (London Interbank Offered Rate):		
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**
Perpetual subordinated bonds		
Sterling Perpetual Subordinated Bonds (5.9884%)	**15.3**	**15.3**
Sterling Perpetual Subordinated Bonds (4.5991%)	**22.3**	**22.3**
Total subordinated liabilities and bonds	**48.4**	**48.5**

Note: The Group has the option to call the £5.0m second tranche of the subordinated debt on 27 September 2019. The values above include accrued interest.

Subordinated liabilities and bonds which are in their final five years to maturity are being amortised on a straight line basis.

Capital requirements

The Group's policy is to be well capitalised, and its approach to capital management is driven by strategic and organisational requirements, while also taking account of the regulatory and commercial environment in which it operates. The Group maintains a strong capital base to support the development of the business and to ensure that Pillar 1 capital requirements and Individual Capital Guidance are met at all times. As a result the Group maintains capital adequacy ratios above minimum regulatory requirements.

Pillar 1 requirements

The Group's Pillar 1 capital requirement is calculated using the following approaches:

- Credit - standardised approach
- Market risk - not applicable
- Credit valuation adjustment (CVA) risk - standardised method
- Operational risk - standardised approach

The following table shows the RWA's in accordance with the standardised approach to credit risk and separately 8% hereof reflecting the minimum Pillar 1 capital requirement for each of the standardised credit risk exposure classes. The table also shows the Group's capital requirements due to counterparty credit risk and operational risk capital requirement calculated in accordance with the basic indicator approach.

Table 7: Pillar 1 capital requirements

	2018		2017	
Standardised Exposure Classes	**Risk Weighted Assets £m**	**Capital Requirement £m**	**Risk Weighted Assets £m**	**Capital Requirement £m**
Central government and central banks (4)	5.1	0.4	6.5	0.5
Regional governments or local authorities	-	-	-	-
Administrative bodies and non-commercial	-	-	-	-
Multilateral development banks	-	-	-	-
International organisations	-	-	-	-
Institutions (1)	11.9	1.0	11.3	0.9
Corporates (2)	76.9	6.1	25.4	2.0
Retail	7.6	0.6	0.7	0.1
Secured by mortgages on residential property	2,846.3	227.7	2,412.3	193.0
Secured by mortgages on commercial real estate	428.3	34.3	293.7	23.5
Exposures in default (3)	272.3	21.8	108.5	8.7
Regulatory high-risk categories	225.1	18.0	215.8	17.3
Covered bonds	-	-	-	-
Securitisation positions	-	-	-	-
Short-term claims on institutions and corporates	-	-	-	-
Collective Investment Undertakings (CIUs)	-	-	-	-
Other items	22.9	1.8	21.8	1.7
Total Credit Risk	**3,896.4**	**311.7**	**3,096.0**	**247.7**
Counterparty Credit Risk	**9.3**	**0.7**	**5.1**	**0.4**
Operational Risk (5)	**4.1**	**0.3**	**241.6**	**19.3**
Credit Valuation Adjustment	**302.0**	**24.2**	**5.8**	**0.5**
Total Pillar 1/Risk Weighted Assets	**4,211.8**	**336.9**	**3,348.5**	**267.9**

Notes:
[1] Excluding those assessed as short-term claims on institutions.
[2] Excluding those assessed as short-term claims on corporates. Includes funding line secured by non mortgage assets and intercompany balances outside the solo consolidated group.
[3] Exposures in default are accounts which are non-performing in accordance with IFRS 9.
[4] In 2017 deferred tax asset moved to Central Government and Central Banks recognising HMRC as the counterparty
[5] 2017 is under the Standardised Approach for Operational Risk. 2017 has been updated for rounding differences.

Large Exposures

The Group tracks its exposures by connection and regularly reports on its largest exposures, those exceeding £3.0m, to the Credit Committee, Risk Committee, and Board*.

As of 31 December 2018, there were 108 connections over £3.0m with a total net exposure of £781.1m. Of these, 90 were allocated provisions under IFRS9, and had a total carrying value of £639.9m and provision of £0.5m.

Connections within the large exposure list are reviewed monthly by the Credit Committee. While the emphasis is on non-performing assets where the Group's actions will have the most impact, the credit profile of large performing connections is also monitored closely to help anticipate any problems.

*Note: This report covers connections that are not defined as large exposures under article 392 of the CRR, for which the threshold is 10 per cent of total capital resources. Exposures below £3.0m are reported at the discretion of the risk team.

Overall Pillar 2 Rule

Additional capital is held under Pillar 2 for risks either not captured or not fully captured under Pillar 1.

At least annually the Group undertakes a detailed, forward-looking assessment of capital adequacy in order to assess the Pillar 2 capital requirement. This exercise is known as the ICAAP. Based on the results of the ICAAP the PRA determines the Group's required capital and supervisory buffers which include the countercyclical capital buffer, the capital conservation buffer and the PRA buffer. It is the Group's policy to hold capital resources in excess of its capital requirements as set by the PRA.

Capital is allocated to businesses in the Board approved Capital Strategy and Plan. The Capital Strategy and Plan is updated at least annually with the associated capital forecasts updated on a monthly basis and reviewed by the ALCO, Risk Committee and Board. The refreshed forecasts reflect the impact of actual performance to that time and any actual or anticipated changes in the business, capital requirements or other changes. Capital forecasts are also produced in circumstances where a potential impact to capital may occur such as revised budget forecasts or in the course of evaluating a substantial acquisition.

Capital Buffers

The Group's business is predominantly in the United Kingdom where the countercyclical capital buffer was 1% as of 31 December 2018. The Group used a fully loaded capital conservation buffer of 2.5% in its risk appetite capital requirements in 2018 as this became compulsory in 2019.

Counterparty risk

Group wholesale counterparty risk through Treasury dealing is concentrated in two main areas. Deposits with institutions and to a lower extent mark to market exposures with derivative counterparties.

Cash deposit exposures are controlled through Board approved limits to banks and selected building societies rated at least investment grade. Counterparty ratings are monitored by Treasury and reviewed monthly by ALCO.

Counterparty risk is mitigated with derivative counterparties that have Collateral Service Agreements (CSA) in place. Regular derivative valuations allow the Group to assess exposures and call for margin when it exceeds threshold tolerances.

Identification and measurement of impairment

During 2018, the Group used the IFRS 9 three stage 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 no significant increase in credit risk since initial recognition.
- Stage 2 – a lifetime loss allowance is held for assets where a significant increase in credit risk 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 the 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 individually assesses provisioning process for loans over £0.5m which are more than three months in arrears, where LPA receivers are 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 effective interest rate (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 significant increase in credit risk 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 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 (SICR) (movement to stage 2)

The Group's transfer criteria determines what constitutes a significant increase in credit risk, which results in an exposure being moved from stage 1 to stage 2.

At the point of recognition a loan is assigned a lifetime PD estimate. For each monthly reporting date thereafter an updated lifetime PD estimate is computed for the life of the loan. The Group's transfer criteria analyses relative changes in lifetime PD versus the origination lifetime PD, where if prescribed thresholds are met, an account will be transferred from stage 1 to stage 2.

IFRS 9 includes a rebuttable presumption that if an account is more than 30 days past due it has experienced a significant increase in credit risk. 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 will be 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 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 ECL 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. At present, the most significant macroeconomic factors relate to the HPI, unemployment and the Bank of England Base Rate.

