ANNUAL REPORT
AND ACCOUNTS
2016

SPECIALIST LENDING
PERSONALFLEXIBLEFAIR

Strategic report

Governance

Financial statements

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ONE SPECIALIST LENDER

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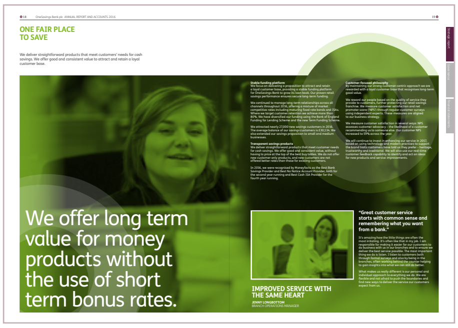
ONE FAIR PLACE TO SAVE

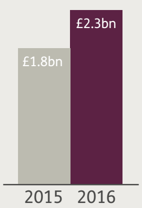


PAGE 20
ONE UNIQUE OPERATING MODEL

HIGHLIGHTS

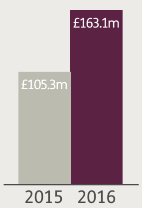
GROSS NEW LENDING

+28%
2016: £2.3bn
2015: £1.8bn



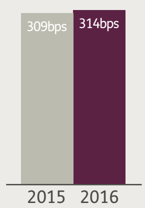
PROFIT BEFORE TAX

+55%
2016: £163.1m
2015: £105.3m



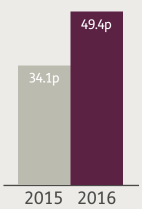
NET INTEREST MARGIN

+5bps
2016: 314bps
2015: 309bps



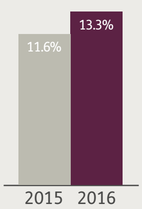
BASIC EPS

+45%
2016: 49.4p
2015: 34.1p



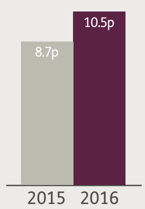
FULLY-LOADED COMMON EQUITY TIER 1 RATIO

Strengthened
2016: 13.3%
2015: 11.6%



FULL YEAR DIVIDEND PER SHARE

+21%
2016: 10.5p
2015: 8.7p



For more information and definitions, see Key performance indicators on page 28

WHO WE ARE

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

MIKE FAIREY
NON-EXECUTIVE CHAIRMAN

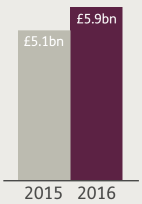
I am delighted to welcome you to OneSavings Bank plc's Annual Report for 2016. The Company continued to deliver strong loan book and earnings growth. I am very pleased with the resilience that our business has shown during a year of regulatory and political uncertainty, combined with economic challenge. We continued to focus on the growth of our core businesses whilst maintaining strong risk management and creating strong shareholder value. We continue to see market demand for our specialist lending capabilities and customer-centric business model, driven by a structural housing market shortage and strong private rental sector.

MIKE FAIREY
Non-Executive Chairman

See Governance section on page 58 for the Chairman's letter to shareholders

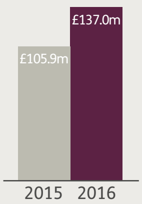
NET LOAN BOOK

+16%
2016: £5.9bn
2015: £5.1bn



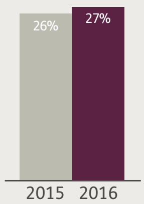
UNDERLYING PROFIT BEFORE TAX

+29%
2016: £137.0m
2015: £105.9m



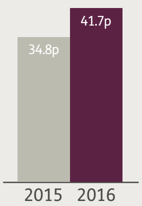
COST:INCOME RATIO

+1% point
2016: 27%
2015: 26%



UNDERLYING BASIC EPS

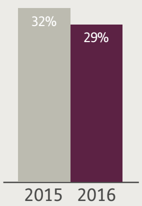
+20%
2016: 41.7p
2015: 34.8p



RETURN ON EQUITY

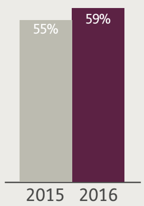
-3% points
2016: 29%
2015: 32%

32% excluding impact of the new bank corporation tax surcharge



CUSTOMER SATISFACTION (NPS)

+4% points
2016: 59%
2015: 55%



AT A GLANCE

OUR BUSINESS

BUY-TO-LET/ SME LENDING

- **BUY-TO-LET MORTGAGES**
  We lend to limited companies and individuals secured on residential property held for investment purposes. Our target market is experienced and professional landlords or high net worth individuals with established and extensive property portfolios.

- **COMMERCIAL MORTGAGES**
  We provide loans to limited companies and individuals secured on commercial and semi-commercial properties held for investment purposes or for owner occupation.

- **RESIDENTIAL DEVELOPMENT**
  We provide development loans to small and medium sized developers of residential property. Loans are staged, with monitoring surveyors signing off each stage of the development before funds are released.

- **FUNDING LINES**
  The Bank provides funding lines (loans) to non-bank finance companies secured against portfolios of financial assets, principally mortgages and leases.

Buy-to-Let/SME	2015	2016
Loans and advances (£bn)	3.1	**4.1**
Gross new lending (£bn)	1.5	**1.9**
Average book LTV at 31 December (%)	66	**69**

For more information go to the Operating and financial review p22

RESIDENTIAL MORTGAGE LENDING

- **FIRST CHARGE**
  We provide bespoke loans to individuals, secured by a first charge against their residential home. Our target market includes high net worth and complex income customers. We are also expert in shared ownership, lending to first-time buyers and key workers buying a property in conjunction with a housing association.

- **SECOND CHARGE**
  We provide loans to individuals seeking to raise additional funds secured by a second charge against their residential home. We predominantly target good credit quality borrowers.

- **FUNDING LINES**
  The Bank provides funding lines to non-bank lenders who operate in high yielding, specialist sub-segments such as residential bridge finance.

Residential	2015	2016
Loans and advances (£bn)	2.0	**1.9**
Gross new lending (£bn)	0.3	**0.4**
Average book LTV at 31 December (%)	56	**58**

For more information go to the Operating and financial review p22

RETAIL SAVINGS

- **ONLINE**
  We attract retail savings deposits via the internet.

- **DIRECT**
  The direct channel sources savings products via the telephone and post.

- **HIGH STREET BRANCHES**
  Our Kent Reliance branded network operates in the South East of England and offers a variety of fixed, notice, easy access and regular savings products, including ISAs.

PERSONAL LOANS

- The Bank acquired the performing former Northern Rock consumer loan portfolio from UK Asset Resolution in July 2013. This portfolio of high-margin, seasoned loans currently represents the Group's only unsecured lending and is serviced by a third party specialist servicer. Net loan book was £9.1m at 31 December 2016 (2015: £42.1m).

Retail savings balance by channel	2015	2016
Direct	44%	**37%**
Online	35%	**32%**
Branches	21%	**31%**

For more information go to One fair place to save p18

OUR TRADING BRANDS

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

KentReliance

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

KentReliance

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

InterBay Commercial

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

Heritable Development Finance

Experienced team providing specialist residential development finance to small and medium sized developers with a proven track record (commenced trading in January 2014).

Prestige Finance

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

Guernsey Home Loans

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

Jersey Home Loans

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

osbIndia

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

CHIEF EXECUTIVE OFFICER'S STATEMENT

ANDY GOLDING
CHIEF EXECUTIVE OFFICER

I am delighted to report another strong performance from the OneSavings Bank Group, in a year where we have once again met or exceeded all of our financial objectives set at IPO. Our clear strategy and unique business model have proven robust and we finish the year with a strong balance sheet, a high quality secured asset portfolio and an excellent reputation for customer service. This continues to position us well going forward.

CONTINUED STRONG PERFORMANCE

OneSavings Bank ('OSB') continued to grow the loan book through our specialist lending brands during 2016, with 28% growth in organic origination, responding well to the headwinds created by the change in Stamp Duty Land Tax ('SDLT'), the EU referendum result and the signalled individual taxation regime changes. This growth was achieved without compromising net interest margin as the Group remained focused on delivering our objective of being a leading specialist lender in our chosen markets, supported by a strong retail savings franchise and an efficient and scalable back office function. We have created value by taking a people-centric approach to our business through bespoke, manual underwriting, distribution and customer service, which have collectively driven the performance of our lending and savings brands.

We achieved particularly strong growth in our core Buy-to-Let lending sub-segment as the market became more focused on our professional landlord audience. We enhanced our core residential segment through selective asset acquisition and I am very pleased that we also increased our capital ratio following the sale of our economic interest in the Rochester Financing No. 1 plc securitisation (the 'Rochester 1 disposal') as well as through our profitable organic origination. We have grown the commercial side of our Buy-to-Let/SME segment cautiously and we have been prudent in business areas exposed to cyclical uncertainty, such as residential development finance, through increased stress testing measures in these sub-segments.

RESULTS AT A GLANCE

The Group delivered strong profit and loan book growth in 2016. Underlying pre-tax profit[1] increased by 29% to £137.0m (2015: £105.9m) and underlying basic earnings per share[1] grew by 20% to 41.7 pence (2015: 34.8 pence). The Group grew its loan book by 16% to £5.9bn in 2016 (2015: £5.1bn), whilst maintaining an appropriate risk return profile. Excluding the Rochester 1 disposal, the loan book grew by 20%. This was driven by strong new originations in our core Buy-to-Let/SME segment, which continued to build on our 2015 achievements.

Our high quality residential mortgage segment also continued to perform well.

“We have continued to focus on customer needs and the quality of new lending, leading to an enhanced customer reputation across our lending and savings brands.”

The balance sheet growth was achieved whilst delivering a strong return on equity of 29% (2015: 32%) or, 32% excluding the impact of the new bank corporation tax surcharge, despite strengthening our fully-loaded common equity tier 1 (‘CET1’) capital ratio to 13.3% (2015: 11.6%). The capital ratio increased following the Rochester 1 disposal, whilst also demonstrating the strong organic capital generation capability of the business through profitability.

The Board is recommending a final dividend of 7.6 pence per share. This gives a total dividend per share for the full year of 10.5 pence in-line with our stated dividend policy.

BEST SPECIALIST LENDER

The increase in gross new origination of 28% to £2.3bn (2015: £1.8bn) demonstrates the strength of our lending franchises in the specialist lending markets we serve. We continue to differentiate ourselves from the competition by offering well defined propositions in high margin, underserved markets, where we have the experience, as well as the internal and intermediary infrastructure, to successfully develop and service those markets.

Changes to SDLT at the end of the first quarter of 2016 and the signalled changes in the individual taxation regime led to varying levels of mortgage applications and completions in Buy-to-Let throughout the year. Completion volumes in our core businesses were strong in the first quarter as we fulfilled heightened demand to accelerate Buy-to-Let mortgage completions ahead of the SDLT changes and then grew again to record levels during the second half. Application volumes in our core businesses remained strong throughout the year with the run-rate increasing in the second half of 2016. It increased further in the last quarter ahead of the introduction of new underwriting standards for Buy-to-Let at the beginning of 2017. This performance demonstrates the sustainable strength of our propositions targeted at professional landlords, particularly our specialist, manual underwriting and our deep relationships with mortgage intermediaries. Professional/multi-property landlords accounted for 68% of completions for OSB by value during the second half of 2016 (2015: 60%).

A significant proportion of the Buy-to-Let market comes from refinancing. OSB’s Buy-to-Let refinancing percentage was 58% during 2016 despite the high level of purchase activity ahead of the change to SDLT (2015: 58%).

I am pleased that our more cyclical commercial businesses continued to perform strongly. Heritable Development Finance continued to grow and deliver high quality residential development lending, with a preference for forging relationships with those active outside prime central London. The business continued to gain momentum in spite of new entrants to the market, as customers sought an experienced and knowledgeable lender. After the EU referendum, the number of potential development schemes which can meet our stringent stress tests may reduce, but our high quality relationships have supported loan book growth, with commitments standing at £212m at year end, an increase of £44m for the year.

In addition, we have also grown the provision of secured funding lines to other lenders that operate in certain high yielding, specialist sub-segments, such as residential bridge finance and asset finance. Total credit approved limits were £330m with total loans outstanding of £122m as at 31 December 2016 (2015: £185m and £126m respectively). During 2016, four new funding lines were added, with a further two credit lines approved and in the documentation process.

We continued to gain recognition amongst mortgage customers and intermediaries, winning multiple awards during the year. I am particularly pleased that Kent Reliance won the Personal Finance Best Buy-to-Let Mortgage Provider award for the second year running and the What Mortgage Best Specialist Lender award in 2016. This combined with our broker net promoter score (‘NPS’) of 48% demonstrates the strength and value of our lending customer franchise.

CHIEF EXECUTIVE OFFICER'S STATEMENT CONTINUED

AWARD WINNING SAVINGS

Our stable and award winning retail funding franchise continues to support lending growth, with retail deposits up 11% to £6.0bn (2015: £5.4bn). Our loan to deposit ratio for 2016 was 90%[2], comfortably within our target of less than 100%, delivering on our strategy to be primarily retail funded. Nearly 27,000 new savings customers joined the Bank during 2016 and our successful programme of creating long-term savings relationships by offering market competitive rates to all customers, including those with maturing fixed rate bonds and ISAs, continued to deliver a very strong 87% retention rate.

The strength and fairness of our retail savings proposition, coupled with excellent customer service and high retention rates, continues to allow the Bank to raise significant funds without needing to price at the very top of the best buy tables.

RETURN ON EQUITY[1]

DOWN 3%

29%

1. 32% excluding impact of the new bank corporation tax surcharge

2015: 32%

DIVIDEND PER SHARE

UP 21%

10.5p

2015: 8.7p

We have diversified sources of funding including the government's Funding for Lending Scheme ('FLS') and Term Funding Scheme ('TFS') and we managed liquidity using a mixture of new and retained retail deposits, FLS and TFS. In 2016, the Group also extended its savings product proposition to small and medium businesses.

OPERATIONAL EXCELLENCE AND SERVICE IS CORE

As the Group has grown, costs have been controlled in-line with our stated financial objectives, resulting in a broadly stable cost to income ratio of 27% (2015: 26%). During 2016, we continued to invest in risk and compliance functions as regulatory costs increased. In particular, we continued to invest in the development of models needed both for IFRS 9 and to progress our stated aim of becoming an internal ratings-based approach bank ('IRB'). The Group's IFRS 9 models and first generation IRB models were delivered on schedule in late 2016. We commenced the parallel run for IFRS 9 at the start of 2017 and are well placed to implement the requirements for 2018. We continue to invest in customer facing and back office infrastructure as previously reported and to accommodate growth in OSBIndia, new premises in Bangalore became operational during the first quarter of 2016.

OSBIndia undertakes a range of primary processing services at a significantly lower cost than an equivalent UK-based operation and with very high quality levels. I am especially pleased that we achieved this whilst maintaining our focus on customers, borne out by an increase in customer NPS to an outstanding 59% (2015: 55%). This is also demonstrated by our numerous awards including Kent Reliance being named in the Moneyfacts awards as Best Bank Savings Provider for the second year in succession.

BUILDING A BUSINESS FOR THE FUTURE

The Group's strength and expertise in manual underwriting has continued to exercise strong diligence over loan and customer assessment, contributing to the Group's loan loss ratio falling to 16bps in the year to 31 December 2016 (2015: 23bps). We remain particularly pleased with the performance of the front book of mortgages. From more than 29,000 loans totalling £5.9bn of new organic originations since the Bank's

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

creation in February 2011, we only have 91 cases of arrears over three months in duration, with an aggregate balance of £8.6m and an average loan to value ('LTV') of 60%, reflecting the continued strength of the Bank's underwriting and lending criteria.

In June 2016, we implemented a revised mortgage product transfer scheme ('Choices') to encourage greater levels of retention amongst those borrowers reaching the end of their initial product term. Under this programme, borrowers are encouraged to engage with their broker to receive advice and select from a bespoke product set. Since the implementation of the scheme there has been a significant increase in the number of borrowers choosing a new product within three months of their initial product ending, driven exclusively by success in switching borrowers who were otherwise remaining on standard variable rate ('SVR') and who, by definition, were therefore in the market for other lenders.

The Bank of England Monetary Policy Committee announced a bank base rate cut of 25bps on 4 August 2016 and signalled that rates could go lower if the economy worsens. OSB reduced its SVR by the full 25bps effective from 1 September 2016. This reduction had a broadly neutral impact on the Bank's NIM due to rate reductions on administered savings. Since the creation of OSB we have kept control of asset pricing in our core businesses, with the majority of new origination linked to our SVR or in naturally hedged fixed rate products. This control over pricing provides significant protection against rate changes.

The Prudential Regulation Authority ('PRA') issued a Supervisory Statement on Buy-to-Let underwriting standards in September 2016, requiring lenders to adopt more stringent affordability assessments from 1 January 2017. We have always assessed affordability for borrowers through our specialist underwriting model and applied stringent stress tests. This can be seen in our weighted average interest coverage ratio ('ICR') for Buy-to-Let origination during 2016, which increased to 171% from 159% in 2015, demonstrating our cautious approach to the assessment of customer affordability.

We continued our focus on disciplined lending following the EU referendum, using lending criteria together with product targeting to position the business to grow its lower risk, low LTV portfolio. The weighted average loan to value (LTV) of the mortgage book remained low at 63% at the end of 2016, with an average LTV of 69% on new origination during the year (2015: 69%). We have limited exposure to high value properties, with only 2% of our total loan book secured on properties valued at greater than £2m and with an LTV above 65%.

In its internal capital adequacy assessment process ('ICAAP'), OSB applies a number of severe stress scenarios to its balance sheet including the H2 2016 PRA Stress Scenario, to demonstrate that it can survive a substantial economic downturn while maintaining capital levels above the Board capital risk appetite. The H2 2016 PRA Stress Scenario contains a severe reduction in house prices of more than 30% over the first two years of the five-year stress period, as well as an increase in unemployment to more than 9% and a significant fall in GDP. OSB's secured balance sheet with low average LTVs and the underlying profitability of its existing loan book allow it to survive such a stress, keeping above regulatory prescribed levels.

STRENGTHENING THE SENIOR MANAGEMENT TEAM

During 2016, we took the opportunity to strengthen the senior management team. Jason Elphick joined as Group General Counsel and Company Secretary in June 2016 from Santander, where he was Legal Director, Head of UK Banking Legal.

Additionally, Lisa Odendaal joined OSB in April 2016 as Head of Internal Audit and is a member of the Executive Team. Lisa was previously part of the outsourced Grant Thornton Internal Audit team.

CHIEF EXECUTIVE OFFICER'S STATEMENT CONTINUED

MARKET OUTLOOK

In 2016 we successfully negotiated regulatory uncertainty and economic challenges, and we believe that our specialist manual underwriting capabilities will become increasingly relevant during 2017 as economic uncertainty persists and regulatory changes take hold. We will maintain a deep understanding of the risks that we can actively manage and price for, and this together with our strong service proposition based on flexibility and speed of turnaround, will underpin the attractiveness of our products to customers.

The SDLT increase for Buy-to-Let purchases introduced in April 2016 has been absorbed by the market with little long-term impact for our target audience of professional landlords.

In 2017 we will see the market adjusting to the new Buy-to-Let underwriting standards which ensure that lenders, inter alia reflect the changes to personal tax on landlords within their affordability assessments. These changes will reduce yield for some higher rate tax payers. We have seen a clear trend for borrowers to seek to mitigate this by opting to borrow via a limited company during 2016. We saw a continued increase in the proportion of applications from limited companies for our main Buy-to-Let brand, Kent Reliance, from around 40% in December 2015 to 57% in the second half of 2016. The Group has always specialised in lending to limited companies, and given the market trends, this gives us competitive advantage over those lenders without such a capability.

Our manual, bespoke approach to underwriting will give us additional advantages when further market-wide measures to strengthen underwriting standards are to be implemented from September 2017, as we already substantively meet the regulatory requirements for assessment of landlords with four or more mortgaged properties.

We remain committed to being retail funded and the through-the-cycle benefits that this brings, but intend to complement this by taking advantage of the four-year term funding provided through the TFS at Bank of England base rate, as we lend into the 'real economy'. We have drawn down £301m to date.

The consultation from the Basel Committee on revised standardised risk weights proposed higher risk weights for Buy-to-Let, to be implemented from 2019 at the earliest. This proposed standardised risk weight revision is based on a global calibration, which in OSB's view is not appropriate for the UK Buy-to-Let market. Additional information is expected in March 2017 updating the Basel Committee proposals. As an alternative to the standardised risk weights, OSB is progressing towards IRB and the required models have been built and are being run during 2017 to test their accuracy. OSB is on target and aims to have it in place for residential and Buy-to-Let lending prior to adoption of final rules on standardised risk weights. The PRA published a consultation, "Refining the PRA's Pillar 2A capital framework" in February 2017 to be implemented by 1 January 2018. The consultation's aim is to ensure that the total amount of capital required is not excessive for firms following the standardised approach for credit risk.

Finally, there is the broader macroeconomic environment, primarily driven by uncertainties following the decision to leave the EU and the intention of the UK Government to trigger Article 50 before the end of March 2017. The UK economy has remained resilient in the face of the uncertainty and we have seen no material change in customer confidence or demand for loans in our core markets. We will continue to concentrate on our core strengths, and remain confident in the quality of our chosen markets and our business model, and believe we are in a strong position to perform well in each of our key market segments.

Our achievements in 2016 are a testament to the management and staff of OSB and I would like to thank my colleagues for their hard work and commitment throughout the year.

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

LOOKING FORWARD TO 2017

Following the strong performance in 2016, we entered 2017 with a strong pipeline of new business and are currently seeing very strong application levels in our core businesses. We expect to deliver net loan book growth in the mid-teens in 2017, whilst keeping NIM and cost to income ratio broadly flat to 2016. We will concentrate on what we have proven we do best; being a people focused business, using our relationships, manual underwriting expertise and secured lending strategy to lend responsibly to customers in underserved markets.

Over the coming year, organic lending, through the Buy-to-Let segment will remain the key driver of loan book growth focused on professional, multi-property landlords. Additionally, we will continue to evaluate selective inorganic opportunities that provide long-term value and meet our strategic objectives.

We start 2017 with a fully loaded CET1 ratio of 13.3% and a proven organic capital generation capability through profitability. We anticipate maintaining a CET1 ratio at a minimum 12% going forward. We remain keen to transition the capital stack to an optimum mix which may include Additional Tier 1 Capital ('AT1') when market conditions are right.

Our dividend policy for 2017 remains a pay-out ratio of at least 25% of underlying profit after taxation.

It is too soon to predict the medium to long-term impact of economic, tax and regulatory changes, but I believe that OneSavings Bank is well placed to take advantage of opportunities that arise and we remain capable of generating attractive returns for our shareholders.

ANDY GOLDING
Chief Executive Officer
16 March 2017

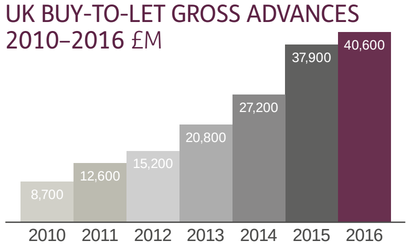
1. See Highlights, page 1 for statutory equivalents
2. Excluding the impact of drawdowns under the FLS and TFS

MARKET REVIEW

ECONOMIC OVERVIEW

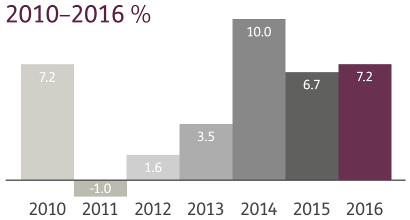
The defining economic event of 2016 was the EU referendum in June. Whilst prior to the vote there were widespread assumptions of a significant negative impact in the event of a vote to leave, the economy proved itself resilient with GDP growth of 1.8% driven by the manufacturing and service sectors. Fiscal intervention, including the reduction in base rate and the devaluation of the pound, were important supporting factors. The prospect of a "hard" Brexit has seen the yield curve flatten and the interest rate outlook remains benign, notwithstanding the inflationary pressures that are starting to be seen and which will see real wage inflation stagnate. The Bank of England has indicated that it will tolerate inflation rising above the 2% target in order to minimise any negative impacts of Brexit on the UK economy.

UK BUY-TO-LET GROSS ADVANCES 2010–2016 £M



Source: CML Research.

UK HOUSE PRICE INFLATION 2010–2016 %



Source: ONS, Survey of Mortgage lenders.

THE HOUSING MARKET

Housing transaction volumes were materially distorted in 2016 by the Stamp Duty Land Tax ('SDLT') change on second properties, and the underlying trend has seen a modest reduction in activity, driven by a number of factors. The most obvious of these was the outcome of the EU referendum, which created uncertainty throughout the second half of the year. This uncertainty undermined consumer confidence, suppressing levels of transactions.

In addition, regulatory and tax changes adversely affected volumes. SDLT increases first applied in 2015 continued to subdue the upper end of the property market and the introduction of a 3% SDLT surcharge in April 2016 on second properties further dampened transaction levels, albeit not before a substantial spike in activity in March.

The stricter affordability assessments that were introduced in the Mortgage Market Review in 2014 have continued to suppress first-time buyers and home movers. High transaction costs and relatively few properties on the market are also holding back activity.

Nonetheless, first-time buyers have been supported by various government schemes, which have helped the number of first-time buyers on an annual basis increase by 116% since its post-crisis low in mid-2009. It is other home movers, whose activity continues to be subdued since the financial crisis, that are underperforming, with mover numbers up by only 44% since the same period.

Average house prices in the UK increased by 7.2% in 2016 according to Land Registry.[1] Growth in the first half of 2016 was reversed in the third quarter as uncertainty followed the EU referendum outcome. The fourth quarter however saw recovery with both December and January showing small gains.

THE MORTGAGE MARKET

The Council of Mortgage Lenders ('CML') entered 2016 expecting 7.7% growth in new lending over 2015, to £237bn.[2] Changes to SDLT that came into effect from April gave rise to a substantial spike in new lending in March, in particular in Buy-to-Let, and the month saw £26.3bn of lending, compared to an average of £18.7bn in the first half of the year (excluding March). This contributed to a full year figure of £245.5bn of new lending in 2016, a 10.6% increase on 2015.[3]

Buy-to-Let lending grew to £40.6bn[4] in the year (2015: £37.9bn), an increase of 7%, supported by the SDLT change in April. Despite the spike in purchase activity that this caused, overall the year saw purchase transactions fall to 102,100 (2015: 117,500). This was entirely offset by an increase in remortgage transactions to 153,000 (2015: 132,300) and marks the beginning of what the CML perceive will be a trend of lower purchase transactions offset by rising remortgage volumes to create growth.

This expectation is driven by the introduction of the changes to personal taxation, which will be phased in from April 2017, coupled with new regulation on Buy-to-Let underwriting and affordability assessment, key elements of which were introduced on 1 January 2017, with further measures to be implemented in September.

THE COMPETITIVE LANDSCAPE

The UK market for lending and savings products is highly concentrated towards the high street banks. It is dominated by five major players, whose strategy is to use current accounts to cross-sell a range of products including savings and investments, mortgages, personal loans and credit cards. The high street banks primarily target the traditional, high-volume consumer markets and rely upon economies of scale and process automation. In recent years, high street banks have been subject to heightened and sustained regulatory, political and public scrutiny following several industry issues: the need for state aid during the financial crisis, alleged complicity in LIBOR rate fixing, mis-selling of payment protection insurance and interest rate swaps.

This has facilitated the entry of challenger banks, a term applied to an emerging group of banks seeking to challenge the dominant market share of the high street banks. These challenger banks also offer current accounts as their core proposition, using them to develop wider customer relationships. Smaller than high street banks and without the negative brand legacy, they develop customer propositions where they have identified areas of competitive advantage such as service, accessibility and product features.

More recent entrants are specialist banks, a group that includes OneSavings Bank. The specialist banks focus on specific UK lending niches that are underserved and do not offer current accounts. A key feature of these specialist banks is a growing presence in the retail savings sector as they develop a range of funding sources.

We have also seen the emergence of fintech banking propositions. These are yet to acquire material traction with UK consumers, however they do attract attention for their innovative use of technology.

ONESAVINGS BANK'S LENDING MARKETS

UK BUY-TO-LET/SPECIALIST SME MARKET

Buy-to-Let

Growth in the private rented housing sector ('PRS') has been consistent since 2000, underpinned by strong tenant demand as a result of social and demographic changes, government policy and the potential difficulties faced by first-time buyers in securing finance. The major shift seen in residential mortgage lending has been to make affordability assessments stricter, and this has curtailed lending activity, despite mortgage rates at historically low levels.

The PRS now provides accommodation for more than 5.3m households in Great Britain (as at September 2016), nearly 20% of the total. Sector growth is expected to continue, increasing to 25% of total households by 2025 (Local Government forecasting). The total value of property in the PRS in Great Britain is £1.3 trillion, driven by house price inflation (HPI) and PRS growth[5]. At the same time, social housing properties as a percentage of the housing sector have decreased, with renting the only major alternative to home ownership.

The Buy-to-Let mortgage market serving the PRS has increased, with the number of outstanding mortgages rising from 120,300 in 2000 to over 1.8 million in 2016.[6] Expansion in the Buy-to-Let market has been criticised for inhibiting growth in the owner-occupied market, particularly for first time buyers. Changes to tax relief, new Buy-to-Let regulation and SDLT are expected to moderate Buy-to-Let market growth, however the PRS is expected to remain a core component of the UK housing supply and the primary issue affecting the owner occupied market remains the lack of available stock and insufficient new build starts, as was recognised in the Housing White Paper in February 2017.

The prospect of changes to personal taxation have seen an increase in the number of landlords seeking to borrow via a limited company entity. With most of the larger lenders in the

MARKET REVIEW CONTINUED

sector not offering a limited company proposition, this has led to a shift towards those lenders who do. With one specialist broker suggesting that 69% of purchase applications in the fourth quarter of 2016 were from limited companies, the inability of the market leaders to meet this demand will have a positive outcome for the pool of smaller lenders who do and marks a shift in the sector.

Moreover, following the implementation of the Prudential Regulation Authority's ('PRA') revised rules on Buy-to-Let underwriting, many lenders who lend to the limited company market offer criteria that allow for greater levels of borrowing than would be available to individual borrowers.

OSB is a respected lender within the specialist Buy-to-Let sector and is experienced in dealing with limited company lending. Therefore whilst the succession of changes, both actual and planned, that have impacted the market will undoubtedly dampen demand as a whole, we believe that this dampening will be more acute at the amateur end of the market, where borrowers own a small number of properties in their personal name. Professional landlords will increasingly grow their portfolios using limited companies.

COMMERCIAL

The UK commercial property market saw investment demand increase in the second half of 2016 following the EU referendum, with the trend positive. The Royal Institute of Chartered Surveyors[7] have noted an increase in demand from foreign investors, potentially attributable to favourable currency movements. Whilst investor demand has grown in all sectors, growth in the retail sector was weakest, with demand notably higher in the office and industrial sectors. Market sentiment is positive, particularly outside of London.

Research from Savills[8] showed commercial property investment decline by 28% in 2016 to £51.4bn however this figure is above the ten year average of £45.9bn, the fourth quarter growth in 2016 at 39% was stronger than in 2015 (25%), driven by overseas investment. The UK is seen as an attractive investment opportunity given the deeper political uncertainties in Europe and there is a degree of optimism in respect of capital values, helped by business confidence levels being greater than the consumer equivalent.

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

RESIDENTIAL DEVELOPMENT

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

The Housing White Paper published in February 2017[9], refers to a "broken housing market" and identified that "not enough homes are being built" and thus prioritised initiatives that will seek to address this. Notable among the initiatives announced in the White Paper were a raft of measures to encourage smaller builders to build more homes, through an improved planning framework. They also expressed a desire that lenders should "back developers…in building more homes". The White Paper represents a holistic assessment of the UK's housing needs, and it is encouraging to note the emphasis placed on supporting the small and medium sized developers who form our core audience for development finance.

SPECIALIST RESIDENTIAL LENDING

The high street banks typically rely on a heavily automated, scorecard-driven approach to lending, as this provides a cost-effective means of servicing a high volume of residential mortgage loans. This is not an effective model for the specialist market, where OneSavings Bank's manual underwriting and individual case assessment model is more appropriate. Customers with complex asset or income structures and those seeking shared ownership mortgages are ill-served by the commoditised and inflexible decision processes of mainstream lenders.

Whilst MMR has been in place for some time, its consequences are still visible in the form of reduced home mover levels, as recognised by the CML. The market share of the top six lenders continues to decline, as specialist and challengers grow market share.

SECOND CHARGE LENDING

The second charge market saw an estimated £874m of gross new lending in 2016 (2015: £844m). OneSavings Bank targets good credit quality mortgage borrowers who wish to extend their borrowing, but do not want to change their existing mortgage arrangements. Borrowers are typically seeking to fund a major purchase, undertake home improvements or consolidate and reschedule other consumer debt without refinancing their existing first charge mortgage, as it often carries a low interest rate.

The market experienced significant change in March 2016 when market regulation was taken over by the Financial Conduct Authority. Most notably, as a result of this, affordability assessment now mirrors the practice seen in first charge lending and is aligned with the MMR.

Whilst the gross lending figures represent year on year growth of 3.6%, this can be attributed wholly to business volumes prior to the change. The first quarter saw 29% growth year on year as business was written in advance of the rule changes. The remainder of the year saw a small reduction in overall lending with the market settling at around £70m of new lending per month.

FUNDING LINES

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

1. Land Registry, UK House Price Index, 14 February 2017
2. CML, Market Review, December 2016
3. CML, New Mortgage by purpose of loan, ML1 UK, 1 March 2017
4. CML, New and Outstanding Buy-to-Let new mortgages, MM17, 7 February 2017
5. Savills.co.uk, UK News 18 January 2016
6. See footnote 4
7. RICS UK Commercial Property Market Survey Q4 2016, 26 January 2017
8. Savills, Market in Minutes UK Commercial, 21 February 2017
9. House of Commons Library briefing paper number 06416, 15 June 2016

STRATEGIC FRAMEWORK

Our strategic objective

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

PRIORITIES	OUR GOALS	2016 PROGRESS
BE A LEADING SPECIALIST LENDER IN OUR CHOSEN MARKETS	**Grow profitable loan origination in key markets** • Deliver strong end-to-end propositions in target markets • Develop our more cyclical businesses • Deliver incremental non-organic business • Invest in highly responsive, customer-focused culture • Innovate to secure sustainable long term market leadership	• BTL origination up 27% to £1,959m and residential origination up 14% to £382m • Residential mortgage portfolio acquisitions for £181m • Four new secured funding lines added • Received multiple awards including Best Specialist Lender and Best Buy-to-Let Mortgage Provider
RETAIN FOCUS ON BESPOKE AND RESPONSIVE UNDERWRITING	**High quality decisions protecting the business** • Skilled manual underwriting with 100% of cases manually underwritten • Deliver a high quality differentiated service supported by highly responsive decision making • Clear decisions recognised by intermediaries for their quality and fairness – a critical friend • Integrated underwriting across all brands	• More than 29,000 loans totalling £5.9bn originated since the Bank's creation in 2011 with only 91 cases of arrears over 3 months, with an aggregate balance of £8.6m and an average LTV of 60% • Transactional Credit Committee met 101 times to assist with more complex or larger new mortgage applications
FURTHER DEEPEN RELATIONSHIPS AND REPUTATION FOR DELIVERY WITH INTERMEDIARIES	**Increase partner reach in response to demand** • Provide access to specialist products developed by listening to intermediary partners • Be accessible and available to intermediaries • One distribution model across all brands • Gain intermediary recognition for delivering long-term sustainable proposition • Deliver bespoke solutions to meet intermediary and customer needs	• Four new fully supported key partners • Introduced Choices, our broker-led customer retention programme • Restructured relationship team to increase levels of engagement • Attended c.130 intermediary events across our target geographies • Enhanced marketing and brand support for intermediaries • Published report with Ernst & Young LLP to help Buy-to-Let property owners understand and deal with changes to UK tax relief on finance costs
MAINTAIN AND BUILD UPON 150 YEAR HERITAGE IN SAVINGS	**Stable, high quality funding platform** • Be primarily funded through attracting and retaining a loyal retail savings customer base • Provide access to our service for customers through their channel of choice • Ensure liquidity requirements are met through the economic cycle • Deliver a proposition offering transparent, straightforward savings products, providing long term value combined with excellent service levels	• Gained c.27k new savings customers • Achieved 87% customer retention • Received multiple awards for savings products including Best Bank Savings Provider, Best Cash ISA Provider and many more • Loan to deposit ratio of 90% • Launched new Corporate Deposit proposition
LEVERAGE UNIQUE AND COST EFFICIENT OPERATING MODEL	**Best in class customer service** • Make customer service at the heart of everything that we do • Extend activity in OSBIndia developing high-quality areas of excellence • Create structure delivering solutions using cross company expertise • Deliver cost efficiencies through excellent process design and management	• Investments in training and process development contributed to enhanced customer NPS of 59% • Increased OSBI headcount by 31% to 276 • Provided support from OSBIndia to new functions including, Finance, Marketing and digital transformation

LOOKING FORWARD

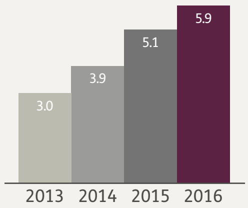
- Focus on organic growth in underserved sub-sectors
- Identify new market sub-sectors with high returns on a risk-adjusted basis

KEY RISKS

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

KPI

LOAN BOOK GROWTH £BN



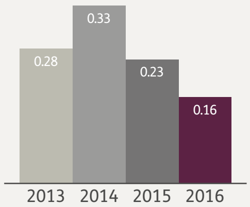
Looking forward

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

Key risks

- Changing regulation for underwriting
- More complex underwriting requirements
- Recruitment of experienced staff

LOAN LOSS RATIO %



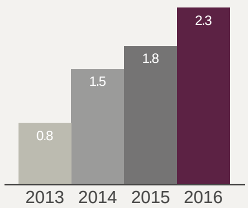
Looking forward

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

Key risks

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

GROSS NEW LENDING £BN



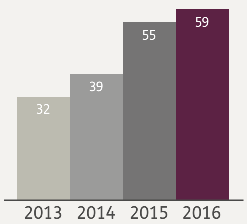
Looking forward

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

Key risks

- Increased competition for retail funds
- NS&I/Government intervention in market
- Increased customer expectation for technology compared to difficulty and cost of delivery

CUSTOMER NPS %



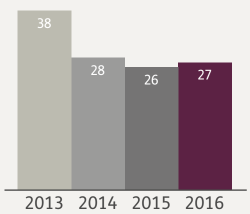
Looking forward

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

Key risks

- Difficulty in continuous service improvement as OSB grows
- Global economic uncertainty increasing costs in India
- Increasing complexity from compliance with changing regulation

COST: INCOME RATIO %



ONE SPECIALIST LENDER

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

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

- private rented Buy-to-Let sector;
- commercial and semi-commercial;
- residential development finance;
- bespoke specialist residential lending;
- second charge residential lending; and
- shared ownership.

OSB also provides funding lines to other lenders, secured against pools of loan collateral providing indirect access to certain high-yielding, specialist sub-segments, such as residential bridge finance and leasing. As at the end of 2016, the Group had total loans outstanding of £122m (2015: £126m).

We continue to identify opportunities where we can use our strengths to take leading sub-sector positions, adding value to the Group and maximising our use of capital.

Intermediary relationships
We build long-term partnerships with a panel of selected specialist mortgage intermediaries that are leaders in their sub-sectors, making it easier for them to serve borrowers by providing swift decision making.

We provide access to specialist products and underwriting through our coordinated multi-brand approach and focus on listening and working with partners to develop new opportunities and bespoke solutions.

We deepen our relationships with these intermediaries and conservatively expand the panel with whom we work. We develop marketing and education campaigns, combined with dedicated marketing support leading to an intermediary NPS of 48% in 2016.

Inorganic growth
The Group is focused on organic origination as its core growth strategy. In addition, OSB has diversified into new lending markets through business acquisitions, including SME/Commercial and second charge residential mortgages.

In 2016, OSB completed the purchase of portfolios of UK first and second charge residential mortgages for £181m.

OSB will continue to actively consider inorganic opportunities as they arise to complement the core organic origination strategy.

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

We differentiate our service proposition by responding quickly and flexibly to requests with direct access to decision makers, and provide a service differential for more complex situations.

We leverage the expertise of our highly-skilled underwriting team to enhance the experience of our partners. Our Transactional Credit Committee met 101 times in 2016 to assess more complex or larger new mortgage applications.

What we will do
We will continue to develop existing and new manual underwriting skills, through a training and coaching programme, ensuring that OSB staff have up-to-date skills and can continue to deliver a high-quality differentiated service.

A RELATIONSHIP BUILT ON RESPECT

MARC CALLAGHAN
BUSINESS DEVELOPMENT MANAGER

"It takes a long time to build trust and a moment to lose it."

My role revolves around people and building relationships. I have spent my whole career getting to know brokers and listening to what is important to them. It is all about helping them to help their clients, offering certainty and treating them properly. Of course honesty and integrity are crucial, and that means doing the small things right, being available and responding to people swiftly but I aim to go beyond that.

Using my expertise I can act as a consultant, helping my brokers put a proposal together to ensure it can meet the needs of OSB and their client. Sometimes that means not being afraid to say no early in the process, even suggesting a more suitable lender where a case does not meet our risk appetite. It makes a difference to me that I can present larger and more complex cases to the Bank's Transactional Credit Committee. I see the decision making process first hand and what will make an application successful. This helps me stand out to my brokers and makes OSB their lender of choice.

ONE FAIR PLACE TO SAVE

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

Stable funding platform
We focus on delivering a proposition to attract and retain a loyal customer base, providing a stable funding platform for OneSavings Bank to grow its loan book. Our proven retail savings performance ensures secure long-term funding.

We continued to manage long-term relationships across all channels throughout 2016, offering a mixture of market competitive rates including maturing fixed rate bonds and ISAs. Where we target customer retention we achieve more than 80%. We have diversified our funding using the Bank of England Funding for Lending Scheme and the new Term Funding Scheme.

We attracted nearly 27,000 new savings customers in 2016. The average balance of our savings customers is £30,134. We also extended our savings proposition to small and medium businesses.

Transparent savings products
We deliver straightforward products that meet customer needs for cash savings. We offer good and consistent value, without having to price at the top of the best buy tables. We do not offer new customer-only products, and new customers are not offered better rates than those for existing customers.

In 2016, we were recognised by Moneyfacts as the Best Bank Savings Provider and Best No Notice Account Provider, both for the second year running and Best Cash ISA Provider for the fourth year running.

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

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

We measure customer satisfaction in several ways: NPS assesses customer advocacy – the likelihood of a customer recommending us to someone else. Our customer NPS increased to 59% across the year.

We will continue to invest in enhancing our service in 2017, based on using technology and modern practices to support the brand traits customers have told us they prefer – heritage, trustworthy and traditional. We will also use our real-time customer feedback capability to identify and act on ideas for new products and service improvements.

IMPROVED SERVICE WITH THE SAME HEART

JENNY LONGBOTTOM
BRANCH OPERATIONS MANAGER

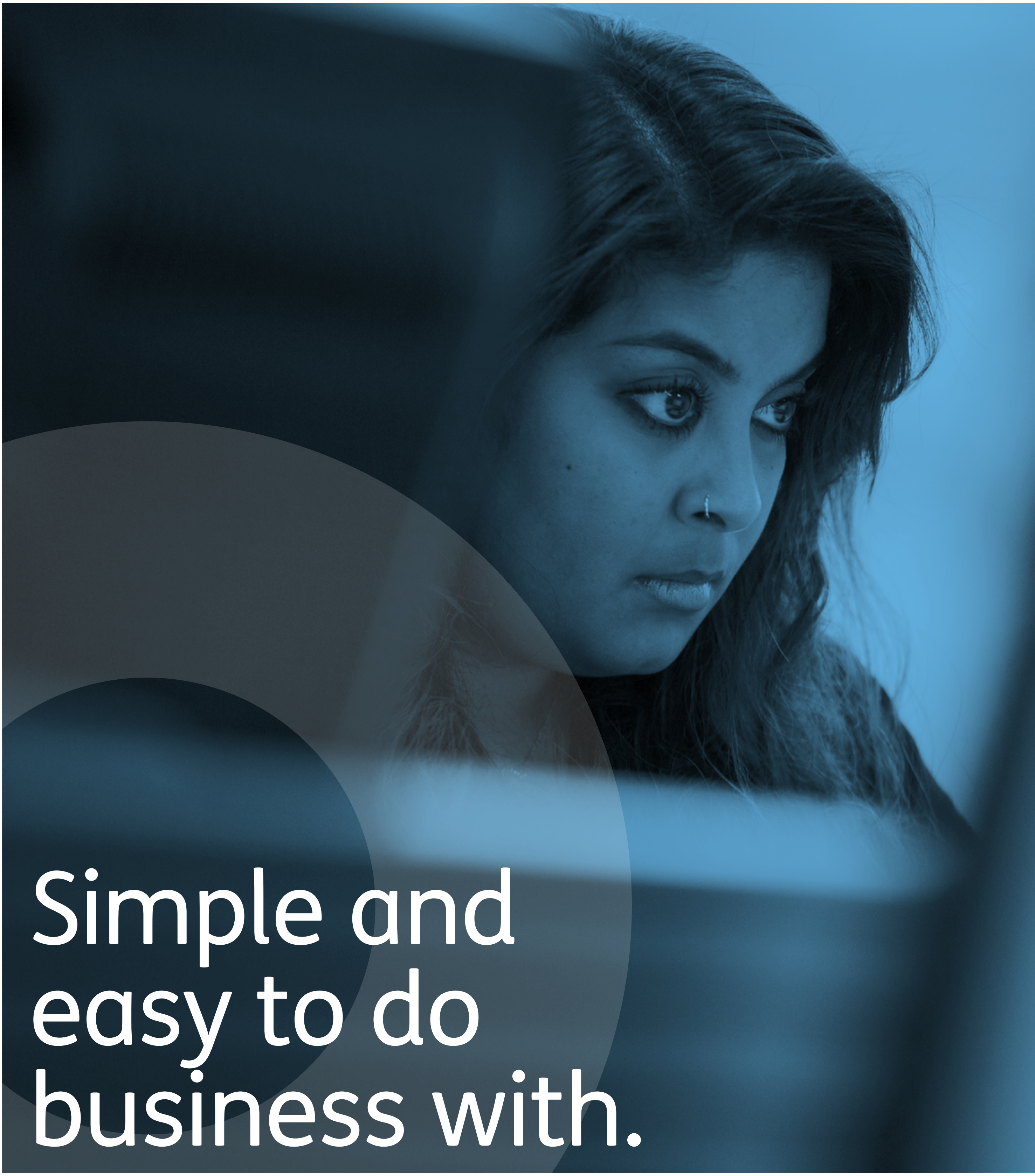
"Great customer service starts with common sense and remembering what you want from a bank."

It's amazing how the little things are often the most irritating. It's often like that in my job. I am responsible for making it easier for our customers to do business with us in our branches and to ensure we deliver the best service possible. The most important thing we do is listen. I listen to customers both through formal surveys and also by being in the branches, often working behind the counter helping to gain insights into what we can still do better.