The Group has derived an approach for factoring probability weighted macroeconomic forecasts into ECL calculations, adjusting PD and LGD estimates. An account's lifetime PD is impacted by the probability weighted macroeconomic scenario and therefore impacts whether an account meets the Group's SICR transfer criteria moving the exposure between stage 1 and stage 2. The macroeconomic scenarios feed directly into the ECL calculation, as the adjusted PD, lifetime PD and LGD estimates are used within the individual account ECL allowance calculations.

The Group currently does not have an in-house economics function and therefore sources economic forecasts from an appropriately qualified third party. The Group will consider a minimum of three probability weighted scenarios, including base, upside and downside scenarios. During 2018 a fourth scenario was introduced relating specifically to a disorderly no-deal Brexit outcome.

The base case is also utilised within the Group's impairment forecasting process which in turn feeds the wider business planning processes. This economic forecast is also used to set the Group's credit risk appetite thresholds and limits.

Expected life

IFRS 9 requires lifetime ECL to be measured over the expected life. Currently the Group considers the loan's behavioural life is equal to the full mortgage term. This approach will continue to be monitored and enhanced if and when deemed appropriate.

Purchase or originated credit impaired (POCI)

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 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 probability of default (PD) and a loss given default (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 (i.e. loss of employment). This EP is then considered within a wider observation period utilised to model the time taken post loss event for the customer to reach a default state.

Loans and the related provision are written off when the underlying security is sold or an unsecured loan customer has not paid for 12 months. Subsequent recoveries of amounts previously written off are taken through profit or loss.

The Group classifies a loan as forborne at the point a concession is granted based on the deteriorated financial status of the borrower. Accounts are classified as forborne only for the period of time which the loan is known to be, or may still be, in financial difficulty. When the borrower is no longer experiencing financial difficulties the loan will revert to standard terms. If the forbearance eliminates the arrears, the loan is no longer considered past due.
None of the currently used forbearance measures modify the overall cash flows to an extent that requires derecognition of the existing and recognition of a new loan under IAS 39.

Loans that have ever had forbearance applied are assigned a higher PD in the collective provision calculation.
Forborne accounts are not treated differently in relation to impairments in any other way.

The following tables analyse impaired loans as treated for accounting purposes and past due loans as treated for regulatory purposes as at 31 December 2018.

Table 8a: Gross loans in default by counterparty type

Counterparty type		2018 Gross loans in default £m	2017 Gross impaired loans £m
Individuals	Stage 3	197.4	-
	Stage 3 (POCI)	56.2	-
	IAS39	-	61.9
SME	Stage 3	28.0	-
	Stage 3 (POCI)	-	-
	IAS39	-	19.7
Total		**281.6**	**81.6**

Table 8b: Past due loans by counterparty type

Counterparty type		2018 Gross past due loans £m	2017 Gross past due loans £m
Individuals	Stage 3	101.9	-
	Stage 3 (POCI)	24.2	-
	IAS39	-	106.9
SME	Stage 3	9.1	-
	Stage 3 (POCI)	-	-
	IAS39	-	20.5
Total		**135.2**	**127.4**

Table 8c: Provisions by counterparty type

Counterparty type		2018 Impairment provisions £m	2017 Impairment provisions £m
Individuals	Stage 1	2.9	-
	Stage 2	4.9	-
	Stage 3	7.3	-
	Stage 3 (POCI)	1.6	-
	IAS39	-	11.3
SME	Stage 1	1.5	-
	Stage 2	0.7	-
	Stage 3	3.0	-
	Stage 3 (POCI)	-	-
	IAS39	-	10.3
Total		**21.9**	**21.6**

Table 8d: Provision charges by counterparty type

Counterparty type	2018 Charges for impairment provisions during the year £m	2017 Charges for impairment provisions during the year £m
Individuals	6.2	2.1
SME	1.9	2.2
Other	-	-
Total	**8.1**	**4.3**

Notes:
- The 2017 counterparty labels have been reclassified and rounding's updated.
- The gross loans in default are defined as loans in Stage 3, Stage 3 (POCI) and include possessions.

Table 9a: Impaired loans by geographic area

Geographic area		2018 Gross impaired loans £m	2017 Gross impaired loans £m
UK	Stage 3	182.7	-
	Stage 3 (POCI)	56.2	-
	IAS39	-	58.8
Channel Islands	Stage 3	42.7	-
	Stage 3 (POCI)	-	-
	IAS39	-	22.8
Total		**281.6**	**81.6**

Table 9b: Past due loans by geographic area

Geographic area		2018 Gross past due loans £m	2017 Gross past due loans £m
UK	Stage 3	93.9	-
	Stage 3 (POCI)	24.3	-
	IAS39	-	102.0
Channel Islands	Stage 3	17.0	-
	Stage 3 (POCI)	-	-
	IAS39	-	25.5
Total		**135.2**	**127.5**

Table 9c: Provisions by geographic area

Geographic area		2018 Impairment provisions £m	2017 Impairment provisions £m
UK	Stage 1	4.3	-
	Stage 2	5.3	-
	Stage 3	7.2	-
	Stage 3 (POCI)	1.6	-
	IAS39	-	16.0
Channel Islands	Stage 1	0.2	-
	Stage 2	0.3	-
	Stage 3	3.0	-
	Stage 3 (POCI)	-	-
	IAS39	-	5.6
Total		**21.9**	**21.6**

Table 9d: Provision charges by geographic area

Geographic area	2018 Charges for impairment provisions during the year £m	2017 Charges for impairment provisions during the year £m
UK	7.1	2.2
Channel Islands	1.0	2.1
Total	**8.1**	**4.3**

Notes:
- The 2017 counterparty labels have been reclassified.
- The gross loans in default are defined as loans in Stage 3, Stage 3 (POCI) and include possessions.

Table 10: Reconciliation of changes in provisions

2018 Impairment provisions	**£m**
Opening balance as at 1 January 2017	21.6
IFRS 9 transitional adjustment	3.6
Originations	2.1
Redemptions and write-offs	(7.7)
Remeasurement of loss allowance	4.8
Changes in assumptions and model parameters	(2.5)
31 December 2018	**21.9**

2017 Impairment provisions	**£m**
Opening balance as at 1 January 2017	25.0
Originations	4.4
Redemptions and write-offs	(7.8)
Disposals	-
Transfers between reserves	-
31 December 2017	**21.6**

Note: Impairment provisions include both collective and specific provisions

Credit risk exposure breakdowns

The following tables show the Group's credit risk exposure as at 31 December 2018.

Table 11: Year end and average exposure by exposure class

Standardised Exposure Classes	Exposure at 31/12/2018 £m	Average exposure (1) in 2018 £m	Exposure at 31/12/2017 £m	Average exposure (1) in 2017 £m
Central government and central banks	1,357.1	1,261.6	1,149.5	656.1
Regional governments or local authorities	-	-	-	-
Administrative bodies and non-commercial	-	-	-	-
Multilateral development banks	19.1	19.1	19.1	21.1
International organisations	-	-	-	-
Institutions (2)	21.9	26.6	23.1	32.3
Corporates (3)	88.7	54.3	25.4	25.6
Retail	13.3	3.0	0.9	3.6
Secured by mortgages on residential property	8,005.7	7,314.7	6,726.3	5,992.9
Secured by mortgages on commercial real estate	586.9	471.2	394.8	348.2
Exposures in default (4)	271.0	238.2	108.0	103.9
High risk	155.8	149.4	143.8	145.5
Covered bonds	-	-	-	-
Securitisation positions	-	-	-	-
Short-term claims on institutions and corporates	-	-	-	-
Collective Investment Undertakings (CIUs)	-	-	-	-
Other items	22.2	25.4	21.6	57.0
Total	**10,541.7**	**9,563.5**	**8,612.5**	**7,386.2**

Notes:
[1] Average exposure is a simple average of quarterly figures.
[2] Excluding those assessed as short-term claims on institutions.
[3] Excluding those assessed as short-term claims on corporates. Includes funding line secured by non mortgage assets and intercompany balances outside the solo consolidated group.
[4] Exposures in default are accounts which are non-performing in accordance with IFRS 9.

Table 12: Exposures by geographic area and material exposure classes

2018

Standardised Exposure Classes (1)	UK £m	Channel Islands £m	Rest of the World £m	Total £m
Central government and central banks	1,357.1	-	-	1,357.1
Regional governments or local authorities	-	-	-	-
Administrative bodies and non-commercial	-	-	-	-
Multilateral development banks	-	-	19.1	19.1
International organisations	-	-	-	-
Institutions (2)	21.9	-	-	21.9
Corporates (3)	88.7	-	-	88.7
Retail	13.3	-	-	13.3
Secured by mortgages on residential property	7,821.4	184.3	-	8,005.7
Secured by mortgages on commercial real estate	576.2	10.7	-	586.9
Exposures in default (4)	228.3	42.7	-	271.0
High risk	155.8	-	-	155.8
Covered bonds	-	-	-	-
Securitisation positions	-	-	-	-
Short-term claims on institutions and corporates	-	-	-	-
Collective Investment Undertakings (CIUs)	-	-	-	-
Other items	22.2	-	-	22.2
Total	**10,284.9**	**237.7**	**19.1**	**10,541.7**

2017

Standardised Exposure Classes (1)	UK £m	Channel Islands £m	Rest of the World £m	Total £m
Central government and central banks	1,149.5	-	-	1,149.5
Regional governments or local authorities	-	-	-	-
Administrative bodies and non-commercial	-	-	-	-
Multilateral development banks	-	-	19.1	19.1
International organisations	-	-	-	-
Institutions (2)	23.1	-	-	23.1
Corporates (3)	25.4	-	-	25.4
Retail	0.9	-	-	0.9
Secured by mortgages on residential property	6,464.6	261.7	-	6,726.3
Secured by mortgages on commercial real estate	383.1	11.7	-	394.8
Exposures in default (4)	87.9	20.1	-	108.0
High risk	143.8	-	-	143.8
Covered bonds	-	-	-	-
Securitisation positions	-	-	-	-
Short-term claims on institutions and corporates	-	-	-	-
Collective Investment Undertakings (CIUs)	-	-	-	-
Other items	15.7	-	5.9	21.6
Total	**8,294.0**	**293.5**	**25.0**	**8,612.5**

Notes:
[1] Credit risk categories shown reflect PRA reporting.
[2] Excluding those assessed as short-term claims on institutions.
[3] Excluding those assessed as short-term claims on corporates. Includes funding line secured by non mortgage assets and intercompany balances outside the solo consolidated group.
[4] Exposures in default are accounts which are non-performing in accordance with IFRS 9

Table 13: Exposures by significant counterparty type and exposure classes

2018

Standardised Exposure Classes	Corporate (3) £m	Retail (3) £m	Other £m	Total £m
Central government and central banks	1,357.1	-	-	1,357.1
Regional governments or local authorities	-	-	-	-
Administrative bodies and non-commercial	-	-	-	-
Multilateral development banks	19.1	-	-	19.1
International organisations	-	-	-	-
Institutions (1)	21.9	-	-	21.9
Corporates (2)	88.7	-	-	88.7
Retail (3)	13.2	0.2	-	13.4
Secured by mortgages on residential property	2,627.1	5,378.6	-	8,005.7
Secured by mortgages on commercial real estate	311.9	275.0	-	586.9
Exposures in default	25.3	245.6	-	270.9
High risk	155.8	-	-	155.8
Covered bonds	-	-	-	-
Securitisation positions	-	-	-	-
Short-term claims on institutions and corporates	-	-	-	-
Collective Investment Undertakings (CIUs)	-	-	-	-
Other items	-	-	22.2	22.2
Total	**4,620.1**	**5,899.4**	**22.2**	**10,541.7**

2017

Standardised Exposure Classes	Corporate (3) £m	Retail (3) £m	Other £m	Total £m
Central government and central banks	1,149.5	-	-	1,149.5
Regional governments or local authorities	-	-	-	-
Administrative bodies and non-commercial	-	-	-	-
Multilateral development banks	19.1	-	-	19.1
International organisations	-	-	-	-
Institutions (1)	23.1	-	-	23.1
Corporates (2)	25.4	-	-	25.4
Retail (3)	-	0.9	-	0.9
Secured by mortgages on residential property	1,552.0	5,174.3	-	6,726.3
Secured by mortgages on commercial real estate	200.9	193.9	-	394.8
Exposures in default	10.3	97.7	-	108.0
High risk	143.8	-	-	143.8
Covered bonds	-	-	-	-
Securitisation positions	-	-	-	-
Short-term claims on institutions and corporates	-	-	-	-
Collective Investment Undertakings (CIUs)	-	-	-	-
Other items	-	-	21.6	21.6
Total	**3,124.1**	**5,466.8**	**21.6**	**8,612.5**

Notes:
[1] Excluding those assessed as short-term claims on institutions.
[2] Excluding those assessed as short-term claims on corporates. Includes funding line secured by non mortgage assets intercompany balances outside the solo consolidated group.
[3] A counterparty is classified as retail when they meet the regulatory definition of retail and are classified as corporate when they do not meet the regulatory definition of retail.

Table 14: Exposures by residual maturity breakdown

2018

Standardised Exposure Classes	< 3 months £m	3 months to 1 year £m	1 to 5 years £m	> 5 years £m	Total £m
Central government and central banks	1,355.1	-	2.0	-	1,357.1
Regional governments or local authorities	-	-	-	-	-
Administrative bodies and non-commercial	-	-	-	-	-
Multilateral development banks	-	19.1	-	-	19.1
International organisations	-	-	-	-	-
Institutions (1)	21.9	-	-	-	21.9
Corporates (2)	37.0	41.8	9.9	-	88.7
Retail	5.0	1.1	5.6	1.6	13.3
Secured by mortgages on residential property	167.1	124.8	300.0	7,413.8	8,005.7
Secured by mortgages on commercial real estate	37.1	36.9	139.0	373.9	586.9
Exposures in default	17.1	3.0	24.2	226.7	271.0
High risk	45.3	65.6	44.9	-	155.8
Covered bonds	-	-	-	-	-
Securitisation positions	-	-	-	-	-
Short-term claims on institutions and corporates	-	-	-	-	-
Collective Investment Undertakings (CIUs)	-	-	-	-	-
Other items	5.8	-	15.9	0.5	22.2
Total	**1,691.4**	**292.3**	**541.5**	**8,016.5**	**10,541.7**