What makes us really different is our personal and individual approach to everything we do. We are flexible and not afraid to push the boundaries and find new ways to deliver the service our customers expect from us.

ONE UNIQUE OPERATING MODEL

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



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

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

We will further develop the coordination and commonality of approach for our lending brands and customer and risk supporting operations in 2017 to maximise the expertise and goodwill we have built up in those customer-facing brands.

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

We benefit from our investment in continuously identifying and curing areas that cause customer dissatisfaction.

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

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

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

We will continue to leverage infrastructure investment across the Group in 2017, maximising customer and efficiency benefits. We will also ensure infrastructure and systems are regularly reviewed and tested, maximising their security and resilience using industry experts with particular focus on cyber security.

WE ARE DRIVEN BY CUSTOMER SATISFACTION

SANDEEP KAUL
MANAGER, CUSTOMER EXPERIENCE

“We are an important part of OneSavings Bank and we make sure our people know that.”

Here at OSBIndia we concentrate on two things.

The first is providing great customer experience to OSB clients by driving continuous improvement. This means that the targets we set for our people are based on customer service and we reward them for delivering just that. It is not about getting customers off the phone quickly, it’s about ensuring that we help them, efficiently and quickly. Experts measure what we do, helping us learn how to get it right first time.

The second is supporting OSB by delivering a flexible and cost effective platform to do business. We spend time in the UK at the Group Head Office and we regularly have visits from managers and directors. This means we understand what we need to do to help the Group deliver strategic improvements to service, and support the best in class cost:income ratio by our efficiency.

OPERATING AND FINANCIAL REVIEW

ONESAVINGS BANK

GROUP OVERVIEW

OneSavings Bank delivered another year of strong performance in 2016. We have once again met or exceeded all of our stated financial objectives as set out at IPO. This strong performance reflects the continued successful delivery of our strategy to:

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

BUSINESS HIGHLIGHTS

OneSavings Bank ('OSB') continued to deliver strong earnings and balance sheet growth during 2016. The Group successfully dealt with a changing political and economic landscape through our focus on professional landlords and limited companies, and high quality specialist underwriting, distribution and product proposition.

Net loans and advances grew by 16% in 2016 to £5.9bn, 20% excluding the impact of the Rochester Financing No. 1 plc disposal ('Rochester 1 disposal'). The growth was due primarily to an increase in new lending in the Buy-to-Let/SME segment and portfolio purchases for £180.7m, partly offset by the sale of OSB's entire economic interest in Rochester 1. This growth was achieved whilst improving the Bank's fully loaded CET1 capital ratio to 13.3%, demonstrating the strength of the capital generation capability of the business through profitability.

The Bank sold its entire economic interest in Rochester Financing No. 1 plc ('Rochester 1') on 26 May 2016. Rochester 1 was issued on 16 October 2013 and securitised approximately £376m of acquired mortgages sold to it by the Bank. The sale resulted in derecognition of securitised mortgage assets from the Bank's balance sheet and deconsolidation of Rochester 1. This removed a total of £239.8m of securitised mortgage assets and cash reserves in the securitisation vehicle, and, as a liability, the most senior notes (A1, A2 and B) of £171.6m from the Group's balance sheet. The transaction generated an exceptional pre-tax gain of £34.7m reflecting the significant increase in the fair value of the securitised mortgages since they were acquired by the Bank, and strengthened the Bank's CET1 ratio by c.1.5%.

In December 2016, the Bank also sold £10.9m gross value of non-performing personal loans. The disposal generated a gain of £0.6m due to the consideration received for the portfolio being greater than the carrying value net of impairment provisions.

The Group remains focused on organic origination as its core growth strategy and gross new organic lending of £2.3bn in 2016 was up 28% compared with £1.8bn in 2015. OSB continued to see good demand for its products during 2016, particularly in Buy-to-Let where the Group continues to target professional landlords with larger portfolios. Buy-to-Let/SME is the Group's largest segment comprising 69% of the gross loan book with Residential Mortgages at 31% as at 31 December 2016. Organic originations in our residential book stood at £382.1m (2015: £334m) up 14% even though the residential loan book as a whole decreased due to the Rochester 1 disposal in the year.

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

In June 2016, we implemented a revised mortgage product transfer scheme ('Choices') to encourage greater levels of retention amongst those borrowers reaching the end of their initial product term. Under this programme, borrowers are encouraged to engage with their broker to receive advice and select from a bespoke product set. Since the implementation of the scheme there has been a significant increase in the number of borrowers choosing a new product within three months of their initial product ending, driven exclusively by success in switching borrowers who were otherwise remaining on SVR and who, by definition, were therefore in the market for other lenders.

The Group continues to actively consider inorganic opportunities as they arise. During 2016, the Bank acquired portfolios of first and second charge residential mortgages for £180.7m (2015: a portfolio of second charge mortgages for £260.8m). The Group conducts extensive due diligence when considering any portfolio acquisitions.

The Bank's secured funding line business in both its Buy-to-Let/SME and Residential segments remains important, although additional controls and more prudent criteria were put in place after the result of the EU referendum in light of potential market uncertainties. Notwithstanding these additional controls, gross advances to other lenders, including bridge and asset finance businesses, were up 19% to £156.2m in 2016 (2015: £131.4m) with total loans outstanding as at 31 December 2016 of £122.3m (2015: £125.8m). Four new funding lines were added in the year.

The Group reported strong profit growth in 2016 with statutory profit before taxation increasing by 55% to £163.1m (2015: £105.3m) and underlying profit before taxation up by 29% to £137.0m (2015: £105.9m).[1] This significant improvement in underlying profitability reflects the strength of our lending and funding franchises and our efficient operating model. Underlying basic earnings per share ('EPS') strengthened to 41.7p (2015: 34.8p). On statutory basis, basic EPS was 49.4p in 2016 (2015: 34.1p).

Our customer-centric strategy of providing transparent savings products which offer long-term value for money continues to deliver high levels of customer satisfaction and loyalty. Our customer net promoter score ('NPS') increased to 59% across the year and the maturing fixed term bond and ISA balance retention rate remained strong at 87% in 2016 (2015: 55% and 89% respectively).

The Group continued to utilise the Bank of England's Funding for Lending Scheme ('FLS'). Total drawings to 31 December 2016 under the scheme stood at £524.6m. In November 2016, the Group was accepted into the Term Funding Scheme ('TFS') and expects to transition out of the FLS into this new facility over the course of 2017, given the more attractive terms. As at 31 December 2016, TFS drawings were £101.0m and the Group anticipates the total to reach £1bn by the end of 2017.

The Bank of England base rate cut of 25bps on 4 August 2016 had a broadly neutral impact on NIM as the Group was able to offset the associated reductions in mortgage rates with rate reduction on administered savings.

In 2016, the Group also extended its savings product proposition to small and medium businesses.

1. See reconciliation of statutory profit to underlying profit in Alternative performance measures on page 31

FINANCIAL OBJECTIVES

The table below sets out the Group's stated financial objectives for 2014–2016 and our performance against them during the year.

The Group remained predominantly retail funded during the year with a loan to deposit ratio of 90% as at 31 December 2016, excluding the impact of drawdowns under the Bank of England's FLS and TFS schemes.

Our focus on cost discipline and efficiency continued throughout 2016, helping to deliver a very strong cost to income ratio. It increased by one percentage point to 27% for the year, comfortably below our financial objective of 35% and reflecting planned further investment in the Bank's infrastructure and operations to enable us to meet increasing regulatory demands.

The Bank ended the year with a fully loaded CET1 capital ratio of 13.3% (2015: 11.6%) demonstrating the Bank's ability to support significant growth through the organic capital generation capability of the business through profitability.

Return on equity remained strong and above our stated objective, decreasing three percentage points to 29% for the year, due to the new 8% Bank Corporation Tax Surcharge ('BCTS'), or 32% excluding the impact of the BCTS, despite our strengthened capital position.

The Board is recommending a final dividend of 7.6 pence per share which together with the interim dividend of 2.9 pence per share, represents 25% of underlying profit after taxation for the year in-line with the Bank's stated dividend policy.

FINANCIAL OBJECTIVES 2014–2016[1]		2016 RESULT
FUNDING/ LIQUIDITY STRENGTH	Maintain loan to deposit ratio of <100%[2]	90%
COST DISCIPLINE	Cost:income ratio of <35%	27%
CAPITAL STRENGTH	CRD IV CET1 ratio >10%	13.3%
SHAREHOLDER RETURNS	Return on equity of >25%[3]	29%
DIVIDEND POLICY	Pay-out ratio of ≥25%[4]	25%

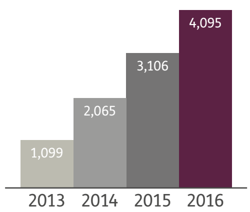
1. Objectives relate to the financial planning cycle that lasted until the end of 2016
2. Excluding the impact of any drawdown under the FLS and TFS schemes
3. For more information see Key performance indicator table on page 28
4. Pay-out ratio of at least 25% of underlying profit after taxation

OPERATING AND FINANCIAL REVIEW CONTINUED

BUY-TO-LET/SME

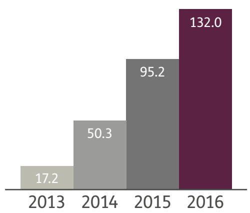
This segment comprises Buy-to-Let mortgages secured on residential property held for investment purposes by experienced and professional landlords, commercial mortgages secured on commercial and semi-commercial properties held for investment purposes or for owner occupation, residential development finance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

GROSS LOAN BOOK £4,094.9M



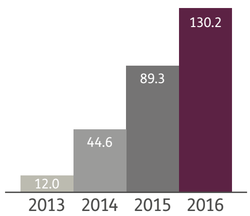
+32%
2015: £3,106m

NET INTEREST INCOME £132.0M



+39%
2015: £95.2m

CONTRIBUTION TO PROFIT £130.2M



+46%
2015: £89.3m

BUY-TO-LET/SME SUB-SEGMENT: GROSS LOANS

	Group 31-Dec-2016 £m	Group 31-Dec-2015 £m
Buy-to-Let	**3,613.3**	2,710.5
Commercial	**268.3**	230.2
Residential development	**141.6**	95.0
Funding lines	**71.7**	69.8
Total	**4,094.9**	3,105.5

At the end of 2016, the Buy-to-Let gross advances stood at £40.6bn (2015: £37.9bn), according to the Council of Mortgage Lending[1], an increase largely attributable to the rise in advances in March 2016 ahead of SDLT changes coming into effect. Subdued activity in the Buy-to-Let market continued for the rest of 2016 compared to 2015.

The Group significantly increased its volume of new organic lending in this segment in 2016 to £1.9bn, an increase of 27% on 2015 new organic lending of £1.5bn. This included a significant increase in Buy-to-Let lending through the Kent Reliance and InterBay brands, where we continued to see strong growth opportunities. Our Buy-to-Let sub-segment stood at £3,613.3m at 31 December 2016 (2015: £2,710.5m) with a weighted average LTV of 69% and average loan size of circa £250,000.

The Group primarily focused on organic origination as its core growth strategy during the year, however, we will continue to actively consider inorganic opportunities in this segment as they arise.

We have always assessed affordability for borrowers through our specialist underwriting model and apply stringent stress tests. This can be seen in our weighted average ICR for Buy-to-Let origination during 2016 which increased to 171% (2015: 159%). The Group focuses on professional multi-property landlords. We have seen a clear trend for borrowers to seek to mitigate changes to personal tax, and during 2016 there was continued increase in the proportion of applications from limited companies for our main Buy-to-Let brand Kent Reliance from over 40% in December 2015 to 57% in the second half of 2016.

We invested in sales capability across all of our lending brands and extended distribution to reach a number of substantial new partners during the year and deepened our existing relationships. Through the Kent Reliance and InterBay brands the Bank distributes via intermediaries throughout England and Wales with a bias towards properties in London and the South-East where the demand supply gap is widest and most sustainable. We have improved our intermediary proposition with the introduction of a broker-led retention programme, the first of its kind in the specialist lending market. We have also deepened our analysis of borrower behaviour throughout the life of a mortgage and are better able to manage our retention activity, with positive results. Product development has continued to increase our focus on the professional landlord community and we have tightened criteria for non-professionals.

We have been prudent in our lending secured on commercial real estate, and have grown the portfolio modestly to a gross value of £268.3m as at 31 December 2016 (2015: £230.2m) with a low weighted average LTV of 59% and average loan size of £270,000.

The Bank's Heritable Development Finance business provides development finance to smaller residential developers, with a preference for forging relationships with those active outside of prime central London. The business continued to gain momentum in spite of new entrants to the market, as customers sought an experienced and cautious lender. However, following the UK vote to leave the EU, the number of potential development schemes which can withstand our stringent stress testing may reduce until the outlook becomes clearer. The residential development funding gross loan book at the end of 2016 was £141.6m, with a further £70.0m committed (31 December 2015, £95.0m and £43.3m respectively).

In addition, the Bank continued to grow the provision of secured funding lines it provides to non-bank lenders which operate in certain high-yielding, specialist sub-segments, such as bridging finance and asset finance. Total credit approved limits as at 31 December 2016 were £244.0m with total loans outstanding of £71.7m (31 December 2015: £116.0m and £69.8m respectively). During 2016, three new funding lines were added, with a further two credit lines approved and in the documentation process. The pipeline remains robust, however following the UK's vote to leave the EU, a cautious risk approach has been adopted.

OSB's combined Buy-to-Let/SME net loan book grew by 32% in 2016 to £4,078.0m (2015: £3,087.8m) due to the gross new lending in the year, partially offset by back book redemptions, and is the Group's largest segment. Buy-to-Let/SME made a contribution to profit of £130.2m in 2016, up 46% compared to £89.3m in 2015, reflecting the positive impact of new lending, the falling cost of funds, and low impairment losses of £2.1m (2015: £5.3m).

The Group remains highly focused on the credit quality of new lending as demonstrated by the average LTV in the Buy-to-Let/SME segment as at 31 December 2016 of 69% (31 December 2015: 66%) with only 0.4% of loans exceeding 90% LTV (31 December 2015: 1%). The average LTV for new Buy-to-Let/SME origination was 70% (2015: 72%).

1. CML, New and outstanding buy-to-let new mortgages, UK, MM17, 7 February 2017

YEAR ENDED 31-DEC-16	BTL/SME £m	Residential mortgages £m	Personal loans £m	Total £m
BALANCES AT THE REPORTING DATE				
Gross loans and advances to customers	**4,094.9**	**1,859.9**	**9.4**	**5,964.2**
Provision for impairment losses on loans and advances	**(16.9)**	**(7.8)**	**(0.3)**	**(25.0)**
Loans and advances to customers	**4,078.0**	**1,852.1**	**9.1**	**5,939.2**
Risk weighted assets	**1,936.6**	**798.7**	**7.7**	**2,743.0**
PROFIT OR LOSS FOR THE PERIOD				
Net interest income	**132.0**	**71.4**	**3.2**	**206.6**
Other income/(expense)	**0.3**	**(4.7)**	**(0.8)**	**(5.2)**
Total income	**132.3**	**66.7**	**2.4**	**201.4**
Impairment (losses)/gains	**(2.1)**	**(7.2)**	**0.3**	**(9.0)**
Contribution to profit	**130.2**	**59.5**	**2.7**	**192.4**

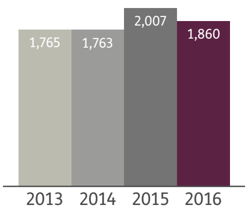
YEAR ENDED 31-DEC-15	BTL/SME £m	Residential mortgages £m	Personal loans £m	Central[1] £m	Total £m
BALANCES AT THE REPORTING DATE					
Gross loans and advances to customers	3,105.5	2,007.1	49.5	–	5,162.1
Provision for impairment losses on loans and advances	(17.7)	(2.2)	(7.4)	–	(27.3)
Loans and advances to customers	3,087.8	2,004.9	42.1	–	5,134.8
Risk weighted assets	1,435.1	858.6	45.8	–	2,339.5
PROFIT OR LOSS FOR THE YEAR					
Net interest income	95.2	69.0	5.6	–	169.8
Other income / (expense)	(0.6)	(5.9)	(1.4)	0.6	(7.3)
Total income	94.6	63.1	4.2	0.6	162.5
Impairment losses	(5.3)	(2.4)	(2.9)	–	(10.6)
Contribution to profit	89.3	60.7	1.3	0.6	151.9

OPERATING AND FINANCIAL REVIEW CONTINUED

RESIDENTIAL MORTGAGES

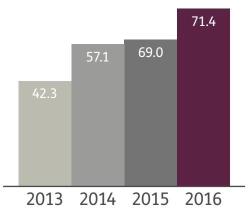
This segment comprises lending to owner occupiers, secured via either first or second charges against the residential home. The Bank provides funding lines to non-bank lenders who operate in high-yielding, specialist sub-segments such as residential bridge finance.

GROSS LOAN BOOK £1,859.9M



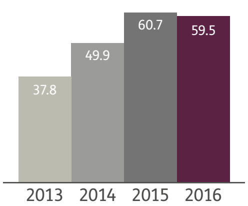
-7%
2015: £2,007m

NET INTEREST INCOME £71.4M



+3%
2015: £69.0m

CONTRIBUTION TO PROFIT £59.5M



-2%
2015: £60.7m

RESIDENTIAL SUB-SEGMENT: GROSS LOANS

	Group 31-Dec-2016 £m	Group 31-Dec-2015 £m
First charge	**1,322.1**	1,433.2
Second charge	**487.2**	517.8
Funding lines	**50.6**	56.1
Total	**1,859.9**	2,007.1

During the year, the Group organically originated residential lending of £382.1m (2015: £334m). This included first charge residential lending in the UK, predominantly in London and the South-East, through the Kent Reliance brand, second charge lending through the Prestige Finance brand, and the provision of secured funding lines to non-bank lenders for residential lending.

Organic growth remains the Group's core growth strategy, however we continue to actively consider inorganic opportunities as they arise, particularly where we have in-house servicing expertise. In 2016, the acquisitions of residential mortgages for £180.7m included portfolios of first and second charge mortgages (2015: £260.8m, a portfolio of second charge mortgages).

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

Kent Reliance also operates in the shared ownership market, where borrowers buy a property in conjunction with a housing association.

Our first charge residential book had a gross value of £1,322.1m as at 31 December 2016 (2015: £1,433.2m) with new organic lending and portfolio acquisitions more than offset by the Rochester 1 disposal and redemptions on the back book and acquired mortgage portfolios in run-off.

Our second charge mortgage brand, Prestige Finance, provides secured finance to good credit quality borrowers who are seeking a loan to raise funds rather than refinancing their first charge mortgage. Competitive pressure in the second charge market caused price reductions and we allowed our market share to fall to ensure we continue to price for risk. The second charge residential loan book was slightly down as at 31 December 2016 with a gross value of £487.2m (2015: £517.8m) with organic origination and book acquisitions offset by redemptions on the organic book and acquired books in run-off.

OSB continued to grow the provision of secured funding lines to non-bank lenders which operate in certain high-yielding, specialist sub-segments, such as residential bridge finance, despite increasing stress testing measures in a more cautious approach in our more cyclical businesses following the EU referendum. Total credit approved limits at 31 December 2016 were £86.2m with total loans outstanding of £50.6m (2015: £69.4m and £56.1m respectively). During 2016, one new funding line was added.

OSB's total residential loan portfolio had a net carrying value of £1,852.1m as at 31 December 2016 (2015: £2,004.9m). The average LTV remained low at 58% (2015: 56%) with only 3% of loans by value with LTV's exceeding 90% (2015: 2%). The average LTV of new residential origination during 2016 was 66% (2015: 64%).

Residential mortgages made a contribution to Group profit of £59.5m in 2016, down 2% (2015: £60.7m), reflecting the positive impact of new lending and portfolio purchases, and the falling cost of funds, more than offset by the impact of the sale of higher yielding mortgages in the Rochester securitisation vehicle and higher impairment losses of £7.2m (2015: £2.4m). The impairment losses were recognised on acquired mortgage portfolios in run-off due to incremental prudence added to the collectively assessed provision calculations following the EU referendum result.

PERSONAL LOANS

OSB acquired the performing former Northern Rock consumer loan portfolio from UKAR in July 2013 for £258.0m. This portfolio of high-margin, seasoned, performing loans currently represents OSB's only unsecured loans. The portfolio, which was purchased at a discount, has a net carrying value after collective provisions of £9.1m as at 31 December 2016 (2015: £42.1m).

In December 2016, the Bank made a disposal of £10.9m gross value of non-performing personal loans in the normal course of business. The disposal generated a gain of £0.6m.

The portfolio made a contribution to profit of £2.7m in 2016 (2015: £1.3m), however, the book is in run-off with a short remaining weighted average life. Impairment credit was £0.3m in 2016 (2015: £2.9m charge).

MAKING A DIFFERENCE

MARTIN WARD
HEAD OF TREASURY

"Treasury is not forgiving; there's no room for mistakes or taking your eye off the ball. That's why I do it."

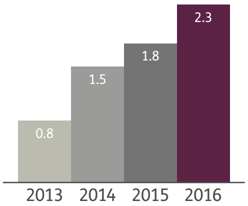
I have been with OSB since 2012 through a period of significant growth and it has been good to have gone through the journey and understand why OneSavings Bank is different. I invested in the systems and processes needed to closely manage the Bank's treasury assets and risks.

In an uncertain external environment Treasury adds certainty. We don't take directional views on the book; instead we use a mixture of natural hedging through our fixed retail deposits, swaps and treasury products to manage the Bank's position, mitigating the impact of interest rate risk. We also have to be responsive. One of the things that I like best is getting involved in product development both for savings and lending to ensure our products deliver for both customers and the Bank. My role is encouraging the business rather than just managing what I am given. It helps me make a difference and keeps OSB Treasury at the forefront, ensuring strong, accessible liquidity and predictable cash flows in all market conditions.

KEY PERFORMANCE INDICATORS

GROSS NEW LENDING

PERFORMANCE £2.3BN



up
28%

DEFINITION

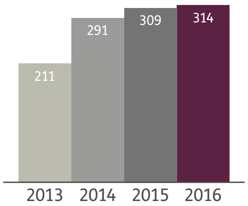
This is defined as gross new organic lending before redemptions.

2016 PERFORMANCE

Gross new lending in 2016 reflects growth in new origination, primarily in the BTL/SME segment.

NET INTEREST MARGIN

PERFORMANCE 314BPS



up
5bps

DEFINITION

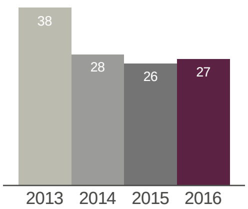
This is defined as net interest income less coupons on perpetual subordinated bonds ('PSBs') classified as equity, as a percentage of average interest bearing assets including off balance sheet FLS drawings. It represents the margin earned on loans and advances and liquid assets after swap expense/income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

2016 PERFORMANCE

Net interest maintained at a slight increase to prior year level through carefully managed pricing of assets and liabilities.

COST:INCOME RATIO

PERFORMANCE 27%



increase
1%
point

DEFINITION

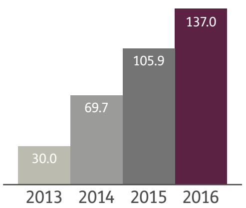
This is defined as administrative expenses including depreciation and amortisation as a percentage of total income after deducting coupons on equity PSBs. It is a measure of operational efficiency.

2016 PERFORMANCE

The cost to income ratio reflects the Bank's additional investment to meet regulatory requirements in 2016 but continues to be significantly below the Bank's target of cost:income ratio of less than 35%. It highlights continued focus on lending in risk-adjusted high-margin sub-segments of the market and on cost control and efficiency. The ratio continues to reflect the benefit of the Bank's efficient and scalable low cost back office based in Bangalore, India.

UNDERLYING PROFIT BEFORE TAXATION

PERFORMANCE £137.0M



up
29%

DEFINITION

This is defined as statutory profit before taxation before exceptional items and after deduction of coupons on equity PSBs. See reconciliation of statutory profit to underlying profit in Alternative performance measures on page 31.

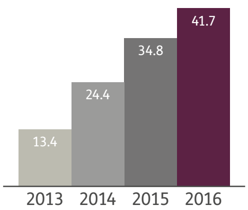
2016 PERFORMANCE

The increase reflects strong balance sheet growth, increased net interest margin and continued focus on cost discipline and efficiency.

Statutory profit before taxation of £163.1m in 2016 increased by 55% compared to £105.3m in 2015.

UNDERLYING BASIC EPS

PERFORMANCE 41.7 PENCE PER SHARE



up
20%

DEFINITION

This is defined as underlying profit after taxation divided by the weighted average number of ordinary shares in issue. It is a measure of shareholder value.

See reconciliation of statutory profit to underlying profit in Alternative performance measures on page 31.

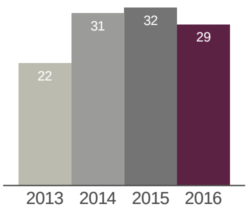
2016 PERFORMANCE

The strong growth is in line with the significant increase in underlying profitability of the Bank.

On a statutory basis basic EPS improved to 49.4 pence per share in 2016 from 34.1 pence per share in 2015.

RETURN ON EQUITY

PERFORMANCE 29%



down
3%
points

DEFINITION

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

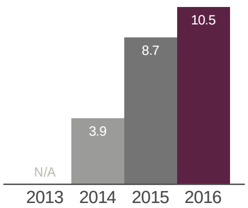
For further information on underlying profit after taxation, see reconciliation of statutory profit to underlying profit in Alternative performance measures on page 31.

2016 PERFORMANCE

The return on equity for 2016 of 29% is ahead of the Bank's target of at least 25%. The reduction compared to 2015 is due to the new 8% Bank Corporation Tax Surcharge. Excluding the impact of the tax surcharge, return on equity would have been 32% despite our strengthened capital position, driven by the Rochester 1 disposal and continued strong organic capital generation through profitability.

DIVIDEND PER SHARE

PERFORMANCE 10.5 PENCE PER SHARE



up
21%

DEFINITION

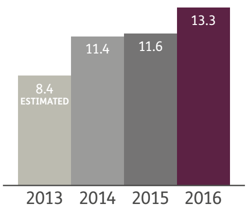
This is defined as the sum of the recommended final dividend for 2016 plus the interim dividend divided by the number of ordinary shares in issue at the year end.

2016 PERFORMANCE

The Board will recommend a final dividend of 7.6 pence per share in respect of 2016 at the Bank's AGM on 10 May 2017. This together with the interim dividend of 2.9 pence per share represents 25% of underlying profit after tax for 2016, in line with the Bank's target dividend pay-out ratio.

CRD IV FULLY-LOADED COMMON EQUITY TIER 1 CAPITAL RATIO

PERFORMANCE 13.3%



strengthened
1.7%
points

DEFINITION

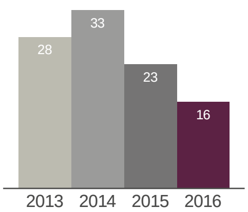
This is defined as common equity tier 1 capital as a percentage of risk-weighted assets (calculated on a standardised basis) and is a measure of the capital strength of the Bank.

2016 PERFORMANCE

The capital ratio of 13.3% reflects the ability of the business to generate capital through profitability to support significant loan book growth.

LOAN LOSS RATIO

PERFORMANCE 16BPS



improved by
7bps

DEFINITION

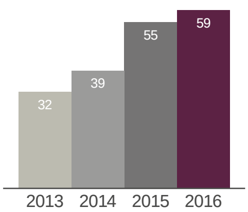
This is defined as impairment losses expressed as a percentage of average gross loans and advances. It is a measure of the credit performance of the loan book.

2016 PERFORMANCE

The improved ratio of 16bps for 2016 (2015: 23bps) reflects the continued strong performance from the front book of loans, originated by the Bank since its creation in 2011. From more than 29,000 loans totalling £5.9bn of new organic originations since the Bank's creation in February 2011, we only have 91 cases of arrears over three months in duration, with an aggregate balance of £8.6m and average LTV of 60%.

CUSTOMER SATISFACTION – NET PROMOTER SCORE

PERFORMANCE 59%



up
4%
points

DEFINITION

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

2016 PERFORMANCE

The Bank's customer NPS across the year for 2016 improved from 55% in 2015 to 59%. This demonstrates that our investment in customer service in the UK and India and customer-centric strategy of providing transparent savings products which offer long-term value for money continues to deliver high levels of customer satisfaction.

FINANCIAL REVIEW

STRONG GROWTH IN GROSS NEW ORGANIC LENDING

up 28% to £2.3bn

2015: £1.8bn

NET LOAN BOOK GROWTH

16%

(20% EXCLUDING THE IMPACT OF ROCHESTER DISPOSAL)

2015: 31%

COST:INCOME RATIO

27%

STRONG INCOME GROWTH AND CONTINUED FOCUS ON COST DISCIPLINE AND EFFICIENCY

2015: 26%

	Group 31-Dec-16	Group 31-Dec-2015
SUMMARY PROFIT OR LOSS	**£m**	£m
Net interest income	**206.6**	169.8
Losses on financial instruments	**(4.3)**	(2.6)
Net fees and commissions	**1.7**	0.0
External servicing fees	**(2.6)**	(4.7)
Administrative expenses[1]	**(53.7)**	(41.1)
FSCS and other provisions	**(0.5)**	(3.4)
Impairment losses	**(9.0)**	(10.6)
Exceptional items	**24.9**	(2.1)
Profit before taxation	**163.1**	105.3
Profit after taxation	**120.9**	84.1
Underlying profit before taxation[3]	**137.0**	105.9
Underlying profit after taxation[3]	**101.5**	84.5
KEY RATIOS		
Net interest margin[2]	**314bps**	309bps
Cost:income ratio[2]	**27%**	26%
Management expense ratio[4]	**0.86%**	0.75%
Loan loss ratio	**0.16%**	0.23%
Basic EPS[2], pence per share	**49.4**	34.1
Underlying basic EPS[2], pence per share	**41.7**	34.8
Return on equity[2]	**29%**	32%
Dividend per share, pence per share	**10.5**	8.7
EXTRACTS FROM THE STATEMENT OF FINANCIAL POSITION	**£m**	£m
Loans and advances	**5,939.2**	5,134.8
Retail deposits	**5,952.4**	5,363.8
Total assets	**6,580.9**	5,970.4
KEY RATIOS		
Liquidity ratio[5]	**17.9%**	16.4%
CET1 capital ratio[6]	**13.3%**	11.6%
Total capital ratio	**15.1%**	14.1%
Leverage ratio	**5.5%**	4.5%

1. Including depreciation and amortisation
2. See definition in Key performance indicators table on pages 28–29
3. For underlying profit before and after taxation calculation, see the reconciliation of statutory profit to underlying profit in Alternative performance measures on page 31
4. Administrative expenses including depreciation and amortisation as a percentage of average total assets
5. Liquid assets as a percentage of funding liabilities
6. Fully-loaded under Basel III/CRD IV

STRONG PROFIT GROWTH

The Group reported very strong profit growth in 2016 with profit before taxation of £163.1m up 55% (2015: £105.3m) including an exceptional gain of £34.7m on the Rochester 1 disposal, partially offset by an exceptional loss of £9.8m in respect of accelerated amortisation of fair value adjustments on hedged assets relating to legacy back book long-dated interest rate swap cancellations.

Underlying profit before taxation, before exceptional items and after deduction of coupons on equity PSBs was up 29% to £137.0m (2015: £105.9m) reflecting strong balance sheet growth and net interest margin combined with continued focus on cost discipline and efficiency.

Profit after taxation in 2016 increased by 44% to £120.9m (2015: £84.1m). This increase reflects the higher pre-tax profitability, partially offset by the impact of the 8% Bank Corporation Tax Surcharge ('BCTS') which increased the Bank's effective tax rate to 25.6%[1] in 2016 (2015: 20.1%). Underlying profit after taxation increased by 20% to £101.5m (2015: £84.5m) despite the impact of the new BCTS.

NET INTEREST MARGIN

The Group reported an increase in net interest income of 22% to £206.6m in 2016 (2015: £169.8m) and NIM of 314bps (2015: 309bps). The improvement in NIM primarily reflects the positive impact of new lending and a reduced cost of funds, partially offset by the sale of high yielding loans in the Rochester 1 disposal and the roll-off of the personal loan portfolio.

ALTERNATIVE PERFORMANCE MEASURES

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

	Profit before taxation		Profit after taxation	
Reconciliation of statutory profit to underlying profits	**Group 31-Dec-2016 £m**	Group 31-Dec-2015 £m	**Group 31-Dec-2016 £m**	Group 31-Dec-2015 £m
Statutory profit	**163.1**	105.3	**120.9**	84.1
Gain on Rochester 1 disposal	**(34.7)**	–	**(25.8)**	–
Coupons on equity PSBs	**(1.2)**	(1.5)	**(0.9)**	(1.2)
Exceptional amortisation of fair value adjustments on hedged assets	**9.8**	–	**7.3**	–
IPO expenses[1]	**–**	2.1	**–**	1.6
Underlying profit	**137.0**	105.9	**101.5**	84.5

1. IPO expenses are £0.4m in 2016, however due to materiality level, this expense is now shown within staff costs, see note 9 for further information

Statutory basic EPS of 49.4 pence per share is calculated by dividing profit attributable to ordinary shareholders of £120.0m (profit after taxation of £120.9m less coupons on equity PSBs including the tax effect of £0.9m) by the weighted average number of ordinary shares in issue during the year of 243.1m.

Underlying basic EPS of 41.7 pence per share is calculated by dividing underlying profit after taxation of £101.5m by the weighted average number of ordinary shares in issue during the year of 243.1m. Further information can be found in note 11 to the financial statements.

The lower cost of funds reflects the continued reduction in the cost of retail funds including the impact of maturing fixed term deposits rolling on to lower prevailing rates, the positive impact of funding from the FLS throughout the year and the introduction of the TFS scheme in the last quarter of 2016. Total drawdowns for FLS stood at £524.6m as at 31 December 2016, down from a peak of more than £600m in October 2016, as the Bank sought to spread the maturity profile and manage liquidity more efficiently.

On 4 August 2016, the Bank of England announced that it would extend provision of up to £100bn funding in cash at base rate to banks and building societies by introducing the TFS scheme. The scheme was available for drawdowns from 19 September 2016 and will run until 28 February 2018 with a term of four years, in the form of a securitised cash loan. The Group was accepted to the scheme in November 2016 and made its first drawdown in December with a balance of £101.0m as at 31 December 2016 reflecting a switch of funds from the FLS.

The TFS, as a collateralised loan, provides cheaper funding than FLS. The Group plans to replace all FLS funding with the TFS during 2017 in a phased way in order to spread the maturity profile.

The Bank of England base rate cut of 25bps on 4 August 2016, had a broadly neutral impact on NIM due to rate reductions on administered savings broadly offsetting the impact of rate reductions on mortgages.

LOSSES ON FINANCIAL INSTRUMENTS

Net loss on financial instruments in 2016 of £4.3m (2015: net loss £2.6m) includes £4.9m amortisation of fair value adjustments on hedged assets relating to cancelled swaps (2015: £3.2m) and £0.6m gain on disposal of the non-performing personal loans with a gross value of £10.9m (2015: a net gain of £0.6m from the sale of the Bank's RMBS portfolio). The increase in the amortisation of fair value adjustments includes the impact of accelerating the amortisation in-line with the run-off of the underlying legacy long-term fixed rate mortgages due to faster than expected prepayments.

NET FEES AND COMMISSION

Net fees and commission income of £1.7m (2015: £0.03m) comprises fees and commission receivable of £2.5m (2015: £1.1m) primarily due to arrangement fees receivable on funding lines and master servicing fees and commission expense of £0.8m (2015: £1.1m).

EXTERNAL SERVICING FEES

External servicing fees decreased to £2.6m in 2016 (2015: £4.7m) due to the transfer of servicing for acquired second charge residential loan books to the Group's second charge platform Prestige Finance at the end of 2015 and the run-off of other acquired portfolios.

EFFICIENT AND SCALABLE OPERATING PLATFORM

Administrative expenses including depreciation were up 31% to £53.7m in 2016 (2015: £41.1m) reflecting the continued build out of the Group's operations and infrastructure to support growth in the business and meet the investment demands of new regulation. This included model building for IFRS 9 and internal ratings-based approach to risk weights ('IRB').

The Group's cost to income ratio increased by one percentage point to 27% in 2016 (2015: 26%) and the management expense ratio increased to 0.86% for 2016 (2015: 0.75%), reflecting the additional regulatory spend and investment. Both ratios reflect the benefit of the Bank's efficient and scalable low cost back office based in Bangalore, India.

FINANCIAL REVIEW CONTINUED

REGULATORY PROVISIONS

Regulatory provisions expense, which is primarily in respect of the Financial Services Compensation Scheme ('FSCS') levies, decreased to £0.5m for 2016 (2015: £3.4m). This includes the full annual charge recognised on 1 April in each year, based on retail savings balances as at the previous 31 December. The reduction is primarily due to the FSCS's announcement that it does not expect to collect contributions in respect of capital loan repayments for 2016, as well as a reduction to the Bank's accrual as at 31 December 2015 based on the FSCS's latest estimates for the prior year levy.

IMPAIRMENT LOSSES

Impairment losses decreased to £9.0m in 2016 (2015: £10.6m) representing 16bps on average gross loans and advances (2015: 23bps). The Group recorded lower loan losses on the organic BTL/SME segment and personal loans portfolios driven by improvements in the credit profile and the continuing roll-off of the personal loans portfolio. Together, these more than offset higher loan losses on the acquired residential mortgage portfolios.

The £0.3m credit on the personal loan portfolio (2015: £2.9m charge) was due to recoveries on loans previously written off more than offsetting additional loan loss provisions.

Impairment losses on acquired mortgage portfolios in run-off increased to £6.8m in 2016 (2015: £2.8m) where despite a fall in total arrears balances, incremental prudence was added to the collectively assessed provision calculations following the EU referendum result.

The performance of the front book of mortgages remains strong, reflecting the continued strength of the Bank's underwriting and lending criteria. We kept tight control on credit quality, as seen in our reportable arrears statistics, from more than 29,000 loans totalling £5.9bn of new organic originations since the Banks's creation in February 2011, there were only 91 cases of arrears over three months or more as at 31 December 2016, with an aggregate value of £8.6m and average LTV of 60%.

EXCEPTIONAL ITEMS

Exceptional items in 2016 of £24.9m comprise the gain on disposal of the Bank's entire economic interest in Rochester 1 of £34.7m (see Business Highlights above for further detail), and an exceptional loss of £9.8m in respect of accelerated amortisation of fair value adjustments on hedged assets relating to legacy back book long-dated swap cancellations.

The Group uses interest rate swaps to hedge fixed rate mortgages and adopts fair value hedge accounting where the criteria specified in IAS 39 (EU endorsed) are met. Under hedge accounting, the change in the fair value of hedged mortgages for interest rate risk is recognised in the statement of profit or loss, as an offset to fair value movements on the swaps, with the cumulative movement reflected as fair value adjustments on hedged assets in the statement of financial position. A number of long-dated legacy swaps were cancelled in 2012 and 2013 whilst still effective. Following the cancellations, fair value adjustments on the legacy hedged long-term fixed rate mortgages (c.25 years at origination) remained in the statement of financial position to be amortised over their remaining lives. Both the cancelled swaps and hedged mortgages were inherited from the Kent Reliance Building Society.

During 2016, the Group reviewed the roll-off of the legacy long-dated fixed rate mortgages. Following this review, the Group accelerated the amortisation of these fair value adjustments on hedged assets in-line with the mortgage asset run-off, due to faster than expected prepayments since cancellation. The exceptional loss represents the impact of accelerating the amortisation in prior years from 2012 to 2015, which was not material in any individual year. It has been presented as an exceptional item and excluded from 2016 underlying profit before tax to provide an appropriate measure of the underlying performance of the Group in 2016. The exceptional loss would have reduced fair value adjustments on hedged assets by £9.8m, retained earnings by £7.6m, including the tax effect, and the CET1 ratio by 0.3% points as at 31 December 2015.

In 2015, the exceptional items of £2.1m related to IPO costs.

DIVIDEND

The Board recommends a final dividend for 2016 of 7.6 pence per share. Together with the 2016 interim dividend of 2.9 pence per share, this represents 25% of underlying profit after taxation for 2016 in-line with the Bank's target dividend pay-out ratio. The proposed final dividend will be paid on 17 May 2017, subject to approval at the AGM on 10 May 2017, with an ex-dividend date of 30 March 2017 and a record date of 31 March 2017.

BALANCE SHEET GROWTH

Net loans and advances grew by 16% in 2016 to £5,939.2m (31 December 2015: £5,134.8m) due primarily to an increase in new lending in the BTL/SME segment and portfolio purchases totalling £180.7m, partly offset by the Rochester 1 disposal and redemptions. Excluding the impact of the Rochester 1 disposal, loan book growth was 20% in 2016.

Retail deposits and total assets grew by 11% and 10%, respectively in 2016 with additional funding supplied by the FLS and TFS. The Bank drew down a total of £524.6m under the FLS as at 31 December 2016 (31 December 2015: £160.7m), having replaced £101.0m with TFS by the end of the year (31 December 2015: £nil).

The FLS drawdowns are in the form of T-bills which are held off balance sheet and replace cash deposits with the Bank of England or other maturing treasury assets in the Bank's liquidity portfolio which can then be used to fund loan book growth. The TFS drawdowns are offered in the form of securitised cash loans.

LIQUIDITY

OneSavings Bank operates under the PRA's liquidity regime. The Bank operates within a target liquidity runway in excess of the minimum regulatory requirement. The Bank prudently increased its liquidity above normal target levels in the first half of 2016 in the run-up to the EU referendum with levels returning to normal by year end. In addition, the Bank maintains a strong retention track record on fixed term bond and ISA maturities. Our liquidity coverage ratio of 239% is significantly in excess of the 2016 regulatory minimum of 80%, including drawings under the Bank of England FLS and TFS funding facilities. The Group's liquidity ratio as at 31 December 2016 was 17.9% (31 December 2015: 16.4%).

SUMMARY CASH FLOW STATEMENT	Group 31-Dec-2016 £m	Group 31-Dec-2015 £m
Profit before tax	**163.1**	105.3
Net cash generated/(used in):		
Operating activities	**(315.2)**	(79.3)
Investing activities	**324.3**	(244.4)
Financing activities	**54.0**	(88.8)
Net increase/(decrease) in cash and cash equivalents	**63.1**	(412.5)
Cash and cash equivalents at the beginning of the period	**355.1**	767.6
Cash and cash equivalents at the end of the period	**418.2**	355.1

CAPITAL

The Bank's fully-loaded CET1 capital ratio under CRD IV strengthened to 13.3% as at 31 December 2016 (31 December 2015: 11.6%), primarily due to the Rochester 1 disposal.

The Bank had a total capital ratio of 15.1% and a leverage ratio of 5.5% as at 31 December 2016 (31 December 2015: 14.1% and 4.5% respectively).

The Bank has a Pillar 2a requirement of 1.2% of risk weighted assets.

CASH FLOW STATEMENT

The Group's cash and cash equivalents at the end of the year were 18% higher than in 2015 at £418.2m (2015: £355.1m).

In 2016, the Group increased its loans and advances to customers by £1,031.3m. This was partially funded by an additional £588.6m of deposits from retail customers. Collectively, these were the main drivers of the £315.2m of cash used in operating activities. The remaining funding came primarily from the Group replacing its maturing on balance sheet available for sale investment securities (£251.8m decrease) with off balance sheet securities under the FLS (£363.9m increase) in its liquidity portfolio. Together with £80.2m of cash received from the Rochester 1 disposal, this generated £324.3m of cash inflows from investing activities. In addition, the Group drew down £101.0m of cash under the TFS which is reflected in the cash generated from financing activities.

In 2015, the Group increased its loans and advances to customers by £1,226.0m. This was mainly funded by an additional £1,032.2m of deposits from retail customers, driving the £79.3m used in operating activities. The remaining funding came from the utilisation of the Group's cash reserves which were replaced with off balance sheet securities from the FLS (£160.7m) in the Group's liquidity portfolio. In addition, the Group purchased £235.3m of investment securities as part of its liquidity management driving cash used in investing activities of £244.4m.

Further information can be found in the Statement of Cash Flows on page 103.

1. Effective tax rate excludes £0.5m of adjustments relating to prior years.

UNDERSTANDING PROPERTY

NEIL RICHARDSON
GROUP REAL ESTATE STRATEGY DIRECTOR

"An in-depth understanding of property is key to our lending strategy."

As a Chartered Surveyor I have spent my entire career working in the residential and commercial property markets. As you would expect, reviewing and analysing third party valuations takes up a large amount of our time and whilst the capital value is of paramount importance we give equal weighting to the marketability of the property from both an occupier and purchaser perspective. We need to ensure the rental and purchaser demand is sustainable and that the asset will represent good lending security throughout the mortgage term. This ensures that the Bank has an excellent understanding of the property when assessing a case in support of the underwriters and then on an ongoing basis.

I have strategic responsibility for the Group's property activity including appointing a panel of surveyors, how we undertake valuations for the larger and more complex properties, and valuation audits. Last year, we audited more than 20% of valuations in-house to make sure they are consistent and aligned with our lending goals.

I also look after the Group's corporate real estate assets so have a hands on role managing and maintaining a number of properties.

CHIEF RISK OFFICER'S REPORT

Throughout 2016, significant progress has been made with respect to embedding the Strategic Risk Management Framework ('SRMF'), through further extending the core risk disciplines defined by the SRMF across all key underlying risk categories, with a particular focus on risk analytical capabilities, data management and management information and reporting.

The Group has continued to grow its balance sheet during 2016 in a profitable and prudent manner. Adherence to Board approved risk appetite has remained strong throughout the period with the underlying quality of the loan portfolio exhibiting strong performance. The Group has further strengthened its core solvency and liquidity ratios in an uncertain economic, political and regulatory environment.

The Risk function has continued to deliver against its overarching objective of being a strategic partner whilst retaining its independence. This has been achieved by judicious and considered investment in risk data and analytics and enhancing risk management capability through a further increase in the size and structure of the Risk function. The nature and quality of engagement with internal and external stakeholders has further strengthened the risk culture and ensured increased embeddedness of the risk disciplines.

Whilst the UK economic performance has remained broadly stable throughout the year, the outlook remains uncertain post the referendum decision to leave the European Union. Further global uncertainty has been created following the recent US presidential election. The Group continues to closely monitor economic developments within the UK and overseas, with support from its independent macroeconomic advisors.

The Group remains highly confident in the underlying robustness of the business model and quality of the balance sheet as demonstrated by ongoing stress testing analysis.

The continued supervisory focus on the Buy-to-Let sector has been an important consideration for the Credit and Risk functions. The inherent strength of the Group's underwriting procedures and risk measurement capabilities have enabled the Group to respond effectively to the changes in its primary sectors.

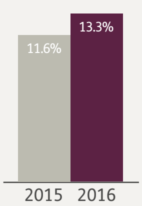
The Group has made significant progress in the development of its IFRS 9 and Internal Ratings Based ('IRB') models. The Board has identified transition towards IRB based capital treatment as an important strategic objective. The net potential benefits of the IRB approval remain uncertain given the ongoing consultations in relation to changes to the standardised risk weights and IRB floors. However, the Group also views the IFRS 9 and IRB model development initiative from the perspective of enhancing wider risk management capabilities. In particular, the increased granularity of risk based information would further enhance portfolio optimisation and pricing capabilities.

RISK PROFILE REVIEW

Coupled with the strong financial performance, the Group's risk profile has been managed in accordance with the Board approved risk appetite. The performance against key risk indicators has been strong throughout the year. The table below outlines the comparative analysis of the leading risk indicators with supporting commentary.

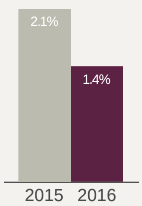
KEY RISK INDICATORS / COMMENTARY

CET1 Ratio



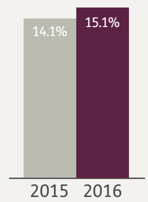
- Improvements in the Group's arrears profile in conjunction with stable LTV ratios resulted in a reduction of average mortgage credit risk weights applied during the year. Strong loan book growth resulted in higher total risk weighted asset values.
- In comparison, CET1 capital increased significantly more owing to strong profitability and an exceptional gain from the disposal of Rochester 1 of £34.7m.

3+ Months in Arrears



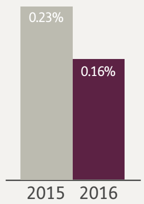
- Marked reduction in the percentage of loan balances more than three months in arrears, resulting from underlying book performance, in conjunction with the sale of non performing loans.
- Continued strong performance across newly originated loans, with improvements in acquired portfolio arrears levels drove overall Group arrears performance throughout 2016 (note: 3+month in arrears ratios exclude the legacy problem loans, underlying 3+ months arrears ratio would have been 1.5%).

Total Capital Ratio



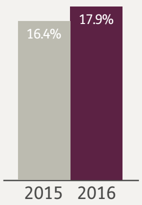
- The Group's Total Capital Ratio (TCR) was further strengthened during 2016 driven by strong profit generation during the period.
- An increase in total risk weighted assets was primarily driven by loan book growth, whilst continued improvements in the Group's credit profile led to a reduction in average mortgage credit risk weights.

Cost of Risk



- The Group observed strong arrears performance over the period, driven by organic origination performance. Problem legacy loans continued to run down during the period. LTV ratios remained broadly stable during the period of continued growth. In conjunction, the acquired portfolios, funding lines and development finance businesses continued to perform in line with expectations, resulting in an improved cost of risk.

Liquidity Ratio



- The Liquidity ratio has improved owing to total liquid assets increasing by 19% driven by increased use of the FLS scheme (off balance sheet). In contrast, liabilities only increased by 9% largely driven by retail funding.

KEY RISK INDICATORS OVERVIEW

INDIVIDUAL RISK TYPE REVIEW

Credit Risk

The Group's credit portfolio has exhibited strong performance across all risk indicators and has operated within the Board approved risk appetite. Deep market knowledge, prudent lending policies and supportive market conditions have been the underlying explanatory factors.

OSB continues to identify low-risk opportunities in areas of the market poorly serviced by mainstream lenders, including the delivery of compelling products to professional Buy-to-Let landlords, first charge bespoke residential, second charge loans to prime borrowers at conservative LTV levels, commercial loans against highly marketable properties, and niche residential development lending to borrowers with strong track records and credible projects. We offer secured funding lines to finance companies, managing credit risk through cross-collateralisation.

The Group carefully underwrites each lending case, maintains sensible LTVs, assesses affordability on each loan and avoids lending on property where we believe current valuations are unsustainable. A suite of portfolio limits have been established in adherence to the Board credit risk appetite. Stress and scenario analysis are used to assess the potential impact on credit impairments, losses and capital requirements when subjected to severe but plausible stress scenarios.

The Group ensures that security valuations are reviewed on an ongoing basis for appropriateness, with ongoing annual indexing of commercial properties, with residential properties indexed against monthly HPI data. Where the Group identifies that a published index is not representative, a formal review will be carried out by the Group Real Estate function to assess valuations appropriately. The Group Real Estate function ensures that newly underwritten lending cases are written to appropriate valuations, with assessment being carried out by appointed, qualified chartered surveyors, accredited by the Royal Institute of Chartered Surveyors (RICS). The Group has ensured that the Real Estate function is placed within the Bank's assurance team and are therefore independent from all credit making decisions.

Since its inception, the Group has experienced material loan growth with Group loans and advances totalling £5.9bn as at December 2016. Importantly, there has been a portfolio composition change over the period, with post 2011 lending (incorporating enhanced lending criteria) now making up a greater proportion of the total Group loan balances. Since 2011, the Group has originated 29,000 loans with only 91 cases with aggregate balances totalling £8.6m greater than three months in arrears, with an average 60% LTV, reflecting the continued strength of the Group's underwriting and lending criteria. During 2016, the Group continued to prudently underwrite new loans, carefully assessing customer affordability as demonstrated by the number of newly originated residential mortgage loans with a loan to income of greater than 4.5 falling to 2.6% from 3.3% during 2015. Buy-to-Let interest coverage ratios ('ICR') for new loans increased to 171% up from 159% during 2015, further demonstrating the prudent underwriting conducted during 2016. Buy-to-Let LTVs for new lending remained stable at 70%, whilst residential mortgage new lending LTVs increased marginally to 66% from 64% during 2016. The acquired portfolios, funding lines and development finance portfolios continued to perform in line with expectations, whilst the Group also sold £10.9m (gross value) of non-performing personal loan accounts during the year. Pre 2011 lending balances continued to run down during the year, and historic problem loans reduced from £17.8m to £13.8m as at December 2016.

The net impact of the above loan book composition changes and strong performance of new lending, in conjunction with the sale of non-performing loan balances resulted in the Group observing a historically low portfolio greater than three months in arrears rate of 1.4% versus 2.1% as at December 2015 (excluding legacy problem loan balances).

Forbearance measures undertaken during 2016:

Forbearance type	Number of accounts 2016	2016 year end balances £m	Number of accounts 2015	2015 year end balances £m	2016 vs 2015 variance number of accounts	2016 vs 2015 variance of balances
Interest only switch	60	6.3	106	10.7	(46)	(4.4)
Interest rate reduction	3	2.2	–	–	3	2.2
Term extension	31	5.9	59	3.5	(28)	2.4
Payment holiday	37	3.6	21	6.5	16	(2.9)
Voluntary assisted sale	–	–	11	7.7	(11)	(7.7)
Payment concession (reduced monthly payments)	58	6.4	70	5.7	(12)	0.7
Capitalisation	3	0.1	4	0.2	(1)	(0.1)
Full or partial debt forgiveness	–	–	–	–	–	–
TOTAL	192	24.5	271	34.3	(79)	(9.8)

Loan Type	Number of accounts 2016	2016 year end balances £m	Number of accounts 2015	2015 year end balances £m	2016 vs 2015 variance number of accounts	2016 vs 2015 variance of balances
First charge owner occupier	117	12.3	200	21.0	(83)	(8.7)
Second charge owner occupier	60	6.2	38	1.3	22	4.9
Buy-to-Let	14	5.5	27	11.5	(13)	(6.0)
Commercial	1	0.5	6	0.5	(5)	(0.1)
TOTAL	192	24.5	271	34.3	(79)	(9.8)

CHIEF RISK OFFICER'S REPORT CONTINUED

There was however an observed increase in Buy-to-Let not impaired past due 1 to 3 months as at December 2016 (see note 35 Risk Management and financial instruments analysis of mortgage portfolio by arrears for BTL/SME), driven by a low number of high balance cases which fell into arrears during 2016 and technical arrears balance inflow during December 2016 resulting from requested payments being carried over into the first working day of January 2017. In all cases the technical arrears accounts moved back up to date. There was also an increase in residential first charge balances not in impairment but past due 1 to 3 months, driven by historic legacy loans falling into arrears during the year in conjunction with arrears balances introduced via portfolio purchases within the year (see note 35 Risk management and financial instruments analysis of mortgage portfolio by arrears for residential).

Occasionally, some borrowers experience financial difficulties which impact their ability to meet mortgage finance obligations. We may seek to identify borrowers who are experiencing financial difficulties as well as contacting borrowers whose loans have gone into arrears, consulting with them in order to ascertain the reasons for the difficulties and to establish the best course of action to be taken to bring the account up-to-date. In certain circumstances, where the borrower is experiencing significant financial distress, we may use forbearance measures to assist them.

Throughout the year the Group materially enhanced its identification and management of forborne accounts. With respect to proactive identification the Group now leverages external forward looking bureau information, analysing probability of default and customer indebtedness which in turn underpin pre arrears watchlist triggers. Watchlist cases are then in turn carefully monitored and managed as appropriate. During the year the Group also internally developed a collections dashboard tool, again leveraging external bureau information which provides the arrears management team with detailed information about the borrower's full financial position, facilitating enhanced conversations when establishing the best course of action to bring their accounts up to date or out of a forborne state.

The Group continues to observe low levels of accounts in forbearance with total forbearance balances reducing materially within the year (see tables on page 35).

Solvency Risk

The Group continues to maintain an appropriate level and quality of capital to support its growth objectives and to meet its prudential requirements. By subjecting its financial operating plan to extreme but plausible stresses, the Group is able to assess the effectiveness of its capital strategy and plan under expected and stressed market conditions.

The Group defines its solvency risk appetite by projecting forward its capital requirements (internal and prudential) and ensuring that it currently holds sufficient CET1 and total capital to meet its target capital ratios.

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

During the course of 2016, the Bank strengthened its common equity tier 1 ('CET1') capital ratio and total capital ratio despite organic and inorganic growth, demonstrating the strength of internal capital generation capabilities of its business through profitability.

Liquidity and Funding

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

The Bank has successfully utilised the Bank of England Funding for Lending ('FLS') and Term Funding Scheme ('TFS') secured funding facilities to manage its liquidity in 2016, and continues to attract new retail savers and retain existing customers through transparent and loyalty-based product offerings.

During the course of 2016, the Bank actively managed its liquidity and funding profile within the confines of its risk appetite as set out in the Liquidity Risk Policy and reviewed in the year-end Individual Liquidity Adequacy Assessment Process ('ILAAP').

Market Risk

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

Interest Rate Risk

The Bank does not actively assume interest rate risk and does not seek to take a significant directional interest rate position. Limits have been set to allow management to run some un-hedged positions in response to balance sheet dynamics and capital has been allocated for this. The Bank does not take a directional view on future interest rates. The capital allocation has been set to be proportionate to the available CET1 capital to allow for balance sheet growth.

The Group sets limits on the mismatch between fixed-rate assets and liabilities, taking into account interest rate swaps that are in place. Exposure is mitigated on a continuous basis through the use of derivatives within limits set by the ALCO, the Board and reserve allocations (currently 1.5% of common equity tier 1 capital). The limit is measured against the sensitivity of the fair value of the portfolio as a whole to defined yield curve scenarios. These moves are specified in the Board-approved interest rate and basis risk policy and capture parallel movement, twist, and flex in the yield curve. The stress scenario interest rate movements are scaled to approximate the potential move over one year at 99.9% two-tailed confidence interval. After taking into account the derivatives entered into by the Group, the highest loss under these scenarios as at year end would have been £1.9m and the highest gain £2.1m. Against a parallel interest rate movement of 2%, the impact would have been £3.9m gain (2015: £0.2m gain) recognised in the statement of profit or loss.

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 common equity tier 1 capital, with exposure assessed and monitored monthly across a range of 'business as usual' and stressed scenarios.

Operational Risk

OSB continues to assume 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 techniques in order to promote an environment of progressive operational risk management. The Group's operational processes, systems and controls are designed to minimise disruption to customers, damage to the Bank's reputation and any detrimental impact on financial performance. The Bank actively promotes the continual evolution of its operating environment through the identification, evaluation and mitigation of risks, whilst recognising that the complete elimination of operational risk is not possible.

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 functional area has 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 Group Operational Risk function.

Regulatory and Compliance Risk

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

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

In order to minimise regulatory risk, OSB maintains a proactive relationship with key regulators, engages with industry bodies such as the Council for Mortgage Lenders and British Bankers' Association, and seeks external advice from our professional advisers. The Group also assesses the impact of upstream regulation on OSB and the wider markets in which we operate, and undertakes robust assurance assessments from within the Risk and Compliance functions.

During 2016, the Group has responded effectively to a broad range of regulatory changes impacting its primary products (Buy-to-Let and ISAs), Board and senior management governance and oversight (Senior Managers and Certification Regime) and financial crime (EU Fourth Money Laundering Directive).

Conduct Risk

The Group's culture and behaviours are central to ensuring a fair and considered approach in dealing with its customers. It operates in a manner that ensures the underlying integrity of markets in which it operates. OSB will not tolerate any systemic failure to deliver fair customer outcomes or practices that distort markets.

On an isolated basis, incidents can result in customer 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 views effective conduct risk management as a core feature of its risk culture and values. A clear tone from the top with respect to conduct ensures awareness of behaviours which demonstrate commitment to good customer outcomes and market integrity.

Strategic and Business Risk

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

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

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

KEY EVENTS AND ACHIEVEMENTS DURING 2016

The Group has further improved its approach to assessing and calibrating its risk appetite through closer alignment with the Group's strategic objectives and business operating plan. Through the use of stress testing analysis the risk appetite has been calibrated to ensure that the level of risk being assumed is commensurate with the risk management and absorption capabilities of the Group.

CHIEF RISK OFFICER'S REPORT CONTINUED

The Group's IFRS 9 programme progressed to plan, moving into the parallel run phase for 2017. Embedding the IFRS 9 framework into the standard monthly reporting processes is ongoing.

An important strategic initiative for the Group is to progress towards the implementation of an IRB approach for credit risk. Tangible progress has been made during 2016 with a suite of first generation IRB models being developed. This is a significant milestone for the Group.

Improvements made to the collective provision methodology have enabled the Group to better align its approach to industry good practice basing its provisioning decisions on a more robust and prudent approach. A comprehensive review of the methodologies, judgements and estimates which underpin IAS 39 collective provisioning calculations took place during 2016.

Risk based management information has been identified as a critical area of enhancement and investment. During 2016, the Group has leveraged the improved analytics and has aligned internal risk data with external credit bureau customer profiles to provide a more insightful and forward looking assessment of its risk profile.

The Group has identified stress testing capabilities as a critical tool to assess and quantify the potential areas of vulnerability in its risk profile. Stress testing as a discipline has been applied across all principal risks, based on industry best practice and regulatory guidelines. Stress testing has also been used to support the Group's development of both the ICAAP and ILAAP.

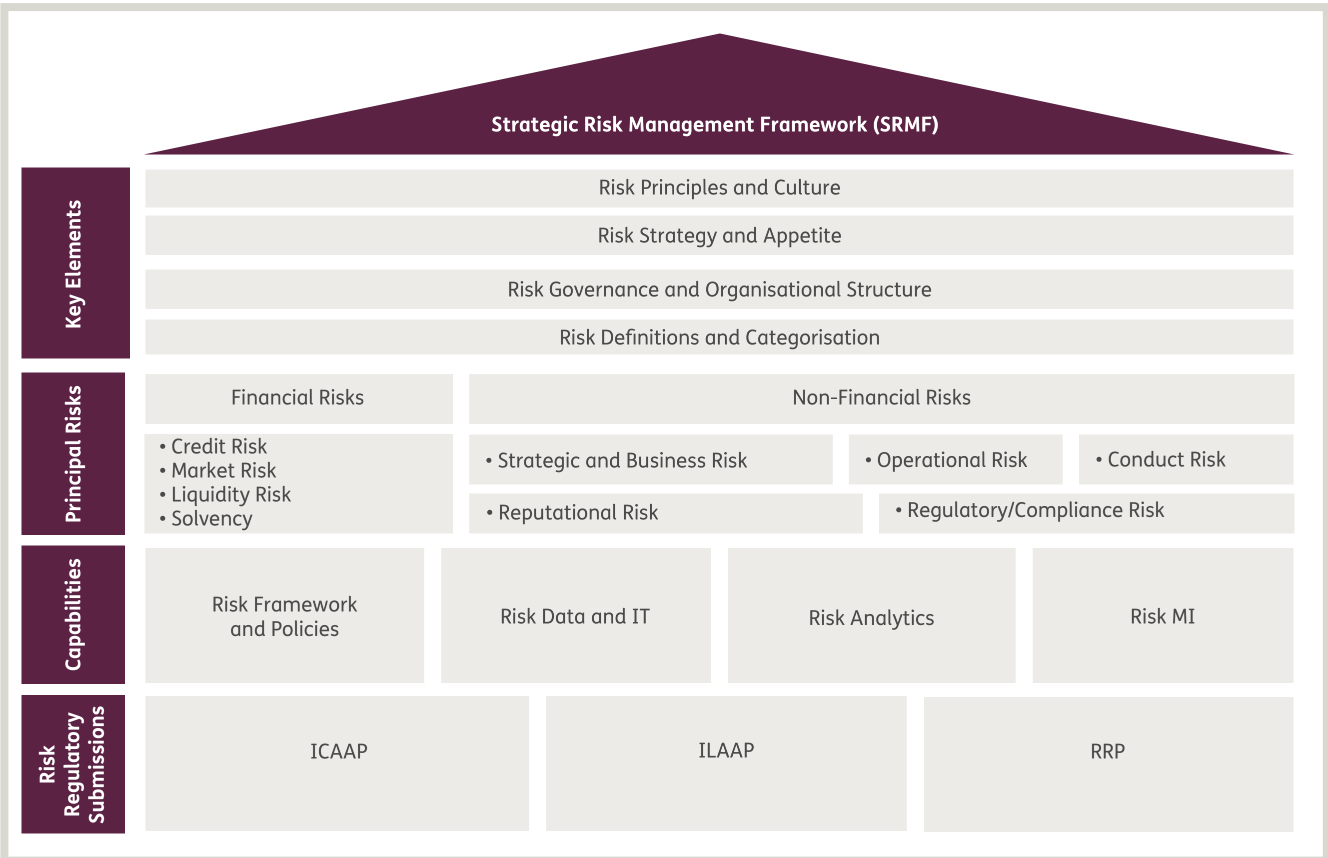
To ensure that the Group's growth objectives are achieved in a stable and controlled operating environment, a significant level of management focus has been placed on further enhancements to the Operational Risk Management Framework. A fully integrated purpose built risk management system ('OSIRIS') has been put in place, supporting both operational and conduct risk management.

A comprehensive Group-wide Risk and Control Self-Assessment ('RCSA') has been performed to identify material risks and assess controls effectiveness. Identified risks have also informed the Bank's operational risk scenario exercise which in turn informed the internal assessment of capital requirements.

PRIORITIES FOR 2017

On a forward looking basis, the Risk function has identified the following areas of priority:

- Integration of the IFRS 9 capability into other core risk processes such as risk appetite, ICAAP, stress testing and risk based pricing, is a priority for 2017.
- Integration of the IRB capability into the Group's capital monitoring and planning framework and independent review and validation of the first generation models are key objectives for 2017. In parallel, a comprehensive self-assessment against the regulatory requirements will take place within the year allowing further development of the implementation route to gaining the necessary regulatory approvals.
- The Risk function will be an important contributor to the Strategic Data Management Project, in light of the requirements arising from IRB, but also the wider risk data



management discipline's outlined in the Strategic Risk Management Framework.
- Further build out of the Group's risk management information capability is a continuing priority for 2017. This is a key area where further enhancements will result in even more informed risk and reward decisions being made across the Group.
- In line with the Group's business model the Risk function plans to build out a risk analytics support function at our OSBIndia subsidiary to support our UK based risk teams. Investment in enhanced risk analytics continues to be viewed as essential in delivering the risk strategy and keeping pace with industry standards and regulatory expectations.

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 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. It is an input to the PRA's L-SREP process, which leads to regulatory liquidity buffer guidance.

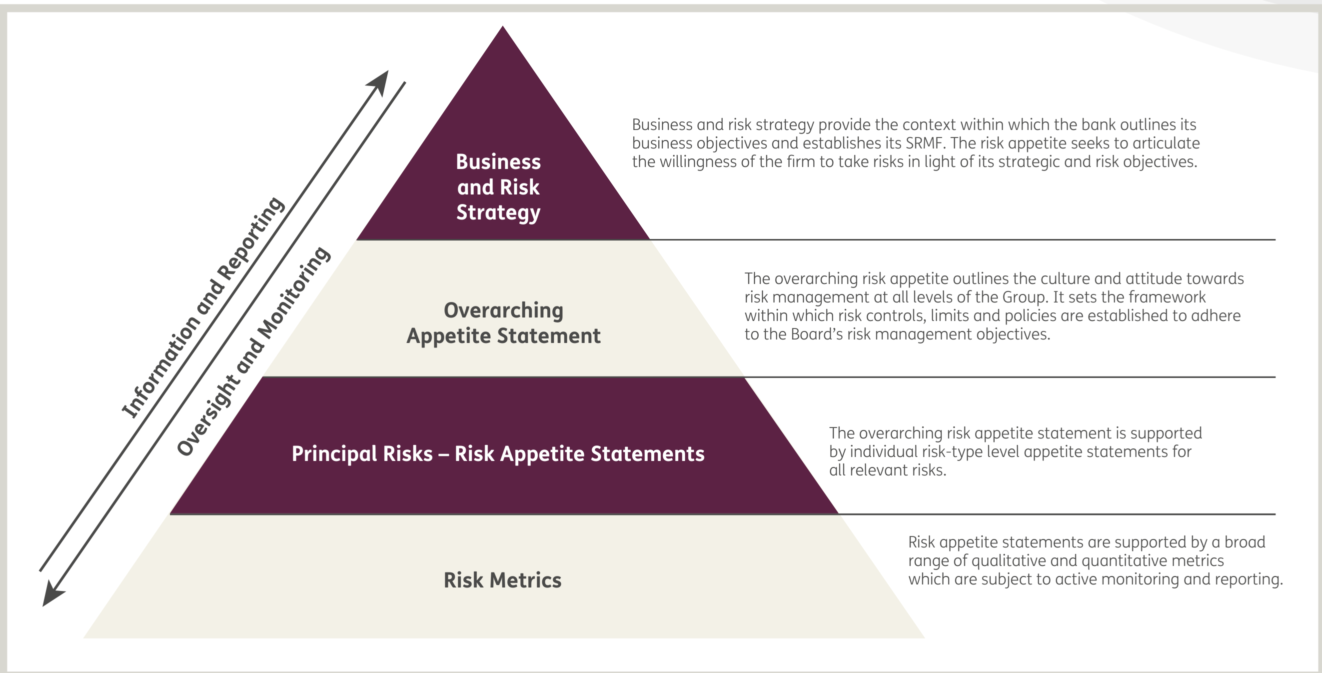
The Group also reviews and updates its Recovery and Resolution Plan ('RRP') on an annual basis. The recovery plan process is designed to ensure that the Group's recovery plan is credible and can be implemented in a time of stress. The Group's recovery options are assessed for feasibility and time to 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 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 Bank actively engages with its key regulators to ensure that the supervisory teams are kept abreast of the Bank's strategic and business objectives, the risks to which it is exposed and the adequacy of risk controls and mitigants.

Strategic Risk Management Framework Overview

OSB continues to enhance and leverage its SRMF in support of its strategic and business growth objectives. OSB's approach to risk management ensures effective identification, assessment and pricing of risk and therefore is a critical driver of the Bank's competitive advantage. Effective risk management has generated shareholder value through the optimisation of the risk-reward profile which is framed within the Board approved risk appetite. Specifically, OSB's risk management capabilities have made it possible to operate in distinct specialist market segments.

The SRMF and its core modular components are subject to periodic review and approval by the Board and its oversight committees. The modular construct of the SRMF makes it dynamic and versatile, making it an enduring framework. The integrated nature of the SRMF provides for improved Board oversight, engagement, and monitoring of the Bank's risk profile. The following sections describe the key modules of the SRMF structure.



CHIEF RISK OFFICER'S REPORT CONTINUED

RISK PRINCIPLES AND CULTURE

The Board has established overarching risk based principles. These risk principles provide for a clearly articulated risk vision and strategy, and ensure that the Bank's risk capabilities and processes are aligned. The risk principles are:

- Customer Interests: Customer outcomes and conduct risk are central to all aspects of OSB's business and control functions
- Proportionate and Commensurate: The Strategic Risk Management Framework reflects the complexity of the Bank's business model and is scalable to accommodate future growth
- Defined Risk Appetite: Risks are assumed subject to defined qualitative statements and quantitative limits and thresholds
- Coverage: All principal risks are identified, assessed and managed based on robust systems and controls
- Risk Governance: Risk taking and oversight responsibility is appropriately segregated, in adherence to the 'three lines of defence' principle
- Integration and Usage: Risk management disciplines are fully integrated into the Board and senior management decision making processes
- Versatile: Risk framework and underlying capabilities are subject to ongoing review and are adaptive to the changing operating environment and the Bank's business model

The Group's corporate vision of being a leading specialist lender within its chosen markets helps to shape its risk culture. The Board and senior management have cultivated a risk culture which encourages a proactive, transparent and informed approach to risk management in a balanced and considered manner, taking into account stakeholder expectations and good customer outcomes.

RISK STRATEGY & APPETITE

RISK STRATEGY

The Group's risk strategy is to create value through correct decisions being taken informed by accurate and timely risk assessments.

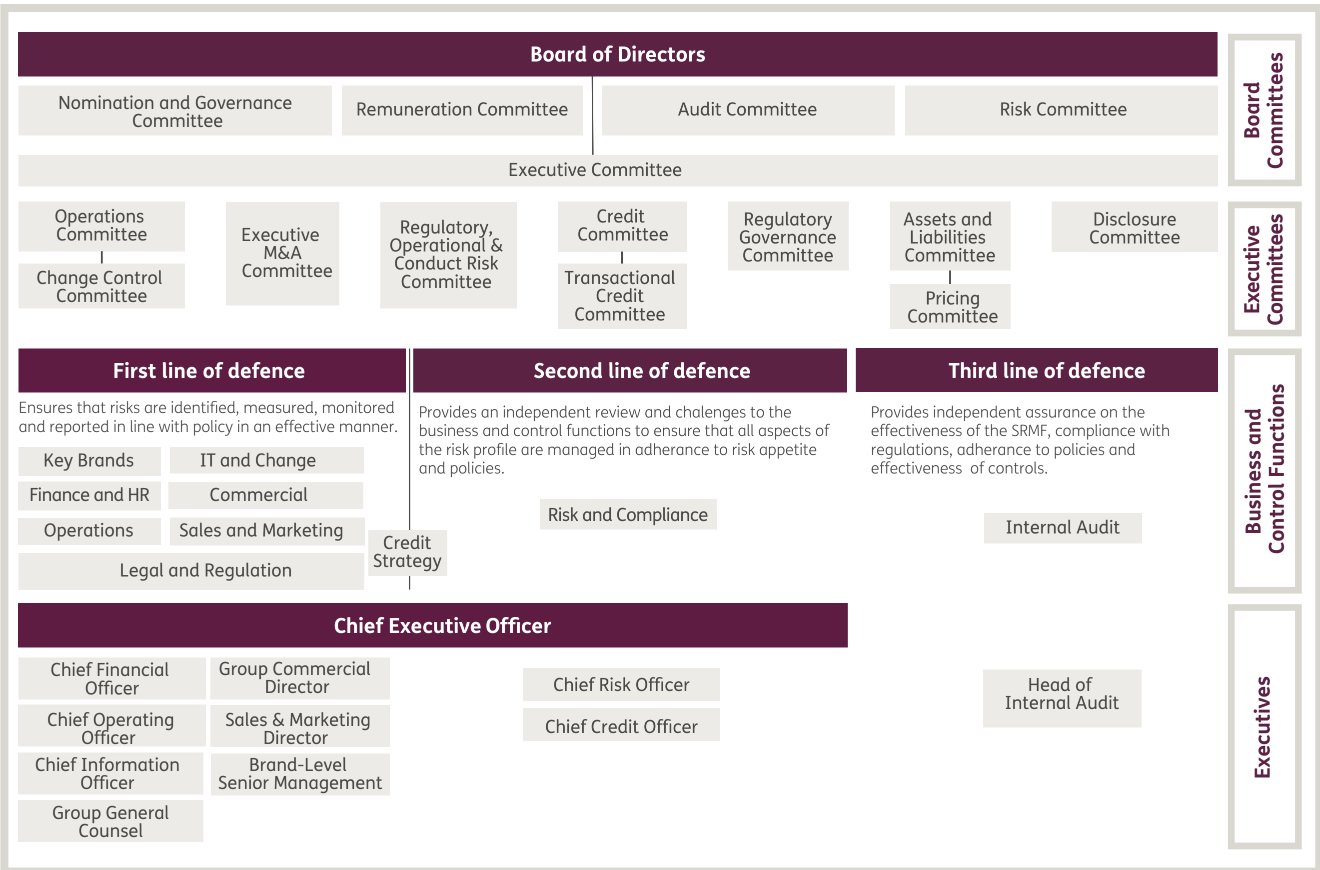
This risk strategy is based on three key components:

- Scalability of the Risk function;
- Structure and discipline around how risks are identified, assessed and managed;
- Risk management capability leveraged to create true information value.

RISK APPETITE

At OSB, we have established a clear linkage between our strategy and risk appetite, ensuring that the setting and monitoring of risk appetite is embedded within the business (with respect to processes e.g. business planning processes, new product development / approval). Our risk appetite is

The OSB risk governance framework is summarised in the diagram below.



informed by our strategic choices and our business strategy, which in turn is developed within the confines of our articulated risk appetite. Our risk appetite is calibrated to a plausible but extreme macroeconomic scenario severity (1 in 20), which seeks to ensure that our strategy and business model remains resilient under a range of macroeconomic environments.

The risk appetite process is informed by robust statistical analysis which supports the development of scenario analysis and stress testing. Our risk appetite framework ensures we understand how the Group performs under current market and economic conditions and under a range of stress scenarios.

OVERARCHING RISK APPETITE STATEMENT

The Bank has a prudent and proportionate approach to risk taking and management, which is reflective of its straightforward business model. The business model is based on secured lending, robust underwriting standards, intermediary based distribution, stable funding, financial strength, and efficient and effective operational capabilities. A strong conduct and compliance culture is critical to the overall success of the Bank.

RISK GOVERNANCE AND ORGANISATIONAL STRUCTURE

Risk governance refers to the processes and structures established by the Board to ensure that risks are taken within the approved appetite, with clear delineation between risk taking and oversight responsibilities.

The Group has established a structural approach to risk governance, ensuring an effective level of alignment between oversight and management responsibility for risk. The risk governance structure has clearly defined roles and responsibilities for Board and Management committees, control functions and the accountable executives. The risk based roles and responsibilities are organised in adherence to the 'three lines of defence' principle to ensure appropriate levels of segregation.

The Board acts directly or through its committees to discharge its risk oversight and control responsibilities. The Board and its committees are provided with appropriate and timely information relating to the nature and level of risks to which the Group is exposed and the adequacy of risk controls and mitigants. Internal Audit provides independent assurance as to the effectiveness and compliance with the SRMF and the underlying risk management policies and procedures.

The executive function has day-to-day responsibility for managing the risk profile of the Group within the defined risk appetite, with oversight and guidance provided by the Board and its Risk Committee. The Chief Risk Officer is the executive accountable for establishing an effective risk management and reporting framework. The Chief Risk Officer has dual reporting lines into the Chief Executive Officer and the Chair of the Board Risk Committee.

The Chief Risk Officer has management responsibility for ensuring an independent risk oversight and reporting function is established and is able to undertake its second line responsibility. The risk function is organised to ensure an appropriate level of resources and capabilities are in place to identify, assess, manage and report all material risks.

Management level risk committees have been established to ensure a more focused approach to the review and challenge of individual principal risk profiles take place. Additional sub-committees are also in place which focus on specific and finer aspects of the risk profile and its ongoing management. For example, the Transactional Credit Committee, a sub-committee of the Credit Committee, meets twice a week to sanction individual lending cases that fall outside the mandates of the underwriting team.

THE OSB RISK GOVERNANCE STRUCTURE IS DETAILED BELOW

RISK	CREDIT	MARKET	LIQUIDITY	OPERATIONAL	REGULATORY	CONDUCT
BOARD GOVERNANCE	Board					
	Risk Committee				Audit Committee	
MANAGEMENT GOVERNANCE	EXECUTIVE COMMITTEE					
	Credit Committee	Asset and Liability Committee (ALCO)		Regulatory, Operational, and Compliance Risk Committee (ROCC)		
	CHIEF RISK OFFICER					
FRAMEWORKS	Strategic Risk Management Framework					
KEY POLICIES AND DOCUMENTS	Lending Policy, Arrears, Repossession and Forbearance Policy	Interest Rate and Basis Risk Policy	Treasury, Funding Risk, and Liquidity Risk Policies	Operational Risk Framework/Policy, Anti Money Laundering Policy, Anti Corruption and the Bribery Policy, Approved persons, Data retention, Fraud, Waiver and Modification policies		Conduct Risk Framework, Conduct Risk Policy
	ICAAP					
		ILAAP				
MANAGEMENT INFORMATION	Credit MI pack	ALCO MI pack		Operational Risk MI pack	Compliance and Financial Crime MI pack	Conduct Risk MI pack

PRINCIPAL RISKS AND UNCERTAINTIES

The Board has carried out a robust assessment of the principal risks and uncertainties facing the Group, including those that could threaten its business model, future performance, solvency or liquidity, as set out in the table below.

STRATEGIC AND BUSINESS RISK

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

RISK APPETITE STATEMENT	RISK	MITIGATION 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 would put at risk its vision of being a leading specialist lender, backed by a strong and dependable savings franchise. The Group adopts a long-term sustainable business model which, while focused on niche sub-sectors, is capable of adapting to growth objectives and external developments.	Performance against strategic and business targets does not meet stakeholder expectations. This has the potential to damage the Group's franchise value and reputation.	Regular monitoring by the Board and the Executive Committee of monitoring of strategic and business performance against market commitments, the balanced business scorecard and risk appetite. Use of stress testing to flex core business planning assumptions to assess potential performance under stressed operating conditions.	UNCHANGED The Group's strategic and business operating environments are subject to ongoing changes primarily driven by market competition, economic outlook and regulation. However, the business model has proven to be resilient and responsive to the dynamic environment in which it operates.

REPUTATIONAL RISK

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

RISK APPETITE STATEMENT	RISK	MITIGATION AND CONTROLS	DIRECTION
The Group does not knowingly conduct business or organise its operations to put its reputation and franchise value at risk.	Potential loss of trust and confidence that our stakeholders and customers place in us as a responsible and fair provider of financial services.	Culture and commitment to treating customers fairly and being open and transparent in communication with key stakeholders. Established processes to proactively identify and manage potential sources of reputational risk.	UNCHANGED The Group has increased the size and capabilities of its Risk and Compliance function to ensure appropriate oversight of the growing balance sheet.

CREDIT RISK

Definition – Potential for loss due to the failure of a counterparty to meet its contractual obligations 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 in benign and stressed periods. The portfolio is actively managed to operate within set criteria and limits based on profit volatility, focusing on key sectors, recoverable values, and affordability and exposure levels. The Group aims to continue to generate sufficient income and control credit losses to a level such that it remains profitable even when subjected to a credit portfolio stress of a 1 in 20 intensity stress scenario.	INDIVIDUAL BORROWER DEFAULTS Borrowers may encounter idiosyncratic problems in repaying their loans, for example, loss of a job or execution problems with a development project. While most of the Bank's lending is secured, some borrowers fail to maintain the value of the security.	All loans are extended only after thorough bespoke and expert underwriting to ensure ability and propensity of borrowers to repay and sufficient security in case of default. Should there be problems with a loan, the collections and recoveries team works with customers unable to meet their loan service obligations to reach a satisfactory conclusion while adhering to the principle of treating customers fairly. Our strategic focus on lending to professional landlords means that properties are likely to be well managed, with income from a diversified portfolio mitigating the impact of rental voids or maintenance costs. Lending to owner-occupiers is subject to a detailed affordability assessment, including the borrower's ability to continue payments if interest rates increase. Lending on commercial property is more based on security, and is scrutinised by the Group's independent Real Estate team as well as by external valuers. Development lending is extended only after a deep investigation of the borrower's track record and the specific project and requires approval by a dedicated Development Finance Transactional Credit Committee.	DECREASED Greater than three months in arrears balances fell to a historically low rate of 1.4% from 2.3% (not including legacy problem loans) during 2016, driven by the strong credit performance of post 2011 lending (underwritten using enhanced lending policy). Pre 2011 lending including legacy problem loans continues to run down. During December 2016, the Group sold £10.9m of non-performing personal loans which contributed to the marked reduction in arrears balances. Group weighted average loan to value ratios of the mortgage book remained low at 63% at the end of 2016, with an average LTV of 69% for new originations within the year.

CREDIT RISK CONTINUED

RISK APPETITE STATEMENT	RISK	MITIGATION AND CONTROLS	DIRECTION
	MACROECONOMIC DOWNTURN A broad deterioration in the economy would adversely impact both the ability of borrowers to repay loans and the value of the Group's security. Credit losses would impact across the lending portfolio, so even if individual impacts were to be small, the aggregate impact on the Group could be significant.	The Group works within portfolio limits on LTV, affordability, name, sector and geographic concentration that are approved by the Risk Committee and the Board. These are reviewed at least annually. In addition, stress testing is performed as part of the ICAAP to ensure the Group maintains sufficient capital to absorb losses in an economic downturn and will continue to meet its regulatory requirements.	INCREASED Although the UK economy has remained stable during 2016, the economic outlook is uncertain following the result of the EU referendum and the US presidential election.
	WHOLESALE CREDIT RISK The Bank has wholesale exposures both through call accounts used for transactional and liquidity purposes and through derivative exposures used for hedging.	The Group transacts only with high-quality wholesale counterparties. Derivative exposures include collateral agreements to mitigate credit exposures.	UNCHANGED The Group continues to utilise a reserve account with the Bank of England, enabling it to eliminate credit risk on most of its liquidity portfolio.

MARKET RISK

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

RISK APPETITE STATEMENT	RISK	MITIGATION 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 has developed a better understanding of the potential impact of more complex movements in rates and enabling better hedging.
	BASIS RISK A divergence in market rates could lead to a loss in value, as assets and liabilities are linked to different rates.	The Group strategically focuses on products linked to administered rates to keep control of yield. Where there is a mismatch of market rates in the portfolio (e.g. base rate vs. LIBOR), the Treasury department hedges the exposure.	UNCHANGED Product design and hedging has enabled the Group to maintain the overall level of basis risk through the year.

LIQUIDITY 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 funding and liquidity to support its ongoing operations. It also maintains an appropriate level and quality of liquid asset buffer so as to withstand market and idiosyncratic liquidity-related stresses.	RETAIL FUNDING STRESS As the Group is primarily funded by retail deposits, a retail run could put it in a position where it could not meet its financial obligations.	The Group's funding strategy is focused on a highly stable retail deposit franchise. The large number of depositors provide diversification, with a high proportion of balances covered by the FSCS and so at no material risk of a retail run. In addition, the Group performs in-depth liquidity stress testing and maintains a liquid asset portfolio sufficient to meet obligations under stress. Finally, the Group has prepositioned mortgage collateral with the Bank of England, so that its liquidity insurance facilities can be accessed in the unlikely event that should become necessary.	DECREASED The Group has made continual improvements in both its regular liquidity forecasting and stress testing framework. In addition, it has gained access to the Bank of England liquidity insurance facilities.

PRINCIPAL RISKS AND UNCERTAINTIES CONTINUED

SOLVENCY RISK

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

RISK APPETITE STATEMENT	RISK	MITIGATION AND CONTROLS	DIRECTION
The Group seeks to ensure that it is able to meet its Board level capital buffer requirements under a 1 in 20 stress severity scenario. The Group's solvency risk appetite is constrained within the leverage ratio related requirements. We manage our capital resources in a manner which avoids excessive leverage and allows us flexibility in raising capital.	Key risks to solvency arise from balance sheet growth and unexpected losses which can result in the Bank's capital requirements increasing or capital resources being depleted such that it no longer meets the solvency ratios as mandated by the PRA and the Board risk appetite. The regulatory capital regime is subject to change and could lead to increases in the level and quality of capital that the Group needs to hold to meet regulatory requirements.	Currently the Bank operates from a strong capital position and a consistent record of strong profitability. The Bank actively monitors its capital requirements and resources against financial forecasts and plans and undertakes stress testing analysis to subject its solvency ratios to extreme but plausible scenarios. The Bank also holds prudent levels of capital buffers based on CRD IV requirements and expected balance sheet growth. The Group engages actively with regulators, industry bodies, and advisers to keep abreast of potential changes and provide feedback through the consultation process, and actively manages its capital strategy and plan.	DECREASED The Group has improved both its CET1 capital and total capital position increasing its 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 Bank's reputation and any detrimental impact on financial performance. The Bank actively promotes the continual evolution of its operating environment through the identification, evaluation and mitigation of risks, whilst recognising that the complete elimination of operational risk is not possible.	NETWORK/SYSTEM INTRUSION If hackers were to penetrate the Group's IT system, consequences could range from the diversion of funds to the theft of customer data.	A series of tools designed to identify and prevent network / system intrusions are deployed across the Group. The effectiveness of the controls is overseen by a dedicated IT Security Governance Committee, with specialist IT Security staff employed by the Bank.	UNCHANGED Whilst the Bank has made a series of enhancements to its defences in respect to IT security threats during 2016 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 Bank continues to invest in and enhance its data management architecture, systems, governance and controls.	INCREASED The increase in data risk has been primarily driven by the increased scale of operations and the multiple sources from which data is derived.
	PEOPLE RISK The risk that the Bank will be unable to meet its future resource requirements through a combination of higher than expected staff attrition and/or the inability to identify and hire candidates with the necessary skills.	The Bank has a series of initiatives that are intended to respond to this risk. This includes the introduction of a range of development programmes intended to improve retention and increase the population of in-house developed talent.	UNCHANGED As the business continues to grow, the need for additional resources increases the pressure on hiring. In a number of specialist areas, the issue is exacerbated by the wider industry demands for individuals with the relevant skills. However, the Bank is adopting a proactive approach to ensure future resource requirements can be met.
	OPERATIONAL RESILIENCE Banks should have business resiliency, continuity monitoring and plans in place to ensure an ability to operate on an ongoing basis and limit losses in the event of severe business disruption.	The Bank carries out scenario based Business Continuity Planning (BCP), has crisis management procedures and recovery and contingency plans. The BCP is periodically tested to ensure operability.	INCREASED The increasing scale and globalisation of operations together with dependencies on a number of third party service and network providers. The sophistication of cyber crime continues to evolve.

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 Bank considers its culture and behaviours in ensuring the fair treatment of customers and in maintaining the integrity of the markets in which it operates a fundamental part of its strategy and a key driver to sustainable profitability and growth. OSB does not tolerate any systemic failure to deliver fair customer outcomes. On an isolated basis, incidents can result in detriment owing to human and / or operational failures. Where such incidents occur they are thoroughly investigated, and the appropriate remedial actions are taken to address any customer detriment and to prevent recurrence.	PRODUCT SUITABILITY Whilst the Group originates relatively simple products, there remains a risk that (primarily legacy) products may be deemed to be unfit for their original purpose in line with the current regulatory definitions.	The Group has a strategic commitment to provide simple, customer-focused products. In addition, a Product Governance framework is established to oversee both the origination of new products and to revisit the ongoing suitability of the existing product suite. The combination of a dedicated Product Governance team and an independent Conduct Risk team serves to effectively manage this risk During the year, the Group established an effective product transfer programme.	DECREASED Whilst this risk has reduced in 2016 as a result of increased awareness and dedicated oversight, the Bank remains aware of the changes to the regulatory environment and their possible impact on product suitability.
	DATA PROTECTION The risk that customer data is accessed inappropriately, either as a consequence of network / system intrusion or through operational errors in the management of the data.	In addition to a series of network / system controls (documented within as part of the operational risks), the Bank performs extensive root cause analysis of any data leaks in order to ensure that the appropriate mitigating actions are taken.	UNCHANGED Despite a number of additional controls being introduced in 2016, the network / system threats continue to evolve 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 will not tolerate systemic failures to comply with the relevant laws, regulations and codes of conduct applicable to its business activities. The Group's compliance culture and supporting procedures ensure adherence to all relevant regulation and it actively monitors and assesses changing and emerging regulatory standards. The Group applies its own intellectual capital and seeks external advice where appropriate to ensure that it is compliant with the intent and spirit of regulation without causing unforeseen detriment to its customers.	Key compliance based regulatory changes that the Bank is subject to include EMCD, SMCR and potential macro prudential controls of the Buy-to-Let sector. Further proposals currently under discussion, including the Basel Committee consultation on standardised risk weights, which could lead to significant increases in the Group's capital requirements.	The Bank has adopted the EMCD and SMCR in an effective and timely manner. The adoption of SS13/16 and the lending policy requirements around affordability mean that the Bank should be well placed to respond to any macro prudential regulation of the Buy-to-Let sector. The Basel proposals will be subject to extensive consultation and the eventual outcome could be materially different to those initially proposed. The adoption of the eventual changes may take a number of years to implement. The Group intends to migrate to IRB. Another consultation of note relates to the recently published CP3/17 issued by the PRA, which details proposed refinements to the PRA's Pillar 2A capital framework. The Group is currently assessing the potential impact this consultation may have on the Group's capital strategy and plan going forward.	INCREASED The Bank has historically responded effectively to regulatory changes and does not believe that future changes represent a heightened level of compliance risk. Recent changes implemented as part of CRD IV have resulted in requirements for more and higher quality capital, though elements of these requirements are being phased in. Further proposals currently under discussion, including the Basel Committee standardised risk weight consultation, could lead to significant increases in the Group's capital requirements.
	CONDUCT REGULATION Regulatory changes focused on the conduct of business could force changes in the way the Group carries out business and impose substantial compliance costs. For example, the Financial Policy Committee's increased focus on Buy-to-Let lending or tax changes such as the Bank Corporation Tax Surcharge must be considered.	The Group has a programme of regulatory horizon scanning linking into a formal regulatory change management programme. In addition, the focus on simple products and customer oriented culture means that current practice may not have to change significantly to meet new conduct regulations.	INCREASED The regulatory environment has tightened and this is likely to continue, exposing the Group to increased risk.

VIABILITY STATEMENT

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

The three-year time period was selected for the following reasons:
- The Group's operating and financial plan covers a three-year period;
- The three-year operating and financial plan considers, among other matters: the Board's risk appetite; macro-economic outlook; market opportunity; the competitive landscape; and sensitivity of the financial plan to volumes, margin pressures and capital requirements;
- The Board believes that there is sufficient visibility over the economic and regulatory landscape and the market outlook offered by the three-year time horizon to make a reasonable assessment of viability;
- Uncertainty in the UK economic outlook over the medium to long-term following the EU referendum outcome; and
- Significant uncertainty exists in the regulatory horizon beyond this point, with the Basel Committee currently in consultation on standardised approaches to credit and operational risk.