2017

Standardised Exposure Classes	< 3 months £m	3 months to 1 year £m	1 to 5 years £m	> 5 years £m	Total £m
Central government and central banks	1,146.9	-	2.6	-	1,149.5
Regional governments or local authorities	-	-	-	-	-
Administrative bodies and non-commercial	-	-	-	-	-
Multilateral development banks	-	-	19.1	-	19.1
International organisations	-	-	-	-	-
Institutions (1)	23.1	-	-	-	23.1
Corporates (2)	0.7	24.7	-	-	25.4
Retail	-	0.1	0.8	-	0.9
Secured by mortgages on residential property	135.0	96.1	225.0	6,270.2	6,726.3
Secured by mortgages on commercial real estate	33.2	7.4	71.7	282.5	394.8
Exposures in default	8.2	1.8	9.9	88.1	108.0
High risk	49.2	46.5	48.1	-	143.8
Covered bonds	-	-	-	-	-
Securitisation positions	-	-	-	-	-
Short-term claims on institutions and corporates	-	-	-	-	-
Collective Investment Undertakings (CIUs)	-	-	-	-	-
Other items	21.1	-	-	0.5	21.6
Total	**1,417.4**	**176.6**	**377.2**	**6,641.3**	**8,612.5**

Notes:
[1] Excluding those assessed as short-term claims on institutions.
[2] Excluding those assessed as short-term claims on corporates. Includes funding line secured by non mortgage assets and intercompany balances outside the solo consolidated group.

Use of External Credit Assessment Institutions (ECAIs)

The Group subscribes to Fitch Ratings (Fitch), a PRA recognised ECAI. Ratings assessments provided by Fitch are used by the Group to establish counterparty credit risk weightings using the PRA standardised approach.

The tables below map the ECAI's credit assessment ratings to credit quality steps in order to establish the appropriate risk weightings for the rated credit exposures.

Table 15: Exposures by Credit Quality Step

Institutions (incl. banks) *						
Credit Quality Step	**Fitch**	**Moody**	**S&P**	**Risk Weight**	**Exposure 2018 £m**	**Exposure 2017 £m**
1	AAA to AA-	AAA to AA-	Aaa to Aa3	20%	25.2	1.3
2	A+ to A-	A+ to A-	A1 to A3	50%	17.2	32.4
3	BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	100%	-	-
4	BB+ to BB-	BB+ to BB-	Ba1 to Ba3	100%	-	-
5	B+ to B-	B+ to B-	B1 to B3	100%	-	-
6	CCC+ and below	CCC+ and below	Caa1 and below	150%	-	-
Total					**42.4**	**33.7**

* Excluding those assessed as short-term claims on institutions and corporates

Short term claims on Institutions and Corporates

Credit Quality Step	Fitch	Moody	S&P	Risk Weight	Exposure 2018 £m	Exposure 2017 £m
1	AAA to AA-	AAA to AA-	Aaa to Aa3	20%	-	-
2	A+ to A-	A+ to A-	A1 to A3	20%	-	-
3	BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	20%	-	-
4	BB+ to BB-	BB+ to BB-	Ba1 to Ba3	50%	-	-
5	B+ to B-	B+ to B-	B1 to B3	50%	-	-
6	CCC+ and below	CCC+ and below	Caa1 and below	150%	-	-
Total					**-**	**-**

Interest Rate Risk in the Non-trading Book

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. In addition, the regulatory scenario of an un-floored parallel shift of 200bps in both directions is applied. After taking into account

the derivatives entered into by the Group, the maximum 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 Standard Variable rate (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.

Asset Encumbrance

As a part of its business strategy, assets are encumbered as part of the Group's funding arrangements. The Group's risk appetite limits the overall amount of assets that can be encumbered. ALCO monitors the current and projected future asset encumbrance profile of the Group on a monthly basis. Additional information on asset encumbrance can be found in Appendix I - Disclosure on Asset Encumbrance.

Operational Risk

The operational risk capital requirement is calculated under the Standardised Approach which is calculated as a blend of 12 per cent of the three-year average of the Group's annual gross income relating to its retail business as defined by the CRR and of 15 per cent of the three-year average of the Group's annual gross income relating to its commercial business.

For 2016 and prior years, the operational risk capital requirement is calculated under the Basic Indicator Approach as 15 per cent of the three-year average of the Group's annual gross income, excluding any negative or zero values.

In addition, the Group maintains levels of operational risk capital consistent with any Pillar 2A adjustment identified through the ICAAP.

Remuneration

Remuneration Policy disclosures in accordance with Article 450 of the CRR (Regulation of the European Parliament and the Council on prudential requirements for credit institutions and investment firms (Regulation (EU) No 575/2013) and amending Regulation (EU) No 648/2012).

This remuneration disclosure is a requirement under Article 450 of the CRR, which applies to companies within the definition of Significant IFPRU firm (FCA/PRA Combined View IFPRU 1.2).

Remuneration policies and practices for categories of staff whose professional activities have a material impact on the Company's risk profile (Material Risk Takers)

Decision-making process

The Remuneration Committee of the Board of OneSavings Bank plc is responsible for governance of remuneration for Executive Directors and other Material Risk Takers. The Remuneration Committee (the Committee) currently comprises three independent Non-Executive Directors; Mary McNamara (Chair), Rod Duke and David Weymouth.

The Committee met six times during the financial year 2018.

The Committee has responsibility for setting and reviewing the remuneration policy and determining pay levels and structure for senior management including Executive Directors and Material Risk Takers. In determining the remuneration policy the Committee takes into account all factors which it deems necessary (including relevant legal and regulatory requirements, the provisions and recommendations of the UK Corporate Governance Code ("Code") and associated guidance). The terms of reference of the Committee are available at www.osb.co.uk.

The Committee obtains independent external advice from Korn Ferry, a consultancy specialising in executive remuneration design. Korn Ferry does not have any other connection to the Company. The Committee also considers advice from the Chairman of the Board, CEO, CFO, HR Director, CRO, Risk Committee and the Group General Counsel and Company Secretary as relevant (though not in relation to their own remuneration). The Committee takes account of the overall approach to reward employees in the Company as a whole when designing the pay structures for Executive Directors and other Material Risk Takers. The Committee engages proactively with major shareholders through consultation on material changes to remuneration policy relating to Executives Directors.

The link between pay and performance

The Committee has approved remuneration principles which support a clear link between pay and performance. These principles govern the design of pay structures within the Group and include:

- striking an appropriate balance between risk taking and reward;
- encouraging and supporting a strong culture of service and delivery;
- aligning employees' interests with those of shareholders and customers;
- rewarding the achievement of the overall business objectives of the Group; and
- guarding against inappropriate risk taking.

The Group's pay and incentive structures (outlined below) reflect these principles. In addition, to enhance the link between pay and performance, a significant proportion of remuneration for members of the ExCo is delivered in OneSavings Bank plc shares and deferred, with the final value dependent on the price of the underlying shares at the time of vesting. Executive Directors are also subject to share ownership guidelines and are required to build up their ownership of shares in the Company. (See share ownership requirements on page 55)

The Committee has implemented a Remuneration Policy, which was approved by shareholders of OneSavings Bank plc in May 2018, in accordance with the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2018 and has been developed taking into account a number of regulatory and governance principles, including:

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

Remuneration Structures and their purpose

This section sets out the key elements of pay for Material Risk Takers, their purpose, and detail on the quantum of variable pay awards and an explanation of the performance conditions which are used.

Fixed pay

In order to attract and retain individuals of a suitable calibre, Material Risk Takers are paid fixed pay components of base salary, pension contribution (or equivalent cash allowance) and fringe benefits which may include a car allowance, medical and life insurance or income protection. These elements are set at a level so as to ensure that there is not an excessive dependence on variable remuneration.

Executive Bonus Scheme (EBS), including the Deferred Share Bonus Plan (DSBP)

Members of the ExCo are eligible to receive awards under the EBS. The purpose of the EBS is to incentivise and reward individuals for the achievement of pre-defined annual financial and operational objectives which are approved by the Committee and are closely linked to the corporate strategy.

The maximum award for Executive Directors is 150% of base salary for excellent performance. The cap for other Material Risk Takers is set by reference to the role and grade within the organisation, but no employee is eligible for a bonus above 100% of salary. Under this scheme, a minimum of 90% of the award is subject to achievement against the Business Balanced Scorecard (BBS). The BBS contains a broad range of metrics so as to provide a comprehensive reflection of performance in all key areas of the business, including a strong focus on customer, staff and quality indicators. The remaining proportion of the award is based on personal performance targets.

Prior to approving awards under the EBS, the Committee receives confirmation from the Risk Committee that the Company has operated within the Board's approved risk framework for the year under review and that the indicative award is appropriate in this context.

For 2018, the performance conditions for Executive Directors in the BBS which comprised 90% of the award were:

- 50% Financial (underlying PBT, all-in ROE, cost to income ratio, net loan book growth, CET1 ratio)
- 15% Customer (customer satisfaction, broker satisfaction, complaints)
- 15% Quality (overdue management actions, arrears, high severity incidents)
- 10% Staff (diversity and employee engagement)

The remaining elements of the award (10%) were based on the Executive Directors' personal performance.

The objectives in the scorecard, and the weightings on each element, will be set annually and varies for members of the ExCo. The weightings may also be flexed according to role (e.g. Material Risk Takers in the Risk and Compliance functions have a significantly higher weighting on Compliance, Credit & Operational Risk).

Executive Directors and members of the ExCo defer 50% of any bonus into shares under the DSBP for three years. These deferred shares vest subject to continued employment and the malus provisions outlined below.

Annual bonus

Below the ExCo, other Material Risk Takers participate in the management bonus plan. Under this plan, performance is assessed against a matrix of individual and corporate performance factors.

The majority of other Code Staff will receive 50% of their bonus as deferred shares over a period of three years under the DSBP.

Performance Share Plan

Members of the ExCo are eligible for awards under the Performance Share Plan (PSP), although this is not cascaded to all Material Risk Takers. The purpose of the PSP is to incentivise and recognise execution of the business strategy over the longer term and reward strong financial performance over a sustained period, and provide a strong equity component to the remuneration package.

The performance conditions will continue to be partly driven by Earnings Per Share (EPS) (40% weighting), and Total Shareholder Return (TSR) (40% weighting) and, since 2018, return on equity (ROE) (20% weighting) to drive and reward the efficient use of capital. The ROE measure will focus on profitable growth and continued stock market outperformance (relative TSR vs the FTSE250 constituents). The Performance criteria for PSP awards granted in 2018 are set out in the table below.

Performance level	EPS element (40% of total award)	TSR element (40% of total award)	Return on Equity (20% of total award)	% of that part of the award vesting
Below 'threshold'	Less than 6% CAGR	Below median	Below 20%	0%
'Threshold'	6% CAGR	Median	20%	25%
'Stretch'	12% CAGR	Upper quartile	25%	100%
Pro-rata vesting in between the above points				

At the time of vesting, the Committee will assess whether the formulaic vesting outcome is aligned with the underlying financial and non-financial performance, risk appetite and individual conduct over the period.

Share ownership requirements

Members of ExCo are also required to build and maintain a shareholding in the Company. The CEO is required to accumulate and maintain 250%, the CFO 200% and other members of ExCo 100% of base salary. 50% of any vested share awards must be retained until the guideline is achieved.

Malus and Clawback

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

Ratios between fixed and variable remuneration

The shareholders of OneSavings Bank plc have approved an increase to the variable pay of its Material Risk Takers to two times fixed pay, where legislation requires that pay is capped.

Additional information on Directors' remuneration

Additional guidance on Directors' remuneration is available on pages 90-105 of the 2018 Annual Report and Accounts.

Aggregate quantitative information on remuneration

Table 16 below provides aggregate quantitative information set out in accordance with clauses 1(h) (i) to (vi) of CRR Article 450.

Table 16: Code staff aggregate remuneration

2018

2018 Remuneration		Executive Directors	Non-Executive Directors	Retail Banking	Independent Control Functions	Corporate Functions
Senior management	Total Remuneration	£3,405,385	£661,885	£2,585,046	£1,176,701	£1,098,028
	Number of Staff	2	7	4	2	2
Other Code Staff	Total Remuneration	-	-	£3,338,331	£990,082	£1,930,173
	Number of Staff	-	-	20	6	11

2017

2017 Remuneration		Executive Directors	Non-Executive Directors	Retail Banking	Independent Control Functions	Corporate Functions
Senior management	Total Remuneration	£2,529,036	£697,084	£2,456,920	£946,174	£828,724
	Number of Staff	2	10	4	2	2
Other Code Staff	Total Remuneration	-	-	£3,043,649	£685,937	£1,639,114
	Number of Staff	-	-	19	7	11

Appendix I - Disclosure on Asset Encumbrance

Template A - Assets

2018

		Carrying amount of encumbered assets		Fair value of encumbered assets		Carrying amount of unencumbered assets		Fair value of unencumbered assets	
		£m	of which notionally eligible EHQLA and HQLA	£m	of which notionally eligible EHQLA and HQLA	£m	of which EHQLA and HQLA	£m	of which EHQLA and HQLA
		010	030	040	050	060	080	090	100
010	**Assets**	2,589.1	2,566.6			7,149.6	1,270.0		
030	Equity instruments					0.5			
040	Debt securities	4.0	4.0	4.0	4.0	15.1	15.1	15.1	15.1
050	of which: covered bonds								
060	of which: asset-backed securities								
070	of which: issue by general governments								
080	of which: issue by financial corporations	4.0	4.0	4.0	4.0	15.1	15.1	15.1	15.1
090	of which: issue by non-financial corporations								
120	Other assets					74.9			
121	of which: …								

2017

		Carrying amount of encumbered assets		Fair value of encumbered assets		Carrying amount of unencumbered assets		Fair value of unencumbered assets	
		£m	of which notionally eligible EHQLA and HQLA	£m	of which notionally eligible EHQLA and HQLA	£m	of which EHQLA and HQLA	£m	of which EHQLA and HQLA
		010	030	040	050	060	080	090	100
010	**Assets**	1,862.3	1,812.9			5,645.2	620.4		
030	Equity instruments					0.5			
040	Debt securities					19.1	19.1	19.1	19.1
050	of which: covered bonds								
060	of which: asset-backed securities								
070	of which: issue by general governments								
080	of which: issue by financial corporations					19.1	19.1	19.1	19.1
090	of which: issue by non-financial corporations								
120	Other assets					72.7			
121	of which: …								