The Company is authorised by the PRA, and regulated by the FCA and PRA, and undertakes regular analysis of its risk profile and assumptions. It has a robust set of policies, procedures and systems to undertake a comprehensive assessment of all the principal risks and uncertainties to which it is exposed on a current and forward-looking basis (as described in Principal Risks and Uncertainties on pages 42 to 45).

The Group manages and monitors its risk profile through its strategic risk management framework, in particular through its risk appetite statement and risk limits (as described in the Chief Risk Officer's Report on pages 34 to 41). Potential changes in its risk profile are assessed across the business planning horizon by subjecting the operating and financial plan to severe but plausible macroeconomic and idiosyncratic scenarios.

Stress testing is a vital discipline, which underpins the Company's ICAAP and ILAAP. The stress scenarios are identified based on the severity of underlying assumptions, relevance to the Company's business model and alignment with the Bank of England's prescribed stress scenario. In addition, the Company identified a suite of credible management actions that would mitigate the impact of the stress scenarios. The Board and executive management use the outcome of the stress test analysis to evaluate the Company's management options and adequacy of the Company's capital and liquidity resources to withstand an extreme but plausible stress scenario. The Company holds sufficient capital to withstand such a stress scenario.

In addition, the Group identifies a range of catastrophic stress scenarios, which could result in the failure of its current business model. Business model failure scenarios (reverse stress tests) are primarily used to inform the Board and executive management of the outer limits of the Group's risk profile. Reverse stress tests play an important role in helping the Board and its executives to identify potential recovery options under a business model failure scenario, and form an important aspect of the Company's recovery and resolution plans prescribed by the regulator.

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

ENHANCING OUR ANALYTICAL AND RISK MANAGEMENT

NICHOLAS HURST
HEAD OF PORTFOLIO CREDIT RISK

"My focus is to help the Group make ever more informed risk / return decisions."

I work with people across the Group to continually enhance analytical, risk measurement and monitoring capabilities.

Key components of my role include the formulation and monitoring of risk appetite, modelling the impact that a range of severity scenarios have on the Group's key performance indicators. This in turn supports the business to make ever more informed decisions across the credit lifecycle. My team also ensures that risk and return performance is in line with or exceeds our expectations.

Throughout 2016, we have made material enhancements to our analytical and risk measurement capabilities, via the ongoing delivery of our IFRS 9 and IRB programmes. Throughout 2017 and beyond, we will now look to leverage these capabilities to enhance the returns across our lending franchises. I believe that our constant drive and creative approach to enhancing our analytical and risk measurement capabilities will set us apart from our peers, allowing us to optimise the risk and return profile in the markets we choose to operate in.

CORPORATE RESPONSIBILITY REPORT

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

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

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

WHAT WE ACHIEVED

In 2016 we successfully delivered on a number of initiatives across the business aimed at improving our relationships with key stakeholders and achieving strong results.

ACHIEVEMENTS IN 2016

- Customers – consistently high consumer net promoter score – 59%
- Employees – committed to signing HM Treasury's Women in Finance Charter in order to promote gender diversity throughout the Group
- Communities – donated over £136,000 to Great Ormond Street Hospital

FOCUSED ON OUR CUSTOMERS

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

- communicate and deal with each customer on an individual basis
- act with consistency across all channels
- be a confident, open and trustworthy workforce
- offer simplicity and ease of business
- offer long-term value for money, and
- offer transparent products without the use of short-term bonus rates, and to offer the same rates to both existing and potential customers

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

The relevant policies include:

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

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

CORPORATE RESPONSIBILITY REPORT CONTINUED

CUSTOMER ENGAGEMENT

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

Our commitment to our customers is evidenced in the strong net promoter score (a measure of how likely a customer is to recommend a business on a scale of -100 to +100) we achieve across our lending and saving franchises which in 2016 has improved to 59%. In addition, we won numerous awards for being the best provider for a range of services from cash ISAs to Buy-to-Let mortgages.

KENT RELIANCE SAVINGS

WINNER: Best Bank Savings Provider, Moneyfacts Awards 2016 (for the second year running)

WINNER: Best Cash ISA Provider, Moneyfacts Awards 2016 (for the fourth year running)

WINNER: Best No Notice Account Provider, Moneyfacts Awards 2016 (for the second year running)

WINNER: ISA Provider of the Year, Consumer Moneyfacts 2016

WINNER: Best Regular Savings Provider, Moneynet Awards 2016

KENT RELIANCE FOR INTERMEDIARIES

WINNER: Best Specialist Lender, What Mortgage Awards 2016

WINNER: Best Buy-to-Let Mortgage Provider, Personal Finance Awards 2015/2016 (for the second year running)

DIGITAL BANKING

We aim to make banking easier for our customers and as such we continue to invest in digital banking and upgrades to our infrastructure which make a significant difference in allowing our customers better access to their money. This includes security, internet capability and handling services.

In 2016, our customers benefited from refurbishment that took place in a number of our branches and we introduced online statements for all of our customers. In November, our savings proposition was also extended to private limited SMEs and we are developing additional services for our new business savings customers.

CUSTOMER COMPLAINTS

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

FOCUSED ON OUR EMPLOYEES

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

Our recruitment process is fair and inclusive, with shortlisting, interviewing and selection always carried out without regard to gender, gender reassignment, sexual orientation, marital or civil partnership status, colour, race, caste, nationality, ethnic or national origins, religion or belief, age, pregnancy or maternity leave or trade union membership. No candidate with a disability is excluded unless it is clear that the candidate is unable to perform a duty that is intrinsic to the role, having taken into account reasonable adjustments. Reasonable adjustments to the recruitment process are made to ensure that no applicant is disadvantaged because of his/her disability and questions asked during the process are not in any way discriminatory or unnecessarily intrusive.

RETENTION AND TRAINING

We encourage employees to carry out their work to the best of their ability and promote learning and skills development opportunities across the organisation. Our Learning and Development team manage the allocation and completion of regular mandatory e-learning modules and delivery of in-house workshops, programmes and coaching in addition to coordinating employees attending external or in-sourced training activities and supporting staff undertaking professional development. In 2016, the completion rate for our mandatory monthly online compliance training was 100%, demonstrating the importance we place on ensuring our employees are suitably aware of key requirements.

While we are still a relatively small business in terms of employee numbers, we actively advertise vacancies internally to provide career development opportunities for existing employees. In 2016, we filled 24% of vacancies (54 of 221) with internal candidates.

Our regretted attrition rate in 2016 was 12% for our UK-based employees and 17% for our employees in India. 2016 also saw the introduction of our long service awards in order to recognise employee loyalty with the awards increasing in value for each five years of tenure. We are proud that our longest serving employee has been with the Group for 32 years.

TALENT MANAGEMENT AND LEADERSHIP PROGRAMMES

We have recently undertaken a talent mapping exercise and have identified the employees who constitute our primary and core talent pools based on their performance and potential. A range of talent management activities will be undertaken in 2017 in order to assist in developing, motivating and retaining identified employees.

2016 saw the launch of OSB's Leadership Development Programme with 20 managers each completing the eight separate day-long modules that make up the programme. The success of the programme has led to another 30 managers signing up to undertake the Leadership and Development Programme in 2017.

REMUNERATION AND BENEFITS

We believe in rewarding our employees fairly and transparently, enabling them to share in the success of the business. Details of the Group's remuneration policies can be found in the Remuneration Report on pages 77 to 90.

We offer our employees a comprehensive range of benefits, and continue to review these to ensure they are in line with market practice. Although the list is not exhaustive, our benefits include pension contributions, medical insurance, life cover, a childcare voucher scheme, interest free season ticket loan and a cycle purchase scheme.

We also encourage our employees to hold shares in the Bank for the long term, and offer a Sharesave scheme. The scheme is open to all UK-based employees and allows them to save a fixed amount of between £5 and £500 per month over either three or five years in order to use these savings at the end of the qualifying period to buy the Company's shares at a fixed price established when the scheme was announced. The Group launched its first Sharesave scheme in June 2014 and granted further options under the scheme in June 2015 and June 2016. As at December 2016, 44% of employees were participating in one of these schemes.

EMPLOYEE ENGAGEMENT

In 2016, for the second time, our employees completed The Sunday Times Best Companies Employee Engagement survey, achieving an overall score that put us in the Best Companies 'One to Watch' category. Take-up of the opportunity to give feedback to the business was very strong at around 80% and highlighted a strong alignment of our people with the Company and their teams.

To utilise the feedback from the survey in the most efficient way, we established the Employee Engagement Team who actively engage with our staff and collect ideas to further enhance the working environment. The initiatives that were introduced throughout the business as a result included an employee recognition programme, enhanced induction workshop, leadership development programme, the election of Group's charities, a paid volunteering day a year and free fruit in the offices. The Employee Engagement Team will be busy in 2017 with more suggestions going live during the year.

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

EMPLOYEE RECOGNITION AND AWARDS

We are proud that the expertise of our employees was recognised in 2016 by the industry. Dawn Mirfin, our Group Head of Underwriting, was the recipient of the Operation / Credit Risk Person of the Year category award at the British Mortgage Awards 2016. This award recognises those who delivered strong initiatives in the last year to improve the quality of business, overall performance and/or controls within their lender which demonstrates that they are exceptional in their position.

Our Chief Executive Officer, Andy Golding, also received the 2016 Leadership Award from Mortgage Finance Gazette which acknowledges his leadership efforts in relaunching and refocusing OneSavings Bank to become a successful FTSE 250 company.

HEALTH AND SAFETY

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

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

ACTIVITIES IN 2016:

- We introduced a monthly Health and Safety report which details the Bank's performance with regards to workplace hazards
- Statutory Health and Safety training has been added for all Group employees

CORPORATE RESPONSIBILITY REPORT CONTINUED

DIVERSITY AND INCLUSION

We recognise the benefits of diversity, including gender diversity, throughout the Group and work to ensure that there is an appropriate balance of skills and experience across the Group.

Over 59% of our workforce is female, we have three female directors (27% of Board) and two female members of the Executive Team (20%). In our office in India, women constitute 37% of the total workforce.

	Male	Female
Number of Board Directors	8	3
Number of Directors of subsidiaries	10	1
Number of senior managers (not directors)	40	12
All other employees[1]	301	354

1. Includes OSBIndia

In early 2017, the Group became a signatory to the HM Treasury's Women in Finance Charter. The Charter is a commitment of the Bank and HM Treasury to work together to promote better gender balance in the financial services industry. The pledge includes appointing a senior executive who is responsible for gender equality, setting internal targets, publishing progress against the targets and taking steps to link senior executives pay to delivery of these gender diversity goals. Accordingly, we have appointed Jason Elphick, Group General Counsel and Company Secretary, as the senior executive responsible for gender diversity throughout the Group and our Board approved a target of 30% of OSB's senior management roles to be represented by women by 2020.

We are continuously tracking the take up of flexible working arrangements and other gender related metrics going forward, and will assess whether any further measures or measurable objectives need to be put in place. In 2016, as a result of the employee survey, we extended paid maternity and paternity leave. Unconscious bias training has been included in a number of workshops for line managers during the year, being a direct outcome of our 2015 gender diversity review. In the coming months, we plan to extend this training to all employees.

HUMAN RIGHTS

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

In 2015, the Modern Slavery Act came into force and it encompasses slavery, human trafficking, forced labour and domestic servitude, and applies not only to OSB as a Group but also to our supply chain. OSB will take steps to promote and continually improve our commitment to eliminating abuse and exploitation in the workplace and we will publish our modern slavery statement in the coming months. To do that, actions are being taken throughout the organisation to ensure we are well prepared not only to support the required disclosure but are also vigilant to any form of forced labour in all of the locations from which we operate including our suppliers.

OSB INDIA

OSB India ('OSBI') is a wholly owned subsidiary of the Group. OSBI operates from an office in Bangalore and currently employs 276 staff. Customer support and some of the Group's back office processing is provided by OSBI. We actively promote integration between our colleagues in the UK and India with frequent employee exchanges, transfers, overseas training and management visits.

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

In compliance with the Modern Slavery Act, we do not support excessive overtime and India employees are encouraged to work in accordance with national legislation. The staff in the Bangalore office enjoy benefits which include 21 days of annual leave, 10 days sick leave and cafeteria services. In the early part of 2016, OSBI moved offices to further enhance the working environment for our Indian colleagues.

FOCUSED ON THE ENVIRONMENT

As an office based financial services provider, we have a relatively low environmental impact.

Despite this, we remain committed to conducting our business in an environmentally responsible way and whenever we can, to reduce consumption of the resources and our negative impact on the environment in which we operate.

In 2016, we delivered on our goal to establish a formal Environmental Policy which confirms that OSB aims to:

- Respect the environment
- Comply with all relevant environmental laws and regulations
- Take action to minimise the direct and indirect impacts of its operations on the environment and environmental performance
- Set, monitor and review environmental objectives and targets for operations across the organisation on a periodic basis
- Communicate our policy to all employees, business partners and make it assessable to customers and any interested shareholders
- Engage employees in the delivery of its environmental strategic agenda and support them in practical ways so they can reduce their own environmental footprints
- Periodically measure and report on its performance in keeping with relevant national and international standards, and where applicable, have its environmental performance and reporting independently assured
- Commit to continual improvement and developing objectives and targets for reducing our environmental impacts

We also apply environmental principles when selecting suppliers and now employ a cleaning company that offsets its carbon emission by planting trees.

ACTIVITIES IN 2016

We have implemented a programme of environmental initiatives and identified areas where we can do more to reduce impact throughout the Group. Activities during the year included:

- Improvements made to real estate resulting in reduction of energy consumption
- Introduction of secure print solutions in all offices which significantly lowered paper consumption
- Online statements are now offered to all of our customers
- ‘Zero to Landfill’ waste policy in operation which means we either recycle, reuse or send all of our waste to a dedicated Energy From Waste facility

GREENHOUSE GAS EMISSIONS

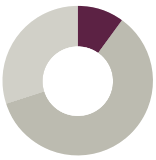
	CO_2e tonnes	
Emission type	Location-based method	Market-based method
Scope 1: Operation of facilities	125	–
Scope 1: Combustion	383	–
TOTAL SCOPE 1 EMISSIONS	508	508[1]
Scope 2: Purchased energy (UK)	364	335
Scope 2: Purchased energy (rest of world)	386	386[1]
TOTAL SCOPE 2 EMISSIONS	750	721
Total emissions	**1,258**	**1,229**

1. Location based figure used where market based not available

CORPORATE RESPONSIBILITY REPORT CONTINUED

EMISSIONS BREAKDOWN BY SOURCE (tCO_2e)

EMISSIONS BREAKDOWN BY CATEGORY (tCO_2e)



GREENHOUSE GAS EMISSIONS INTENSITY RATIO:

	Total footprint (Scope 1 and Scope 2) – CO_2e		
	Previous year (2015)	**Current year (2016)**	Year on year variance
Turnover (£m)	162.5	**201.0**	23.7%
Intensity ratio – Scope 2 location based method (tCO_2e/£100,000)	0.004	**0.004**	–
Intensity ratio – Scope 2 market based method (tCO_2e/£100,000)	0.003	**0.003**	–

Notes:

- Our methodology has been based on the principles of the Greenhouse Gas Protocol, taking account of the 2015 amendment which sets out a 'dual reporting' methodology for the reporting of Scope 2 emissions. This means that UK electricity is reported using two methods
- This includes emissions under Scope 1 and 2, except where stated, but excludes any emissions from Scope 3
- Conversion factors for UK electricity (location-based methodology), gas and other emissions are those published by the Department for Environment, Food and Rural Affairs for 2016/17
- Conversion factors for UK electricity (market-based methodology) are published by electricityinfo.org
- The market based methodology has only been applied to UK electricity supplies
- Conversion factors for overseas electricity, gas and other emissions are those published by the International Energy Agency for 2016
- Conversion factor used for R417A (F-gas) is published by Linde Gas
- Conversion factor used for R22 (F-gas) is published by Department for Environment, Food and Rural Affairs for 2016/17
- In addition, due to expansion of the India offices in 2016, there is an associated increase in total tCO_2e reported
- It has been confirmed there is no LPG use within the estate either in the UK or overseas
- It has been confirmed that there is no mains gas supply in relation to the India operations
- Two UK sites; Heritable and InterBay, have been excluded from reporting as it has been confirmed that these are managed rented properties and are therefore considered to be Scope 3 emissions and are not readily available
- We have reported on all the measured emissions sources required under The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013, except where stated
- The period of our report is 1 January 2016–31 December 2016
- An increase in the availability of data this year has meant that the scope of the emissions reporting has increased. In addition to the emission sources reported in 2015, the following sources have now been accounted for:
  - F-gas (India)
  - Diesel generators (India)
  - Disaster Recovery Unit – Electricity and Diesel (India)
- As a result, reported emissions this year have increased

Statement of exclusions

- Global diesel/petrol use (for vehicles) has been excluded from the report on the basis that it is not material to our carbon footprint

FOCUSED ON OUR COMMUNITY

OSB has traditionally had very strong links with the community in which it operates, through its building society heritage, and this is continued through its Kent Reliance brand.

We have a well-established community services programme that does not simply take the form of donations and fundraising, but also includes staff volunteering and involvement.

As one of the largest employers in the region, many of our staff live in the local area – they are a part of the local and regional community and therefore local causes and campaigns particularly resonate with our workforce. Staff feedback is crucial to informing where our support can be best placed within the community, from an in-office collection to our major charity partners.

Our diverse community services programme includes being a major sponsor of Demelza Hospice Care for Children, donating to local Kent-based charitable causes through our Kent Reliance Community Fund including sponsorship of Kent County Football Association ('Kent FA') 23 County Cup competitions and development centre and Kent County Cricket Club's ('KCCC') sponsorship for the disability squads and adding its Academy Programme sponsorship in 2016. Our Kent Reliance 'Kent Heroes' and 'Make Someone's Christmas' campaigns are undertaken with a local media partner. We also supported Kent Literacy which offers reading initiative in ten Medway schools.

However, our charitable endeavours cannot simply take place on our front doorstep; we also support both national and international charities too. Through our savings arm of Kent Reliance we fundraise for Great Ormond Street Hospital through in-office and branch initiatives.

Overall the Bank has contributed through sponsorship and donations a total of over £200,000 to community and charitable causes in 2016.

Feedback from our 2016 Employee Engagement survey brought to our attention the desire of our employees to get involved in voluntary work in their communities and to assist them, we introduced a paid volunteering day a year.

DEMELZA HOSPICE CARE FOR CHILDREN

Demelza Hospice Care for Children provides specialist care and support to babies, children, young people and their loved ones from diagnosis, day-to-day family life, times of crisis, end of life and through bereavement. As a registered charity, Demelza offers bespoke support, free of charge, to families and are available 24 hours a day, 365 days a year. In order to provide these vital services, they need to raise over £10m a year.

As a locally based charity, staff from Kent Reliance are hugely aware of and are keen supporters of Demelza. They have participated in a number of fundraising events throughout the year including headline sponsors and participants of the annual KM Dragon Boat Race, which helped raise more than £100,000 in sponsorship for local charities and good causes across the county. The event continues to be one of the biggest charity fundraising events staged in Kent and the Kent Reliance teams raised the majority share of donations for Demelza through their efforts on the day.

Kent Reliance also take huge pride in Demelza's annual fundraising event, 'Go Dotty' which this year culminated in a week long campaign involving office and branch staff who enthusiastically embraced the challenges set upon them which ranged from dotty based quizzes to bake-off challenges. Aside from straightforward fundraising, we also engaged with the local community by gifting our branch network as collection and promotion outlets for the charity. Engagement with the charity doesn't end with our sponsorship. We welcomed the opportunity to get actively hands-on with Demelza, with many of our employees visiting the Hospice on volunteer days to help clear and maintain the gardens, build new outdoor activity centres for the children and assist with building maintenance.

KENT COUNTY FOOTBALL ASSOCIATION

The partnership between the Kent FA and Kent Reliance has grown over the last three years and now covers 23 Kent County Cup competitions and the Kent Girls and Disability Player Development Centres; leading Kent Reliance to become Kent FA's first official 'Community Partner'. This is a great enhancement to the successful partnership, and for grassroots football in Kent.

CORPORATE RESPONSIBILITY REPORT CONTINUED

Paul Dolan, Kent FA's Chief Executive is delighted to have the continued backing from Kent Reliance: "Throughout our relationship with Kent Reliance, they have shown how committed they are to the Kent grassroots football community and, through the support they give us, it seemed like a natural fit for them to become our first ever 'Community Partner'. To have Kent Reliance on board helps to ensure that we lead the way in creating competitions and opportunities that uphold the highest standards."

The Kent Reliance Girls and Disability Player Development Centres provide excellent opportunities to deliver elite training and support to talented young football players in the county while the 23 Kent Reliance County Cups have over 1,000 teams competing from across the county, catering for all standards and abilities. The partnership will also see continued support and investment into grassroots football through the Kent Reliance 'Magic of the Cup' competition. Over 15 teams won football equipment during the competition last season, and our overall winner, Mangravet FC from the Maidstone & District Football League, was presented with 16 tickets by Kent Reliance to see an England match at Wembley.

Barry W. Bright, Kent FA's Chairman and Managing Director stated that: "the partnership with Kent Reliance has enabled us to professionalise the service we provide. Grassroots football provides so many opportunities and we are delighted that Kent Reliance continues to help support the growing football talent in Kent communities."

KENT HEROES

Kent Heroes returned in 2016 in conjunction with KM Media Group, led by KMFM, to give the Kent community the opportunity to celebrate local, unsung heroes who may not otherwise gain recognition for their selfless acts. This community initiative was powered by nominations from the public who were asked to nominate who they thought should receive the awards. This year's categories were:

- Unsung Hero
- Teacher of the Year
- Carer of the Year
- Fundraiser of the Year
- Young Person of the Year

Each award recipient was publicly recognised with an exclusive story in the Kent Messenger and a £500 cheque from Kent Reliance. The campaign built upon the success of its inaugural edition last year and increased in popularity, with more nominations and interest via social media that led to over 20,000 people having viewed the awards on video alone.

GREAT ORMOND STREET HOSPITAL

As a business, we like to think of our staff as extended family – a cliché, perhaps, but one that certainly rings true with Kent Reliance. It is perhaps because of this family-focused ethos that we naturally feel drawn to charities that support families at their time of need.

Great Ormond Street Hospital's mission is simple, as a charity their aim is to raise enough money to enable the hospital to continue to provide the very best care for its young patients and their families as well as fund vital research. Since 2011, we committed to donate a minimum of £25,000 a year to the hospital and we do that through our Peter Pan savings accounts. To date, we have donated in excess of £305,000 to the children's hospital and in 2016 alone we gave in excess of £136,000 to this cause.

KENT CHARITY AWARDS

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

KENT COUNTY CRICKET CLUB

In 2016, Kent Reliance continued its partnership with KCCC, by supporting the Club's community programme. As with our commitment to Kent FA, this relationship is another opportunity to really support grassroots activity within the county and encourage people of all abilities to get involved and enjoy sport. Our sponsorship activity provides for funding for the Disability Performance Squads who currently operate two teams:

- The Kent Reliance Learning and Physically Disabled ('LDPD') Performance Squad
- The Kent Reliance Visually Impaired ('VI') Performance Squad

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

In 2016, Kent Reliance increased its commitment to KCCC by supporting its Academy Programme. Jamie Clifford, CEO, KCCC: "We are very pleased with the achievements of the Academy since its inception in 2003 but with Kent Reliance's support it is hoped we can take the programme to another level. Their partnership will enable us to bring in more specialist coaches and further develop life skills to prepare scholars for a professional career. Our disability cricket programmes have also been boosted by the support of Kent Reliance which allows us to provide kit, coaching and facilities for our players. The inclusion of Kent Spitfires player Amin Afshari in England's Visually Impaired World Cup squad is evidence that the programme really does work."

MAKE SOMEONE'S CHRISTMAS

Make Someone's Christmas encourages listeners and readers of KMFM and KM Media Group respectively, to nominate those they feel deserve something special during the festive season. Following the big success of the programme in 2015, this year's edition was a hard task but we were not disappointed. In 2016, we helped ten special people in Kent with ten bespoke prizes. Nominations were varied and included a young family that had lost their dad just before Christmas, a seven and nine year old who had raised hundreds of pounds for charity by making cards and selling them and an elderly man who had devoted his life to serving his local community.

KENT LITERACY

In 2016, Kent Reliance also supported the educational charity to launch and develop its new home reading initiative – Buster's Book Club – in ten Medway schools. The scheme was extremely successful across the county with more than 2.8m minutes of reading achieved and making the 11,000 children involved official members of the Millionaire Reading Club. The feedback from schools has been so positive that major plans to expand the initiative are being drawn up, which Kent Reliance aims to continue to support.

The Strategic Report is approved by the Board and signed on its behalf.

JASON ELPHICK
Group General Counsel and Company Secretary
16 March 2017

IT'S ALL ABOUT BESPOKE UNDERWRITING

DAWN MIRFIN
GROUP HEAD OF UNDERWRITING

"Putting myself in the customer's shoes."

Basic, traditional underwriting is pretty straightforward. It focuses on whether the property is valued correctly and the borrower both, wants to, and has the means to, repay the loan. But I think that there is a lot more to it than that. I see underwriting as central to growing and developing OSB and how we approach underwriting is all about understanding customers and what both they and the Bank are trying to achieve.

I am lucky to have recruited great, experienced staff who care about the decisions they make. They can read accounts, balance the risks and see a proposition from the Bank's and the customer's point of view. Of course we have processes and systems but at the end of the day, decisions down to our people's skill and expertise. 100% of cases are assessed by an underwriter. They are here at OSB because they want to be responsible for making decisions, and not ticking boxes in an automated process. This makes us different.

I always stress that we should look to lend and be positive. If a proposition doesn't fit then we can often help adapt it and make it work. We try to be innovative across our Kent Reliance, InterBay and Prestige brands to help customers.

One of our mantras that makes us stand out is being responsive, working with intermediaries and our sales team as a partnership. Building long-term relationships means that I have to be able to put myself in the customer's shoes and see through their eyes.

DIRECTORS' REPORT
BOARD OF DIRECTORS (BIOGRAPHIES)





	MIKE FAIREY[1] NON-EXECUTIVE CHAIRMAN	ANDY GOLDING CHIEF EXECUTIVE OFFICER	APRIL TALINTYRE CHIEF FINANCIAL OFFICER	TIM HANFORD NON-EXECUTIVE DIRECTOR	MARGARET HASSALL[1] NON-EXECUTIVE DIRECTOR
APPOINTMENT	Mike was appointed to the Board in April 2014.	Andy was appointed to the Board in December 2011.	April was appointed to the Board in May 2012.	Tim was appointed to the Board in February 2011.	Margaret was appointed to the Board in July 2016.
COMMITTEE MEMBERSHIP	Member of the Nomination and Governance Committee.	None.	Member of the Risk Committee.	Member of the Nomination and Governance Committee.	Member of the Risk Committee.
KEY SKILLS	Mike is an extremely experienced banking executive. In a career spanning more than 40 years, he has held a range of senior positions.	Andy has over 30 years' experience in financial services.	April has broad financial services experience. She has been a member of the Institute of Chartered Accountants in England and Wales since 1992.	Tim has over 25 years' experience in banking and investment, including in credit strategies, risk management, mergers and acquisitions.	Margaret brings a broad range of experience developed across various industry sectors including manufacturing, utilities, and financial services.
EXPERIENCE & QUALIFICATIONS	Mike was previously Deputy Chief Executive of Lloyds Banking Group for ten years, until 2008. Currently, he holds a number of Non-Executive positions with the Energy Saving Trust, Retirement Advantage, Stonehaven UK and Hastings Group Holdings plc. He is also the Chairman of the Trustees of the Lloyds TSB Pension Funds. Mike spent the first 25 years of his banking career with Barclays.	Andy was previously CEO of Saffron Building Society, where he had been since 2004. Prior to that he held senior positions at NatWest, John Charcol and Bradford & Bingley. He is a Non-Executive Director of Kreditech Holding SSL GmbH and currently holds a number of posts with industry institutions including membership of the Council of Mortgage Lenders Executive Committee. He is also a Director of the Building Societies Trust and has also served as a Non-Executive Director for Northamptonshire NHS.	April was previously an Executive Director in the Rothesay Life pensions insurance business of Goldman Sachs and worked for Goldman Sachs International for over 16 years, including as an Executive Director in the Controllers division in London and New York. April began her career at KPMG in a general audit department.	Tim is Managing Director of J.C. Flowers & Co. UK Ltd. Previously, he was Head of Private Equity at Dresdner Bank and a member of the Institutional Restructuring Unit's Executive Committee. Tim has also served as a Board Director of Schroders, based in Hong Kong and Tokyo, where he was responsible for structured finance.	Margaret spent seven years working for Deloitte and Touche as a consultant and led the financial services consulting business for Charteris Plc. More latterly Margaret has been engaged as chief operations officer or chief information officer for divisions within some of the world's largest banks, namely Bank of America Merrill Lynch, Barclays and RBS. Margaret is a Non-Executive Director for Ascension Trust (Scotland).

1. Independent Non-Executive Director

ROD DUKE[1]
SENIOR INDEPENDENT NON-EXECUTIVE DIRECTOR

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

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

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

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

ANDREW DOMAN[1]
NON-EXECUTIVE DIRECTOR

Andrew was appointed to the Board in July 2016.

Member of the Risk and Audit Committees.

Andrew is an experienced financial services executive.

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

MARY MCNAMARA[1]
NON-EXECUTIVE DIRECTOR

Mary was appointed to the Board in May 2014.

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

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

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

GRAHAM ALLATT[1]
NON-EXECUTIVE DIRECTOR

Graham was appointed to the Board in May 2014.

Chairman of the Risk Committee and member of the Audit Committee.

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

Graham was previously Acting Group Credit Director at Lloyds TSB and Chief Credit Officer at Abbey National. Prior to this he spent 18 years in the NatWest Group culminating in the role of Managing Director, Credit Risk at NatWest Markets. A Fellow of the Institute of Chartered Accountants, Graham is Deputy Chairman of the Friends of the British Library and was involved in housing associations for nearly 30 years as Treasurer and Board member in the North of England and in London.

NATHAN MOSS[1]
NON-EXECUTIVE DIRECTOR

Nathan was appointed to the Board in May 2014.

Member of Remuneration, Audit and Nomination and Governance Committees.

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

Nathan was previously Group Strategy Director at Friends Life from 2010 to 2013 and prior to that Nathan was Managing Director of Wealth Management at Lloyds TSB Group having joined Scottish Widows in 2002 as Managing Director, Marketing & Distribution. Prior to this he spent 18 years with HSBC Group including four years as General Manager, Personal Financial Services and culminating as COO of Merrill Lynch HSBC. Nathan is a Non-Executive Director of Homeserve Membership Ltd and Canada Life Group (UK) Ltd.

ERIC ANSTEE[1]
NON-EXECUTIVE DIRECTOR

Eric was appointed to the Board in December 2015.

Chairman of the Audit Committee and member of the Risk Committee.

Eric has extensive corporate finance and Mergers & Acquisitions experience over a broad range of business sectors. He is a member of the Takeover Panel Appeals Board and Visiting Professor, London Metropolitan University Business School.

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

CORPORATE GOVERNANCE REPORT

MIKE FAIREY
NON-EXECUTIVE CHAIRMAN

The statement of corporate governance practices, including the Reports of Committees, set out on pages 58 to 93 and information incorporated by reference, constitutes the Corporate Governance Report of OneSavings Bank.

UK CORPORATE GOVERNANCE CODE ('THE CODE') – COMPLIANCE STATEMENT

During 2016, the Company applied all of the main principles of the Code and has complied with all Code provisions. The Code is available at www.frc.org.uk.

Dear Shareholder,

I am pleased to present to you the Company's Corporate Governance Report for 2016, and to report our full compliance throughout the year with the Code as updated in 2014.

The Board continues to be committed to the highest standards of corporate governance and considers that good corporate governance is essential to provide the executive team with the environment and culture in which to drive the success of the business.

We welcomed Margaret Hassall and Andrew Doman to the Board in July 2016 as independent Non-Executive Directors. Margaret and Andrew have extensive financial skills and knowledge of the financial services industry which is extremely valuable to the continued development of the Bank. Stephan Wilcke, Malcolm McCaig and Dr David Morgan left the Board during 2016. I would like to thank them for their enormous contribution towards the success of the Bank over the years. I wish them well in all their future ventures. I have also informed the Board of my intention to step down as Chairman at the conclusion of the annual general meeting (AGM). The Board and its Committees continue to operate effectively, as identified in the formal performance review exercise carried out during 2016, details of which are set out in the Report below.

The Investor Relations function continues to assist the Board in developing a programme of meetings and presentations to both institutional and private shareholders, details of which are also set out in the Report. We welcome shareholders to attend the AGM, which will be held at the offices of Addleshaw Goddard LLP, 60 Chiswell Street, London, EC1Y 4AG on 10 May 2017 at 11am.

Finally, as this is my last report to you in this role, I would like to take this opportunity to thank you for your support over the years.

MIKE FAIREY
Non-Executive Chairman
16 March 2017

THE ROLE AND STRUCTURE OF THE BOARD

The Board of Directors (the Board) is responsible for the long term success of the Company and provides leadership to the Group. The Board focuses on setting strategy and monitoring performance, and ensures that the necessary financial and human resources are in place to enable the Company to meet its objectives. In addition, it ensures 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 ensuring the Company's continuing commitment to carrying on its business fairly, honestly and openly, with a commitment to zero tolerance towards bribery.

The Board operates in accordance with the Company's Articles of Association (the 'Articles') and its own written terms of reference. The Board has established a number of Committees as indicated in the chart on page 40. Each Committee has its own terms of reference which are reviewed at least annually.

The Board retains specific powers in relation to the approval of the Bank's strategic aims and policies and other matters, which must be approved by it under legislation or the 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 treasury policies
- Approval of significant changes in accounting policies
- Ensuring maintenance of a sound system of internal control and risk management

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

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

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

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

ACCOUNTABILITY

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

FINANCIAL AND BUSINESS REPORTING

The Board is committed to ensuring that all external financial reporting presents a fair, balanced and understandable assessment of the Group's position and prospects. Matters considered in establishing this include whether there is consistency between the front and back ends of the accounts; there is a balanced review of the competitive landscape; the language used is sufficiently simple; there is an appropriate analysis of risks facing the business; and there is equal prominence given to statutory and underlying profit. Under the Schedule of Reserved Matters, the Board has responsibility for the approval of all externally-published information including, but not limited to, annual and half-yearly financial statements, regulatory news announcements and publications required by regulators or to satisfy statutory requirements.

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

CORPORATE GOVERNANCE REPORT CONTINUED

RISK MANAGEMENT AND INTERNAL CONTROL

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

The Board has carried out a robust assessment of the principal risks facing the business, including those that would threaten its business model, future performance, solvency or liquidity. Further details are contained in the viability statement on page 46.

The Board has established a Risk Committee to which it has delegated responsibility for oversight of the Group's risk appetite, risk monitoring and capital management. The Risk Committee provides oversight and advice to the Board on current risk exposures and future risk strategy, assists the Board in fostering a culture within the Group which emphasises and demonstrates the benefits of a risk-based approach to internal control and management. Further details of the Group's risk management approach, structure and principal risks are set out in the risk management report on pages 34 to 45.

The Board has delegated to the Audit Committee responsibility for reviewing the effectiveness of the Company's internal control systems. The Audit Committee is supported by the internal audit function in discharging this responsibility, and receives regular reports from internal audit as to the overall effectiveness of the control system within the Group. Details of the Group's review of the effectiveness of the Company's internal control systems are set out in the Audit Committee report on page 72.

CONTROL ENVIRONMENT

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

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

The third line of defence is the internal audit function.

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

DIRECTORS

The Directors who served during the year are listed in the table on page 61. Stephan Wilcke retired on 11 May 2016, Dr David Morgan and Malcolm McCaig retired on 31 December 2016. Andrew Doman and Margaret Hassall were appointed on 26 July 2016.

The Board currently consists of 11 Directors, being the Chairman, two Executive Directors, seven independent Non-Executive Directors and one Non-Executive Director who is not regarded as being independent. The biographies of Directors can be found on pages 56 to 57. The Board approves a formal meeting schedule each year with ad hoc meetings called as and when circumstances require. There is an annual calendar of agenda items to ensure that all matters are given due consideration and are reviewed at the appropriate point in the regulatory and financial cycle; 12 Board meetings were held during 2016. The Board has established a number of committees as shown on the chart on page 40. Each committee has its own terms of reference which are reviewed at least annually and are available on our website www.osb.co.uk. Details of each Committee's activities during 2016 are shown in the Nomination and Governance Committee, Audit Committee, Risk Committee and Remuneration Committee Chairs' reports on pages 66 to 90. The table below shows each Director's attendance at the Board and Committee meetings they were eligible to attend in 2016:

	Board[1]	Audit Committee	Remuneration Committee[1]	Nomination and Governance Committee[1,4]	Risk Committee[1]
Mike Fairey (Chairman)	10/12	n/a	n/a	4/7	n/a
Graham Allatt	12/12	4/4	n/a	n/a	10/11
Eric Anstee	10/12	4/4	n/a	n/a	10/11
Andrew Doman[2]	4/5	1/1	n/a	n/a	3/3
Rod Duke	12/12	2/2	6/6	7/7	7/7
Andy Golding	12/12	n/a	n/a	n/a	n/a
Tim Hanford	11/12	n/a	n/a	n/a	n/a
Margaret Hassall[2]	5/5	n/a	n/a	n/a	3/3
Malcolm McCaig	10/12	4/4	7/9	n/a	n/a
Mary McNamara	12/12	n/a	9/9	7/7	10/11
Dr David Morgan	9/12	n/a	n/a	4/7	n/a
Nathan Moss	12/12	n/a	8/9	7/7	n/a
April Talintyre	12/12	n/a	n/a	n/a	10/11
Stephan Wilcke[3]	4/4	n/a	n/a	n/a	n/a

1. All absences are due to scheduling clashes. Some ad hoc meetings were scheduled at short notice
2. Appointed on 26 July 2016
3. Retired on 11 May 2016
4. Mike Fairey did not attend meetings where his successor was discussed

In October 2016, the Board attended a strategy away day. All Directors are expected to attend all meetings of the Board and any committees of which they are members, and to devote sufficient time to the Company's affairs to fulfil their duties as Directors. Where Directors are unable to attend a meeting, they are encouraged to submit any comments on papers to be considered at the meeting to the Chairman in advance to ensure that their views are recorded and taken into account during the meeting.

Key Board activities during the year included:

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

Role of the Chairman and Chief Executive Officer

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

As Chairman, Mike Fairey is responsible for setting the 'tone at the top' and ensuring that the Board has the right mix of skills, experience and development so that it can focus on the key issues affecting the business; and for leading the Board and ensuring it acts effectively. Our CEO Andy Golding has overall responsibility for managing the Group and implementing the strategies and policies agreed by the Board. A summary of the key areas of responsibility of the Chairman and CEO, and how these have been discharged during the year, are set out on page 62.

CHIEF EXECUTIVE OFFICER'S RESPONSIBILITIES

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

An experienced senior executive team comprising of specialists in finance, banking, risk, legal, and IT matters assist the CEO in carrying out his responsibilities. The biographies for the senior executive team can be found on our website at www.osb.co.uk.

CORPORATE GOVERNANCE REPORT CONTINUED

CHAIRMAN'S RESPONSIBILITIES	ACTIVITIES CARRIED OUT IN 2016
Chairing the Board and general meetings of the Company.	The Chairman chaired almost all of the Board meetings held in 2016 and the 2016 AGM.
Setting Board agenda and ensuring that adequate time is available for discussion of all agenda items.	The Chairman, in liaison with the Company Secretary, sets the annual calendar of Board business and the agendas for the individual meetings. Time is allocated for each item of business at meetings.
Promoting the highest standards of integrity, probity and corporate governance throughout the Company.	The Board received regular updates from its Committees and reviewed its corporate governance policies and procedures at its meeting in May.
Ensuring that the Board receives accurate, timely and clear information in advance of meetings.	The Chairman, in liaison with the Company Secretary, agrees the information to be circulated to the Board in advance of each meeting.
Promoting a culture of openness and debate by facilitating the effective contribution of all Non-Executive Directors. Ensuring constructive relations between Executive and Non-Executive Directors and the CEO in particular.	The Chairman runs the meetings in an open and constructive way, encouraging the contribution from all Directors. He met formally with the Non-Executive Directors without management present in July so that any concerns could be expressed. Informal meetings are held throughout the year.
Regularly considering succession planning and the composition of the Board.	The Board receives regular updates from the Nomination and Governance Committee. Details of the Committees activities are explained in the Nomination and Governance Committee report on page 66.
Ensuring training and development needs of all Directors are met, and that all new Directors receive a full induction.	The Chairman, in liaison with the Company Secretary, has reviewed Directors training requirements. Details of induction and training held during the year are given on page 64.
Ensuring effective communication with shareholders and stakeholders.	The Chairman, with the Board, assisted by the CEO, Chief Financial Officer and Investor Relations Manager, agrees a programme of investor relations meetings. Details of those carried out during the year are shown on page 65.

EXECUTIVE COMMITTEE

The CEO chairs the Executive Committee (ExCo), whose members are the Chief Financial Officer, the Chief Operating Officer, Chief Risk Officer, Group General Counsel and Company Secretary (advisory), Commercial Director, Chief Information Officer, Chief Credit Officer, Sales and Marketing Director and Head of Internal Audit (advisory). There are seven other committees reporting to the ExCo (see the Governance Structure Chart on page 40).

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

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; and
- Monitoring target operating model progress.

SENIOR INDEPENDENT DIRECTOR

Rod Duke is the Senior Independent Director (SID). His role is to act as a sounding board for the Chairman and to support him in the delivery of his objectives. This includes ensuring that the views of all other Directors are communicated to, and given due consideration by, the Chairman. In addition, the SID is responsible for leading the annual appraisal of the Chairman's performance.

The SID is also available to shareholders should they wish to discuss concerns about the Company other than through the Chairman and CEO.

COMPANY SECRETARY

The Company Secretary, Jason Elphick, plays a key role within the Company assisting the Directors with their pursuit of profit and growth, acting with integrity and independence to protect the interests of the Company, its shareholders and employees. Jason ensures that the Company complies with all statutory and regulatory requirements and works closely with the Chairman, CEO and Chairs of the Board Committees so that Board procedures (including setting agendas and the timely distribution of papers) are complied with, and that there are good communication flows between the Board, its Committees, senior management and Non-Executive Directors. Jason is also available to Directors to provide advice and support, including facilitating induction programmes and training in conjunction with the Chairman.

EFFECTIVENESS

Balance and independence

The effectiveness of the Board and its Committees in discharging their duties is essential for the success of the Company. In order to operate effectively, the Board and its Committees comprise of a balance of skills, experience, independence and knowledge to encourage constructive debate and challenge to the decision making process.

The Board comprises nine Non-Executive Directors including the Chairman and two Executive Directors. Eight of the Non-Executive Directors including the Chairman have been determined by the Board to be independent in character and judgement and free from relationships or circumstances which may affect, or could appear to affect, the relevant individual's judgement. Andrew Doman is considered independent notwithstanding that he is Chairman of Castle Trust Capital plc, an unlisted company, of which Tim Hanford is also a Director. Tim Hanford is not considered to be independent due to his position as a representative of the Major Shareholder. The independence of the Non-Executive Directors is reviewed continually, including formal review annually.

The size and composition of the Board is kept under review by the Nomination and Governance Committee and the Board itself to ensure an appropriate balance of skills and experience is represented. The Board is satisfied that its current composition allows it to operate effectively and that all Directors are able to bring specific insights and make valuable contributions to the Board due to their varied commercial backgrounds. The Non-Executive Directors, and in particular the Independent Non-Executive Directors, provide constructive challenge to the executive management and the Chairman ensures that the views of all Directors are taken into consideration in the Board's deliberations. Directors' biographies can be found on pages 56 to 57.

Non-Executive Directors terms of appointment

Non-Executive Directors are appointed for terms of three years, subject to annual re-election by shareholders. The initial term may be renewed up to a maximum of three terms (nine years). The terms of appointment of the Non-Executive Directors specify the amount of time they are expected to devote to the Company's business which is a minimum of two and half days per month, calculated based on the time required to prepare for and attend Board and Committee meetings, the AGM, meetings with shareholders and training. Their commitment also extends to working such additional hours as may be required in exceptional circumstances.

Non-Executive Directors are required to confirm annually that they continue to have sufficient time to devote to the role.

Appointment, retirement and re-election of Directors

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

Relationship Agreement

On admission of its shares to the London Stock Exchange following the IPO in June 2014, the Company entered into a relationship agreement (the 'Relationship Agreement') with its major shareholder OSB Holdco Limited (the Major Shareholder). Pursuant to the Relationship Agreement, the Major Shareholder has been granted the right to appoint one Non-Executive Director to the Board for so long as it holds at least 10% of the Company's ordinary shares and a further Non-Executive Director for so long as it holds at least 30% of the Company's ordinary shares. Tim Hanford was appointed by the Major Shareholder. The Directors believe that the terms of the Relationship Agreement enable the Company to carry on its business independently of the Major Shareholder and ensure that all agreements and transactions between the Company, on the one hand, and the Major Shareholder and its associates and/or persons acting in concert with the Major Shareholder or its associates, on the other hand, are at arm's length and on a normal commercial basis. So far as the Company is aware such terms have been complied with throughout the year.

Conflicts of interest

The Company's Articles set out the policy for dealing with Directors' conflicts of interest and are in line with the Companies Act 2006. The Articles permit the Board to authorise conflicts and potential conflicts, as long as the potentially conflicted Director is not counted in the quorum and does not vote on the resolution to authorise the conflict.

Directors are required to complete an annual confirmation including a fitness and propriety questionnaire, which requires declarations of external interests and potential conflicts. In addition, all Directors are required to declare their interests in the business to be discussed at each Board meeting.

The Board has also adopted a conflicts of interest policy which includes a procedure for identifying potential conflicts of interest within the Group. Under this procedure, all potential conflicts of interest must be disclosed to the Company Secretary, who advises on proportionate controls to address the conduct risks associated with them. In addition, compliance maintains and reviews a Group wide register of potential conflicts of interest.

Directors' indemnities

The Company's Articles provide, subject to the provisions of UK legislation, an indemnity for Directors and officers of the Company and the Group in respect of liabilities they may incur

CORPORATE GOVERNANCE REPORT CONTINUED

in the discharge of their duties or in the exercise of their powers, including any liabilities relating to the defence of any proceedings brought against them which relate to anything done or omitted, or alleged to have been done or omitted, by them as officers or employees of the Company and the Group. Directors' and officers' liability insurance cover is in place in respect of all Directors.

Directors' powers

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

TRAINING AND DEVELOPMENT

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

Typical induction programme

Materials include:

- Group and organisational structure charts
- Details of Board Committees, including terms of reference and copies of relevant minutes
- Contact details for all Directors, Company Secretary and key staff
- Current business plan
- Articles of Association
- Minutes of recent Board meetings and dates of future meetings
- Current budget and last annual accounts
- Current Internal Capital Adequacy Assessment Process and Internal Liquidity Adequacy Assessment Process
- Current Risk Appetite Statement

Meetings with:

- Chairman
- Other Directors
- Company Secretary
- Executive team
- Senior management

Visits to:

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

As senior managers, under the Senior Managers Regime operated by the PRA and FCA under the FSMA, all Directors have had to maintain the skills, knowledge and expertise required to meet the demands of their positions of 'significant influence' with the Bank. As part of the Annual Fitness and Propriety Assessment, Directors are required to complete a self-certification that they have undertaken sufficient training during the year to maintain their skills, knowledge and expertise and to make declarations as to their fitness and propriety. The Company Secretary supports the Directors to identify relevant internal and external courses to ensure Directors are kept up-to-date with key regulatory changes, their responsibilities as senior managers and other matters impacting on the business.