Template B - Collateral received

2018

		Fair value of encumbered collateral received or own debt securities issued		Fair value of collateral received or own debt securities issued available for encumbrance	
		£m	of which notionally eligible EHQLA and HQLA	£m	of which EHQLA and HQLA
		010	030	040	060
130	**Collateral received**				
140	Loans on demand				
150	Equity instruments				
160	Debt securities				
170	of which: covered bonds				
180	of which: asset-backed securities				
190	of which: issue by general governments				
200	of which: issue by financial corporations				
210	of which: issue by non-financial corporations				
220	Loans and advances other than loans on demand				
230	Other collateral received				
231	of which: …				
240	**Own debt securities issued other than own covered bonds or ABSs**				
241	**Own covered bonds and asset-backed securities issued and not yet pledged**				
250	**TOTAL ASSETS, COLLATERAL RECEIVED AND OWN DEBT SECURITIES ISSUED**	1,588.9	1,500.0		

Note: Total Assets, Collateral Received and Own Debt Securities Issued' represents the total carrying amount of 'Encumbered Assets of the Reporting Institution of Template A and 'Collateral received' and 'Own Debt Securities Issued of Template B.

2017

		Fair value of encumbered collateral received or own debt securities issued		Fair value of collateral received or own debt securities issued available for encumbrance	
		£m	of which notionally eligible EHQLA and HQLA	£m	of which EHQLA and HQLA
		010	030	040	060
130	**Collateral received**	25.0		908.3	908.3
140	Loans on demand				
150	Equity instruments				
160	Debt securities	25.0		389.6	389.6
170	of which: covered bonds				
180	of which: asset-backed securities				
190	of which: issue by general governments	25.0		389.6	389.6
200	of which: issue by financial corporations				
210	of which: issue by non-financial corporations				
220	Loans and advances other than loans on demand			551.3	551.3
230	Other collateral received				
231	of which: …				
240	**Own debt securities issued other than own covered bonds or ABSs**				
241	**Own covered bonds and asset-backed securities issued and not yet pledged**				
250	**TOTAL ASSETS, COLLATERAL RECEIVED AND OWN DEBT SECURITIES ISSUED**	1,860.3	1,812.9		

Template C-Encumbered assets/collateral received and associated liabilities

2018

		Matching liabilities, contingent liabilities or securities lent £m	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m
		010	030
010	**Carrying amount of selected financial liabilities**	**1527.3**	**2572.5**
011	of which ...	1527.3	2572.5

2017

		Matching liabilities, contingent liabilities or securities lent £m	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m
		010	030
010	**Carrying amount of selected financial liabilities**	**686.3**	**1336.1**
011	of which ...	686.3	1336.1

Note: The values are a median of four quarter end balances.

Template D- Information on importance of encumbrance

Assets are encumbered as part of the Group's funding arrangements. The main activities relate to securitisation, repurchase agreements, the Funding for Lending Scheme (FLS) and the Term Funding Scheme (TFS). The Group also holds encumbered assets in the form of the required cash ratio deposit with the Bank of England. Other Assets items are deemed not able to be encumbered include intangible assets, deferred tax asset, property, plant and equipment, derivative assets and sundry debtors. The Group's ALCO reviews the asset encumbrance of the institution as a whole on a monthly basis and any events causing change in the asset encumbrance level are examined.

Appendix II - Own Funds

Disclosure of the Group's own funds for the current year comparing the transitional rules position to the final CRD IV rules. The main difference is the grandfathering of £10,000k of tier 2 instruments that are amortising down to nil by 2024.

OneSavings Bank plc	**£m**	**£m**	**£m**	**£m**
Common Equity Tier 1 capital: instruments and reserves	**31/12/2018**	**Final CRD IV**	**31/12/2017**	**Final CRD IV**
Capital instruments and the related share premium accounts	**172.4**	**172.4**	**172.2**	**172.2**
of which: Common shares	2.4	2.4	2.4	2.4
Retained earnings	439.6	439.6	337.5	337.5
Accumulated other comprehensive income (and any other reserves)	-13.3	-13.3	-12.9	-12.9
Common Equity Tier 1 (CET1) capital before regulatory adjustments	**598.7**	**598.7**	**496.8**	**496.8**
Common Equity Tier 1 (CET1) capital: regulatory adjustments				
Foreseeable dividends	-25.2	-25.2	-22.6	-22.6
Solo consolidation adjustments	-5.4	-5.4	-4.8	-4.8
IFRS 9 transitional adjustments	2.7	2.7	-	-
Prudent Valuation adjustment	-0.1	-0.1	-	-
Goodwill and Other intangible assets (net of related tax liability)	-7.7	-7.7	-6.8	-6.8
Deferred tax assets that rely on future profitability excluding those arising from temporary difference	**-1.4**	**-1.4**	**-2.5**	**-2.5**
Total regulatory adjustments to Common Equity Tier 1 (CET1)	-37.1	-37.1	-36.7	-36.7
Common Equity Tier 1 (CET1) capital	561.6	561.6	460.1	460.1
Additional Tier 1 (AT1) capital	60.0	60.0	60.0	60.0
Tier **1 capital (T1 = CET1 + AT1)**	621.6	621.6	520.1	520.1
Tier 2 (T2) capital: instruments and provisions				
Subordinated loans	**47.4**	**47.4**	**47.7**	**47.7**
Credit risk adjustments	-	-	2.0	2.0
Tier 2 (T2) capital before regulatory adjustment	**47.4**	**47.4**	49.7	49.7
Tier 2 (T2) capital: regulatory adjustments				
of which holdings existing before 1 January 2013	**-3.3**	**-10.0**	**-2.5**	**-10.0**
Total **regulatory adjustments to Tier 2 (T2) capital**	-3.3	-10.0	-2.5	-10.0
Tier 2 (T2) capital	**44.1**	**37.4**	47.2	39.7
Total capital (TC = T1 **+ T2)**	665.7	659.0	567.3	559.8
Total risk-weighted exposures	4,211.8	4,211.8	3,348.5	3,348.5
Capital ratios and buffers				
Common Equity Tier 1 ratio	13.33%	13.33%	13.74%	13.74%
Tier 1 ratio	14.76%	14.76%	15.53%	15.53%
Total capital ratio	15.81%	15.65%	16.94%	16.72%
Applicable caps on the inclusion of provisions in Tier 2				
Credit risk adjustments included in T2 in respect of exposures subject to standardised approach (prior to the application of the cap)	0.0	0.0	2.0	2.0

Appendix III - Subordinated Debt Instruments

Capital instruments' main features template							
Issuer	OneSavings Bank plc	OneSavings Bank plc	OneSavings Bank plc	OneSavings Bank plc	OneSavings Bank plc	OneSavings Bank plc	OneSavings Bank plc
Unique identifier (e.g. CUSIP, ISIN or Bloomberg identifier for private placement)	-	GB00B67JQX63	GB00B61ZXL72	-	-	-	-
Governing law(s) of the instrument	England	England	England	England	England	England	England
Regulatory treatment							
Transitional CRR rules	AT1	Tier 2	Tier 2	Tier 2	Tier 2	Tier 2	Tier 2
Post-transitional CRR rules	AT1	Tier 2	Tier 2	Tier 2	Tier 2	Tier 2	Tier 2
Eligible at solo/(sub-)consolidated/solo & (sub-)consolidated	Solo consolidated	Solo consolidated	Solo consolidated	Solo consolidated	Solo consolidated	Solo consolidated	Solo consolidated
Instrument type (types to be specified by each jurisdiction)	Additional Tier 1	Subordinated Debt	Subordinated Debt	Subordinated Debt	Subordinated Debt	Subordinated Debt	Subordinated Debt
Amount recognised in regulatory capital (£)	60,000,000	15,000,000	22,000,000	2,500,000	5,000,000	322,722	240,000
Nominal amount of instrument (£)	60,000,000	15,000,000	22,000,000	5,000,000	5,000,000	322,722	240,000
Issue price	Par	Par	Par	Par	Par	Par	Par
Redemption price	Par	Par	Par	Par	Par	Par	Par
Accounting classification	Equity	Liabilities	Equity	Liabilities	Liabilities	Liabilities	Liabilities
Original date of issuance	25 May 2017	27 August 2004	07 March 2006	30 September 2016	30 September 2016	14 September 2012	14 September 2012
Perpetual or dated	Perpetual	Perpetual	Perpetual	Dated	Dated	Dated	Dated
Original maturity date	N/A	N/A	N/A	30 September 2019	27 September 2024	14 September 2022	14 September 2022
Issuer call subject to prior supervisory approval	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Optional call date, contingent call dates, and redemption amount	-	-	-	-	-	-	-
Subsequent call dates, if applicable	-	-	-	-	-	-	-
Coupons / dividends	-	-	-	-	-	-	-
Fixed or floating dividend/coupon	Fixed	Fixed	Fixed	Fixed	Fixed	Floating	Floating
Coupon rate and any related index	9.125000%	5.98840%	4.59910%	6.45000%	7.45000%	3.04994%	6.04994%
Existence of a dividend stopper	No	No	No	No	No	No	No
Fully discretionary, partially discretionary or mandatory (in terms of timing)	Partially discretionary	Mandatory	Mandatory	Mandatory	Mandatory	Mandatory	Mandatory
Fully discretionary, partially discretionary or mandatory (in terms of amount)	Partially discretionary	Mandatory	Fully discretionary	Mandatory	Mandatory	Mandatory	Mandatory
Existence of step up or other incentive to redeem	No	Yes	Yes	Yes	Yes	Yes	Yes
Noncumulative or cumulative	Non-cumulative	Cumulative	Cumulative	Cumulative	Cumulative	Cumulative	Cumulative
Convertible or non-convertible	Convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible
If convertible, conversion trigger(s)	CET1 capital ratio falls below 7.00%	-	-	-	-	-	-
If convertible, fully or partially	Partially	-	-	-	-	-	-
If convertible, conversion rate	Optional at holders' discretion	-	-	-	-	-	-
If convertible, mandatory or optional conversion	Optional at holders' discretion	-	-	-	-	-	-
If convertible, specify instrument type convertible into	Ordinary shares	-	-	-	-	-	-
If convertible, specify issuer of instrument it converts into	OneSavings Bank plc	-	-	-	-	-	-
Write-down features	-	-	-	-	-	-	-
If write-down, write-down trigger(s)	-	-	-	-	-	-	-
If write-down, full or partial	-	-	-	-	-	-	-
If write-down, permanent or temporary	-	-	-	-	-	-	-
If temporary write-down, description of write-up mechanism	-	-	-	-	-	-	-
Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	Perpetual subordinated debt	Dated subordinated debt	Dated subordinated debt	Unsecured & unsubordinated debt	Unsecured & unsubordinated debt	Unsecured & unsubordinated debt	Unsecured & unsubordinated debt
Non-compliant transitioned features	No	No	No	Yes	Yes	No	No
If yes, specify non-compliant features	-	-	-	-	-	-	-

Appendix IV: Leverage Ratio

Summary reconciliation of accounting assets and leverage ratio exposures

Item		2018 CRR leverage Ratio Exposure £m	2017 CRR leverage Ratio Exposure £m
1	Total assets as per published accounts	10,460.2	8,589.1
4	Adjustments for derivative financial instruments	0.3	(38.5)
5	Adjustment for securities financing transactions (SFTs)		
6	Adjustment for off-balance sheet items (ie conversation to credit equivalent amounts of off-balance sheet exposures)	130.0	98.7
7	Other adjustments	(12.8)	(17.9)
8	**Leverage ratio total exposure**	**10,577.7**	**8,631.4**

Leverage ratio common disclosure

On-balance sheet exposures (excluding derivatives and SFT's)

Item		2018 CRR leverage Ratio Exposure £m	2017 CRR leverage Ratio Exposure £m
	On-balance sheet items (excluding derivatives and , SFT's)		
1	On-balance sheet items (excluding derivatives, SFT's and fiduciary assets, but including collateral)	10,434.9	8,528.4
2	Asset amounts deducted in determining Tier 1 capital	(7.7)	(6.8)
3	**Total on-balance sheet exposures (excluding derivatives, SFT's and fiduciary assets)**	**10,427.2**	**8,521.6**
	Derivative exposures		
4	Replacement cost associated with all derivatives transactions (ie net of eligible cash variation margin)	12.1	6.3
5	Add-on amounts of PFE associated with all derivatives transactions (mark-to-market method)	8.4	4.8
11	**Total derivatives exposures**	**20.5**	**11.1**
	Other off-balance sheet exposures		
17	Off-balance sheet exposures at gross notional amount	710.8	530.2
18	(Adjustments for conversion to credit equivalent amounts)	(580.8)	(431.5)
19	**Other off-balance sheet exposures**	**130.0**	**98.7**
	Capital and total exposures		
20	**Tier 1 capital**	**621.6**	**520.1**
21	**Leverage ratio total exposure measure (sum of lines 3, 11, 19)**	**10,577.7**	**8,631.4**
	Leverage ratio		
22	**Leverage ratio**	**5.9%**	**6.0%**
EU-23	**Choice on transitional arrangements for the definition of the capital measure**	Fully phased in	Fully phased in

Split-up of on balance sheet exposures (excluding derivatives and SFTs)

		2018 CRR leverage Ratio Exposure £m	2017 CRR leverage Ratio Exposure £m
EU-1	**Total on-balance sheet exposures (excluding derivatives and SFTs)**	**10,577.7**	**8,631.4**
EU-2	Trading book exposures		
EU-3	Banking book exposures of which:	10,577.7	8,631.4
EU-5	Exposures treated as sovereigns	1,357.1	1,149.5
EU-6	Exposures to regional governments, MDB, international organisations and PSE **not** treated as sovereigns	19.1	19.1
EU-7	Institutions	42.4	34.2
EU-8	Secured by mortgages of immovable properties	8,592.7	7,121.1
EU-9	Retail exposures	13.3	0.9
EU-10	Corporate	88.7	25.4
EU-11	Exposures in default	271.0	108.0
EU-12	Other exposures (eg equity, securitisations, and other non-credit obligations)	193.4	173.2

1	Description of the processes used to manage the risk of excessive leverage	The Group's Capital Plan and Risk Appetite statements set out the Leverage ratio limits, targets, notification points, decisions and action plans including supporting forecasts and stress scenarios that the Group manages to remain in compliance at all times. The Group's SRMF sets out the governance framework for the management and procedures for establishing and changing the limits, targets, notification points, decisions and actions plans for leverage ratio set out in the Capital Plan and Risk Appetite Statements. This involves the Risk Committee and ultimately the Board in making these changes to the policy. The Group's ALCO provides the oversight that evaluates and monitors the Group's compliance with the Capital Plan and Risk Appetite policy on an ongoing basis.
2	Description of the factors that had an impact on the leverage ratio during the period to which the disclosed leverage ratio refers	The Group's leverage ratio decreased slightly by 0.1% from 6.0% at 31 December 2017 to 5.9% at 31 December 2018 driven by Tier 1 capital increasing by £101.6m due to the continued retention of up to 75% of underlying profit after tax in retained earnings and the AT1 issuance in the year. Net total assets (Leverage exposures) increased 23% during the year driven predominately by increases loans and advances through organic lending through the Groups various brands and increase in loans and advances to credit institutions.