Information and support

The Company Secretary and the Chairman agree an annual calendar of matters to be discussed at each Board meeting to ensure that all key Board responsibilities are discharged over the year. Board agendas are then circulated with accompanying detailed papers to the Board in advance of each Board meeting. These include reports from Executive Directors and other members of senior management, and all Directors have direct access to senior management should they require additional information on any of the items to be discussed. The Board and Audit Committee also receive further regular and specific reports to allow the monitoring of the adequacy of the Company's systems and controls.

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

The Company has adopted a formal procedure through which Directors may obtain independent professional advice at the Company's expense. The Directors also have access to the services of the Company Secretary as described on page 63.

Performance evaluation

The Board undertakes an evaluation of its performance and that of its Committees and individual Directors annually. In 2016, a formal evaluation process was externally facilitated by Promontory Financial Group LLC[1], a board evaluation firm. Promontory concluded that the Board, including its Committees, discharges its duties effectively; and that the current Directors have an appropriate range of knowledge and experience giving rise to open and effective challenge, scrutiny and debate and the structure of the governance arrangements works well. Promontory found that the relationship between the Board and executive management was open and transparent and that this was reflected in the discussions that they witnessed as part of their review.

1. Does not have any other connection with the Company

Promontory were satisfied that no individual or group of Directors dominated the discussions or had undue influence in the decision making process.

Promontory identified some areas where the overall effectiveness of the Board could be enhanced. A summary of those areas is included below along with an action plan.

Theme	Action taken
The frequency of meetings and the breadth and frequency of matters discussed.	The frequency of meetings and items requiring Board debate were discussed at the February 2017 Board meeting and adjustments to the calendar and agendas of the Board and its Committees are being progressed.
Alignment of terms of reference	An initial terms of reference review was concluded in March 2017. A further review will be undertaken, as required, by the end of 2017.
The length and quality of papers	A programme of improvements to Board papers will be introduced in 2017, including training for frequent preparers of papers and improvements to formatting.

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

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

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

RELATIONS WITH SHAREHOLDERS
Dialogue with shareholders
The Company has established a dedicated Investor Relations function to liaise with institutional investors and analysts. Investor relations activity and a review of the share register are regular items on the Board agenda.

Over the year the Company has engaged in active discussion with shareholders and investors, both on an individual basis and through attendance at investor conferences and roadshow events and the AGM during the year. There has been ongoing dialogue with its key stakeholders, including institutional investors, to discuss issues relating to the performance of the Group including strategy and new developments. During 2016 more than 80 investors and potential investors met with senior management face to face. Following full year and interim results presentations, senior management undertake roadshows and meet with investors. A comprehensive plan of Investor Relations activity is in place for the coming year. The Non-Executive Directors are available to discuss any matter stakeholders might wish to raise. The Chairman, Senior Independent Director and other Non-Executive Directors are also available to attend meetings with investors and analysts.

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

Annual General Meeting
The AGM will be held at the offices of Addleshaw Goddard LLP, 60 Chiswell Street, London, EC1Y 4AG on 10 May 2017 at 11am. The Chairs of each of the Committees of the Board will be present to answer questions put to them by shareholders. The Annual Report and Accounts and Notice of the AGM will be sent to shareholders at least 20 working days prior to the date of the meeting.

Shareholders are encouraged to participate in the AGM process, and all resolutions will be proposed and voted on at the meeting on an individual basis by shareholders or their proxies. Voting results will be announced and made available on the Company's website (www.osb.co.uk).

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

NOMINATION AND GOVERNANCE COMMITTEE REPORT

ROD DUKE
CHAIR

Dear Shareholder

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

MEMBERSHIP AND MEETINGS

The Committee is required to meet at least four times per year. In 2016, there were seven meetings held. I would like to welcome Tim Hanford who became a member of this Committee on 1 January 2017. The other members are Mike Fairey, Nathan Moss and Mary McNamara.

APPOINTMENT OF DIRECTORS (INCLUDING THE CHAIRMAN)

Following the annual review of Board and Committee composition and the skills and experience available, the need for additional independent Non-Executive Directors with recent relevant financial services experience was identified. A specialist board level headhunter, Lomond Consulting[1], was appointed to conduct a search, with the specific direction to include suitable female candidates in the shortlist. The Committee discussed in detail the skills, experience and other commitments of each candidate and agreed a shortlist of four. The Committee received feedback from all parties and unanimously recommended to the Board that Andrew Doman and Margaret Hassall be appointed. In addition to them both having extensive experience of the financial services industry, Andrew has significant experience leading strategy and delivering successful performance and mergers and acquisitions activity, while Margaret brings additional operations experience particularly information technology experience to the Board.

Also, in anticipation of Mike Fairey's retirement as Chairman at the conclusion of the 2017 AGM we have instructed Per Ardua[1] to conduct an extensive search for candidates with strong financial services experience, and again the remit was to provide where possible a 50/50 split of female and male candidates. The search is well underway and an announcement will be made once the final candidate is chosen. I would like to take this opportunity to thank Mike for his outstanding contribution to a successful IPO and the subsequent development of the Group and wish him well for his future.

Taking into account these changes, we are satisfied that the composition we have established is operating well, and we will continue to monitor Board and Committee membership in 2017. Further details on the composition and balance of the Board and its Committees are provided below.

ROD DUKE
Chair and Senior Independent Director
16 March 2017

1. Does not have any other connection with the Company

RESPONSIBILITIES

The specific responsibilities and duties of the Committee are set out in its terms of reference which were significantly expanded in February 2016 to include conflicts responsibility for Board evaluation, corporate governance and sustainability. This has led to the Committee changing its name to the Nomination and Governance Committee. The terms of reference of the Committee are available on our website www.osb.co.uk.

COMPOSITION OF THE BOARD AND ITS COMMITTEES

The Committee conducted a review of the composition of the Audit, Remuneration and Risk Committees; and its own composition during 2016 carefully considering the skills of the existing members and looking at any skills gaps applicable to any Committee.

Andrew Doman and Margaret Hassall were appointed to the Board. Margaret became a member of the Risk Committee and Andrew became a member of the Audit and Risk Committees. The Committees were further refreshed with Eric Anstee and Graham Allatt becoming Chair of the Audit and Risk Committee, respectively. I, Rod Duke, became a member of the Remuneration Committee and Chair of this Committee.

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

SUCCESSION PLANNING

The Committee considered both Executive and Board level succession planning during 2016. The Executive succession planning review highlighted the need for a formal talent development programme, which was rolled out during 2016. Executives are invited to regularly attend Board and Committee meetings as part of their development.

DIVERSITY

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

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

The Committee is responsible for reviewing on an annual basis the Company's Board diversity policy; in particular whether introducing measurable objectives is appropriate for the Company. In 2016, the Board voted in favour of signing the Women in Finance Charter. Our aim is that 30% of Senior Management positions within the Group's UK population will be undertaken by female employees by the end of 2020. Currently, 27% of our Board are female. The Company has also appointed a diversity champion to promote a series of diversity initiatives.

Further details relating to diversity and inclusion are set out on page 50.

GOVERNANCE

The Committee reviewed the changes required following the implementation of the EU Market Abuse Regulation 596/2014 which came into effect on 3 July 2016. Following its review, the Committee recommended the implementation of new internal dealing policies for employees and persons discharging managerial responsibilities.

The Committee also reviewed changes in the regulatory landscape and the Company's approach to addressing them.

NOMINATION AND GOVERNANCE COMMITTEE REPORT CONTINUED

ACTIVITIES DURING 2016

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

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

OBJECTIVE	ACTION TAKEN
Continued evaluation of the skills, knowledge and experience required for a balanced Board.	Regular review and appointment of additional Directors.
Consider succession planning for directors and other senior executives.	Succession planning for a new Chairman is well underway and an announcement will be made once finalised. Succession planning for senior executives is also considered.
Review the structure, size, composition and diversity of the Board.	Appointment of additional Directors.
Consider composition of Board Committees.	Board Committees have been refreshed with new members.
Oversee compliance with corporate governance best practice and the UK Corporate Governance Code.	Review of changes in the corporate governance landscape and implementation as required.
Oversee sustainability matters such as environmental, diversity and equal opportunities and advising on business principles, values and purpose.	The Board approved an environmental policy and updated the Diversity and Equality policy

PRIORITIES FOR 2017

The Committee's priorities for 2017 are:

- Review and embed Board effectiveness recommendations from the Promontory Report
- Chairman search
- Succession planning for Senior Executives
- Developing the talent pipeline
- Development of corporate purpose and sustainability
- Oversee the successful implementation of diversity initiatives
- Focusing on the attainment of the Women in Finance Charter target by 2020

AUDIT COMMITTEE REPORT

ERIC ANSTEE
CHAIR

Dear Shareholder

I am pleased to present the report of the Audit Committee for my first year as Chairman, having assumed the role on 1 January 2016, following my appointment to the Board in December 2015.

The Committee continued to spend a significant amount of time in 2016 considering significant issues and areas of judgement as set out in the report below. The Committee also worked closely with Pamela McIntyre who took over as lead external audit partner for KPMG from 1 January 2016 to ensure a smooth transition.

The Committee has also considered the additional requirements in respect of external audit rotation, tender and use of external auditors for non-audit services as a result of the UK adoption of EU legislation to reform the statutory audit market. The new legislation is effective for financial periods commencing on or after 17 June 2016, subject to a number of transitional arrangements which are explored in more detail in the report below.

Further details on the activities of the Committee during the year and how it discharged its responsibilities are also provided in the report below. All members of the Committee are independent Non-Executive Directors.

I would like to take this opportunity to thank Malcolm McCaig, who stepped down from the Committee at the end of 2016 when he left the Board, for his significant contribution. I would also like to welcome Andrew Doman and Nathan Moss to the Committee.

ERIC ANSTEE
Chair
16 March 2017

AUDIT COMMITTEE REPORT CONTINUED

COMPOSITION AND MEMBERSHIP

The Audit Committee is required to meet at least four times per year, with meetings scheduled at appropriate intervals in the reporting and audit cycle. Additional meetings are held as required. In 2016 there were four meetings held, reflecting the workload of the Committee during the year.

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

Membership of the Committee was reviewed by the Nomination and Governance Committee during the year which recommended to the Board that Rod Duke resign from the Committee when he assumed the Chairmanship of the Nomination and Governance Committee. It further recommended that Andrew Doman join the Committee on 1 September 2016 following his appointment to the Board. Subsequent to the year end and Malcolm McCaig stepping down from the Committee and the Board, the Nomination and Governance Committee recommended the appointment of Nathan Moss to the Committee with effect from 7 February 2017. Eric Anstee, the Committee Chair has a wealth of recent and relevant financial and accounting experience in financial services. Taken as a whole, the Committee has an appropriate balance of skills, including recent and relevant financial experience.

ROLE

The primary role of the Committee is to assist the Board in overseeing the systems of internal control and external financial reporting across the Group. The Committee's specific responsibilities are set out in its terms of reference, which are reviewed at least annually. These are available on the Company's website www.osb.co.uk and cover external and internal audit, financial and narrative reporting, compliance, whistleblowing and fraud and internal controls and risk management (primary risk oversight will move to the Risk Committee in 2017).

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

KEY RESPONSIBILITIES

External Audit

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

Internal Audit

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

Financial and narrative reporting

- Monitor the integrity of the financial statements
- Review and report to the Board on significant financial issues and judgements
- Review and challenge accounting policies, methods used to account for significant or unusual transactions, clarity and completeness of disclosure
- Where requested by the Board, advise whether the Annual Report is fair, balanced and understandable
- Review and approval of Pillar 3 disclosures

Compliance, whistleblowing and fraud

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

Internal controls and risk management

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

ACTIVITY DURING 2016

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

Significant issues and areas of judgement considered by the Committee

The following significant issues and accounting judgements were considered by the Committee in relation to the 2016 Annual Report and financial statements. In its assessment, the Committee considered and challenged reports from management prior to both the interim and full-year results, explaining each area of judgement and management's recommended approach. The Committee also received reports from the external auditor setting out its views on the accounting treatment and judgements underpinning the financial statements.

Loan book impairments

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

All assets without a specific provision are assessed collectively. Collective provisions are calculated using 12-month delinquency roll rates and one-year probability of defaults (PD) on different segments of the loan book. The PD calculations include assumptions for emergence periods, cure rates and forbearance. Loss given default (LGD) includes assumptions on forced sale discounts and the level of house prices. Significant judgement needs to be exercised in deciding how to apply historic experience to current market conditions in both the PD and LGD calculations.

The Committee received and challenged reports from management prior to each reporting date, explaining the approach taken to provisioning and the resulting changes in provision levels during the period. The Committee assessed the appropriateness of proposed enhancements to the methodologies, judgements and estimates underpinning the collective provision calculations. These enhancements covered definition of default, cure rate and emergence periods in the PD calculations and the treatment of loans that had received forbearance. Enhancements were also made to the process of determining forced sale discounts, sales costs and discounting periods in the LGD calculations.

The Committee reviewed additional information by loan book during the year including provision coverage ratios, assumed probability of default, loss given default and loan to value ratios for loans three months or more in arrears to help with their assessment of the reasonableness of provisions.

The Committee asked the Risk Committee to review and provide advice on the collective provision methodologies and assumptions and to review the top 20 impaired loans for the half year and year end. At least two members of the Committee were also members of the Risk Committee throughout 2016 and as such received additional detailed credit information on the loan book throughout the year.

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

The Committee also received reports on the Company's preparations for and approach to IFRS 9; Financial Instruments, covering the classification and measurement of the loan book and determination of loan book impairment provisions from management.

Loan book acquisition accounting and income recognition

Acquired loan books are initially recognised at cost. Significant judgement is required in calculating their effective interest rate (EIR), using cash flow models which include assumptions on the likely macroeconomic environment, including HPI, unemployment levels and interest rates, as well as loan level and portfolio attributes and history used to derive prepayment rates, the probability and timing of defaults and the amount of incurred losses. The EIRs on loan books purchased at significant discounts are particularly sensitive to the prepayment and default rates derived as the purchase discount is recognised over the expected life of the loan book through the EIR. New defaults are modelled at zero loss (as losses will be recognised in profit and loss as impairment losses and therefore have the same impact on EIR as prepayments). Incurred losses at acquisition are calculated using the Group's collective provision model. The Committee reviewed and challenged reports from management before each reporting date on the approach taken. Particular focus was given to loan books purchased at significant discounts, including sensitivity analysis on the impact of estimated future prepayment rates and other assumptions on carrying value and the timing of the release of discounts to profit and loss. The Committee reviewed a comparison of actual cash flows to those assumed in the cash flow models by book to challenge management's assessment of the need to update cash flow projections and adjust carrying values accordingly. Based on this work, the Committee is satisfied that the approach taken and judgements made were reasonable.

Effective interest rate

A number of assumptions are made when calculating the effective interest rate for newly originated loan assets. These include their expected lives, likely redemption profiles and the anticipated level of any early redemption charges. Certain mortgage products offered by the Bank include significant directly attributable net fee income, in particular Buy-to-Let, and/or revert to the standard variable rate ('SVR') after an initial discount or fixed period. Judgment is used in assessing the expected rate of prepayment during the discounted or fixed period of these mortgages and the expected life of those that prepay. The Bank uses historical experience in its assessment. Judgment is also used in assessing whether and for how long mortgages that reach the end of the product term stay on SVR. The most significant area of judgment is the period spent on SVR. The Bank prudently assumes no period on SVR before the borrower refinances onto a new product or redeems, pending the results of the new broker led retention programme launched in the second half of 2016. The Committee reviewed and challenged the assumptions used in EIR calculations, in particular the period over which net fee income is spread, and also received sensitivity analysis for different product lives including a period on the Company's standard variable rate. Based on this work, the Committee is satisfied that the approach taken and judgements made were reasonable.

Further details of the above significant areas of judgment can be found in Note 1 to the financial statements.

AUDIT COMMITTEE REPORT CONTINUED

The Committee also reviewed the Company's approach to hedge accounting and received reports on the effectiveness of the Company's macro-hedging throughout the year.

The Committee considered the results of management's review of the fair value adjustments on hedged assets associated with cancelled swaps and the roll-off of the underlying legacy back book of long-dated fixed rate mortgages since cancellation. Following this review the Bank accelerated the amortisation of fair value adjustments on hedged assets in line with the mortgage asset run-off, due to faster than expected prepayments since cancellation. The Committee considered and approved the treatment and disclosures associated with the accelerated amortisation, in particular the treatment of the adjustment as an exceptional loss of £9.8m to the extent it related to non-material adjustments to prior years.

Fair, balanced and understandable

The Committee considered on behalf of the Board whether the 2016 Annual Report and financial statements taken as a whole are fair, balanced and understandable, and whether the disclosures are appropriate. The Committee reviewed the Group's procedures around the preparation, review and challenge of the Report and the consistency of the narrative sections with the financial statements and the use of alternative performance measures and associated disclosures.

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

Internal Audit

The Company moved from an outsourced arrangement for internal audit to a co-sourced arrangement from 1 April 2016, following the appointment of the Head of Internal Audit. Grant Thornton LLP continued to supply expert resource when requested on specific internal audits, on a co-source basis from that date.

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

The Internal Audit Charter, which formally defines internal audit's purpose, authority and responsibility, was approved by the Committee in December 2016. The Committee also approved the annual Internal Audit Plan, which was developed, based on a prioritisation of the audit universe using a risk-based methodology, including input from senior management and the Committee. A written report is prepared following the conclusion of each internal audit engagement and distributed to the Committee and senior management. Responsibility for ensuring appropriate corrective action is taken lies with management. The Internal Audit function will follow-up on engagement findings and recommendations until remedial action is completed.

The Committee carries out an annual review of the effectiveness of the Internal Audit function. This was facilitated for 2016 by a survey completed by Committee members, certain Executives and the External Auditors who had interacted with the Internal Audit function during the year. Following the review the Committee was satisfied that the Internal Audit function operated effectively during the year.

Systems of internal control and risk management

The Committee received regular reports from the Internal Audit function during 2016, which included progress updates against the Internal Audit Plan, the results of audits undertaken and any outstanding audit action points. The Committee used these reports and reports from the Group's Compliance function and the Annual Statement of Compliance from the Head of Compliance as the basis for its assessment of the effectiveness of the Group's system of internal controls and risk management. The Committee also received a report on the effectiveness of the Group's system of controls from the CEO, which was based on a self-certification process completed by senior managers and executives in the Company.

The Committee received and reviewed reports from management on the status of the substantiation of balance sheet general ledger accounts prior to the reporting date. The Committee also received an update on the status of detailed process documentation on loan book acquisition accounting after an internal review by management in late 2015 identified the need to update and complete this documentation in 2016.

The Committee reviewed and approved a number of policies following their annual refresh, including; anti-bribery and corruption, data retention, fraud (including fraud prevention arrangements and a summary of fraud incidents), sanctions, whistleblowing, acceptable use and conduct risk (including the conduct risk framework). Responsibility for the conduct risk policy and review of the adequacy and effectiveness of the Bank's Conduct Risk Framework was transferred to Risk Committee with effect from 1 January 2017. The Committee also requested and received enhanced whistleblowing reporting during the year and formally reported to the Board on its annual review of the effectiveness of the whistleblowing policy in early 2017.

The Committee requested that management provide regular updates on data governance and controls in 2017 as the Company enhances its data governance arrangements in connection with its planned application for an internal ratings based model for capital requirements.

External auditor

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

Appointment and Tenure

KPMG was appointed as the first external auditor of the Bank for the period ended 31 December 2011. Prior to that date it fulfilled the external audit function for KRBS, whereby following a tender process it was first appointed for the 31 December 2010 period-end. A new lead audit partner, Pamela McIntyre, was appointed for the year ended 31 December 2016. The Audit Committee confirms that the Group is in compliance with the Statutory Audit Services for Large Companies Market Investigation (mandatory use of competitive tender processes and Audit Committee Responsibilities) Order 2014 which requires FTSE 350 companies to put their statutory audit services out to tender not less frequently than every 10 years.

New EU legislation adopted by the UK in 2016 sets a maximum audit tenure of 20 years and also requires a tender at least every ten years. The new legislation is effective for financial periods commencing on or after 17 June 2016. The Company therefore intends to put the external audit contract out for tender no later than for the 2020 financial year.

Effectiveness

The Committee assesses the effectiveness of the external audit function on an annual basis. The review was facilitated for 2016 through a survey completed by members of the Committee, certain Executive Directors and other key staff who had significant interaction with the external audit team during the year. The survey assessed the effectiveness of the lead partner and audit team, the audit approach and execution, the role of management in the audit process, communication, reporting and support to the Committee as well as the independence and objectivity of the external auditor. The assessment concluded that the external audit process was effective, however the Committee asked the external auditor to revisit prior year audits of the fair value adjustments on hedged assets associated with cancelled swaps in light of management's review.

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

AUDIT COMMITTEE REPORT CONTINUED

Non-audit services

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

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

The Committee pre-approved a number of permitted services in 2016: interim profit verifications, the half year review and tax compliance for the Group. The Committee also pre-approved other permitted non-audit services subject to an overall threshold of 70% of the final cost of the 2015 Group annual audit services and subject to any single item above £100,000 being pre-agreed with the Committee Chair. The Committee reviews a schedule of year-to-date non-audit services at each meeting.

The fees paid to the external auditor in respect of non-audit services during 2016 totalled £250,000, representing 47% of 2016 Group audit services of £535,000 (2015: £171,000 representing 44% of the proposed 2015 Group audit services of £390,000) and are detailed in the table below. The 2016 audit fee includes non-recurring fees of £80,000 in respect of the audit of system migrations and the sale of the Company's economic interest in the Rochester securitisation vehicle.

The new EU statutory audit market reform legislation adopted in the UK includes restrictions on the nature and extent of non-audit services provided by the statutory auditor. Restrictions on the nature of permissible non-audit services are effective for financial periods commencing on or after 17 June 2016. These included certain restrictions on the use of the statutory auditor for tax compliance and advice. Accordingly, the Company ceased using KPMG for tax compliance or advice after 31 December 2016. The new legislation also applies a cap on permissible non-audit services of 70% of the proceeding three year average of audit fees. This is applicable for financial periods commencing on or after 17 June 2019. Against this backdrop the Committee set a pre-approved threshold for permissible non-audit services for 2017 of 50% of the 2016 audit fee.

The Committee's assessment of the external auditor's independence in 2016 took into account the non-audit services provided during the year, and confirmations given by KPMG as to its continued independence at various stages in the year.

Nature of service	**2016 £'000**	2015 £'000
Audit-related assurance services including half year review and interim profit verifications	96	71
Tax compliance and advice	70	59
Regulatory advice and support	36	8
Other[1]	48	33
Total non-audit services	250	171

1. 2016 includes agreed upon procedures in respect of a new securitisation vehicle and assurance work in relation to net lending for the Funding For Lending Scheme

Training

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

Effectiveness

The Committee formally considers its effectiveness annually. The assessment was facilitated for 2016 using a survey completed by members of the Committee. The review concluded that the Committee operated effectively throughout 2016 with no significant improvements required.

RISK COMMITTEE REPORT

GRAHAM ALLATT
CHAIR

Dear Shareholder

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

Membership and meetings

The Committee is required to meet at least six times per year. In 2016 the Committee met 11 times. Andrew Doman and Margaret Hassall joined the Committee on 1 September 2016 following their appointments to the Board. The other members are Eric Anstee, Mary McNamara and April Talintyre. Only members of the Committee are entitled to attend meetings, however the Chief Risk Officer (CRO), Chief Executive Officer (CEO) and Chief Credit Officer (CCO) have standing invitations to the Committee, unless, I, as Chair, inform any of them that they should not attend a particular meeting or discussion.

The Committee reviewed and commented on various reports, including the Internal Capital Adequacy Assessment Processes, Internal Liquidity Adequacy Assessment Processes and Recovery and Resolution Plan, before recommending the documents to the Board for approval or noting. The Committee spent an appropriate proportion of its time reviewing a number of inorganic transactions, as well as its other advisory and oversight responsibilities.

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

GRAHAM ALLATT
Chair
16 March 2017

RESPONSIBILITIES

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

Risk appetite and assessment

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

Risk monitoring and framework

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

Chief Risk Officer (CRO) and risk governance structure

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

The Committee's terms of reference are available on the Company's website, www.osb.co.uk.

RISK COMMITTEE REPORT CONTINUED

ACTIVITY DURING 2016

In 2016, the Group continued to implement its enhanced strategic risk management framework, which represents the overarching framework established to manage its risk profile in line with its business strategy and objectives. The strategic risk management framework of the Group is set out in detail on pages 39 to 41.

In order to discharge its duties and responsibilities, the Committee receives reports from those responsible for specific areas of risk within that framework. The Group's compliance function reports on conduct risk and regulatory risk to the Committee and the CRO on all other risks. Examples of how the Committee has discharged its responsibilities during the year are as follows:

Credit risk

The Committee received and reviewed regular detailed credit reports during the year identifying large exposures, loan to values and arrears within various categories (e.g. residential loans, Buy-to-Let, consumer lending). These reports now include more forward-looking credit risk data including debt service coverage ratios for Buy-to-Let and external bureau data. The reports also highlight early warning indicators, which allow the Committee and the risk function to address potential credit issues before they develop into significant risk areas.

The Committee reviewed individual cases from the legacy problem loans population, making recommendations, where appropriate, to ensure the best outcomes are reached. The Committee also reviewed and commented on updates to the Group lending policy and the loan loss provisioning policy prior to their submission to the Board for approval.

During 2016, the Committee reviewed, challenged and ultimately approved proposed enhancements to the IAS 39 methodologies, judgements and estimates which underpinned collective provision calculations. The Committee also assessed and approved the Group's provision adequacy levels throughout the year.

Market risk and liquidity risk

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

The Committee also reviewed and commented on updates to the treasury policy, interest rate and basis risk policy, asset encumbrance policy and the funds transfer pricing policy prior to submission to the Board for approval.

OPERATIONAL RISKS

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

Although there were operational incidents during the course of 2016, the Committee was satisfied that the action taken was appropriate and that the control of operational incidents continued to improve.

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

Internal Capital Adequacy Assessment Process (ICAAP)

The Committee was involved with the design and approval of appropriate macroeconomic scenarios to be used in the Group's ICAAP. The ICAAP engages the Board in the ongoing assessment of risks and demonstrates how the Group would manage its business and capital during adverse macroeconomic and idiosyncratic stresses, and the Committee reviews and comments on all ICAAP submissions before they are submitted to Board for approval.

Internal Liquidity Adequacy Assessment Process (ILAAP)

The Committee reviewed and commented on the proposed ILAAP prior to its submission to the Board for approval. This process sets out the Group's approach to liquidity and funding, including the assessment and quantification of liquidity risk, how the Group intends to mitigate those risks, and how much current and future liquidity is required.

Recovery and Resolution Plan (RRP)

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

In addition to the specific examples given above, the Committee reviewed various transaction proposals, assessing their potential impact on the risk profile of the Group. It also approved the Group's Pillar 3 disclosure and various policies and policy updates.

Risk appetite

The Committee reviewed and commented on the Group's enhanced risk appetite framework resulting in a number of refinements being made to the process.

ANNUAL STATEMENT BY THE CHAIR OF THE REMUNERATION COMMITTEE

MARY MCNAMARA
CHAIR

Dear Shareholder

I am pleased to present the Committee's report for 2016.

As set out earlier in this Annual Report, the Bank has continued to perform well in 2016 despite macro-economic headwinds. We have now exceeded all of the financial objectives which were set at IPO with 2016 delivering continued earnings growth together with a strong balance sheet, a reputation for excellent customer service and strong risk management.

2016 INCENTIVE OUTCOMES

The Executive Bonus Scheme is based on performance against a suite of measures with financial, customer, quality, staff and personal metrics. Targets for each measure were set at the start of the year and assessed by the Committee following year-end.

50% of this award will be deferred into shares under the Deferred Share Bonus Plan. These shares will be held for a three-year period and are subject to strict clawback and malus provisions.

Annual bonus plan

The Company's bonus scheme was designed to ensure that executives are rewarded for strong underlying performance which is sustainable over the long-term. Bonus outcomes have been determined based on performance measures spanning four categories – financial, customer, quality and staff with between 3 and 10 metrics under each category in 2016 and 24 measures in total. This has ensured a focus on overall performance, aligning with the PRA and FCA Remuneration Code.

For 2017 we will maintain the focus on our key performance indicators (financial, customer, quality and staff) but will simplify the bonus and have fewer metrics in each area. These changes will mean that, going forward, we will be able to disclose all of the targets in the Company's scorecard.

Due to the granularity of the 2016 measures, the Committee does not feel that it is possible to disclose the targets for all of the metrics used as to do so would give sensitive information to our competitors. Where we feel able to disclose the targets we have done so in full, including all of the financial metrics. In total, we have disclosed the targets for measures equating to around 80% of the annual bonus.

Remuneration for 2017

At the time of IPO in 2014 the Committee awarded the CEO, Andy Golding, a modest salary increase but did not fully align his total remuneration to "market" preferring to phase any correction based on performance of both the individual and the Company. As we were aware that the Company had the potential to evolve significantly by the final year of the remuneration policy, we purposely built flexibility into our remuneration policy allowing us to increase pay to reflect growth.

In both of the two years since IPO, we have moved Andy Golding's salary, but not other elements of pay. A considerable gap still exists, therefore, to the market. Given the performance of the bank, and the contribution of Andy Golding to that success, we are recommending to increase Andy Golding's salary by £40,000 to £490,000 (8.9%) together with an uplift to the long-term incentive from 100% of salary to 130% of salary. These increases are very well deserved in the context of performance and though they do not bring the remuneration in line with that paid at our competitors we feel it is important to "close the gap" and not to allow ourselves to become too far adrift from the market.

Targets attached to 2017 long-term incentive awards

The performance conditions attached to the long-term incentive award are unchanged – TSR relative to the constituents of the FTSE and EPS. Our EPS targets remain stretching in the context of our internal business plan together with external forecasts and the targets seen at other companies. 2017 LTIP awards will be subject to targets from 6% CAGR (threshold performance) to 12% CAGR (maximum performance). While these have come down from those set immediately after IPO they reflect the development of the business together with the external environment in which we operate.

Review of Directors' Remuneration Policy

During 2017 we will be reviewing the Directors' Remuneration Policy with a view to presenting the revised policy to shareholders at the 2018 AGM. We will engage with major shareholders on any significant changes that we are proposing and seek feedback on them.

Membership

I would like to thank Malcolm McCaig, who stepped down as a member and to welcome Rod Duke, who joined as a member during 2016.

MARY MCNAMARA
Chair
16 March 2017

ANNUAL STATEMENT BY THE CHAIR OF THE REMUNERATION COMMITTEE CONTINUED

INTRODUCTION

This section sets out details of the remuneration which the Executive and Non-Executive Directors (including the Chairman) received in respect of the financial year ended 31 December 2016 together with the operation of the Committee over the same period. The annual report on remuneration will, in conjunction with the annual statement of the Committee Chair on pages 77 to 90, be proposed for an advisory vote by shareholders at the forthcoming AGM to be held on 10 May 2017. Where required, data has been audited by KPMG LLP and this is indicated where appropriate. In preparing this report consideration has been given to the GC100 and Investor Group Directors' Remuneration Reporting Guidance.

REMUNERATION COMMITTEE

MEMBERSHIP

The Committee met nine times during the year. Mary McNamara (Chair), Rod Duke and Nathan Moss are members. Malcolm McCaig ceased to be a Director and member on 31 December 2016. The attendance of individual Committee members, is set out in the Corporate Governance Report.

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

ROLE OF THE REMUNERATION COMMITTEE

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

- Pay for employees under the Committee's purview:
  - Setting the Remuneration Policy
  - Determine the total individual remuneration (including salary increases, bonus opportunities and outcomes and LTI awards)
  - Ensure that contractual terms on termination, and any payments made, are fair to the individual, and the Company, that failure is not rewarded and that the duty to mitigate loss is fully recognised
- Approve the design of, and determine targets for, any performance related pay schemes operated by the Company and approve total annual payments made under such schemes

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

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

In carrying out its duties the Committee takes into account any legal requirements, the PRA Code, UK Corporate Governance Code and UK Listing Rules.

KEY MATTERS CONSIDERED BY THE REMUNERATION COMMITTEE

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

- For staff under the Committee's purview
  - Review and approve 2016 salary increases
  - Review and approve 2015 bonus awards
  - Agree 2015 awards size and targets for grants under the Performance Share Plan (granted in 2016)
- Consider shareholder feedback on remuneration proposals
- Consider and approve the 2015 directors' remuneration report
- Consider market trend and regulation updates
- Review structure of annual bonus
- Review remuneration policy

ADVISERS TO THE COMMITTEE

New Bridge Street (part of Aon plc) served as remuneration consultants to the Committee during the year. Aon plc provided advice on all aspects of executive remuneration including development of remuneration policy, guidance on performance metrics and benchmarking exercises. The total fees paid to New Bridge Street for work in 2016 were £51,300.

New Bridge Street was appointed by the Committee as its adviser in 2014. Neither New Bridge Street nor Aon plc have any other connection with the Group and therefore the Committee is satisfied that it provides objective and independent advice. New Bridge Street is a member of the Remuneration Consultants Group and abides by the voluntary code of conduct of that body, which is designed to ensure objective and independent advice is given to remuneration committees.

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

EXECUTIVE PAY OUTCOMES FOR 2016

2016 SALARY

In spring 2016, the Committee reviewed the base salaries of the Executive Directors. This review took into account the salary increase budgets for other employees, the performance and experience of the Directors and the performance of the Bank as a whole together with the relative pay levels and practice in other listed companies of a similar size (both within the financial services sector and the wider market). As a result of the continued growth of the Company, both the CEO and CFO salaries remained below competitive external levels. The Committee considered that in light of this positioning, combined with strong corporate and individual performance, adjustments should be made to bring them closer to market levels. Accordingly, the Committee increased the base salary for the CEO by 9.8% and the base salary for the CFO by 6.9%.

Salary paid in the year was therefore:

Executive £	Salary from 1 January 2016 – 31 March 2016	Salary from 1 April 2016 – 31 December 2016	Total salary paid in 2016
Andy Golding	410,000	450,000	440,000
April Talintyre	290,000	310,000	305,000

2016 PENSION CONTRIBUTIONS

Executives received pension payments totalling 13% of salary (£57,000 for Andy Golding and £40,000 for April Talintyre). Payments were either made into the defined contribution scheme or as a cash allowance.

EXECUTIVE BONUS SCHEME: 2016 COMPANY PERFORMANCE (AUDITED)

In 2016, the bonus plan operated on a similar basis to previous years with a wide range of performance metrics covering all aspects of performance. Consistent with the approach taken last year, we believe that some of the measures contained in the scorecard remain commercially sensitive beyond the end of the performance period. That said, the Committee is committed to being as transparent as possible and aims to provide shareholders with sufficient data to judge the resulting outcomes. To that end, we have sought to provide all information on the 2016 targets which is not commercially sensitive. The targets disclosed account for around 80% of the scorecard.

We have simplified our 2017 Executive Bonus Scheme such that we expect to be able to disclose performance on all measures.

The measures for 2017 are set out on page 83.

Category[1]	Key Performance Indicator	Targets[2] Threshold	Budget	Max	Actual result
Financial (35%)	Annual underlying PBT £m	119	123	131	137
	All-in Return on equity (whole book)	27%	28%	30%	29%
	Annual cost to income ratio	28.4%	27.4%	25.4%	27%
	CET1 ratio[3]	10.15%	10.4%	10.9%	13.3%
Customer (15%)	Customer satisfaction[4]	28%	30%	34%	59%
	Broker satisfaction[5]	37.5%	40%	45%	48%
	Monthly complaints[6]	0.80%	0.50%	0.10%	0.06%
Quality (15%)	Deficient internal audits[7]	1	n/a	0	0
	Arrears[8]	2.3%	2.0%	1.5%	0.6%
	IT system up-time[9]	99.0%	99.5%	99.7%	99.9%
	High severity incidents[10]	10	8	4	4
Staff (10%)	Headcount actual versus planned	89%	90%	93%	93.9%
	Regretted Attrition UK	13%	12%	10%	11.6%
	Regretted Attrition India	22%	20%	18%	17.3%
Personal (25%)	The personal performance of both executives during the year was rated as 'outstanding'. Details on this are shown below.				

1. Weightings for the individual elements are not shown as they vary by executives. Weighting shown is as a percentage of total bonus (25% is based on personal objectives)
2. Threshold pays out at 25% of maximum and budget at 50% of maximum
3. Excluding unverified profits & foreseeable dividends
4. Average monthly customer satisfaction (NPS)
5. Average monthly broker satisfaction (NPS) (KRBS)
6. Average monthly complaints as % of total customers (KRBS)
7. Total number of deficient (red) internal audits during year
8. Average monthly originated good book arrears
9. Average monthly IT system up-time
10. Total number of high severity operational incidents

ANNUAL STATEMENT BY THE CHAIR OF THE REMUNERATION COMMITTEE CONTINUED

2016 INDIVIDUAL PERFORMANCE

The executive directors are allocated up to a maximum of 25% of their bonus based on their personal performance against agreed objectives, overlaid over the Board's appraisal of the Group's overall performance.

For 2016, the personal objectives for the CEO included setting the cultural tone from the top, sponsoring delivery of the change and project agenda for the group and management of executive and board budgets, coupled with an appraised assessment against required behaviours and quality and compliance matters.

Against these objectives, the CEO was rated as outstanding based on the significant change delivery, strong staff engagement, excellent customer metrics and robust cost management. Accordingly, 25% out of a possible 25% was awarded for this element.

For 2016, the personal objectives for the CFO included delivering to timelines on our IFRS 9 and IRB project, co-sponsoring the Rochester 1 disposal and management of all finance and HR budgets, coupled with an appraised assessment against required behaviours and quality and compliance matters.

Against these objectives, the CFO was rated as outstanding based on the significant project delivery, the profit generated from the Rochester 1 disposal and strong departmental cost management. Accordingly, 25% out of a possible 25% was awarded for this element.

2016 BONUS OUTCOME (AUDITED)

This performance resulted in a bonus of £399,375 for the CEO and a payment of £270,475 to the CFO. 50% of the bonus will be paid in cash in April 2017 with the remaining 50% deferred into shares under the Deferred Share Bonus Plan (DSBP). These shares will be held for a three-year period. There are no further performance conditions attached to this award however it is subject to clawback or malus in the circumstances set out in the Policy Report. If the Executive Director leaves prior to vesting any entitlement to the deferred shares is forfeited unless for a good leaver reason such as redundancy, retirement or ill health.

2016 LONG-TERM INCENTIVE VESTING

There were no executive long-term incentive plans which vested in 2016.

SINGLE TOTAL FIGURES OF REMUNERATION – EXECUTIVE DIRECTORS (AUDITED INFORMATION)

The table below sets out a single figure for the total remuneration received by each Executive Director for the years ending 31 December 2016 and 31 December 2015.

Executive Directors	Year	Basic salary £000	Taxable benefits	Pension	Annual bonus paid	Amount bonus deferred	Vested LTIP	Total
Andy Golding	2016	440	13	57	200	200	0	910
	2015	401	13	52	191	191	0	848
April Talintyre	2016	305	9	40	135	135	0	624
	2015	284	9	37	130	130	0	590

The strong performance of the Company has led to a bonus of 85% of maximum for the CEO and 83% of maximum for the CFO. Additional detail on the performance which was achieved relative to the targets is set out on page 79 of this report.

EXECUTIVE PAY OUTCOMES IN CONTEXT

PERCENTAGE CHANGE IN THE REMUNERATION OF THE CHIEF EXECUTIVE OFFICER

The table below sets out the percentage change in base salary, value of taxable benefits and bonus for the CEO compared with the average percentage change for employees. For these purposes UK employees who have been employed for over a year (and therefore eligible for a salary increase) have been used as a comparator group as they are the analogous population (based on service and location). In 2016, this group formed the majority of OneSavings Bank's (OSB) employees.

	Average percentage change 2015–2016		
	Salary	Taxable Benefits	Annual Bonus
CEO	8.89%	0%	4.74%
UK employees	8.13%	0%	18.07%

COMPARISON OF COMPANY PERFORMANCE AND CEO REMUNERATION

The following table summarises the CEO single figure for total remuneration and annual bonus pay-out as a percentage of maximum opportunity in 2013–2016:

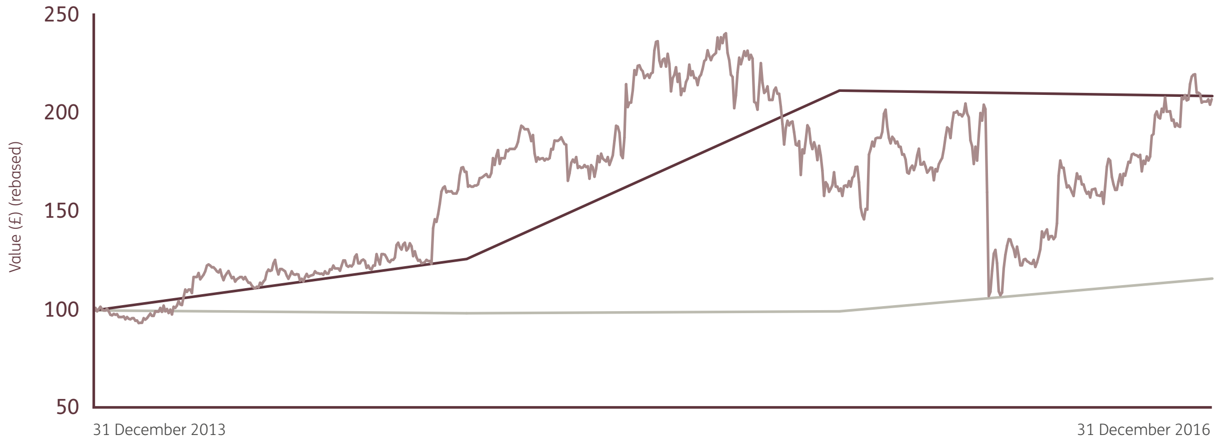
	2013	2014	2015	2016
Andy Golding				
Annual bonus (as a percentage of maximum opportunity)	92.5%	92.63%	93.00%	88.75%
CEO single figure of remuneration (£'000)	518	777	848	910

TOTAL SHAREHOLDER RETURN

The graph below shows the total shareholder return (TSR) performance of the Company over the period from listing to 31 December 2016 compared to the performance of the FTSE All Share Index. This index is considered to be the most appropriate index against which to measure performance as the Company is a member of this index. As OSB has only been listed for a relatively short period (2.5 years) the entire historical performance to date as well as the statutory requirement to show movement in performance between listing and financial year ends has been shown.

TOTAL SHAREHOLDER RETURN

Source: Datastream (Thomson Reuters)



This graph shows the value, at 31 December 2016, of £100 invested in OneSavings Bank plc on admission (5 June 2014) compared with the value of £100 invested in the FTSE All Share Index on the same date.

The other points plotted are the values at intervening financial year-ends.

OneSavings Bank plc — OneSavings Bank plc daily return — FTSE All Share Index

RELATIVE IMPORTANCE OF THE SPEND ON PAY

The chart below shows the Company's total employee remuneration (including the Directors) compared to distributions to shareholders and operating profit before tax for the year under review and the prior year. In order to provide context for these figures, underlying operating profit as a key financial metric used for remuneration purposes has been shown.

	2015	2016
Total employee costs	£21.7m	£29.5m
Distributions to shareholders	£21.1m	£25.5m
Underlying profit before tax	£105.9m	£137.0m
Total employee costs v PBT	20.50%	21.5%
Average headcount	544	674
Average PBT per employee	£194,669	£203,264

OTHER DISCLOSURE ON 2016 EXECUTIVE REMUNERATION

SCHEME INTERESTS AWARDED DURING THE FINANCIAL YEAR

The table below shows the awards made to Executive Directors in 2016 under the performance share plans and the performance conditions attached to these awards:

Executive	Face value of award (percentage of salary)	Face value of award	Percentage of awards released for achieving threshold targets	End of performance period	Performance conditions
Andy Golding	100%	410,000	25%	31 December 2018	EPS & TSR
April Talintyre	100%	290,000	25%	31 December 2018	EPS & TSR

1. The number of shares awarded was calculated using a share price of £2.53 (the average mid-market quotation for the preceding 5 days before grant)
2. Performance conditions are:
   i. 50% TSR versus the FTSE 250 (25% vesting for median performance increasing to maximum vesting for upper quartile performance); and
   ii. 50% EPS (25% vesting for growth in EPS of 8% per annum increasing to maximum vesting for 15% per annum)

Deferred bonus awards of £191,000 (75,356 shares) and £130,000 (51,374 shares) were made to Andy Golding and April Talintyre respectively for performance in 2015. These awards are not subject to any further performance conditions (other than malus/Clawback) and will vest in Spring 2019.

ANNUAL STATEMENT BY THE CHAIR OF THE REMUNERATION COMMITTEE CONTINUED

ALL EMPLOYEE SHARE PLANS

In 2016 OSB made a third annual award under the Sharesave scheme allowing all eligible employees to save a portion of their monthly salary with the option to use these savings to purchase shares at a pre-agreed price at the end of the exercise period. For the 2016 grant, the maximum amount an employee could save across all plans was £500 per month for three and five years. The exercise price was discounted by 20% from the share price on award.

The Executive Directors have the following interests under the scheme:

				Exercise period		Number of options		
Executive	Date of grant	Exercise price £	Market price (31 December 2016) £	Beginning	End	Beginning of period	Granted/ exercised/ forfeited/ lapsed	End of period
April Talintyre	2014	1.34	3.38	18-Jul-17	18-Jan-18	6,716	–	6,716

SHARE OWNERSHIP GUIDELINES

The CEO is required to accumulate and maintain a holding in ordinary shares in the Company equivalent to no less than 200% of salary (150% of salary for the CFO). 50% of any vested share awards must be retained until the guideline is achieved.

STATEMENT OF EXECUTIVE DIRECTORS' SHAREHOLDINGS AND SHARE INTERESTS (AUDITED INFORMATION)

Total shares owned by executives:

	Total interest in shares at 31 December 2016	Shares owned at 31 December 2016	Interests in share incentive schemes awarded without performance conditions at 31 December 2016	Interests in share incentive schemes awarded subject to performance conditions as at 31 December 2016	Shareholding requirement (percentage of basic salary)	Current shareholding (percentage of basic salary)
Andy Golding	2,137,951	1,650,000	154,663	333,288	200%	1,239%
April Talintyre	921,325	579,415	106,280	235,630	150%	632%

1. Includes shares in OSB Holdco Limited
2. Shareholding based on the closing share price on 31 December 2016 – £3.38 and year end salaries
3. There were no changes to directors' interests in the Company's shares during the period 31 December 2016 to 16 March 2017

EXTERNAL BOARD APPOINTMENTS

Andy Golding is a Director/trustee of Building Societies Trust Limited and a Non-Executive Director of Kreditech Holding SSL GmbH, and receives no remuneration for these positions.