Appendix V: Disclosure on LCR

2018

		Total adjusted value £m			
		Q1 2018	Q2 2018	Q3 2018	Q4 2018
21	LIQUIDITY BUFFER	1,207.2	1,292.1	1,261.2	1,160.5
22	TOTAL NET CASH OUTFLOWS	472.1	515.8	576.4	589.8
23	LIQUIDITY COVERAGE RATIO (%)	256.2%	250.6%	218.7%	196.4%

2017

		Total adjusted value £m			
		Q1 2017	Q2 2017	Q3 2017	Q4 2017
21	LIQUIDITY BUFFER	923.8	933.9	991.2	1,127.0
22	TOTAL NET CASH OUTFLOWS	451.2	457.9	498.3	492.5
23	LIQUIDITY COVERAGE RATIO (%)	204.9%	204.6%	199.3%	229.4%

Note: Figures quoted are average of the three month end reporting positions within the quarter.

EU LIQA on liquidity risk management

	Comment
Strategies and processes in the management of the liquidity risk	The Group adopts a thorough approach to risk management ensuring the effective identification, assessment, monitoring and management of all risks as defined by the Group's SRMF. Liquidity and funding risk are both principal risks included with the SRMF. The Group's Risk Framework ensures that internal and external expectations (including the Prudential Regulation Authority Rulebook and Basel Committee on Banking Supervision Principles for Sound Liquidity Risk Management and Supervision) are met and liquidity usage is optimised. This includes the reporting of metrics including the LCR and Liquidity Ratio (LQ). A set of Standard Operating Procedures (SOP) sit below the policies. These are a formal set of instructions to be followed when executing out an analytical or reporting process.
Structure and organisation of the liquidity risk management function (authority, statute, other arrangements)	The Market and Liquidity Risk Framework articulates how Group manages market and liquidity risk and is developed based on the principles, structure and ethos of the SRMF. The ILAAP is a key regulatory submission requirement and is underpinned by the liquidity risk governance structures in place across the Bank, in conjunction with reporting how the liquidity and funding profile influences the liquidity requirements of the Group. The Group utilises a hierarchical committee structure to oversee and manage market and liquidity risk. Key decisions are reviewed and challenged at all of the

	Group's committees, including; The Board, Risk Committee, and ALCO.
Scope and nature of liquidity risk reporting and measurement systems	In order to understand the risk which the Group is exposed to, and to provide information to the Board, Senior Management and external parties that the Group is operating within its market and liquidity risk limits, regular and accurate liquidity risk management information, reporting, and analytics are produced. These include; • **Cash flow forecasting**: Daily cash flow forecasting to ensure the Group will continue to meet risk appetite and regulatory requirements. • **Advances, redemptions and rollovers**: The Group model expected fixed rate savings rollovers and mortgage advances and redemptions based on historical information, seasonality and key future events such as repricing periods and reversion to SVR. Advances, redemptions and rollovers are monitored on a weekly basis and reported monthly to ALCO. • **Stress Testing**: Stress tests are conducted on a regular basis by Risk to identify sources of potential liquidity stress. The stress testing considers the potential impact of institution-specific, market-wide and combined alternative scenarios. Different time periods and varying degrees of stressed conditions are considered. • **ALCO Reporting**: The Group's key market and liquidity risk report is the ALCO pack, which is reviewed by the Committee on a monthly basis and extracts from the pack are provided to the Risk Committee.
Policies for hedging and mitigating the liquidity risk and strategies and processes for monitoring the continuing effectiveness of hedges and mitigants	Interest rate risk and basis risk are mitigated through three main approaches, natural hedges (i.e. matching assets and liabilities with similar repricing timing or index rates), Fixed-Floating (or Floating-Fixed) interest rate swaps, and allocation of reserves. The target for interest rate risk and basis risk is broadly neutral. Exposures are monitored on a regular basis and must remain within Board approved risk appetite.
A declaration approved by the management body on the adequacy of liquidity risk management arrangements of the institution providing assurance that the liquidity risk management systems put in place are adequate with regard to the institution's profile and strategy	The Board approves the liquidity risk appetite and the ILAAP document on an at least annual basis.
A concise liquidity risk statement approved by the management body succinctly describing the institution's overall liquidity risk profile associated with the business strategy. This statement shall include key ratios and figures (other than those already covered in Annex II of these guidelines) providing external stakeholders with a comprehensive view of the institution's management of liquidity risk, including how the liquidity risk profile of the institution interacts with the risk tolerance set by the management body	The Group will maintain sufficient liquidity to meet its liabilities as they fall due under normal and stressed business conditions; this will be achieved by maintaining a strong retail savings franchise, supported by a high quality liquid asset portfolio comprised of cash and readily-monetizable assets, and through access to prearranged secured funding facilities. The Board requirement to maintain balance sheet resources sufficient to survive a 1 in 20 severity stress is interpreted in terms of the LCR and corresponding LQ.

Template on qualitative information on LCR, which complements the LCR disclosure template

	Comment
Concentration of funding and liquidity sources	In addition to the regulatory ALMM metrics, the Group ensures that funding diversification is measured on a regular basis, paying particular attention to the split between sources of funding (retail, wholesale, central bank facilities etc.) and any concentrations by maturity, customer, and product type in its internal risk metrics. These monitoring metrics are reported on a regular basis and escalated to the appropriate levels for review.
Derivative exposures and potential collateral calls	The Group maintains the capability to value all derivative trades as often as daily if necessary. Margin calls are assessed and made in line with the Group's Treasury Risk Policy. The Policy also sets out the limits around changes in valuations. OSB also considers the impact of external factors to its derivative margin and looks at the impact of shifts in the yield curve.
Currency mismatch in the LCR	Due to the simple nature of the Group's balance sheet, currency mismatch does not pose a significant risk.
A description of the degree of centralisation of liquidity management and interaction between the group's units	Liquidity Risk management is carried out on a consolidated Group level, which encompasses all entities. Funding of different business lines and the reporting of risk monitoring metrics are therefore carried out on a holistic basis.
Other items in the LCR calculation that are not captured in the LCR disclosure template but that the institution considers relevant for its liquidity profile	In its ILAAP, the Group has taken into consideration a range of risk factors that may not be captured by the regulatory LCR disclosure. As defined in its ILAAP document, these include; Intraday Liquidity Risk, Off Balance Sheet Risk, Concentration & Correlation Risk, and LAB Monetisation.