PAYMENTS TO DEPARTING DIRECTORS

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

IMPLEMENTATION OF REMUNERATION POLICY FOR EXECUTIVE DIRECTORS FOR 2017

As set out in the Chair's letter on page 77, the CEO's salary will be increased by £40,000 to £490,000 (8.9%). The salary for the CFO will be increased by 6% to £328,600. There will be a modest raise to the car allowance to £20,000 for the CEO and £15,000 for the CFO in line with changes made to other employees below the Board. Other benefits and pension provisions will remain unchanged.

ANNUAL BONUS AND DEFERRED SHARE BONUS PLAN

For 2017 we have reduced the number of measures in the Company scorecard while retaining the original structure of the bonus and operation of the plan as outlined in the policy report. The performance measures in the 2017 annual bonus are:

Financial	Customer	Quality	Staff	Personal objectives
35% of bonus opportunity	15% of bonus opportunity	15% of bonus opportunity	10% of bonus opportunity	25% of bonus opportunity
Annual Underlying PBT All-in ROE Annual cost income ratio Net loan book growth CET1 Ratio	Customer satisfaction Broker satisfaction Complaints	Deficient internal audits Arrears IT system up-time High severity incidents	Diversity Employee engagement	Vary by executive Details of objectives (and performance against these) will be disclosed retrospectively in next year's report

Performance targets will be set out in the 2017 Annual Report on Remuneration.

The maximum opportunity for the year ending 31 December 2017 will be 100% of salary for all Executive Directors.

PERFORMANCE SHARE PLAN

Awards under the PSP will be made in March 2017. Awards for the Executive Directors will be 130% of salary for the CEO and 100% of salary for the Chief Financial Officer. The performance conditions that will apply to the 2017 awards continue to be EPS and TSR.

The performance targets:

Performance level	EPS element (50% of total award)	TSR element (50% of total award)	Percentage of that part of the award vesting
Below 'threshold'	Less than 6% CAGR	Below median	0%
'Threshold'	6% CAGR	Median	25%
'Stretch'	12% CAGR	Upper quartile	100%
Pro rata vesting in between the above points			

IMPLEMENTATION OF NON-EXECUTIVE DIRECTOR REMUNERATION POLICY

SINGLE TOTAL FIGURES OF REMUNERATION – CHAIRMAN AND NON-EXECUTIVE DIRECTORS (AUDITED INFORMATION)

The table below sets out a single figure for the total remuneration received by the Chairman and each Non-Executive Director for the years ending 31 December 2016 and 31 December 2015.

Total fees £000	2015	**2016**
CHAIRMAN		
Mike Fairey	150	**161**
NON-EXECUTIVE DIRECTORS		
Graham Allatt[1]	70	**73**
Eric Anstee	2	**72**
Andrew Doman[2]	–	**26**
Rod Duke	80	**77**
Tim Hanford[3]	60	**60**
Margaret Hassall[2]	–	**26**
Malcolm McCaig[4]	60	**60**
Mary McNamara	70	**70**
Dr David Morgan[4]	60	**60**
Nathan Moss	60	**60**
Stephan Wilcke[5]	60	**22**
TOTAL	672	**767**

1. Additional duties were performed during the year
2. Andrew Doman and Margaret Hassall joined the Board on 26 July 2016
3. Fees paid to the major shareholder
4. Malcolm McCaig and Dr David Morgan left the Board on 31 December 2016
5. Stephan Wilcke left the Board on 11 May 2016

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

ANNUAL STATEMENT BY THE CHAIR OF THE REMUNERATION COMMITTEE CONTINUED

CHAIRMAN AND NON-EXECUTIVE DIRECTOR FEES

The Chairman's fee was increased to £165,000 in 2016. This reflects the continued contribution and time commitment made by the incumbent to the role and brings the fee closer to the market level versus similar sized companies within the sector. Other Non-Executive Director fees will remain unchanged.

Base fees £000	2015	2016
Chairman	150	**165**
Non-Executive Director	60	**60**
Additional fees		
Senior Independent Director	10	**10**
Audit Committee Chair	10	**10**
Remuneration Committee Chair	10	**10**
Nomination Committee Chair	10	**10**
Risk Committee Chair	10	**10**

NON-EXECUTIVE DIRECTORS' SHAREHOLDINGS (AUDITED INFORMATION)

Non-executive	Shareholding as at 31 December 2016
Graham Allatt	**0**
Eric Anstee	**4,960**
Andrew Doman	**100,499**
Rod Duke	**94,537**
Mike Fairey	**30,000**
Tim Hanford	**0**
Margaret Hassall	**0**
Malcolm McCaig[1]	**111,805**
Mary McNamara	**22,350**
Dr David Morgan[1]	**0**
Nathan Moss	**0**
Stephan Wilcke[2]	**50,000**

1. Malcolm McCaig and Dr David Morgan ceased to be Directors on 31 December 2016
2. As at 11 May 2016 when Stephan Wilcke ceased to be a Director

At the time of IPO, two current directors (Mike Fairey and Rod Duke) received awards of shares, some or all of which were required to be retained during the period for which they serve as directors.

STATEMENT OF VOTING AT GENERAL MEETING

At the 2016 Annual General Meeting, shareholders were asked to approve the 2015 Annual Report on Remuneration. The votes received were:

Resolution	Votes for	% of votes cast	Votes against	% of votes cast	Total votes cast	Votes withheld
To approve the Remuneration Report	198,918,622	94.36	11,891,823	5.64	210,810,445	2,798,284

REMUNERATION POLICY REPORT

This policy report was approved at the 2015 AGM with a vote in favour of 97.2% and took effect from the date of approval. It is reported here for information only. The policy will apply for the three-year period following approval and the Company will present another policy to shareholders at the 2018 AGM. The scenario charts have been updated based on 2017 salaries.

Policy overview

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

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

Objectives of the Remuneration Policy

The overarching principles of the Remuneration Policy for employees across the Group are as follows:

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

In respect of the Executive Directors and senior management, performance-related pay will form a significant but appropriate part of remuneration packages and there will be an appropriate balance between short and longer-term performance targets linked to the delivery of the Group's objectives. The policy is intended to be delivered via a remuneration framework with the flexibility of being able to combine base salary, benefits, commission, annual bonuses and employee share plans. The specific policy applying to Executive Directors is set out in the table and accompanying notes on page 86.

How we take account of risk in the Remuneration Policy

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

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

As a Level 3 PRA regulated firm, we also take seriously the requirements of the Remuneration Code. In the design of our Remuneration Policy, we have therefore responded to the evolving regulation in this area, including the application of the European Banking Authority cap on variable remuneration to Level 3 Code banks. As a result, we sought shareholder approval to increase the cap on our variable pay to up 200% of fixed pay (i.e. a 2:1 ratio), and our Remuneration Policy is designed to operate within this cap.

How the views of shareholders and employees are taken into account

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

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

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

ANNUAL STATEMENT BY THE CHAIR OF THE REMUNERATION COMMITTEE CONTINUED

THE REMUNERATION POLICY FOR EXECUTIVE DIRECTORS

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

Element	Purpose and link to strategy	Operation and performance conditions	Maximum
Salary	To recruit and reward executives of a suitable calibre for the role and duties required. Recognises individual's experience, responsibility and performance.	Paid monthly. Base salaries are reviewed annually, with any changes effective from 1 April. No performance conditions apply to the payment of salary. However, when setting salaries, account is taken of an individual's specific role, duties, experience and contribution to the organisation. As part of the salary review process, the Committee takes account of the external market for UK listed companies both in the Financial Services sector and across all sectors, in order to ensure that salary positioning is appropriate. Whilst this is not the key driver of salary increases, it provides important background context.	Average annual increases will generally be broadly in line with the average of the workforce. Higher increases may be awarded in response to acute retention issues, an increase in the scope of the role, following the appointment of a new executive (which could also include internal promotions) to bring that executive's package in line with market over a number of years or in response to market factors.
Benefits	To provide market competitive benefits to ensure the well-being of employees.	The Company provides: • car allowance (£12,000 and £8,000 for the CEO and CFO respectively); • life assurance; • income protection; and • private medical insurance.	There is no maximum cap on benefits, as the cost of benefits may vary according to the external market but the nature of the benefits themselves will not change.
Pension	To provide retirement planning to employees.	Directors may participate in a defined contribution plan, or, if they are in excess of the HMRC annual or lifetime allowances for contributions, may elect to receive cash in lieu of all or some of such benefit.	Up to 13% of salary, subject to employee matching.
Annual bonus	To incentivise and reward individuals for the achievement of pre-defined, Committee approved, annual financial and operational objectives which are closely linked to the corporate strategy.	The annual bonus targets will have at least a 75% weighting based on performance under an agreed balanced scorecard which includes an element of risk appraisal. The remaining balance will be based on personal performance targets. The objectives in the scorecard, and the weightings on each element will be set annually, and may be flexed according to role. Each element will be assessed independently, but with Committee discretion to reduce the resulting outcome. Details of the performance targets set for the year under review and a summary of performance against them will normally be provided in the annual report on remuneration. 50% of any bonus paid will be made in shares under the OSB DSBP. These deferred shares will vest after three years, provided that the executive remains in employment at the end of the three year period. Clawback/malus provisions apply, as described in note 1 below.	The maximum bonus opportunity is 100% of salary.

Element	Purpose and link to strategy	Operation and performance conditions	Maximum
Performance Share Plan	To incentivise and recognise execution of the business strategy over the longer term. Rewards strong financial performance over a sustained period.	PSP awards will be made annually at the discretion of the Committee, usually following the announcement of full-year results. Normally, policy awards will be made to Executive Directors and the senior leadership team, based on a mixture of internal financial performance targets and relative TSR. Any vesting will be subject to an underpin, whereby the Remuneration Committee must be satisfied that the business has operated within the Board's risk appetite framework. This takes into account capital adequacy, liquidity, credit risk, operational risk and conduct and compliance risk. The performance targets will be measured over three financial years. Clawback and malus provisions apply and are structured as for the annual bonus.	The PSP has a grant limit of 200% of salary. Actual awards may be lower than this, and will comply with any overall regulation over the permitted level of variable pay.
All-employee share incentive plan (Sharesave Plan)	All employees including Executive Directors are encouraged to become shareholders through the operation of an all-employee share plan.	Tax favoured plan under which regular monthly savings may be made over a three or five year period and can be used to fund the exercise of an option, where the exercise price is discounted by up to 20%. Provides tax advantages to UK employees, with Executive Directors eligible to participate on a similar basis to other employees.	Maximum permitted savings based on HMRC limits from time to time.
Share ownership guidelines	To increase alignment between executives and shareholders. Executive Directors are expected to build and maintain a minimum holding of shares.	Executives must retain at least 50% of the shares acquired on vesting of any share awards (net of tax) until the required holding is attained.	At least 200% of salary for the CEO and at least 150% of salary for the CFO or such higher level as the Committee may determine from time to time.

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

A description of how the Company implemented the policy set out in this table in 2016, and how it intends to implement it in 2017, is set out in the annual report on remuneration.

Choice of performance measures for Executive Directors' awards

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

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

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

ANNUAL STATEMENT BY THE CHAIR OF THE REMUNERATION COMMITTEE CONTINUED

How the Remuneration Committee operates the variable pay policy

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

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

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

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

AWARDS GRANTED PRIOR TO THE EFFECTIVE DATE

Authority has been given to the Company to honour any commitments entered into with Directors that were entered into prior to the effective date of this policy. Details of any such payments will be set out in the annual report on remuneration as they arise.

Remuneration Policy for other employees

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

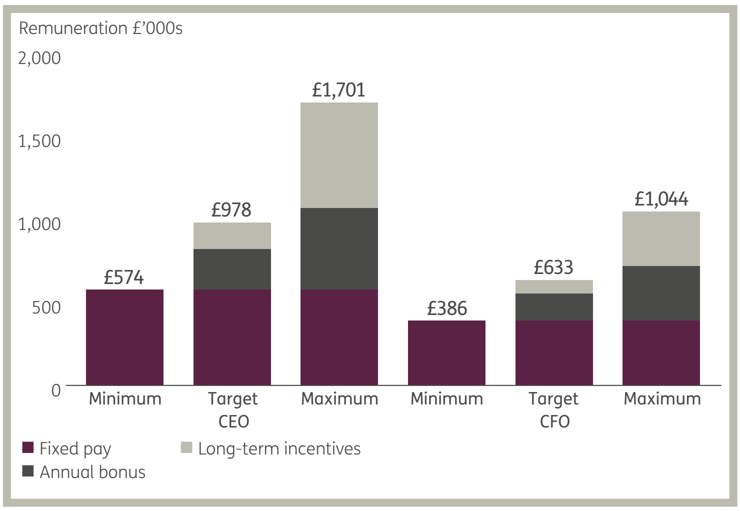
A highly collegiate approach is followed in the assessment of annual bonus, with our corporate scorecard being used to assess bonus outcomes throughout the organisation, with measures weighted according to role, where relevant.

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

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

Illustrations of application of Remuneration Policy

The chart below illustrates how the composition of the Executive Directors' remuneration packages, as it is intended the policy will be implemented in 2016, would vary under various performance scenarios.



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

SERVICE CONTRACTS

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

Provision	Policy
Notice period	12 months on either side
Termination payments	A payment in lieu of notice may be made on termination to the value of their basic salary at the time of termination. Such payments may be made in instalments and in such circumstances can be reduced to the extent that the Executive Directors mitigate their loss. Rights to DSBP and PSP awards on termination are shown below. The employment of each Executive Director is terminable with immediate effect without notice in certain circumstances, including gross misconduct, fraud or financial dishonesty, bankruptcy or material breach of obligations under their service agreements.
Remuneration	Salary, pension and core benefits are specified in the agreements. There is no contractual right to participate in the annual bonus plan or to receive long-term incentive awards.
Post-termination restrictions	These include six-month post-termination restrictive covenants against competing with the Company; nine month restrictive covenants against dealing with clients or suppliers of the Company; Nine-month restrictive covenant against soliciting clients, suppliers and key employees.
Contract date	Andy Golding 19 May 2014, April Talintyre 19 May 2014
Unexpired term	Rolling contracts

PAYMENTS FOR LOSS OF OFFICE

Annual bonus on termination

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

PSP on termination

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

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

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

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

Approach to recruitment and promotions

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

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

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

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

ANNUAL STATEMENT BY THE CHAIR OF THE REMUNERATION COMMITTEE CONTINUED

For all appointments, the Committee may agree that the Company will meet certain appropriate relocation costs.
For the appointment of a new Chairman or Non-Executive Director, the fee arrangement would be in accordance with the approved Remuneration Policy in force at that time.

External appointments

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

Chairman and Non-Executive Directors' remuneration

The Company has a Non-Executive Chairman and eight Non-Executive Directors. Seven are Independent Non-Executive Directors. One of the Non-Executive Directors, Tim Hanford, was nominated by the major shareholder OSB Holdco Limited in accordance with the terms of the Relationship Agreement, further details of which are given on page 63.

The remuneration policy for the Chairman and Non-Executive Directors

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

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

Letters of appointment

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

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

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

JCF Directors

Tim Hanford was nominated by the major shareholder. His appointment will terminate in accordance with the terms of the Relationship Agreement. Under the Relationship Agreement, the major shareholder will receive an annual fee of £60,000 from the Company in respect of each JCF Director that it appoints to the Board, in consideration for the provision of the Director's time and expertise. Where the Relationship Agreement allows, the fees for the JCF Directors may be increased in line with other Non-Executive Director fee increases. Tim Hanford does not receive fees for the provision of this service.

Approval

This report was approved by the Board of Directors, on the recommendation of the Remuneration Committee, on 16 March 2017 and signed on its behalf by:

MARY MCNAMARA
Chair
16 March 2017

DIRECTORS' REPORT: OTHER INFORMATION

Share capital and rights attaching to shares

The Company had 243,082,091 ordinary shares of £0.01 each in issue as at 31 December 2016. 2,126 ordinary shares were issued during 2016. Further details relating to share capital can be found in Note 32.

Without prejudice to any special rights previously conferred on the holders of any existing shares or class of shares, any share in the Company may be issued with such rights (including preferred, deferred or other special rights) or such restrictions, whether in regard to dividend, voting, return of capital or otherwise as the Company may from time to time by ordinary resolution determine (or, in the absence of any such determination, as the Directors may determine).

Authorities to allot and pre-emption rights

At the 2016 AGM, shareholders renewed the general authority for the Directors to allot up to £810,266 of the nominal value of ordinary shares of £0.01 each. In addition, shareholders gave authority for the Directors to grant rights to subscribe for, or to convert any security into regulatory capital convertible instruments equivalent to 12% of issued share capital.

Repurchase of shares

The Company has an unexpired authority to repurchase ordinary shares up to a maximum of 24,308,000 ordinary shares. The company did not repurchase any of its ordinary shares during 2016 (2015: none).

Employee share schemes

The Details of the Company's employee share schemes are set out on pages 82 to 83 in the Remuneration Report.

Results and dividends

The results for the year are set out in the statement of profit or loss on page 99. The Directors recommend the payment of a final dividend of 7.6 pence per share on 17 May 2017, subject to approval at the AGM on 10 May 2017, with an ex-dividend date of 30 March 2017 and a record date of 31 March 2017. This is in addition to the 2016 interim dividend of 2.9 pence per share paid during the year (2015: 8.7 pence total dividend).

Directors' interests

Directors' interests in the shares of the Company are set out on pages 82 and 84 in the Remuneration Report. None of the Directors had interests in shares of the Company greater than 0.7% of the ordinary shares in issue. There were no changes to Directors' interests in shares since 31 December 2016.

Equal opportunities

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

Employee engagement

Employees are kept informed of developments within the business and in respect of their employment through a variety of means, such as staff meetings, briefings and the intranet. Employee involvement is encouraged and views and suggestions are taken into account when planning new products and projects. The sharesave 'save as you earn' scheme is open to all UK-based employees and allows them to save a fixed amount of between £5 and £500 per month over either three or five years in order to use these savings at the end of the qualifying period to buy the Company's shares at a fixed price established when the scheme was announced. The Group launched its first sharesave scheme in June 2014 and granted further options under the scheme in June 2015 and June 2016.

Greenhouse Gas Emissions

Information relating to greenhouse gas emissions can be found on page 52 in the Strategic Report.

Political donations

Shareholder authority to make aggregate political donations not exceeding £50,000 was obtained at the 2016 AGM. Neither the Company nor any of its subsidiaries made any political donations this year.

DIRECTORS' REPORT: OTHER INFORMATION CONTINUED

Notifiable interests in share capital

At 31 December 2016, the Company had received the following notifications of major holdings of voting rights pursuant to the requirements of Rule 5 of the Disclosure Guidance and Transparency Rules DTRs:

	% of issued share capital
OSB Holdco Limited	53.78%
Old Mutual plc	12.08%

No notifications have been received since 31 December 2016.

The details of a Relationship Agreement with the Major Shareholder is set out on page 63.

Annual General Meeting

Accompanying this report is the Notice of the AGM which sets out the resolutions to be proposed to the meeting, together with an explanation of each. This year's AGM will be held at the offices of Addleshaw Goddard, 60 Chiswell Street, London, EC1Y 4AG on 10 May 2017. The meeting will start at 11.00am with registration from 10.30am.

Going concern statement

The Directors have undertaken a going concern assessment in accordance with 'Going Concern and Liquidity Risk Guidance for UK directors of UK Companies 2014', published by the Financial Reporting Council in September 2014.

As a result of this assessment, the Directors are satisfied that the Group and the Company have adequate resources to continue to operate as a going concern for a period in excess of 12 months and have prepared the financial statements on that basis. In assessing whether the going concern basis is appropriate, the Directors have considered the information contained in the financial statements, the latest business plan, profit forecasts and the latest working capital forecasts.

These forecasts have been subject to sensitivity tests and having reviewed the ICAAP and ILAAP the Directors are satisfied that the Group and the Company have adequate resources to continue in operational existence for a period in excess of 12 months.

Key information in respect of the Group's strategic risk management framework, objectives and processes for mitigating risks including liquidity risk are set out in detail on pages 42 to 45.

JASON ELPHICK
Group General Counsel and Company Secretary
OneSavings Bank plc
Registered number: 07312896
16 March 2017

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT AND THE FINANCIAL STATEMENTS

The Directors are responsible for preparing the Annual Report and the Group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors are required to prepare the Group financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and applicable law and have elected to prepare the parent company financial statements on the same basis.

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

In preparing each of the Group and parent company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently
- make judgements and estimates that are reasonable and prudent
- state whether they have been prepared in accordance with IFRS as adopted by the EU
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company, and enable them to ensure that the financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

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

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the Strategic Report includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

We consider the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

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

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

OTHER INFORMATION

Likely future developments in the Company and its subsidiaries are contained in the Strategic Report on pages 1 to 47.

Information on financial instruments including financial risk management objectives and policies including the policy for hedging the exposure of the Company and its subsidiaries to price risk, credit risk, liquidity risk and cash flow risk can be found in the Chief Risk Officer's Report on pages 34 to 45.

Approved by the Board and signed on its behalf by:

JASON ELPHICK
Group General Counsel and Company Secretary
16 March 2017

INDEPENDENT AUDITOR'S REPORT
TO THE MEMBERS OF ONESAVINGS BANK PLC ONLY

Opinions and conclusions arising from our audit

1. Our opinion on the financial statements is unmodified

We have audited the financial statements of OneSavings Bank Plc for the year ended 31 December 2016 set out on pages 99 to 158. In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 December 2016 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU);
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

2. Overview

The starting point for our audit was a consideration of the inherent risks to the Group's business model and how these have been mitigated. This consideration included understanding the strength of the Group's capital and liquidity position, the diversification of assets, the flexibility and composition of its balance sheet and the management of its cost base. In addition, we assessed external economic, political and regulatory factors, through:

- Conversations with management and the Board of directors;
- Ongoing knowledge gained through reading pertinent management information;
- Reading independent economic forecasts and commentary;
- Incorporating the views of our internal specialists regarding bank regulation, IT and tax;
- Changes in banking regulations and the views of the Prudential Regulation Authority and Financial Conduct Authority; and
- Peer comparisons.

We first considered these in June 2016, and refreshed our assessments following the results of the EU referendum and through our half year review, interim and final audits.

Further factors we considered in our assessment of audit risks included the emergence of digital and technological disrupters and increased regulation, including the need to prepare for major financial reporting changes such as updated accounting standards on financial instruments.

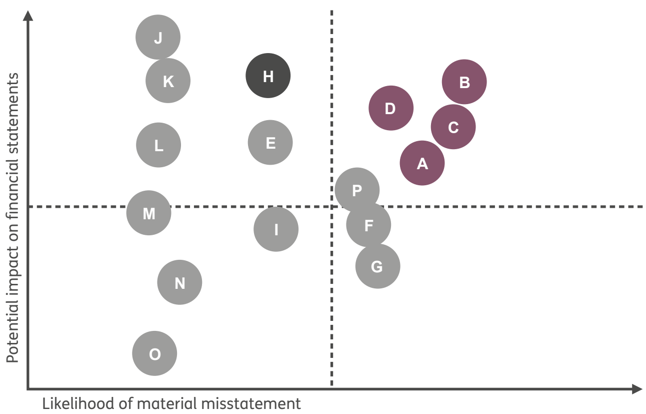
We also considered the Group's control environment and in particular whether its systems were processing transactions completely and faithfully, and included appropriate controls designed to prevent fraud. Our work included testing the key controls over the processing of transactions and the key inter-system and bank reconciliations.

Our assessment of the audit risk in the area of income recognition continues to be impacted by further information available for analysis as the portfolios age, the level of competition in the Group's markets and the challenge of meeting market expectations.

We consider the audit risk in relation to loan impairment to have been affected by the impact of the result of the EU referendum, the regulatory and tax changes to the Buy-to-Let market, continued strong loan growth both organically and through further portfolio acquisitions, and the challenge of meeting market expectations. However, we note that these risk factors continue to be allayed by the low interest rate environment.

These assessments enabled us to form a judgement on going concern and also highlighted the key areas of financial statement risk on which our audit has focused. By looking at both broad risk themes across the Group and particular concerns within the business, we were able to calibrate our work to financial statements risk more precisely.

The final result of our risk consideration is shown in the table. Consistent with 2015, we are of the view that loan impairment, recognition of revenue on acquired loans and EIR on organic



- Risks of greater significance – assessed below
- Other financial statement audit risks
- Significant risk as required by the International Standards on Auditing

- A Loan impairment including forborne loans
- B Recognition of revenue on acquired loans
- C Effective Interest Rate (EIR) on organic loans
- D Amortisation of fair value hedge asset
- E Valuation of treasury instruments and hedge accounting
- F Use of third parties for loan book servicing
- G Legal, compliance and regulatory developments
- H Management override of controls (risk required by ISAs)
- I Accounting for executive compensation scheme
- J Going Concern risk and longer term viability
- K Risk of fraudulent transactions
- L Disposal of Rochester securitisation vehicle
- M Recoverability of deferred tax assets
- N Financial reporting and robustness of reporting processes
- O Valuation of investments in subsidiaries
- P IT environment and effectiveness of general IT controls

Note: Risks B, C and D have been assessed as one risk below due to the similar underlying nature of the risks and our responses loans carry the greatest significance. In addition, the amortisation of the fair value hedged asset is significant in 2016. Due to the similarity in the underlying principles of revenue recognition on acquired loans, EIR on organic loans and the amortisation of the fair value hedged asset, we have assessed these as one risk below. As described on pages 69 to 74 these are also areas that have been focused on by the Group's Audit Committee.

3. Our assessment of risks of material misstatement

In arriving at our audit opinion above on the financial statements the risks of material misstatement that had the greatest effect on our audit, in decreasing order of audit significance, were as follows (unchanged from 2015):

(a) Recognition of revenue on organic and acquired loans £309.5 million (2015: £268.2 million) Risk versus 2015: < > (unchanged)

Refer to page 69 for (Audit Committee report), page 104 (accounting policy) and pages 99 to 158 (financial disclosures).

The risk – The effective interest rate calculation, which uses relevant interest rates, fees and transaction costs, incorporates assumptions around loan expected lives (driven by estimations of loan repayment profiles) and, in the case of acquired credit impaired mortgages and loans, additional variables such as the purchase price and estimated recoverable values. Due to the relatively low levels of historical organic lending in comparison to the significant recent growth, the Group has limited information available from which to assess trends in prepayment, redemption and product transfers, resulting in increased subjectivity to these assumptions, as detailed patterns of customer behaviour have not been clearly established from which to estimate future customer behaviour and performance. For acquired loan portfolios, any change in the repayment profile results in the discount received or premium paid on purchase of the portfolio to be adjusted and spread over the revised expected life.

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

As further portfolios are purchased by the Group, there is a need to assess the consistency and accuracy of the effective interest rate calculations across the individual models. A number of the acquired portfolios are serviced by third parties, leading to data inputs from a number of sources.

There is also a risk that the amortisation profile of the fair value adjustments on hedged assets relating to a proportion of the legacy back book long dated mortgages no longer matches the observed repayment pattern.

Our response – our procedures included:

- For loans originated by the Group:
  - We tested the accuracy of data inputs from the mortgage systems into the effective interest rate models and the consistency of methodology and application across the loan portfolios owned by the Group;
  - We assessed and challenged the reasonableness of the models' key assumptions, including interest rates, product structures and expected lives by performing stress tests, considering their limited historical experience; and
  - We assessed the mathematical accuracy of models through re-performance of the model calculations, and checked the effective interest rates used within the monthly calculations agreed to the models.
- Additional procedures for acquired loans
  - We performed regression testing to identify any significant deviations from the original forecast cash flows;
  - We considered whether any 'catch up' adjustments were required on portfolios where actual cash flow experience has differed from that originally predicted. For those loans where catch up adjustments have been recorded, we assessed the appropriateness of the payment assumptions used in the future forecast cash flow calculations, by comparing to payment rates previously experienced; and
  - We visited each of the servicers for the mortgage and personal loan books where these were not administered by the Group to consider the adequacy of the control environment at these entities and performed sample testing to assess the accuracy and consistency of the information provided by the servicer companies to the Group.
- For the loan books acquired during the year, we performed an assessment of the effective interest rate model. We checked the consistency of the formulae used and to check the mathematical accuracy of the calculation, in order to determine whether the effective interest rate calculated was appropriate. We also considered the composition of the loan portfolio to determine the reasonableness of the acquisition fair values and the total amounts recoverable.
- For the fair value adjustments on hedged assets relating to the legacy back book mortgages, we assessed the reasonableness of the amortisation of the asset which arose on cancelled swaps through checking key inputs to source documentation and re-performance of the calculation.
- We also considered the adequacy of the Group's disclosures relating to the recognition of revenue on organic and acquired loans.

INDEPENDENT AUDITOR'S REPORT CONTINUED
TO THE MEMBERS OF ONESAVINGS BANK PLC ONLY

(b) Loan impairment £25.0 million (2015: £27.3 million) Risk versus 2015: < > (unchanged)
Refer to page 69 for (Audit Committee report), page 104 (accounting policy) and pages 99 to 158 (financial disclosures).

The risk – This is a key judgemental area due to the level of subjectivity inherent in estimating the recoverability of loan balances, compounded by the fact that lower levels of lending historically have provided the Group with little historical experience to use in predicting the likelihood of loans falling into arrears.

The Group identifies individual mortgage loan cases for a specific impairment assessment based on the current level of arrears and nature of the loan. The individual impairment requirement for the loan is determined based on estimated future cash flows discounted to present value at the rate inherent in the loan. This is a highly manual process, with a number of data inputs and assumptions including the cost of obtaining and selling the repossessed property, probable sale proceeds and any rental income prior to sale.

An assessment is performed collectively on all other loans for impairment, with the key assumptions being the probability of an account falling into arrears and subsequently defaulting, the market valuations of any collateral provided, the emergence period for losses and the estimated time and cost to sell any collateral property repossessed by the Group. Due to the majority of the acquired portfolios being serviced by third parties, the collective provision calculation requires data inputs from a number of different sources.

The assumptions noted above differ across the Group's loan portfolios of residential lending (comprising first charge, second charge and shared ownership lending), Buy-To-Let and SME lending, development finance, and personal loans, reflecting the diverse nature of lending performed by the Group and different characteristics of each book. Due to the relatively young nature of these loan books, which result in limited historical information, and sensitivity of the impairment assessments to these assumptions, there is a risk that actual experience may differ from the Group's current expectations.

Increased lending in recent years has been at a time of historically low interest rates, which may distort customer behaviour and loss experience data for use in future assumptions, particularly if interest rates were to increase in coming years.

The Group implements a number of forbearance procedures on selected loans in arrears, such as restructuring of a loan or capitalisation of arrears balances. As this is a manual process, there is the risk that these measures are not appropriately taken into consideration when calculating the required provisions, as the apparent improvement in the arrears on the loans could result in a lower impairment provision if the loans are not identified as forborne.

Our response – our procedures included:

- We tested the design, implementation and operating effectiveness of key controls over the monitoring and reporting of loans and advances to customers.
- For loans assessed for specific provision:
  - We tested the completeness of the loans identified by the Group as high risk through a consideration of all loans for risk factors such as magnitude, arrears and previous loan restructures;
  - We re-performed the calculations of impairment and agreed the key data inputs to third party documentation; namely projected selling price and costs to valuation reports, rental income to tenancy agreements and discount rates to the interest rate of the loan; and
  - We challenged and assessed the reasonableness of the key judgemental areas of the calculation, being forecast sale value of the collateral and the time to sale of the property, through stress testing.
- For loans assessed collectively for impairment:
  - We re-performed the model calculations and agreed the data inputs in the model to the mortgage data system and third party reports in order to assess the accuracy of performance of the collective impairment model;
  - We critically assessed the assumptions inherent in the model against our understanding of the different loan portfolios across the Group, their recent performance and industry developments;
  - We assessed the methodology used by the Group to calculate the propensity of accounts with different arrears profiles to fall into and out of default, and recalculated these rates based on the Group's actual historical experience. These actual rates were compared to those assumed by the Group to assess the validity of the rates used in the collective impairment assessment;
  - We stress tested the collateral valuations, forced sales discount and costs to sell the collateral (being the expected recovery on sale of the property) to assess the sensitivity of the impairment provision to these assumptions;
  - We considered the consistency of the probabilities of default and the emergence periods with the limited historical internal data available;
  - We considered the accuracy of previous estimates of the collective provision against the current book profile;
- We benchmarked the provision coverage rates and the Group's assumptions such as forced sale discounts, emergence period and costs to sell collateral rates against other similar institutions to assess both the level of the impairment provision in comparison to industry norms and the continuing appropriateness of the assumptions used;
- We monitored credit trends in the portfolio, to assess whether emerging trends are reflected in the provision level;
- We checked that forbearance activity is accurately reflected in the impairment provision calculation. The reasonableness of the provision on the forborne loans was tested by checking that for each forborne loan, the uplift to the propensity to default assumption in the collective impairment assessment was appropriately applied; and
- We also considered compliance with the relevant accounting standards including the adequacy of the Group disclosures in relation to impairment.

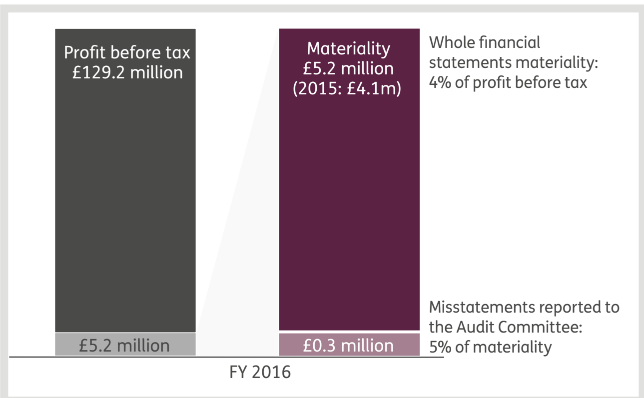
4. Our application of materiality and an overview of the scope of our audit

Materiality for the Group financial statements as a whole was set at £5.2 million (2015: £4.1 million), determined with reference to a benchmark of Group profit before tax adjusted to remove the exceptional profit on disposal of Rochester Financing No1 Plc, of which it represents 4% (2015: 4% of Group profit before tax). The Group team performed procedures on the profit on disposal including checking proceeds received and the terms of the sale agreement.

We reported to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.3 million (2015: £0.2 million), in addition to other identified misstatements that warranted reporting on qualitative grounds.

In 2016 the Group audit team performed the audit of the Group as if it was a single aggregated set of financial information, completing testing over the Interbay, Prestige and OSBIndia components. The audit was performed using the materiality level set out above and covered 100% of total Group revenue, Group profit before tax, and total Group assets.

In 2015 audits for Group reporting purposes were performed at all three of the Group's components; the InterBay sub-group, the Prestige sub-group, and OSBIndia. These audits also covered 100% of Group revenue, profit before tax and total assets. In 2015 the Group audit team instructed component auditors as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. In 2015 the Group audit team set component materiality at £3,570,000 for all components, having regard to the size and risk profile of the Group across the components. The audit of one of the three components was performed by component auditors with the rest being performed by the Group audit team. In 2015 Group instructions were provided to the component auditors, and telephone conference meetings were also held. At these meetings, the findings reported to the Group audit team were discussed in more detail to ensure understanding.



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

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Strategic Report and the Directors' Report for the financial year is consistent with the financial statements.

Based solely on the work required to be undertaken in the course of the audit of the financial statements and from reading the Strategic Report and the Directors' Report:

- we have not identified material misstatements in those reports; and
- in our opinion, those reports have been prepared in accordance with the Companies Act 2006.

6. We have nothing to report on the disclosures of principal risks

Based on the knowledge we acquired during our audit, we have nothing material to add or draw attention to in relation to:

- the directors' statement of longer-term viability on page 46, concerning the principal risks, their management, and, based on that, the directors' assessment and expectations of the Group's continuing in operation over the three years to 31 December 2019; or
- the disclosures in note 1 of the financial statements concerning the use of the going concern basis of accounting.

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

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

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

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

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

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

INDEPENDENT AUDITOR'S REPORT CONTINUED
TO THE MEMBERS OF ONESAVINGS BANK PLC ONLY

Under the Listing Rules we are required to review:
- the directors' statements, set out on pages 92 and 46, in relation to going concern and longer-term viability; and
- the part of the Corporate Governance Statement on page 58 relating to the company's compliance with the eleven provisions of the 2014 UK Corporate Governance Code specified for our review.

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

Scope and responsibilities
As explained more fully in the Directors' Responsibilities Statement set out on page 93, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate. This report is made solely to the company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at www.kpmg.com/uk/auditscopeukco2014a, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

PAMELA MCINTYRE (SENIOR STATUTORY AUDITOR)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London E14 5GL
16 March 2017

STATEMENT OF PROFIT OR LOSS
FOR THE YEAR ENDED 31 DECEMBER 2016

	Notes	**Group Year ended 31-Dec-16 £m**	Group Year ended 31-Dec-15 £m
Interest receivable and similar income	2	**309.5**	268.2
Interest payable and similar charges	3	**(102.9)**	(98.4)
Net interest income		**206.6**	169.8
Fair value losses on financial instruments	4	**(4.9)**	(3.2)
Gains on sales of financial instruments	5	**0.6**	0.6
Fees and commissions receivable		**2.5**	1.1
Fees and commissions payable		**(0.8)**	(1.1)
External servicing fees		**(2.6)**	(4.7)
Total income		**201.4**	162.5
Administrative expenses	6	**(51.1)**	(39.4)
Depreciation and amortisation	20,21	**(2.6)**	(1.7)
Impairment losses	17	**(9.0)**	(10.6)
FSCS and other provisions	29	**(0.5)**	(3.4)
Exceptional gain on sale	9	**34.7**	–
Exceptional amortisation of fair value adjustments on hedged assets	9	**(9.8)**	–
Exceptional IPO expenses	9	**–**	(2.1)
Profit before taxation		**163.1**	105.3
Taxation	10	**(42.2)**	(21.2)
Profit for the year		**120.9**	84.1
Dividend, pence per share	12	**10.5**	8.7
Earnings per share, pence per share			
Basic	11	**49.4**	34.1
Diluted	11	**49.0**	34.0

The above results are derived wholly from continuing operations.

The notes on pages 104 to 158 form part of these accounts.

The financial statements on pages 99 to 158 were approved by the Board of Directors on 16 March 2017.

STATEMENT OF OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2016

	Group Year ended 31-Dec-16 £m	Group Year ended 31-Dec-15 £m
Profit for the year	**120.9**	84.1
Other comprehensive income/(expense)		
Items which may be reclassified to profit or loss:		
Fair value changes on available-for-sale securities:		
Arising in the year	**0.1**	(0.5)
Transferred to profit or loss	**–**	(0.6)
Revaluation of foreign operations	**0.9**	(0.5)
Tax on items in other comprehensive income	**–**	0.2
	1.0	(1.4)
Total comprehensive income for the year	**121.9**	82.7

The notes on pages 104 to 158 form part of these accounts.

STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2016

	Notes	Group As at 31-Dec-16 £m	Group As at 31-Dec-15 £m	Bank As at 31-Dec-16 £m	Bank As at 31-Dec-15 £m
Assets					
Cash in hand		**0.4**	0.4	**0.4**	0.4
Loans and advances to credit institutions	13	**417.8**	354.7	**413.5**	323.4
Investment securities	14	**141.7**	393.4	**141.7**	393.4
Loans and advances to customers	15	**5,939.2**	5,134.8	**4,893.5**	4,166.6
Derivative assets	35	**1.8**	1.0	**1.8**	1.0
Fair value adjustments on hedged assets	18	**46.9**	58.2	**46.9**	58.2
Deferred taxation asset	22	**3.4**	3.4	**0.8**	0.7
Intangible assets	20	**4.7**	3.1	**4.1**	2.7
Property, plant and equipment	21	**13.1**	9.6	**9.9**	7.0
Investments in subsidiaries and intercompany loans	19	**–**	–	**984.0**	944.5
Other assets	23	**11.9**	11.8	**3.8**	5.4
Total assets		**6,580.9**	5,970.4	**6,500.4**	5,903.3
Liabilities					
Amounts owed to retail depositors	24	**5,952.4**	5,363.8	**5,952.4**	5,363.8
Amounts owed to credit institutions	25	**101.7**	1.5	**101.7**	1.5
Amounts owed to other customers	26	**4.0**	5.9	**4.0**	5.9
Debt securities in issue	27	**–**	188.4	**–**	–
Derivative liabilities	35	**24.4**	19.8	**24.4**	19.8
Fair value adjustments on hedged liabilities	18	**1.9**	1.4	**1.9**	1.4
Current taxation liability		**21.1**	9.2	**18.1**	7.0
Deemed loan liability	19	**–**	–	**–**	169.5
Intercompany loans	19	**–**	–	**1.9**	4.9
Other liabilities	28	**18.6**	18.9	**7.4**	9.5
FSCS and other provisions	29	**1.5**	2.3	**1.5**	2.3
Subordinated liabilities	30	**21.6**	24.6	**21.6**	24.6
Perpetual subordinated bonds	31	**15.3**	15.3	**15.3**	15.3
		6,162.5	5,651.1	**6,150.2**	5,625.5
Equity					
Share capital	32	**2.4**	2.4	**2.4**	2.4
Share premium	32	**157.9**	157.9	**157.9**	157.9
Retained earnings		**240.7**	144.0	**175.3**	104.4
Other reserves	33	**17.4**	15.0	**14.6**	13.1
		418.4	319.3	**350.2**	277.8
Total equity and liabilities		**6,580.9**	5,970.4	**6,500.4**	5,903.3

The notes on pages 104 to 158 form part of these accounts.

The financial statements on pages 99 to 158 were approved by the Board of Directors on 16 March 2017.

ANDY GOLDING
Chief Executive Officer
16 March 2017

APRIL TALINTYRE
Chief Financial Officer
16 March 2017

Company number: 07312896

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2016

Group	Share capital £m	Share premium £m	Capital contribution £m	Transfer reserve £m	Foreign exchange reserve £m	Available-for-sale reserve £m	Share-based payment reserve £m	Retained earnings £m	Equity bonds[1] £m	Total £m
Balance at 1 January 2016	**2.4**	**157.9**	**5.8**	**(12.8)**	**(0.8)**	**(0.1)**	**0.9**	**144.0**	**22.0**	**319.3**
Profit for the year	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**120.9**	**–**	**120.9**
Coupon paid on equity bonds[2]	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(0.9)**	**–**	**(0.9)**
Dividends paid	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(23.3)**	**–**	**(23.3)**
Other comprehensive income	**–**	**–**	**–**	**–**	**0.9**	**0.1**	**–**	**–**	**–**	**1.0**
Share-based payments	**–**	**–**	**0.4**	**–**	**–**	**–**	**1.0**	**–**	**–**	**1.4**
Balance at 31 December 2016	**2.4**	**157.9**	**6.2**	**(12.8)**	**0.1**	**–**	**1.9**	**240.7**	**22.0**	**418.4**

Group	Share capital £m	Share premium £m	Capital contribution £m	Transfer reserve £m	Foreign exchange reserve £m	Available-for-sale reserve £m	Share-based payment reserve £m	Retained earnings £m	Equity bonds[1] £m	Total £m
Balance at 1 January 2015	2.4	157.9	4.5	(12.8)	(0.3)	0.8	0.1	75.0	22.0	249.6
Profit for the year	–	–	–	–	–	–	–	84.1	–	84.1
Coupon paid on equity bonds[2]	–	–	–	–	–	–	–	(1.2)	–	(1.2)
Dividends paid	–	–	–	–	–	–	–	(14.3)	–	(14.3)
Other comprehensive income	–	–	–	–	(0.5)	(0.9)	–	–	–	(1.4)
Share-based payments	–	–	1.3	–	–	–	0.8	0.4	–	2.5
Balance at 31 December 2015	2.4	157.9	5.8	(12.8)	(0.8)	(0.1)	0.9	144.0	22.0	319.3

Bank	Share capital £m	Share premium £m	Capital contribution £m	Transfer reserve £m	Foreign exchange reserve £m	Available-for-sale reserve £m	Share-based payment reserve £m	Retained earnings £m	Equity bonds[1] £m	Total £m
Balance at 1 January 2016	**2.4**	**157.9**	**5.6**	**(15.2)**	**–**	**(0.1)**	**0.8**	**104.4**	**22.0**	**277.8**
Profit for the year	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**95.1**	**–**	**95.1**
Coupon paid on equity bonds[2]	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(0.9)**	**–**	**(0.9)**
Dividends paid	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(23.3)**	**–**	**(23.3)**
Other comprehensive income	**–**	**–**	**–**	**–**	**–**	**0.1**	**–**	**–**	**–**	**0.1**
Share-based payments	**–**	**–**	**0.3**	**–**	**–**	**–**	**1.1**	**–**	**–**	**1.4**
Balance at 31 December 2016	**2.4**	**157.9**	**5.9**	**(15.2)**	**–**	**–**	**1.9**	**175.3**	**22.0**	**350.2**

Bank	Share capital £m	Share premium £m	Capital contribution £m	Transfer reserve £m	Foreign exchange reserve £m	Available-for-sale reserve £m	Share-based payment reserve £m	Retained earnings £m	Equity bonds[1] £m	Total £m
Balance at 1 January 2015	2.4	157.9	4.5	(15.2)	–	0.8	0.1	51.9	22.0	224.4
Profit for the year	–	–	–	–	–	–	–	67.6	–	67.6
Coupon paid on equity bonds[2]	–	–	–	–	–	–	–	(1.2)	–	(1.2)
Dividends paid	–	–	–	–	–	–	–	(14.3)	–	(14.3)
Other comprehensive income	–	–	–	–	–	(0.9)	–	–	–	(0.9)
Share-based payments	–	–	1.1	–	–	–	0.7	0.4	–	2.2
Balance at 31 December 2015	2.4	157.9	5.6	(15.2)	–	(0.1)	0.8	104.4	22.0	277.8

1. Equity bonds comprise £22.0m of Perpetual Subordinated Bonds, see note 33 for more detail
2. Coupon paid on equity bonds is shown net of tax

The reserves are further disclosed in note 33.

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2016

	Group Year ended 31-Dec-16 £m	Group Year ended 31-Dec-15 £m	**Bank Year ended 31-Dec-16 £m**	Bank Year ended 31-Dec-15 £m
Cash flows from operating activities				
Profit before tax	**163.1**	105.3	**130.8**	84.5
Adjustments for non-cash items:				
Depreciation and amortisation	**2.6**	1.7	**2.2**	1.5
Interest on subordinated liabilities	**1.2**	1.3	**1.2**	1.3
Interest on perpetual subordinated bonds	**0.9**	1.0	**0.9**	1.0
Impairment charge on loans	**9.0**	10.6	**6.9**	10.2
Gain on sale of financial instruments	**(0.6)**	(0.6)	**(0.6)**	(0.6)
FSCS and other provisions	**0.5**	3.4	**0.5**	3.4
Fair value losses on financial instruments	**4.9**	3.2	**4.9**	3.2
Share-based payments	**1.5**	1.8	**1.5**	1.7
Exceptional items	**(24.9)**	–	**(24.9)**	–
Changes in operating assets and liabilities				
Increase in loans to customers	**(1,031.3)**	(1,226.0)	**(951.7)**	(1,105.8)
Increase in retail deposits	**588.6**	1,032.2	**588.6**	1,032.2
Increase in intercompany balances	**–**	–	**(42.5)**	(140.5)
Decrease/(increase) in other assets	**–**	0.5	**(14.7)**	0.9
Decrease in derivatives and hedged items	**0.9**	–	**0.9**	–
(Decrease)/increase in other liabilities	**(1.4)**	5.3	**(3.2)**	0.4
Exchange differences on working capital	**0.9**	(0.5)	**–**	–
Cash used in operating activities	**(284.1)**	(60.8)	**(299.2)**	(106.6)
Interest paid on bonds and subordinated debt	**(2.1)**	(2.2)	**(2.1)**	(2.2)
Sales of financial instruments	**1.9**	–	**1.9**	–
FSCS and other provisions paid	**(1.3)**	(2.7)	**(1.3)**	(2.7)
Tax paid	**(29.6)**	(13.6)	**(24.3)**	(12.0)
Net cash used in operating activities	**(315.2)**	(79.3)	**(325.0)**	(123.5)
Cash flows from investing activities				
Maturity and sales of investment securities	**712.2**	213.8	**712.2**	213.8
Purchases of investment securities	**(460.4)**	(449.1)	**(460.4)**	(449.1)
Proceeds from disposal of a subsidiary[1]	**80.2**	–	**99.0**	–
Purchases of equipment and intangible assets	**(7.7)**	(9.1)	**(6.5)**	(6.5)
Cash generated from/(used in) investing activities	**324.3**	(244.4)	**344.3**	(241.8)
Cash flows from financing activities				
Increase/(decrease) in amounts owed to credit institutions	**98.3**	(20.0)	**98.3**	(20.0)
Coupon paid on equity bonds	**(1.2)**	(1.5)	**(1.2)**	(1.5)
Dividends paid	**(23.3)**	(14.3)	**(23.3)**	(14.3)
Repayment of debt	**(19.8)**	(53.0)	**(3.0)**	(2.9)
Cash generated from/(used in) financing activities	**54.0**	(88.8)	**70.8**	(38.7)
Net increase/(decrease) in cash and cash equivalents	**63.1**	(412.5)	**90.1**	(404.0)
Cash and cash equivalents at the beginning of the period				
Cash in hand	**0.4**	0.3	**0.4**	0.3
Loans and advances to credit institutions repayable on demand	**354.7**	767.3	**323.4**	727.5
	355.1	767.6	**323.8**	727.8
Cash and cash equivalents at the end of the period				
Cash in hand	**0.4**	0.4	**0.4**	0.4
Loans and advances to credit institutions repayable on demand	**417.8**	354.7	**413.5**	323.4
	418.2	355.1	**413.9**	323.8
Movement in cash and cash equivalents	**63.1**	(412.5)	**90.1**	(404.0)

1. Proceeds from a disposal of a subsidiary relates to the Group's disposal of the entire economic interest in Rochester Financing No.1 plc securitisation vehicle

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016

1. Accounting policies

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

a) Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRS's') as adopted by the European Union ('EU'); and interpretations issued by the International Financial Reporting Interpretations Committee ('IFRIC').

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

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

Note on rounding

In preparing the 2016 financial statements, the 2015 comparative numbers were restated from the original £ thousands to £ millions to one decimal place. As a result of rounding issues arising from this change, the presentation of some of the comparative numbers may differ slightly to the 2015 financial statements.

b) Going concern

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

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

The Board has therefore concluded that the Group has sufficient resources to continue in operational existence for a period in excess of 12 months and as a result it is appropriate to prepare these financial statements on a going concern basis.

c) Basis of consolidation

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

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

d) Foreign currency translation

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

The assets and liabilities of foreign operations with functional currencies other than Sterling are translated into the presentation currency at the exchange rate on the reporting date. The income and expenses of foreign operations are translated at the rates on the dates of transactions. Exchange differences on foreign operations are recognised in other comprehensive income and accumulated in the foreign exchange reserve within equity.

e) Segmental reporting

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

The Group lends within the UK and the Channel Islands.

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

1. Accounting policies continued

f) Interest income and expense

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

When calculating the EIR, the Group estimates cash flows considering all contractual terms of the instrument (for example, prepayment options) but does not consider future credit losses. The calculation of the EIR includes all transaction costs and fees paid or received that are an integral part of the interest rate, together with the discounts or premiums arising on the acquisition of loan portfolios. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial instrument.

The Group monitors the actual cash flows for each acquired book and where they diverge significantly from expectation, the future cash flows are reset (an AG8 adjustment). In assessing whether to adjust future cash flows on an acquired portfolio, the Group considers the cash variance on an absolute and percentage basis. The Group also considers the total variance across all acquired portfolios. Where cash flows for an acquired portfolio are reset, they are discounted at the EIR to derive a new carrying value, with changes taken to profit or loss as interest income. The EIR rate is adjusted for AG7 events where there is a change to the reference interest rate (LIBOR or Base Rate) affecting portfolios with a variable interest rate which will impact future cash flows. The revised EIR is the rate which exactly discounts the revised cash flows to the net carrying value of the loan portfolio.

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

g) Fees and commissions

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

h) Taxation

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

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

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

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

i) Dividends

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

j) Cash and cash equivalents

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

k) Intangible assets

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

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

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

NOTES TO THE FINANCIAL STATEMENTS CONTINUED
FOR THE YEAR ENDED 31 DECEMBER 2016

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

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

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

Buildings	50 years
Leasehold improvements	10 years
Equipment, fixtures and vehicles	5 years

Land, deemed to be 25% of purchase price of buildings, is not depreciated.

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

m) Financial instruments
The Group initially recognises loans and advances, deposits, debt securities issued and subordinated liabilities on the date on which they are originated. All other financial instruments are accounted for on trade date which is when the Group becomes a party to the contractual provisions of the instrument. The Group classifies its financial instruments in accordance with IAS 39 and IAS 32 into the following categories:

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

(ii) Financial assets at fair value through profit or loss: include derivatives with positive fair values. Financial assets in this category are initially recognised and subsequently re-measured at fair value in the statement of financial position, with transaction costs recognised in profit or loss. All changes in fair value are recognised in profit or loss.

(iii) Available-for-sale financial assets: comprise securities held for liquidity purposes (UK treasury bills and supranational bonds in the nature of investment securities). These assets are non-derivatives that are designated as AFS. These are held at fair value with movements being taken to other comprehensive income and accumulate in the AFS reserve within equity, except for impairment losses which are taken to profit or loss. When the instrument is sold, the gain or loss accumulated in equity is reclassified to profit or loss.

(iv) Financial liabilities: comprise deposits from retail customers and credit institutions, including deposits from the Bank of England under the Term Funding Scheme ('TFS'), issued debt securities and subordinated liabilities used as sources of funding. They include the Sterling Perpetual Subordinated Bond ('PSB') where the terms allow no discretion over the payment of interest. These financial liabilities are initially measured at fair value less direct transaction costs, and subsequently held at amortised cost using the EIR method.

The Group has no financial liabilities held for trading or designated at fair value through profit or loss except for derivatives with negative fair values. These financial liabilities are initially recognised and subsequently re-measured at fair value, with changes taken to profit or loss.

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

Equity financial instruments comprise own shares and a PSB which was issued with terms that include discretion over the payment of interest. Accordingly, the coupon paid on the bond and related tax effects are recognised directly in retained earnings when paid.

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

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

1. Accounting policies continued

(vii) Sale and repurchase agreements: Financial assets sold subject to repurchase agreements ('repo') are retained in the financial statements if they fail de-recognition criteria of IAS 39 described in paragraph (vi) above. The financial assets that are retained in the financial statements are reflected as loans or investment securities and the counterparty liability is included in amounts owed to depositors, credit institutions or other customers. Financial assets purchased under agreements to resell at a pre-determined price where the transaction is financing in nature ('reverse repo') are accounted for as loans and receivables. The difference between the sale and repurchase price is treated as interest and accrued over the lives of agreements using the EIR method.

(viii) Funding for Lending Scheme ('FLS') and Term Funding Scheme ('TFS'): Loans and advances over which the Group transfers its rights to the collateral thereon to the Bank of England under the FLS and TFS are not derecognised from the statement of financial position, as the Group retains substantially all the risks and rewards of ownership, including all cash flows arising from the loans and advances and exposure to credit risk. The treasury bills that the Group borrows against the transferred assets under the FLS are not recognised in the statement of financial position. Cash received under the TFS is recorded in deposits from credit institutions. Interest is accrued over the life of the agreements on an EIR basis.

n) Derivative financial instruments and hedge accounting

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

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

All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative. Derivatives covered by master netting agreements are settled and therefore recognised on a net basis.

In accordance with IAS 39, the Group adopts hedge accounting where the criteria specified in IAS 39 (EU endorsed) are met. A hedged item is defined as a recognised asset or liability which exposes the entity to risk of changes in fair value or future cash flows, and is designated as being hedged. The Group uses fair value hedge accounting for a portfolio hedge of interest rate risk (IAS39 – AG 114). Portfolio hedge accounting allows for hedge effectiveness testing and accounting over an entire portfolio of derivatives.

Where there is an effective hedge relationship for fair value hedges, the Group recognises the change in fair value of each hedged item in the statement of profit or loss account with the cumulative movement in their value being shown separately on the statement of financial position as 'Fair value adjustments on hedged assets and liabilities'. The fair value changes of both the derivative and the hedge substantially offset each other to reduce profit volatility. To qualify for hedge accounting at inception, the hedge relationship is clearly documented and the derivative must be expected to be highly effective in offsetting the hedged risk. In addition, effectiveness must be tested throughout the life of the hedge relationship.

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

If a derivative is cancelled it is derecognised from the balance sheet. If a derivative no longer meets the criteria for hedge accounting or is cancelled whilst still effective, the fair value adjustment relating to the hedged assets or liabilities within the hedge relationship prior to the derivative becoming ineffective or being cancelled remains on the balance sheet and is amortised over the remaining life of the hedged assets or liabilities. The rate of amortisation over the remaining life is in-line with the income or cost generated from the hedged assets or liabilities.

o) Impairment of financial assets

The Group regularly assesses its financial assets valued at amortised cost for impairment. During the reporting period, the main category within the scope was loans and advances to customers.

The Group individually assesses for impairment loans over £0.5m which are more than three months in arrears, where LPA receivers are appointed, the property is taken in possession or there are any other events that suggest a high probability of credit loss. Loans are considered at a connection level, i.e. including all loans belonging to and connected to the customer.

The Group estimates cash flows from these loans, including expected interest and principal payments, rental or sale proceeds, selling costs, etc. The Group obtains up-to-date independent valuation for properties put up for sale.

The Group ensures that security valuations are reviewed on an ongoing basis for appropriateness, with ongoing annual indexing of commercial properties, with residential properties indexed against monthly HPI data. Where the Group identifies that a published index is not representative, a formal review is carried out by the Group's real estate function to assess valuations appropriately. The Group's real estate function ensures that newly underwritten lending cases are written to appropriate valuations, with assessment being carried out by appointed, qualified chartered surveyors, accredited by the Royal Institute of Chartered Surveyors ('RICS'). The Group has ensured that the real estate function is placed within the Group's assurance team and is therefore independent from all credit making decisions.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED
FOR THE YEAR ENDED 31 DECEMBER 2016

1. Accounting policies continued

If the present value of estimated future cash flows discounted at the original effective interest rate is less than the carrying value of the loan, a specific provision is recognised for the difference. Such loans are classified as impaired. If the present value of the estimated future cash flows exceeds the carrying value no specific provision is recognised.

All loans which do not have a specific provision are subsequently assessed for impairment collectively with each loan being assigned a one-year probability of default ('PD') and a loss given default ('LGD') generally consistent with the requirements of the internal ratings based ('IRB') approach, leading to the expected loss ('EL'). The provision is the sum of all ELs. The calculation uses indexed valuations from ONS statistics applied at a postcode level, as it is usually impossible to request market property valuation for loans not in default. From 2016, all provisions on loans greater than 3 months in arrears are treated as a specific provision as they are considered to be impaired. Loans less than 3 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 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 risk of interest-only customers not repaying at maturity is currently not calculated. The Group has been contacting customers with upcoming interest-only loan maturities and tracking responses and outcomes through specific campaigns since 2014.

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 incorporate 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. Within the year the Group implemented an elongated EP within the PD calculations.

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 overriding principle when dealing with a borrower in arrears is that the Group follows prescribed policies and procedures that allow for flexibility and an individual approach, tailored to the circumstances of the particular borrower. The Group offers assistance and a range of tools to act in the best long-term interests of borrowers who are experiencing financial stress. These are designed to allow customer loans to be brought back into a sustainable position. Cases are managed on an individual basis, with the circumstances of each customer considered separately and the action taken judged as being affordable and sustainable for the customer.

The Group will consider all relevant forbearance options when attempting to reach an affordable and sustainable plan with the borrower. Forbearance is the restructuring of loans to conditions and by means not stipulated under the original contract when the borrower is in financial difficulty. The specific tools available to assist customers vary by product and the customer's status. The various treatments considered for customers are as follows:

Temporary switch to interest-only: a temporary account change to assist customers through periods of financial difficulty where arrears do not accrue at the original contractual payment. Any arrears existing at the commencement of the arrangement are retained.

Interest rate reduction: the Group may in certain circumstances, where the borrower meets the required eligibility criteria, transfer the mortgages to a lower contractual rate. Where this is a formal contractual change the borrower will be requested to obtain independent financial advice as part of the process.

Loan term extension: a permanent account change for customers in financial distress where the overall term of the mortgage is extended, resulting in a lower contractual monthly payment.

Payment holiday: a temporary account change to assist customers through periods of financial difficulty where arrears accrue at the original contractual payment. Any arrears existing at the commencement of the arrangement are retained.

Voluntary assisted sale: a period of time is given to allow borrowers to sell the property and arrears accrue based on the contractual payment.

Reduced monthly payments: a temporary arrangement for customers in financial distress. For example, a short-term arrangement to pay less than the contractual payment. Arrears continue to accrue based on the contractual payment.

1. Accounting policies continued

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 a borrower has an agreed sale and there will be a shortfall in the amount required to redeem the Group's charge, in which case the 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 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 probability of default in the collective provision calculation. Forborne accounts are not treated differently in relation to impairments in any other way.

p) Debit and credit valuation adjustments

The debit and credit valuation adjustments ('DVA' and 'CVA') are included in the fair value of derivative financial instruments. The DVA is based on the expected loss a counterparty faces due to the risk of the Group's default. The CVA reflects the Group's risk of the counterparty's default.

The methodology is based on a standard calculation, taking into account:
- the one-year probability of default, updated on a regular basis
- the expected exposure at default
- the expected loss given default and
- the average maturity of the swaps.

q) Provisions and contingent liabilities

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

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

r) Employee benefits – defined contribution scheme

Obligations for contributions to defined contribution pension arrangements are recognised as an expense in profit or loss as incurred.

s) Share-based payments

In accordance with IFRS 2 Share-based payments, options and awards granted to employees over the Bank's shares under the Group's share-based incentive schemes are measured at fair value at grant and are charged on a straight-line basis to the profit or loss account (with a corresponding increase in equity) over the vesting period in which the employees become unconditionally entitled to the awards. The amount recognised as an expense is adjusted to reflect the actual number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of awards that do meet the related conditions at the vesting date. The amount recognised as an expense for awards subject to market conditions is based on the proportion that is expected to meet the condition as assessed at the grant date. No adjustment is made for the actual proportion that meets the market condition at vesting. Share-based payments that vest on grant are immediately expensed in full with a corresponding increase in equity.

The grant date fair value of a nil price option over the Bank's shares which vests at grant or which carries the right to dividends or dividend equivalents during the vesting period (IPO share awards) is the share price at the grant date. The grant date fair value of awards of the Bank's shares that do not carry automatic rights to dividends or dividend equivalents (the Deferred Share Bonus Plan ('DSBP')) is based on the Bank's share price at the grant date adjusted for the impact of the expected dividend yield. The fair value at grant date of awards made under the Share Save Schemes is determined using a Black-Scholes Option model.

The grant date fair value of awards that are subject to non-market conditions and which do not carry automatic rights to dividends or dividend equivalents (the earnings per share ('EPS') element of the Performance Share Plan ('PSP')) is based on the share price at the grant date adjusted for the impact of the expected dividend yield. An assessment is made at each reporting date on the proportion of the awards expected to meet the related non-market vesting conditions.

The fair value of an award that is subject to market conditions (the relative share price element of the PSP) is determined at grant date using a Monte Carlo model. No adjustment is made for the actual proportion that meets the market condition at vesting.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED
FOR THE YEAR ENDED 31 DECEMBER 2016

1. Accounting policies continued

Where the allowable cost of share-based awards for tax purposes is greater than the cost determined in accordance with IFRS 2, the tax effect of the excess is taken to the share-based payment reserve within equity. The tax effect is reclassified to retained earnings upon vesting.

Employer's national insurance is charged to the profit or loss account at the share price at the reporting date on the same vesting schedule as the underlying awards.

t) Exceptional items

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

In 2016 the Group's exceptional items comprise the gain on disposal of the entire economic interest in Rochester Financing No.1 plc ('Rochester 1') securitisation vehicle and a loss in respect of accelerated amortisation of fair value adjustments on hedged assets relating to prior years. Further details can be found in note 9.

In 2015 the Group's exceptional items comprised of IPO related share awards. Some of the share awards vested immediately on admission while others vest over various periods of up to four years. IPO share awards which vested on IPO and related national insurance contributions were expensed immediately. The awards with vesting periods along with the accruing national insurance are expensed on an on-going basis in profit or loss. With the decrease in this expense, the separate line disclosure is no longer warranted with the expense included within staff costs during 2016.

Further detail on accounting for share-based payments is disclosed in note s) above.

u) Securitisation

The Group assesses whether it controls special purpose entities ('SPE') and the requirement to consolidate them under the criteria of IFRS 10. The criteria include the power to direct relevant activities, exposure or rights to variable returns and the ability to use its power to affect the amount of these returns.

At the 2016 reporting date, the Group had no economic interest in SPEs. The Group's entire economic interest in Rochester 1 was disposed of during the year.

At the 2015 reporting date, the Group had one securitisation scheme administered through the Rochester 1 SPE. The Group had the power to appoint directors and control daily operations of Rochester 1 through securitisation documents. It owned the certificates which gave rights to the residual interest income remaining after servicing the external debt. It had the ability to affect the amount of outgoing payments if required. On this basis, Rochester 1 was considered a wholly owned subsidiary and consolidated in the Group's 2015 operations.

The Bank had retained the risks and rewards of ownership in respect of the loans transferred to Rochester 1, therefore, they fail derecognition criteria and remained in its 2015 assets.

Whilst the securitisation entity had been consolidated as a 100% subsidiary, the mortgage loans included within the securitisation structure were ring-fenced, with the cash flows being used to repay its liabilities in line with the priority of payments set out in the securitisation prospectus. The senior debt was held externally while junior debt and residual certificates were retained by the Bank. The Group statement of financial position shows externally held notes as debt securities in issue.

v) Judgements in applying accounting policies and critical accounting estimates

In preparing these financial statements, the Group has made judgements, estimates and assumptions which affect the reported amounts within the current and next financial year. Actual results may differ from these estimates.

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

(i) Loan book impairments: This section provides details of the critical elements of judgement which underpin loan impairment calculations. Less significant judgements are not disclosed.

Individual impairment

Assessments for individually significant loans involve significant judgement to be made by management in relation to estimating future cash flows, including the cost of obtaining and selling collateral, the likely sale proceeds and any rental income prior to sale. The most significant area of judgement is the likely sale proceeds. As at 31 December 2016, a 10% fall in house prices would result in an incremental £4.7m (2015: £3.2m) of provisions being required. All assets which do not have a specific provision are assessed on a collective basis.

1. Accounting policies continued

Collective impairment

Collective provision assessments are also subject to estimation uncertainty, underpinned by a number of judgements and estimates being made by management which are utilised within impairment calculations. Key areas of judgement utilised within collective provisioning calculations include probability of default ('PD'), the loss given default ('LGD') and the emergence period ('EP'). Provisions on loans 3 months plus in arrears are treated as specific provisions. Provisions on loans less than 3 months in arrears are treated as collective provisions.

Probability of default

To compute PD rates the Group analyses how accounts transition from up to date and varying arrears severity positions to the default state which is reached once an account is greater than six months in arrears. Embedded within the PD calculation is a computed cure rate, which allows the Group to model the probability of an account curing from each state. A 10% relative worsening of the PD rate would increase total provisions by £0.3m as at 31 December 2016 (2015: £0.1m). The increase year on year is primarily driven by management's implementation of a stricter default and cure rate definition during 2016 as part of a wider methodology and judgement and estimate review.

Loss given default

The LGD model simulates the likely loss once a default event has occurred. The key components of the LGD calculation relate to the valuation of the underlying collateral, forced sale discount rates post repossession and the costs to sell (variable and fixed). Therefore the LGD is sensitive to the application of the house price index ('HPI'). As at 31 December 2016 a 10% fall in house prices would result in an incremental £4.7m (2015: £3.2m) of provision being required. The increase year on year is primarily driven by the impact of updated and more granular forced sale discount rates and cost to sell parameters being implemented during 2016.

Emergence period

The current collective provision methodology does not utilise an explicit EP within incurred but not reported ('IBNR') calculations, however the observation period which is utilised within PD calculations includes an implied EP. Within the year the Group conducted a detailed analysis to understand the time it takes for a loss event (e.g. becoming unemployed) to be identified (i.e. missed payment) using external and internal data sources. The outcome of this review resulted in the observation period used within PD calculations elongating, due to a lengthening of the implied EP.

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

The EIR's on loan books purchased at significant discounts or premiums are particularly sensitive to the prepayment ('CPR') and default ('CDR') rates derived, as the purchase discount or premium is recognised over the expected life of the loan book through the EIR. New defaults are modelled at zero loss (as losses will be recognised in profit or loss as impairment losses) and therefore have the same impact on the EIR as prepayments.

Different assumptions to derive the CPR and CDR in the cash flow models at acquisition will impact the EIR rates. A 10% increase/decrease in the EIR% for each of the Bank's acquired mortgage books would increase/decrease interest income by c.£4.8m in 2016.

Incurred losses at acquisition are calculated using the Group's collective provision model (see (i) Loan book impairments above for further details).

The EIR calculated at acquisition is not changed for subsequent variances in actual to expected cash flows. The Group monitors the actual cash flows for each acquired book and where they diverge significantly from expectation, the future cash flows are reset (an 'AG8' adjustment). In assessing whether to adjust future cash flows on an acquired portfolio, the Group considers the cash variance on an absolute and percentage basis. The Group also considers the total variance across all acquired portfolios. Where cash flows for an acquired portfolio are reset, they are discounted at the EIR to derive a new carrying value, with changes taken to profit or loss as interest income. The Group recognised £1.4m in 2016 as a result of resetting cash flows on acquired mortgage books (2015: £2.0m).

(iii) **Effective interest rate:** A number of assumptions are made when calculating the EIR for newly originated loan assets. These include their expected lives, likely redemption profiles and the anticipated level of any early redemption charges.

Certain mortgage products offered by the Group include significant directly attributable net fee income, in particular BTL, and/or revert to the standard variable rate ('SVR') after an initial discounted or fixed period. Judgement is used in assessing the expected rate of prepayment during the discounted or fixed period of these mortgages and the expected life of those that prepay. The Group uses historical experience in its assessment. Judgement is also used in assessing whether and for how long mortgages that reaches the end of the product term stay on SVR. The most significant area of judgement is the period spent on SVR.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED
FOR THE YEAR ENDED 31 DECEMBER 2016

1. Accounting policies continued

A 10% increase/decrease in the rate of prepayments during the product term for 2016 new originations would increase/decrease interest income for 2016 by c.£0.1m. A 3 month shorter/longer life for those prepaying mortgages would increase/decrease interest income in 2016 by c.£0.4m/£0.3m.

The Group prudently assumes no period on SVR before the borrower refinances on to a new product or redeems, pending the result of the new broker led retention programme launched in the second half of 2016.

The impact of a 6 month longer expected life on 2016 new origination, that is expected to reach the end of the discounted or fixed period, would be to recognise an additional £1.4m (2015: £1.1m) of interest income, as the impact of spreading fee income over a longer period is more than offset by the impact of a higher revert rate for the additional period.

w) Adoption of new standards

The Group continuously monitors new standards and amendments, with no changes within the reporting period.

Included below are standards and amendments which are being considered for future reporting periods which have not been applied in preparing these financial statements. IFRS 16 is yet to be endorsed by the EU.

- IFRS 9 Financial Instruments, effective from 1 January 2018, replaces IAS 39 Financial Instruments: Recognition and Measurement that includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting.

  The Group has made good progress in its IFRS 9 programme and moved into the parallel testing phase at the start of 2017 on schedule. Business as usual ('BAU') processes are being implemented with a complete end-to-end control framework expected to be completed in the second quarter of 2017. The IFRS 9 steering committee was set up in September 2015 to manage the project and includes the CFO, CRO and other senior managers and members from finance, credit, risk, management information and regulatory reporting to ensure the programme is completed to a high standard and on time.

  IFRS 9 introduces a different classification of financial assets and liabilities based on the Group's business model and the cash flow characteristics of the instruments. These factors determine whether financial assets are measured at amortised cost, fair value through other comprehensive income ('FVOCI') or fair value through profit or loss ('FVPL'). The Group has made significant progress with its assessments of solely payment of principal & interest ('SPPI') compliance, that reviews the cash flow characteristics of financial assets to ensure they can continue to be classified within an amortised cost model under IFRS 9. Based on its assessments to date, the Group does not expect that the overall impact of any change in its classification of assets and liabilities will be significant.

  IFRS 9 will replace the existing incurred loss impairment approach with an expected credit loss approach. Under this approach at initial recognition of a loan, an allowance is required for expected credit losses ('ECL') resulting from default events that are possible within the next 12 months. In the event of a significant increase in credit risk, an allowance is required for ECL resulting from all possible default events over the expected life of the financial instrument. The assessment of whether credit risk has increased significantly since initial recognition is performed for each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument, rather than by considering an increase in ECL. The assessment of credit risk and the estimation of ECL must be unbiased and probability-weighted, and should incorporate all available information which is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of economic conditions at the reporting date.

  The Group has developed a series of IFRS 9 models to address the different requirements of its loan portfolios that include both organic and acquired loan books. The models developed consider for each loan the probability of a default ('PD'), its exposure at default ('EAD') and the possible loss given default ('LGD') that could arise. The assessment and development of the key variables have been through an extensive book by book review process based on available information and externally sourced data as required. The models have been built on the Group's definition of default, definition of credit impairment that also considers forbearance, and definition of significant risk to facilitate the development of the necessary transfer criteria to assess whether there has been a significant increase in credit risk to determine the level of ECL's required for each loan. The models are currently being reviewed, refined and recalibrated during the parallel run which compares IAS 39 to IFRS 9 impairments. Whilst the macro economic variables the Group will use in its modelling have been completed subject to final approval, the various scenarios for consideration within the models are still being finalised. The IFRS 9 models have been completed to a high standard in conjunction with the Group's first generation IRB models that have also been completed and are currently being reviewed. All models will undergo an external independent review process in the first quarter of 2017 that will be completed in the second quarter of 2017.

  The adoption of IFRS 9 is likely to increase the Group's loan loss provision balance and expense, although the financial impact will be spread over the year of adoption and restated opening reserves. At this stage it is not possible to assess the impact that the introduction of IFRS 9 will have on regulatory capital until a final determination is made on the transitional arrangements from IAS 39 to IFRS 9. However based on information available to date, we do not expect there will be a significant impact. The Group is continuing to monitor this situation through its regulatory capital work stream that reports into the IFRS 9 steering committee as part of this project. With the development of the Group's first generation IRB models it should also be in a position to understand the impact of IFRS 9 on regulatory capital under an IRB approach once the transitional arrangements for IFRS 9 have been confirmed.

1. Accounting policies continued

IFRS 9 is expected to have a significant impact on operations particularly in the risk and finance functions of the Group. The appropriate governance framework is being set up to review ECLs, models used and judgements made. The Group has engaged external consultants to work alongside existing teams in the completion of its IFRS 9 models, model monitoring, controls and procedures and to assist with initial parallel running, refining and recalibrating of IFRS 9 models during 2017, following the delivery of initial models in late 2016.

Hedge accounting will become more closely aligned with risk management practices under IFRS 9. The Group has elected to continue with IAS 39 hedging that is an option under IFRS 9 until a separate IASB project to address macro hedge accounting strategies is finalised and can be assessed. Whilst at this stage the Group expects to continue with IAS 39 hedge accounting, it will implement the revised hedge accounting disclosures required by the related amendments to IFRS 7 Financial Instruments: Disclosures.

The Group continues to make solid progress in its IFRS 9 implementation programme and is well placed to implement the requirements for 2018.

- IFRS 15 Revenue from Contracts with Customers, effective from 1 January 2018, replaces IAS 11 Construction contracts, IAS 18 Revenue and several related interpretations. It introduces a single framework for revenue recognition based on new concepts and principles. The new standard is not expected to have a significant impact on the financial statements.
- IFRS 16 Leases, effective from 1 January 2019, replaces IAS 17 Leases, IFRIC 4 Determining Whether an Arrangement Contains a Lease and two related SIC interpretations. The new standard requires the lessees to recognise right-of-use assets and lease liabilities for most leases over 12 months long. Lessor accounting has largely remained unchanged. Adoption of IFRS 16 in respect of rented properties is not expected to have a material effect on the financial statements.

2. Interest receivable and similar income

	Group Year ended 31-Dec-16 £m	Group Year ended 31-Dec-15 £m
On BTL/SME mortgages	**205.0**	149.7
On Residential mortgages	**107.1**	115.9
On Personal loans	**3.8**	7.5
On investment securities	**1.2**	1.6
On other liquid assets	**1.6**	2.8
Net expense on derivative financial instruments	**(9.2)**	(9.3)
	309.5	268.2

Included within interest receivable is £1.3m (2015: £2.4m) in respect of interest accrued on accounts with an individually assessed specific provision.

3. Interest payable and similar charges

	Group Year ended 31-Dec-16 £m	Group Year ended 31-Dec-15 £m
On retail deposits	**101.8**	94.8
On Perpetual Subordinated Bonds	**0.9**	1.0
On subordinated liabilities	**1.2**	1.3
On wholesale borrowings	**3.2**	5.7
Net income on derivative financial instruments	**(4.2)**	(4.4)
	102.9	98.4

NOTES TO THE FINANCIAL STATEMENTS CONTINUED
FOR THE YEAR ENDED 31 DECEMBER 2016

4. Fair value gains and losses on financial instruments

	Group Year ended 31-Dec-16 £m	Group Year ended 31-Dec-15 £m
Fair value changes in hedged assets	**3.2**	(7.4)
Hedging of assets	**(3.0)**	7.3
Fair value changes in hedged liabilities	**(0.5)**	1.7
Hedging of liabilities	**0.3**	(1.6)
Ineffective portion of hedges[1]	**–**	–
Amortisation of fair value adjustments on hedged assets	**(4.9)**	(3.2)
Net gains/(losses) on unmatched swaps	**0.1**	0.1
Debit and credit valuation adjustment	**(0.1)**	(0.1)
	(4.9)	(3.2)

1. Ineffective portion of hedges was less than £0.1m in 2016 and 2015.

Amortisation of fair value adjustments on hedged assets relates to hedged assets and liabilities where the hedges were terminated before maturity and were effective at the point of termination.

The DVA adjustment is calculated on the Group's derivative liabilities and represents exposure of their holders to the risk of the Group's default. The CVA reflects the Group's risk of the counterparty's default.

5. Gain on sales of financial instruments

During the year the Group sold £10.9m of non-performing loans from its personal loan portfolio. These loans had a carrying value of £1.3m after provisions of £5.6m and prior year write-offs of 4.0m. The loans were sold for cash proceeds of £1.9m, creating a £0.6m gain on sale.

The Bank routinely buys and sells liquidity assets in order to confirm the ease with which cash can be realised and the robustness of the valuations assigned to such assets. During the year, transactions in liquid assets resulted in a net loss of £nil (2015: £0.6m).

6. Administrative expenses

	Group Year ended 31-Dec-16 £m	Group Year ended 31-Dec-15 £m
Staff costs[1]	**29.5**	21.6
Facilities costs	**2.4**	2.2
Marketing costs	**2.2**	1.8
Support costs	**6.2**	5.2
Professional fees	**5.6**	4.6
Other costs[2]	**5.2**	4.0
	51.1	39.4

1. Staff costs include £0.4m relating to IPO share awards reported in prior periods within exceptional items
2. Other costs mainly consist of irrecoverable VAT expense

6. Administrative expenses continued

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

	Group Year ended 31-Dec-16 £'000	Group Year ended 31-Dec-15 £'000
Audit of the Bank and Group accounts	**414**	291
Audit of the Group's subsidiary undertakings pursuant to legislation	**121**	99
Audit related assurance services	**96**	71
Tax compliance and advice	**70**	59
Regulatory advice and support	**36**	8
All other non-audit services	**48**	33
	785	561

Other non-audit services in 2016 comprises agreed upon procedures in respect of a new securitisation vehicle and assurance work in relation to net lending for the FLS in 2016.

Staff numbers and costs

Staff costs comprise the following categories:

	Group Year ended 31-Dec-16 £m	Group Year ended 31-Dec-15 £m
Salaries, incentive pay and other benefits	**24.4**	18.9
Share-based payments	**1.5**	0.5
Social security costs	**2.5**	1.1
Other pension costs	**1.1**	1.1
	29.5	21.6

The average number of persons employed by the Group (including executive Directors) during the period was 674 (2015: 544), analysed below:

	Group 2016	Group 2015
Operations	**315**	259
Administrative	**359**	285
	674	544

7. Directors' emoluments and transactions

	2016 £'000	2015 £'000
Director's emoluments[1]	**1,869**	1,700
Payments in respect of personal pension plans	**97**	89
	1,966	1,789

1. Director's emoluments comprises salary costs, NED fees and other short-term incentive benefits as disclosed in the Annual Report on Remuneration

In addition to the total Directors' emoluments above, the Executive Directors were granted a deferred bonus of £335k (2015: £321k) in the form of shares deferred for three years under the DSBP. The DSBP does not have any further performance conditions attached, however it is subject to clawback and is forfeited if the Executive Director leaves prior to vesting unless a good leaver reason applies such as redundancy, retirement or ill health.

The Executive Directors received a further share award under the PSP with a grant date face value of £700k (2015: £640k) using a share price of £2.53 (2015: £2.19) (the average mid-market quotation for the preceding 5 days before grant). These shares vest in three years subject to performance conditions discussed in note 8 and the Annual Report on Remuneration.

There was no compensation for loss of office during either 2016 or 2015.

There were no outstanding loans granted in the ordinary course of business to Directors and their connected persons as at 31 December 2016 and 2015.

The Annual Report on Remuneration and note 8 provide further details on Directors' emoluments.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED
FOR THE YEAR ENDED 31 DECEMBER 2016

8. Share-based payments
The Group operates the following share-based schemes:

IPO Share Awards
Certain Directors, senior managers and other employees of the Bank received one-off share awards in the form of nil price options over shares in the Bank on its admission to the London Stock Exchange in June 2014. A proportion of these awards vested on admission with the remainder vesting over either a 12, 24 or 48 month period. The cost of IPO Share Awards based on their fair value at grant date of 170 pence per share (the IPO offer price) is recognised over the respective vesting period (adjusted for expected attrition) with awards that vested on admission being immediately expensed in full. The expense is reported within administrative expenses (2015: exceptional items) in the statement of profit or loss and is offset fully by an additional capital contribution as the awards were granted by OSB Holdco Limited, the Bank's major shareholder.

OSB Sharesave Scheme
The Save As You Earn ('SAYE') or Sharesave Schemes are open to all UK-based employees and allow them to save a fixed amount of between £5 and £500 per month over either three or five years in order to use these savings at the end of the qualifying period to buy the Bank's shares at a fixed price established when the schemes were announced. The Group has offered 3 and 5 year sharesave schemes annually since 2014, with the exercise price set at a 20% discount on the share price on the scheme dates.

Deferred Share Bonus Plan
The DSBP applies to Executive Directors and certain senior managers and requires 50% of their performance bonuses to be deferred in shares for 3 years. There are no further performance conditions attached, but the share awards are subject to clawback provisions. The DSBP is a share-based award and as such is expensed over its vesting period. The first DSBP relating to 2014 bonuses was granted in March 2015.

Performance Share Plan
Executive Directors and certain senior managers are also eligible for a PSP based on performance conditions linked to earnings per share and total shareholder return over a 3 year vesting period. The first award was issued in March 2015.

The performance conditions applying to 2016 and 2015 awards are based on a combination of EPS and total shareholder return ('TSR') equally weighted and assessed independently. For the EPS element, growth targets are linked to the Company's three year growth plan, measuring growth from the base figure of 2014. For the TSR element, OSB share's relative performance is measured against the FTSE All Share index excluding investment trusts.

The share-based expense for the year includes a charge in respect of the remaining IPO awards with future vesting provisions, Sharesave schemes, the DSBP and PSP. All charges are included in employee expenses within note 6 Administrative expenses during 2016, with IPO awards being included within exceptional items during 2015.

The share-based payment expense during the year comprised of the following:

	Group Year ended 31-Dec-16 £m	Group Year ended 31-Dec-15 £m
Included in exceptional IPO expenses:		
IPO share award expensed in the year	**–**	1.3
	–	1.3
Included in administrative expenses:		
IPO share award expensed in the year	**0.4**	–
Sharesave	**0.1**	–
Deferred Share Bonus Plan	**0.5**	0.2
Performance Share Plan	**0.5**	0.3
	1.5	0.5
	1.5	1.8

8. Share-based payments continued

Movements in the number of share awards and their weighted average exercise prices are presented below:

2016

	IPO share awards	Sharesave		Deferred Share Bonus plan	Performance Share Plan
	Number	Number	Weighted average exercise price, £	Number	Number
At 1 January 2016	**1,237,844**	**761,927**	**1.66**	**301,575**	**579,157**
Granted	**–**	**149,675**	**2.40**	**456,806**	**519,757**
Exercised	**(465,855)**	**(2,126)**	**1.34**	**–**	**–**
Forfeited	**(119,791)**	**(91,223)**	**1.83**	**–**	**(17,923)**
At 31 December 2016	**652,198**	**818,253**	**1.78**	**758,381**	**1,080,991**
Exercisable at					
At 31 December 2016	**–**	**–**	**–**	**–**	**–**

2015

	IPO share awards	Sharesave		Deferred Share Bonus plan	Performance Share Plan
	Number	Number	Weighted average exercise price, £	Number	Number
At 1 January 2015	2,673,508	527,821	1.34	–	–
Granted	–	282,889	2.27	322,933	612,262
Exercised	(1,114,635)	–	–	–	–
Forfeited	(321,029)	(48,783)	1.70	(21,358)	(33,105)
At 31 December 2015	1,237,844	761,927	1.66	301,575	579,157
Exercisable at					
At 31 December 2015	119,791	15,342	1.62	–	–

For the share-based awards granted during the year, the weighted average grant date fair value was 251 pence (2015: 152 pence).

The weighted average market price at exercise for IPO share awards exercised in the year was 307 pence (2015: 298 pence).

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

	2016		2015	
Exercise price	**Number**	**Weighted average remaining contractual life**	Number	Weighted average remaining contractual life
IPO share awards				
Nil	**652,198**	**1.4**	1,237,844	2.5
Sharesave				
134–240 pence	**818,253**	**1.6**	761,927	3.4
Deferred Share Bonus Plan				
Nil	**758,381**	**1.8**	301,575	2.2
Performance Share Plan				
Nil	**1,080,991**	**1.7**	579,157	2.2
	3,309,823	**1.6**	2,880,503	2.6

NOTES TO THE FINANCIAL STATEMENTS CONTINUED
FOR THE YEAR ENDED 31 DECEMBER 2016

8. Share-based payments continued
The valuation of share awards is based on the following assumptions:

IPO Share Awards
The grant date fair value of the IPO share awards was the issue price of £1.70 as they are in the form of nil price options which carry rights to dividends during the vesting period. The charge in respect of awards with future vesting provisions assumed a weighted average attrition of nil (2015: nil) per annum. This is lower than the overall expected staff attrition rate as nil attrition was assumed for certain Senior Managers who received larger awards.

Sharesave schemes
The grant date fair values of awards under the sharesave schemes were determined using a Black-Scholes model. This determined the fair value of options over 1 ordinary share in the 2016 3 and 5 year sharesave schemes as 18 pence and 20 pence respectively (2015: 17 pence and 19 pence), using the following assumptions:

Inputs to valuation model
Sharesave

	2016	2015	2014
Contractual life, years	**3/5 years**	3/5 years	3/5 years
Share price at issue, £	**3.00**	2.84	1.68
Exercise price, £	**2.40**	2.27	1.34
Expected volatility[1]	**18.7%**	20.0%	20.0%
Attrition rate	**12.0%**	9.6%	10.5%
Dividend yield	**4.6%**	3.6%	3.0%

1. The volatility was based on a benchmark of the FTSE 350 diversified financials as insufficient history was available for the Bank's shares

Deferred Share Bonus Plan
The grant date fair value of awards under the DSBP of 253 (2015: 219) pence per share is based on the mid-market share price at the grant date of 309 (2015: 251) pence per share, adjusted for the impact of dividends, as the options don't carry automatic rights to dividends. A dividend yield of 4.6% (2015: 3.7%) was used based on available analyst consensus. The expense for 2016 assumes an attrition rate of 12.0% (2015: 9.1%).

Performance Share Plan
The grant date fair value of awards under the PSP of 253 (2015: 219) pence per share is based on the mid-market share price at the grant date of 309 (2015: 251) pence per share, adjusted for the impact of dividends, as the options don't carry automatic rights to dividends. A dividend yield of 4.6% (2015: 3.7%) was assumed based on available analyst consensus. The expense for 2016 assumes an attrition rate of 12.0% (2015: 9.1%).

A vesting rate is incorporated into the EPS element of the PSP, based on the expectation that the required target growth will be achieved over the vesting period. A vesting rate is also calculated for TSR element of the PSP, based on a Monte Carlo model using historical share price performance data for the target benchmark FTSE All Share Index excluding investment trusts and the FTSE 350 Diversified Financials as a proxy for the Company's shares as insufficient history was available.

9. Exceptional items
Exceptional items to December 2016 consist of the gain on disposal of the Group's entire economic interest in Rochester 1 securitisation vehicle and an exceptional loss of £9.8m in respect of accelerated amortisation of fair value adjustments on hedged assets relating to legacy back-book long-dated interest rate swap cancellations.

The Rochester 1 sale resulted in derecognition of securitised mortgage assets from the Group's balance sheet and the deconsolidation of Rochester 1. This removed a total of £239.8m of securitised mortgage assets and cash reserves in the vehicle and £171.6m of debt securities in issue from the Group's balance sheet.

The Group uses interest rate swaps to hedge fixed rate mortgages and adopts fair value hedge accounting where the criteria specified in IAS39 (EU endorsed) are met. Under hedge accounting, the change in the fair value of hedged mortgages for interest rate risk is recognised in profit or loss, as an offset to fair value movements on the swaps, with the cumulative movement reflected as fair value adjustments on hedged assets in the statement of financial position. A number of long-dated legacy swaps were cancelled in 2012 and 2013 whilst still effective. Following the cancellations, the fair value adjustment on the legacy hedged long-term fixed rate mortgages (c. 25 years at origination) remained in the statement of financial position to be amortised over their remaining lives. Both the cancelled swaps and hedged mortgages were inherited from the Kent Reliance Building Society.

During 2016, the Group reviewed the roll-off of the legacy long-dated fixed rate mortgages. Following this review, the Group accelerated the amortisation of the associated fair value adjustments in line with the mortgage asset run-off, due to faster than expected prepayments since cancellation. The exceptional loss represents the impact of accelerating the amortisation in prior years from 2012 to 2015, which was not material in any individual year. It has been presented as an exceptional item and

9. Exceptional items continued

excluded from 2016 underlying profit before tax to provide an appropriate measure of the underlying performance of the Group in 2016. The exceptional loss would have reduced fair value hedged assets by £9.8m, retained earnings by £7.6m (including the tax effect) and the CET1 ratio by 0.3% points as at 31 December 2015.

Exceptional items in 2015 consist of expenses incurred in connection with share-based IPO awards granted to certain Directors, Senior Managers and employees of the Bank at admission. With the decrease in this expense (as the awards have vested to £0.4m for 2016), the separate line disclosure is no longer warranted with the expense included within staff costs during 2016.

Exceptional items are summarised in the table below:

	Group Year ended 31-Dec-16 £m	Group Year ended 31-Dec-15 £m
Gain on disposal of Rochester 1	**34.7**	–
Amortisation of fair value adjustments on hedged assets	**(9.8)**	–
IPO expenses	**–**	(0.7)
IPO share awards with future vesting provisions	**–**	(1.4)
	24.9	(2.1)

IPO share awards represented the fair value at grant date of nil price options over OSB shares. These options were granted by OSB Holdco Limited, the Bank's major shareholder and as such the expense is fully covered by an additional capital contribution. IPO expenses consisted of employer's national insurance on IPO share awards.

10. Taxation

	Group Year ended 31-Dec-16 £m	Group Year ended 31-Dec-15 £m
Corporation tax	**(42.3)**	(20.8)
Total current taxation	**(42.3)**	(20.8)
Deferred taxation	**0.1**	(0.4)
Total taxation	**(42.2)**	(21.2)

The taxation on the Group's profit before taxation differs from the theoretical amount that would arise using the weighted average taxation rate applicable to profits of the Group as follows:

	Year ended 31-Dec-16 £m	Year ended 31-Dec-15[3] £m
Profit before taxation	**163.1**	105.3
Profit multiplied by the weighted average rate of corporation taxation in the UK during 2016 of 20% (2015: 20.25%)	**(32.6)**	(21.3)
Bank surcharge[1]	**(8.6)**	–
Taxation effects of:		
Expenses not deductible for taxation purposes[2]	**(0.4)**	–
Adjustments in respect of earlier years	**(0.5)**	–
Tax adjustments in respect of share-based payments	**0.1**	(0.1)
Impact of tax losses carried forward	**0.1**	0.1
Timing differences on capital items	**(0.2)**	0.3
Re-measurement of deferred taxation – change in tax rate	**–**	(0.2)
Other	**(0.1)**	–
Total taxation charge	**(42.2)**	(21.2)

1. During the year the Government announced an additional 8% surcharge on banking profits over £25.0m, effective from 1 January 2016
2. Expenses not deductible for taxation purposes includes £0.4m (2015: nil) of intercompany interest charge corrections, taken by the Bank in 2016 and the subsidiaries in 2015
3. Restated to be consistent with current year presentation

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10. Taxation continued
A reduction in the UK corporation tax rate from 21% to 20% (effective from 1 April 2015) was substantively enacted on 2 July 2013. Further reductions to 19% (effective from 1 April 2017) and to 18% (effective from 1 April 2020) were substantively enacted on 26 October 2015, and an additional reduction to 17% (effective 1 April 2020) was substantively enacted on 6 September 2016. This will reduce the Group's future current tax charge accordingly.

11. Earnings per share
EPS are based on the profit for the period and the number of ordinary shares in issue. Basic EPS are calculated by dividing profit attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year. Diluted earnings per share take into account share options and awards which can be converted to ordinary shares.

For the purpose of calculating earnings per share, profit attributable to ordinary shareholders is arrived at by adjusting profit for the year for the after-tax amounts of coupons on equity bonds:

	Group Year ended 31-Dec-16 £m	Group Year ended 31-Dec-15 £m
Profit for the year	**120.9**	84.1
Adjustments:		
Coupon on Perpetual Subordinated Bonds classified as equity[1]	**(1.2)**	(1.5)
Tax on coupon	**0.3**	0.3
Profit attributable to ordinary shareholders	**120.0**	82.9
Exceptional items:		
Gain on disposal of Rochester 1	**(34.7)**	–
Amortisation of fair value adjustments on hedged assets	**9.8**	–
IPO expenses	**–**	2.1
Tax on above	**6.4**	(0.5)
Underlying profit attributable to ordinary shareholders	**101.5**	84.5

1. During the year the Group changed from accrual based accounting to cash accounting for the interest paid on PSBs classified as equity. The coupon rate was 6.591% until the reset date on 7 March 2016 after which it was reset to 4.5991% until the next reset date on 7 March 2021

	Group Year ended 31-Dec-16	Group Year ended 31-Dec-15
Weighted average number of shares, millions		
Basic	**243.1**	243.1
Diluted	**244.6**	243.8
Earnings per share, pence per share		
Basic	**49.4**	34.1
Diluted	**49.0**	34.0
Underlying earnings per share, pence per share		
Basic	**41.7**	34.8
Diluted	**41.5**	34.7

12. Dividends
During the year, the Group paid the following dividends:

	Group Year ended 31-Dec-16		Group Year ended 31-Dec-15	
	£m	**Pence per share**	£m	Pence per share
Final dividend for the prior year	**16.3**	**6.7**	9.5	3.9
Interim dividend for the current year	**7.0**	**2.9**	4.8	2.0
	23.3		14.3	

The Directors propose a final dividend of 7.6 pence per share (2015: 6.7 pence) payable on 17 May 2017 with an ex-dividend date of 30 March 2017 and a record date of 31 March 2017. This dividend is not reflected in these financial statements as it is subject to approval by shareholders at the AGM on 10 May 2017. Together with the interim dividend of 2.9 pence (2015: 2.0 pence), it makes a total dividend for 2016 of 10.5 pence per share (2015: 8.7 pence).

13. Loans and advances to credit institutions

Loans and advances to credit institutions have remaining maturities as follows:

	Group As at 31-Dec-16 £m	Group As at 31-Dec-15 £m	**Bank As at 31-Dec-16 £m**	Bank As at 31-Dec-15 £m
Repayable on demand:				
Bank of England[1]	**401.0**	311.5	**401.0**	311.5
Others	**16.8**	43.2	**12.5**	11.9
	417.8	354.7	**413.5**	323.4

1. Balances with the Bank of England include £9.1m (2015: £8.2m) held in the cash ratio deposit

At 31 December 2016 £nil (2015: £29.4m) was ring-fenced within the Rochester 1 securitisation vehicle and could only be used to pay interest and principal of the issued debt securities. The Group disposed of its entire economic benefit in Rochester 1 during 2016.

At 31 December 2016 the Group and Bank had £6.4m (2015: £1.4m) of loans and advances with other credit institutions in the form of margin cash collateral.

14. Investment securities

	Group and Bank As at 31-Dec-16 £m	Group and Bank As at 31-Dec-15 £m
Government investment securities	**141.7**	393.4
	141.7	393.4
Investment securities have remaining maturities as follows:		
Less than three months	**82.6**	25.0
Three months to one year	**40.0**	339.3
One to five years	**19.1**	29.1
	141.7	393.4

At 31 December 2016 the Group held £524.6m (2015: £160.7m) of treasury bills received from the Bank of England under their asset purchase facilities. These securities are accounted for off-balance sheet but included in liquid assets for regulatory purposes. In exchange, the Group pledges with the Bank of England either loans to customers or other investment securities. These assets cannot be sold or pledged further under normal circumstances.

At the reporting date, the Group had no treasury assets (2015: £nil) pledged with the Bank of England in exchange for the treasury bills. The value of pledged loans to customers is disclosed in note 15.

The Group had no assets sold under repos at the 2016 and 2015 reporting dates.

The Directors consider that the primary purpose of holding investment securities is prudential. These securities are held as liquid assets with the intention of use on a continuing basis in the Group's activities and are classified as AFS.

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

	Group and Bank As at 31-Dec-16 £m	Group and Bank As at 31-Dec-15 £m
At 1 January	**393.4**	158.6
Additions	**460.4**	449.0
Disposals and maturities	**(712.2)**	(213.1)
Changes in fair value	**0.1**	(1.1)
At 31 December	**141.7**	393.4

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15. Loans and advances to customers

	Group As at 31-Dec-16 £m	Group As at 31-Dec-15 £m	**Bank As at 31-Dec-16 £m**	Bank As at 31-Dec-15 £m
BTL/SME mortgages	**4,094.9**	3,105.5	**3,290.1**	2,442.5
Residential mortgages	**1,859.9**	2,007.1	**1,613.1**	1,697.9
Personal loans	**9.4**	49.5	**9.4**	49.5
	5,964.2	5,162.1	**4,912.6**	4,189.9
Less: provision for impairment losses on loans and advances (see note 16)	**(25.0)**	(27.3)	**(19.1)**	(23.3)
	5,939.2	5,134.8	**4,893.5**	4,166.6

Maturity analysis

Loans and advances to customers are repayable from the reporting date as follows:

	Group As at 31-Dec-16 £m	Group As at 31-Dec-15 £m	**Bank As at 31-Dec-16 £m**	Bank As at 31-Dec-15 £m
Less than three months	**150.8**	108.5	**135.9**	100.8
Three months to one year	**162.9**	140.9	**123.3**	119.0
One to five years	**279.5**	326.8	**170.2**	217.1
More than five years	**5,371.0**	4,585.9	**4,483.2**	3,753.0
	5,964.2	5,162.1	**4,912.6**	4,189.9
Less: provision for impairment losses on loans and advances (see note 16)	**(25.0)**	(27.3)	**(19.1)**	(23.3)
	5,939.2	5,134.8	**4,893.5**	4,166.6

The above analysis is based on contractual maturity and may not reflect actual experience of repayments, since many mortgage loans are repaid early.

During the year the Group purchased mortgage books from other financial institutions with a gross value of £205.2m for a total of £180.7m (2015: gross value £244.0m, purchase price £260.8m).

At 31 December 2016, mortgages with a carrying value of £1,413.9m (2015: £465.6m) were pledged with the Bank of England under their asset purchase facilities.

Included within loans and advances to customers are mortgages totalling £21.4m (2015: £nil) retained by the Group, who act as master servicer for a securitisation vehicle, to comply with the EU risk retention requirements.

At 31 December 2016, mortgages with a carrying value of £nil (2015: £283.7m) were pledged under the Group's securitisation programme.

16. Provision for impairment losses on loans and advances

Movement in provision for impairment losses on loans and advances to customers is as follows:

2016

Specific	BTL/SME £m	Residential mortgages £m	Personal loans £m	Total £m
Group				
At 1 January 2016	17.3	0.9	–	18.2
Write-offs in year	(2.9)	(1.6)	–	(4.5)
Transfer between reserves[1]	0.1	4.8	0.3	5.2
Charge/(credit) for the year net of recoveries	2.0	2.5	–	4.5
At 31 December 2016	16.5	6.6	0.3	23.4
Bank				
At 1 January 2016	14.5	–	–	14.5
Write-offs in year	(3.0)	(1.4)	–	(4.4)
Transfer between reserves[1]	0.1	4.7	0.3	5.1
Charge/(credit) for the year net of recoveries	1.0	1.5	–	2.5
At 31 December 2016	12.6	4.8	0.3	17.7

Collective	BTL/SME £m	Residential mortgages £m	Personal loans £m	Total £m
Group				
At 1 January 2016	0.5	1.3	7.3	9.1
Write-offs in year	(0.1)	–	(1.1)	(1.2)
Disposals[2]	–	–	(5.6)	(5.6)
Transfer between reserves[1]	(0.1)	(4.8)	(0.3)	(5.2)
Charge/(credit) for the year net of recoveries	0.1	4.7	(0.3)	4.5
At 31 December 2016	0.4	1.2	–	1.6
Bank				
At 1 January 2016	0.4	1.1	7.3	8.8
Write-offs in year	–	–	(1.1)	(1.1)
Disposals[2]	–	–	(5.6)	(5.6)
Transfer between reserves[1]	(0.1)	(4.7)	(0.3)	(5.1)
Charge/(credit) for the year net of recoveries	(0.1)	4.8	(0.3)	4.4
At 31 December 2016	0.2	1.2	–	1.4

Total	BTL/SME £m	Residential mortgages £m	Personal loans £m	Total £m
Group				
At 1 January 2016	17.8	2.2	7.3	27.3
Write-offs in year	(3.0)	(1.6)	(1.1)	(5.7)
Disposals[2]	–	–	(5.6)	(5.6)
Transfer between reserves[1]	–	–	–	–
Charge/(credit) for the year net of recoveries	2.1	7.2	(0.3)	9.0
At 31 December 2016	16.9	7.8	0.3	25.0
Bank				
At 1 January 2016	14.9	1.1	7.3	23.3
Write-offs in year	(3.0)	(1.4)	(1.1)	(5.5)
Disposals[2]	–	–	(5.6)	(5.6)
Transfer between reserves[1]	–	–	–	–
Charge/(credit) for the year net of recoveries	0.9	6.3	(0.3)	6.9
At 31 December 2016	12.8	6.0	0.3	19.1

1. In 2016 there was an update to the categorisation where all loans greater than 3 months in arrears are treated as specific provisions, in addition to loans that are individually assessed. This resulted in an increase to the specific provisions of £5.2m for the Group and £5.1m for the Bank during 2016, with a corresponding decrease in collective provisions. If the categorisation change had been applied during 2015, the Group's opening collective provision for 2016 would have been £8.4m lower, with the opening specific provision for 2016 being £8.4m higher
2. During 2016 the Group sold a portion of non-performing loans from its personal loan portfolio. See note 5 for further details

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16. Provision for impairment losses on loans and advances continued

2015

Specific	BTL/SME £m	Residential mortgages £m	Personal loans £m	Total £m
Group				
At 1 January 2015	15.3	0.9	–	16.2
Write-offs in year	(2.9)	(0.2)	–	(3.1)
Charge/(credit) for the year net of recoveries	4.9	0.2	–	5.1
At 31 December 2015	17.3	0.9	–	18.2
Bank				
At 1 January 2015	11.2	0.4	–	11.6
Write-offs in year	(1.7)	(0.1)	–	(1.8)
Charge/(credit) for the year net of recoveries	5.0	(0.3)	–	4.7
At 31 December 2015	14.5	–	–	14.5

Collective	BTL/SME £m	Residential mortgages £m	Personal loans £m	Total £m
Group				
At 1 January 2015	0.1	1.8	8.0	9.9
Write-offs in year	–	(2.7)	(3.6)	(6.3)
Charge/(credit) for the year net of recoveries	0.4	2.2	2.9	5.5
At 31 December 2015	0.5	1.3	7.3	9.1
Bank				
At 1 January 2015	–	1.5	8.0	9.5
Write-offs in year	–	(2.7)	(3.6)	(6.3)
Charge/(credit) for the year net of recoveries	0.4	2.3	2.9	5.6
At 31 December 2015	0.4	1.1	7.3	8.8

Total	BTL/SME £m	Residential mortgages £m	Personal loans £m	Total £m
Group				
At 1 January 2015	15.4	2.7	8.0	26.1
Write-offs in year	(2.9)	(2.9)	(3.6)	(9.4)
Charge/(credit) for the year net of recoveries	5.3	2.4	2.9	10.6
At 31 December 2015	17.8	2.2	7.3	27.3
Bank				
At 1 January 2015	11.2	1.9	8.0	21.1
Write-offs in year	(1.7)	(2.8)	(3.6)	(8.1)
Charge/(credit) for the year net of recoveries	5.4	2.0	2.9	10.3
At 31 December 2015	14.9	1.1	7.3	23.3

17. Impairment losses

	Group Year ended 31-Dec-16 £m	Group Year ended 31-Dec-15 £m
Write-offs in the year	**5.7**	9.4
Disposals	**5.6**	–
(Decrease)/increase in provisions	**(2.3)**	1.2
	9.0	10.6

18. Fair value adjustments on hedged items

	Group and Bank As at 31-Dec-16 £m	Group and Bank As at 31-Dec-15 £m
Hedged assets		
Current hedge relationships	**23.6**	20.4
Cancelled hedge relationships	**23.3**	37.8
	46.9	58.2
Hedged liabilities		
Current hedge relationships	**(1.9)**	(1.4)

The fair value adjustments on hedged assets in respect of cancelled hedge relationships represent the fair value adjustment for interest rate risk on legacy long-term fixed rate mortgages (c.25 years at origination) where the interest rate swap hedges were terminated before maturity and were effective at the point of termination.

The movement in cancelled hedge relationships is as follows:

	Group and Bank 2016 £m	Group and Bank 2015 £m
Balance at 1 January	**37.8**	41.0
New cancellations	**0.2**	–
Amortisation (see note 4)	**(4.9)**	(3.2)
Exceptional loss (see note 9)	**(9.8)**	–
Balance at 31 December	**23.3**	37.8

19. Investments in subsidiaries, intercompany loans and transactions with related parties

The balances between the Bank and its subsidiaries at the reporting date are summarised in the table below:

	As at 31-Dec-16 £m	As at 31-Dec-15 £m
Investments in subsidiaries and intercompany loans receivable	**984.0**	944.5
Deemed loan liability	**–**	(169.5)
Intercompany loans payable	**(1.9)**	(4.9)
	982.1	770.1

During the year the Group disposed of its entire economic interest in Rochester 1 securitisation vehicle.

The net movement during the year is as follows:

2016	Shares in subsidiary undertakings £m	Loans to subsidiary undertakings £m	Total £m
At 1 January	**1.8**	**768.3**	**770.1**
Additions	**–**	**298.5**	**298.5**
Repayments	**–**	**(86.5)**	**(86.5)**
At 31 December	**1.8**	**980.3**	**982.1**

2015	Shares in subsidiary undertakings £m	Loans to subsidiary undertakings £m	Total £m
At 1 January	3.4	626.2	629.6
Additions	–	221.1	221.1
Reclassifications[1]	(1.6)	1.6	–
Repayments	–	(80.6)	(80.6)
At 31 December	1.8	768.3	770.1

1. During 2015, indirect investments held through intermediary holding companies were reclassified to intercompany loans

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19. Investments in subsidiaries, intercompany loans and transactions with related parties continued

A list of the Bank's subsidiaries are below. Subsidiaries have a registered office of Reliance House, Sun Pier, Chatham, Kent, ME4 4ET ('Reliance House') unless otherwise stated.

2016	Class of shares	Activity	Registered office	Ownership	Charged by (to) the Bank £m	Balance due to (by) the Bank £m
Direct investments						
Easioption Ltd	Ordinary	Holding company	Reliance House	100%	–	0.5
Guernsey Home Loans Ltd	Ordinary	Mortgage provider	Reliance House	100%	(0.5)	21.3
Guernsey Home Loans Ltd	Ordinary	Mortgage provider	1st Floor, Tudor House, Le Bordage, St Peter Port, Guernsey, GY1 1DB	100%	(1.5)	64.1
Heritable Development Finance Ltd[1]	Ordinary	Mortgage originator and servicer	Reliance House	85%	2.1	(1.0)
Interbay Group Holdings Ltd	Ordinary	Holding company	Reliance House	100%	–	–
Jersey Home Loans Ltd	Ordinary	Mortgage provider	Reliance House	100%	(0.1)	4.5
Jersey Home Loans Ltd	Ordinary	Mortgage provider	26 New Street, St Helier, Jersey, JE2 3RA	100%	(6.1)	262.2
OSB India Private Ltd	Ordinary	Back office processing	Salarpuria Magnificia, 10th Floor, 78 Old Madras Road, Bangalore, 560016, Karnataka, India	100%	3.7	0.5
Prestige Finance Ltd[2]	Ordinary	Mortgage originator and servicer	Reliance House	100%	3.0	(0.9)
Reliance Property Loans Ltd	Ordinary	Mortgage provider	Reliance House	100%	(0.1)	4.4
Rochester Mortgages Ltd	Ordinary	Mortgage provider	Reliance House	100%	–	–
Indirect investments						
Cavenham Financial Services Ltd[2]	Ordinary	Dormant entity	Reliance House	100%	0.1	–
Interbay Financial I Ltd	Ordinary	Holding company	Reliance House	100%	(0.4)	19.6
Interbay Financial II Ltd	Ordinary	Holding company	Reliance House	100%	(0.4)	17.5
Interbay Funding Ltd	Ordinary	Mortgage servicer	Reliance House	100%	(0.1)	4.4
Interbay ML Ltd	Ordinary	Mortgage provider	Reliance House	100%	(12.0)	583.1
Interbay Holdings Ltd	Ordinary	Holding company	Reliance House	100%	–	–
5 D Finance Ltd	Ordinary	Mortgage servicer	Reliance House	100%	–	0.2
5 D Lending Ltd	Ordinary	Mortgage provider	Reliance House	100%	–	(0.1)
					(12.3)	980.3

1. Heritable Development Finance Ltd is a business development partnership with Heritable Capital Ltd. The entity is majority owned and controlled by the Bank. It has minimal retained earnings and immaterial non-controlling interest which is not presented separately in the Group reserves
2. Prestige Finance Ltd completed the rationalisation of activities from Cavenham Financial Services Ltd during 2016. An application to strike-off Cavenham Financial Services Ltd was submitted during 2016 with the company being struck-off on 17 January 2017

19. Investments in subsidiaries, intercompany loans and transactions with related parties continued

2015	Class of shares	Activity	Registered office	Ownership	Charged by (to) the Bank £m	Balance due to (by) the Bank £m
Direct investments						
Easioption Ltd	Ordinary	Holding company	Reliance House	100%	–	0.5
OSB India Private Ltd (Formerly Easiprocess Private Ltd)	Ordinary	Back office processing	Salarpuria Magnificia, 10th Floor, 78 Old Madras Road, Bangalore, 560016, Karnataka, India	100%	(0.4)	(0.5)
Guernsey Home Loans Ltd	Ordinary	Mortgage provider	Reliance House	100%	0.9	25.7
Guernsey Home Loans Ltd	Ordinary	Mortgage provider	1st Floor, Tudor House, Le Bordage, St Peter Port, Guernsey, GY1 1DB	100%	2.8	79.4
Heritable Development Finance Ltd	Ordinary	Mortgage originator and servicer	Reliance House	85%	(0.9)	(0.5)
Interbay Group Holdings Ltd	Ordinary	Holding company	Reliance House	100%	–	–
Jersey Home Loans Ltd	Ordinary	Mortgage provider	Reliance House	100%	0.3	7.4
Jersey Home Loans Ltd	Ordinary	Mortgage provider	26 New Street, St Helier, Jersey, JE2 3RA	100%	10.9	323.2
Prestige Finance Ltd	Ordinary	Mortgage originator and servicer	Reliance House	100%	(0.9)	(3.7)
Reliance Property Loans Ltd	Ordinary	Mortgage provider	Reliance House	100%	0.1	4.4
Rochester Financing No.1 Plc[1]	Ordinary	Securitisation entity	Reliance House	–	–	(159.9)
Rochester Mortgages Ltd	Ordinary	Mortgage provider	Reliance House	100%	–	–
Rochester Mortgage Holdings Ltd	Ordinary	Securitisation entity	Reliance House	100%	–	–
Swingcastle Ltd[2]	Ordinary	Dormant entity	Reliance House	100%	–	(0.2)
Indirect investments						
Cavenham Financial Services Ltd	Ordinary	Dormant entity	Reliance House	100%	(1.7)	2.9
Interbay Financial I Ltd	Ordinary	Holding company	Reliance House	100%	0.5	19.2
Interbay Financial II Ltd	Ordinary	Holding company	Reliance House	100%	0.5	17.1
Interbay Funding Ltd	Ordinary	Mortgage servicer	Reliance House	100%	–	2.3
Interbay ML Ltd	Ordinary	Mortgage provider	Reliance House	100%	9.7	450.9
Interbay Holdings Ltd	Ordinary	Holding company	Reliance House	100%	–	–
5 D Finance Ltd	Ordinary	Mortgage servicer	Reliance House	100%	–	0.1
5 D Lending Ltd	Ordinary	Mortgage provider	Reliance House	100%	–	–
					21.8	768.3

1. Rochester Financing No.1 plc was a securitisation entity established by the Bank in October 2013 to raise diversified funds. Although not legally owned by the Group, it was fully controlled and subsequently consolidated as a 100% subsidiary. The entity was sold during 2016
2. Swingcastle Ltd was struck-off on 18 October 2016

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19. Investments in subsidiaries, intercompany loans and transactions with related parties continued

All of the above investments are reviewed annually for impairment. All of the subsidiaries are either actively trading or are fully funded by the Bank. Based on management's assessment of the future cash flows of each entity, no impairment has been recognised.

In addition to the above subsidiaries, the Bank has transactions with Kent Reliance Provident Society ('KRPS'), one of its founding shareholders. KRPS runs member engagement forums for the Bank. In exchange, the Bank provides KRPS with various services including IT, finance and other support functions. During the year the Bank covered operating expenses of KRPS amounting to £0.2m (2015: £0.2m).

All related party transactions were made on terms equivalent to those that prevail in arm's length transactions. During the year there were no related party transactions between the key management personnel and the Bank other than as described below.

Transactions with key management personnel

The Board considers the key management personnel to comprise Executive and Non-Executive Directors. Directors' remuneration is disclosed in note 7 and the Annual Report on Remuneration.

No loans were issued to related parties during 2016 (2015: £nil).

Key management personnel and connected persons held deposits with the Group of £1.3m (2015: £1.1m).

20. Intangible assets

	Group Year ended 31-Dec-16 £m	Group Year ended 31-Dec-15 £m	**Bank Year ended 31-Dec-16 £m**	Bank Year ended 31-Dec-15 £m
Cost				
At 1 January	**5.6**	5.3	**4.3**	5.3
Reclassification from property, plant and equipment	**–**	1.2	**–**	–
Additions	**2.9**	1.3	**2.5**	1.2
Disposals and write-offs	**–**	(2.2)	**–**	(2.2)
At 31 December	**8.5**	5.6	**6.8**	4.3
Amortisation				
At 1 January	**2.5**	3.0	**1.6**	3.0
Reclassification from property, plant and equipment	**–**	0.8	**–**	–
Charged in year	**1.3**	0.9	**1.1**	0.8
Disposals and write-offs	**–**	(2.2)	**–**	(2.2)
At 31 December	**3.8**	2.5	**2.7**	1.6
Net book value				
At 31 December	**4.7**	3.1	**4.1**	2.7

Intangible assets consist of computer software. There were no capitalised costs related to the internal development of software during the period.

During 2015, fully depreciated assets were written off.

21. Property, plant and equipment

Group 2016	Freehold land and buildings[1] £m	Equipment, fixtures and vehicles £m	Total £m
Cost			
At 1 January 2016	**6.3**	**5.8**	**12.1**
Additions	**2.9**	**1.9**	**4.8**
Disposals and write-offs	**–**	**(0.3)**	**(0.3)**
Translation difference	**–**	**0.1**	**0.1**
At 31 December	**9.2**	**7.5**	**16.7**
Depreciation			
At 1 January 2016	**0.3**	**2.2**	**2.5**
Charged in year	**0.2**	**1.1**	**1.3**
Disposals and write-offs	**–**	**(0.3)**	**(0.3)**
Translation difference	**–**	**0.1**	**0.1**
At 31 December	**0.5**	**3.1**	**3.6**
Net book value			
At 31 December	**8.7**	**4.4**	**13.1**

Group 2015	Freehold land and buildings[1] £m	Equipment, fixtures and vehicles £m	Total £m
Cost			
At 1 January 2015	1.4	9.5	10.9
Reclassification to intangible assets	–	(1.2)	(1.2)
Additions	4.9	3.0	7.9
Disposals and write-offs	–	(5.5)	(5.5)
At 31 December 2015	6.3	5.8	12.1
Depreciation			
At 1 January 2015	0.3	7.6	7.9
Reclassification to intangible assets	–	(0.7)	(0.7)
Charged in year	–	0.8	0.8
Disposals and write-offs	–	(5.5)	(5.5)
At 31 December 2015	0.3	2.2	2.5
Net book value			
At 31 December 2015	6.0	3.6	9.6

Bank 2016	Freehold land and buildings[1] £m	Equipment, fixtures and vehicles £m	Total £m
Cost			
At 1 January 2016	**4.0**	**4.6**	**8.6**
Additions	**2.9**	**1.1**	**4.0**
At 31 December	**6.9**	**5.7**	**12.6**
Depreciation			
At 1 January 2016	**0.3**	**1.3**	**1.6**
Charged in year	**0.2**	**0.9**	**1.1**
At 31 December	**0.5**	**2.2**	**2.7**
Net book value			
At 31 December	**6.4**	**3.5**	**9.9**

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21. Property, plant and equipment continued

Bank 2015	Freehold land and buildings[1] £m	Equipment, fixtures and vehicles £m	Total £m
Cost			
At 1 January 2015	1.5	5.9	7.4
Additions	2.5	2.8	5.3
Disposals and write-offs	–	(4.1)	(4.1)
At 31 December 2015	4.0	4.6	8.6
Depreciation			
At 1 January 2015	0.3	4.7	5.0
Charged in year	–	0.7	0.7
Disposals and write-offs	–	(4.1)	(4.1)
At 31 December 2015	0.3	1.3	1.6
Net book value			
At 31 December 2015	3.7	3.3	7.0

1. Included within freehold land and buildings is £0.5m (2015: £0.4m) of leasehold improvement costs, depreciated in-line with note 1(l)

During the year fully depreciated assets were written off.

22. Deferred taxation asset

Deferred taxation asset	**Group As at 31-Dec-16 £m**	Group As at 31-Dec-15 £m	**Bank As at 31-Dec-16 £m**	Bank As at 31-Dec-15 £m
At 1 January	**3.4**	3.5	**0.7**	0.5
Profit or loss credit/(charge)	**0.1**	(0.4)	**0.1**	(0.1)
Tax taken to other comprehensive income and reserves	**(0.1)**	0.3	**–**	0.3
At 31 December	**3.4**	3.4	**0.8**	0.7
Analysed as:				
Losses carried forward	**2.3**	2.4	**–**	–
Accelerated depreciation	**0.1**	0.2	**–**	–
Share-based payments	**1.0**	0.7	**0.8**	0.7
Other	**–**	0.1	**–**	–
	3.4	3.4	**0.8**	0.7

The deferred tax has been calculated using the relevant rates for the expected periods of utilisation.

As at 31 December 2016, the Group had £5.1m (2015: £4.8m) of losses for which a deferred tax asset has not been recognised.

During the year the Government announced an additional 8% surcharge on banking profits over £25.0m, effective from 1 January 2016. The Bank's profits are expected to be subject to the surcharge, however, subsidiaries' profits are not, which means their losses of prior years will not attract an additional tax relief. The deferred tax calculation does not take into account the surcharge effect.

A reduction in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and to 18% (effective from 1 April 2020) were substantively enacted on 26 October 2015. An additional reduction to 17% (effective 1 April 2020) was substantively enacted on 6 September 2016. The deferred tax asset at 31 December 2016 has been calculated based on these rates.

23. Other assets

	Group As at 31-Dec-16 £m	Group As at 31-Dec-15 £m	**Bank As at 31-Dec-16 £m**	Bank As at 31-Dec-15 £m
Prepayments	**1.4**	2.5	**1.3**	1.9
Other assets[1]	**10.5**	9.3	**2.5**	3.5
	11.9	11.8	**3.8**	5.4

1. Included within the Group's other assets are £7.3m (2015: £5.6m) of deferred broker fees paid on the completion of new loans in the Interbay group of subsidiaries

24. Amounts owed to retail depositors

	Group and Bank As at 31-Dec-16 £m	Group and Bank As at 31-Dec-15 £m
Amounts owed to retail depositors	**5,952.4**	5,363.8

Repayable in the ordinary course of business as follows:

	Group and Bank As at 31-Dec-16 £m	Group and Bank As at 31-Dec-15 £m
On demand	**1,932.5**	1,890.0
Less than three months	**702.4**	450.4
Three months to one year	**1,977.2**	1,903.2
One to five years	**1,340.3**	1,120.2
	5,952.4	5,363.8

25. Amounts owed to credit institutions

Repayable in the ordinary course of business as follows:

	Group and Bank As at 31-Dec-16 £m	Group and Bank As at 31-Dec-15 £m
Less than three months	**0.7**	1.5
Three months to one year	**–**	–
One to five years	**101.0**	–
	101.7	1.5

As at 31 December 2016, amounts owed to credit institutions included £101.0m (2015: £nil) owed to the Bank of England under their asset purchase facilities. In exchange, the Group pledges with the Bank of England either loans and advances to customers or other investment securities. The value of pledged loans and advances to customers is disclosed in note 15. The value of pledged investment securities is disclosed in note 14.

26. Amounts owed to other customers

Repayable in the ordinary course of business as follows:

	Group and Bank As at 31-Dec-16 £m	Group and Bank As at 31-Dec-15 £m
Less than three months	**4.0**	5.8
Three months to one year	**–**	–
One to five years	**–**	0.1
	4.0	5.9

27. Debt securities in issue

	Group As at 31-Dec-16 £m	Group As at 31-Dec-15 £m	Bank As at 31-Dec-16 £m	Bank As at 31-Dec-15 £m
One to five years	**–**	188.4	**–**	–
	–	188.4	**–**	–

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27. Debt securities in issue continued

At the 2015 reporting date, debt securities in issue comprise AAA and AA+ rated notes issued by Rochester 1 and sold to third-party investors in 2013. Rochester 1 being a mortgage securitisation entity established by the Bank in 2013. The Bank retained the remaining notes and residual certificates issued by Rochester 1 and as such did not transfer substantially the risks and rewards of ownership of the securitised mortgages. These mortgages therefore remained on the Bank's balance sheet and the Group consolidated Rochester 1.

The Bank sold its entire economic interest including the remaining notes and residual certificates issued in Rochester 1 on 26 May 2016. The sale resulted in derecognition of securitised mortgage assets from the Bank's balance sheet and the deconsolidation of Rochester 1 which included the debt securities in issue.

28. Other liabilities

	Group As at 31-Dec-16 £m	Group As at 31-Dec-15 £m	**Bank As at 31-Dec-16 £m**	Bank As at 31-Dec-15 £m
Falling due within one year:				
Tax deducted at source from interest paid	**–**	1.7	**–**	1.7
Accruals and deferred income	**7.6**	7.7	**6.0**	6.3
Other creditors[1]	**11.0**	9.5	**1.4**	1.5
	18.6	18.9	**7.4**	9.5

1. Included within the Group's other creditors are £8.7m (2015: £7.1m) of accrued arrangement fees received on the completion of new loans in the Interbay group of subsidiaries

29. FSCS and other provisions

The Financial Services Compensation Scheme ('FSCS') provides protection of deposits for the customers of authorised financial services firms, should a firm collapse. FSCS protects retail deposits of up to £75,000 (2015: £85,000) for single account holders and £150,000 (2015: £170,000) for joint holders. From 30 January 2017 protected deposits will increase to £85,000 for single account holders and £170,000 for joint holders.

The compensation paid out to consumers is initially funded through loans from the Bank of England and HM Treasury. In order to repay the loans and cover its costs, the FSCS charges levies on firms regulated by the PRA and the Financial Conduct Authority ('FCA'). The Group is among those firms and pays the FSCS a levy based on its share of total UK deposits. The FSCS levy is the main regulatory provision of the Group.

The ultimate FSCS levy to the industry as a result of the insolvencies cannot currently be estimated reliably as it is dependent on various uncertain factors including the potential recoveries of assets by the FSCS and changes in the level of protected deposits and the population of FSCS members at the time.

An analysis of the Group and Bank's FSCS and other provisions are presented below:

Group and Bank	**FSCS Year ended 31-Dec-16 £m**	**Other provisions Year ended 31-Dec-16 £m**	**Total Year ended 31-Dec-16 £m**	FSCS Year ended 31-Dec-15 £m	Other provisions Year ended 31-Dec-15 £m	Total Year ended 31-Dec-15 £m
As at 1 January	**2.2**	**0.1**	**2.3**	1.5	0.1	1.6
Paid during the year	**(1.3)**	**–**	**(1.3)**	(2.7)	–	(2.7)
Charge/(credit)	**0.5**	**–**	**0.5**	3.4	–	3.4
At 31 December	**1.4**	**0.1**	**1.5**	2.2	0.1	2.3

In accordance with IFRIC 21 interpretation of IAS 37, FSCS liability for 2016 will be recognised in 2017. The FSCS balance at the reporting date relates to the levy from previous years.

30. Subordinated liabilities

	Group and Bank As at 31-Dec-16 £m	Group and Bank As at 31-Dec-15 £m
Linked to LIBOR (London Interbank Offered Rate):		
Floating rate subordinated liabilities 2016 (LIBOR + 1.5%)	**–**	3.0
Floating rate subordinated liabilities 2017 (LIBOR + 1.5%)	**5.7**	5.7
Floating rate subordinated loans 2022 (LIBOR + 5%)	**0.3**	0.3
Floating rate subordinated loans 2022 (LIBOR + 2%)	**0.4**	0.4
Linked to the average standard mortgage rate of the five largest building societies:		
Floating rate subordinated liabilities 2017 (+5.963%)	**5.0**	5.0
Fixed rate:		
Subordinated liabilities 2024 (7.45%)[1]	**5.1**	–
Subordinated liabilities 2024 (6.45%)[2]	**5.1**	10.2
	21.6	24.6

1. On 27 September 2016 the Group decided not to call the £5m first tranche of the subordinated debt with original maturity of 27 September 2024. As the debt was not called, the coupon rate reset to 7.45% until maturity
2. The Group has the option to call the £5m second tranche of the subordinated debt on 27 September 2019

Subordinated liabilities are repayable at the dates stated or earlier at the option of the Group with the prior consent of the PRA. All subordinated liabilities are denominated in Sterling and are unlisted.

The rights of repayment of the holders of these subordinated liabilities are subordinated to the claims of all depositors and all creditors.

31. Perpetual subordinated bonds

	Group and Bank As at 31-Dec-16 £m	Group and Bank As at 31-Dec-15 £m
Sterling perpetual subordinated bonds	**15.3**	15.3

The bonds are listed on the London Stock Exchange. They were issued with no discretion over the payment of interest and are therefore classified as financial liabilities. The coupon rate is 5.9884%.

32. Share capital

Group and Bank

OSB ordinary shares of £0.01 each

	Number of shares	Nominal value (£m)	Premium (£m)
At 1 January 2016	243,079,965	2.4	157.9
Shares issued under OSB employee share plan	2,126	–	–
At 31 December 2016	**243,082,091**	**2.4**	**157.9**
As at 1 January and 31 December 2015	243,079,965	2.4	157.9

33. Other reserves

Transfer reserve

The transfer reserve of £12.8m (Bank: £15.2m) represents the difference between the true value of net assets transferred to the Group from Kent Reliance Building Society in 2011 and the value of shares issued to the A ordinary shareholders.

AFS reserve

The AFS reserve of £nil (2015: £0.1m asset) represents the cumulative net change in the fair value of investment securities measured at fair value through other comprehensive income net of deferred tax.

Perpetual subordinated bonds

In addition to the PSBs in note 31, the Bank has issued £22.0m of PSBs which are classified as equity, as full discretion can be exercised by the Directors over the payment of the coupon. The classification of these PSBs means that any coupon payments on them are treated within retained earnings rather than through profit or loss. The coupon rate was 6.591% until the reset date on 7 March 2016 after which it was reset to 4.5991% until the next reset date on 7 March 2021.

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34. Financial commitments and guarantees

a) As at 31 December 2016, the Group's contracted or anticipated capital expenditure commitments not provided for amounted to £1.1m (2015: £0.1m). 2016 consists of branch refurbishment costs and UK head office improvements. 2015 consisted of unfinished refurbishment of the new Indian office.

b) Operating lease commitments are summarised in the table below:

	Group As at 31-Dec-16 £m	Group As at 31-Dec-15 £m	**Bank As at 31-Dec-16 £m**	Bank As at 31-Dec-15 £m
Land and buildings: due within:				
One year	**0.4**	0.3	**0.4**	0.2
Two to five years	**0.9**	1.0	**0.8**	0.6
	1.3	1.3	**1.2**	0.8

c) Undrawn mortgage loan facilities:

	Group As at 31-Dec-16 £m	Group As at 31-Dec-15 £m	**Bank As at 31-Dec-16 £m**	Bank As at 31-Dec-15 £m
As at 31 December	**365.4**	339.1	**297.2**	317.3

Undrawn loan facilities are approved loan applications which have not yet been exercised. They are payable on demand and are usually drawn down or expire within three months.

d) The Group did not have any issued financial guarantees as at 31 December 2016 (2015: nil).

35. Risk management and financial instruments

Overview

Financial instruments form the vast majority of the Group's and Bank's assets and liabilities. The Group manages risk on a consolidated basis, and risk disclosures are provided on this basis.

Types of financial instrument

Financial instruments are a broad definition which includes financial assets, financial liabilities and equity instruments. The main financial assets of the Group are loans to customers and liquid assets which in turn consist of cash in the Bank of England reserve account, call accounts with other credit institutions and UK and EU sovereign debt. These are funded by a combination of financial liabilities and equity instruments. Financial liability funding comes predominantly from retail deposits, supported by debt securities, subordinated debt, wholesale and other funding. Equity instruments include own shares and perpetual bonds meeting the equity classification criteria. The Group's main activity is mortgage lending; it raises funds or invests in particular types of financial assets primarily in order to satisfy banking industry regulations and manage the risks arising from its operations. The Group does not trade in financial instruments for speculative purposes.

The Group uses derivative instruments to manage its financial risks. Derivative financial instruments ('derivatives') are financial instruments which value changes in response to changes in underlying variables such as interest rates. Typically the contract value of derivatives is much smaller than that of the instruments they relate to which makes them a convenient tool for benefiting from value changes without the need to buy or sell the whole underlying product. The most common derivatives comprise futures, forwards and swaps. Among these, the Group only uses swaps.

Derivatives are used by the Group solely to reduce ('hedge') the risk of loss arising from changes in market factors. Derivatives are not used for speculative purposes.

Types of derivatives and uses

The derivative instruments used by the Group in managing its risk exposures are interest rate swaps and basis rate swaps. Interest rate swaps convert fixed interest rates to floating or vice versa. Basis rate swaps perform a similar function by converting cash flows from one interest rate basis to another. As with other derivatives, the underlying product is not sold and payments are based on notional principal amounts.

Unhedged fixed rate liabilities create the risk of paying above-the-market rate if interest rates subsequently decrease. Unhedged fixed rate mortgages and liquid assets bear the opposite risk of earning below-the-market income when rates go up. While fixed rate assets and liabilities naturally hedge each other to a certain extent, this hedge is usually never balanced.

35. Risk management and financial instruments continued

The Group uses swaps to convert its instruments, such as mortgages, deposits and liquid assets, from fixed or base rate-linked rates to LIBOR-linked variable rates. This ensures a guaranteed margin between the interest income and interest expense, regardless of changes in the market rates.

Types of risk

The principal financial risks to which the Group is exposed are credit, liquidity and market risks, the latter comprising of interest and exchange rate risk. In addition to financial risks, the Group is exposed to various other risks, most notably operational, conduct and regulatory, covered in the Chief Risk Officer's Report.

The financial risks are analysed below.

Credit risk

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

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

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

Credit risk – loans and advances to customers

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

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

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

The following table shows an analysis of the lending portfolio by borrower type at the reporting date:

	Group As at 31-Dec-16		Group As at 31-Dec-15	
	£m	**%**	£m	%
BTL/SME mortgages	**4,094.9**	**69%**	3,105.5	60%
Residential mortgages	**1,859.9**	**31%**	2,007.1	39%
Personal loans	**9.4**	**–**	49.5	1%
Total loans before provisions	**5,964.2**	**100%**	5,162.1	100%

	Bank As at 31-Dec-16		Bank As at 31-Dec-15	
	£m	**%**	£m	%
BTL/SME mortgages	**3,290.1**	**67%**	2,442.5	58%
Residential mortgages	**1,613.1**	**33%**	1,697.9	41%
Personal loans	**9.4**	**–**	49.5	1%
Total loans before provisions	**4,912.6**	**100%**	4,189.9	100%

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35. Risk management and financial instruments continued

Property values are updated to reflect changes in the house price index. A breakdown of the table above by indexed loan-to-value ('LTV') is as follows:

LTV analysis by band for all loans:

Group	As at 31-Dec-16 BTL/SME £m	Residential £m	Total £m	%
Band				
0%–50%	**755.9**	**761.7**	**1,517.6**	**25%**
50%–60%	**859.6**	**278.7**	**1,138.3**	**19%**
60%–70%	**1,202.4**	**282.7**	**1,485.1**	**25%**
70%–80%	**1,041.2**	**257.1**	**1,298.3**	**22%**
80%–90%	**194.8**	**196.9**	**391.7**	**7%**
90%–100%	**5.0**	**48.0**	**53.0**	**1%**
>100%	**36.0**	**34.8**	**70.8**	**1%**
Total mortgages before provisions	**4,094.9**	**1,859.9**	**5,954.8**	**100%**
Personal loans			**9.4**	
Total loans before provisions			**5,964.2**	

Group	As at 31-Dec-15 BTL/SME[1] £m	Residential £m	Total £m	%
Band				
0%–50%	452.2	771.3	1,223.5	24%
50%–60%	618.3	331.7	950.0	19%
60%–70%	960.6	364.1	1,324.7	26%
70%–80%	780.0	303.3	1,083.3	21%
80%–90%	259.0	172.0	431.0	8%
90%–100%	10.0	43.2	53.2	1%
>100%	25.4	21.5	46.9	1%
Total mortgages before provisions	3,105.5	2,007.1	5,112.6	100%
Personal loans			49.5	
Total loans before provisions			5,162.1	

Bank	As at 31-Dec-16 BTL/SME £m	Residential £m	Total £m	%
Band				
0%–50%	**613.0**	**714.8**	**1,327.8**	**27%**
50%–60%	**663.7**	**251.1**	**914.8**	**19%**
60%–70%	**940.0**	**249.7**	**1,189.7**	**24%**
70%–80%	**892.5**	**206.8**	**1,099.3**	**22%**
80%–90%	**157.8**	**129.5**	**287.3**	**6%**
90%–100%	**1.1**	**38.4**	**39.5**	**1%**
>100%	**22.0**	**22.8**	**44.8**	**1%**
Total mortgages before provisions	**3,290.1**	**1,613.1**	**4,903.2**	**100%**
Personal loans			**9.4**	
Total loans before provisions			**4,912.6**	

35. Risk management and financial instruments continued

Bank	As at 31-Dec-15 BTL/SME[1] £m	Residential £m	Total £m	%
Band				
0%–50%	339.8	684.9	1,024.7	25%
50%–60%	504.0	284.8	788.8	18%
60%–70%	735.6	314.9	1,050.5	25%
70%–80%	604.2	245.6	849.8	21%
80%–90%	239.3	121.8	361.1	9%
90%–100%	6.1	35.1	41.2	1%
>100%	13.5	10.8	24.3	1%
Total mortgages before provisions	2,442.5	1,697.9	4,140.4	100%
Personal loans			49.5	
Total loans before provisions			4,189.9	

1. During 2016 the Group received enriched data for BTL/SME items and has subsequently reclassified the 2015 comparatives for funding line items. In 2015 the Group made an assumption that all funding lines have LTVs in the 60%–70% band

LTV analysis by band for BTL/SME:

Group	**As at 31-Dec-16** Buy-to-Let £m	**Commercial £m**	**Residential development £m**	**Funding lines £m**	**Total £m**
Band					
0%–50%	**534.1**	**85.2**	**104.7**	**31.9**	**755.9**
50%–60%	**750.4**	**67.1**	**23.5**	**18.6**	**859.6**
60%–70%	**1,096.8**	**71.0**	**13.4**	**21.2**	**1,202.4**
70%–80%	**1,006.2**	**35.0**	**–**	**–**	**1,041.2**
80%–90%	**193.0**	**1.8**	**–**	**–**	**194.8**
90%–100%	**5.0**	**–**	**–**	**–**	**5.0**
>100%	**27.8**	**8.2**	**–**	**–**	**36.0**
Total mortgages before provisions	**3,613.3**	**268.3**	**141.6**	**71.7**	**4,094.9**

Group	As at 31-Dec-15 Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Band					
0%–50%	376.2	58.7	17.3	–	452.2
50%–60%	517.6	50.5	50.2	–	618.3
60%–70%	793.2	75.6	22.0	69.8	960.6
70%–80%	736.8	37.7	5.5	–	780.0
80%–90%	255.3	3.7	–	–	259.0
90%–100%	8.6	1.4	–	–	10.0
>100%	22.8	2.6	–	–	25.4
Total mortgages before provisions	2,710.5	230.2	95.0	69.8	3,105.5

Bank	**As at 31-Dec-16** Buy-to-Let £m	**Commercial £m**	**Residential development £m**	**Funding lines £m**	**Total £m**
Band					
0%–50%	**458.6**	**17.8**	**104.7**	**31.9**	**613.0**
50%–60%	**613.2**	**8.4**	**23.5**	**18.6**	**663.7**
60%–70%	**905.1**	**0.3**	**13.4**	**21.2**	**940.0**
70%–80%	**891.2**	**1.3**	**–**	**–**	**892.5**
80%–90%	**157.8**	**–**	**–**	**–**	**157.8**
90%–100%	**1.1**	**–**	**–**	**–**	**1.1**
>100%	**17.7**	**4.3**	**–**	**–**	**22.0**
Total mortgages before provisions	**3,044.7**	**32.1**	**141.6**	**71.7**	**3,290.1**

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35. Risk management and financial instruments continued

Bank	As at 31-Dec-15 Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Band					
0%–50%	313.4	9.1	17.3	–	339.8
50%–60%	437.8	16.0	50.2	–	504.0
60%–70%	640.1	3.7	22.0	69.8	735.6
70%–80%	598.7	–	5.5	–	604.2
80%–90%	238.0	1.3	–	–	239.3
90%–100%	6.1	–	–	–	6.1
>100%	13.5	–	–	–	13.5
Total mortgages before provisions	2,247.6	30.1	95.0	69.8	2,442.5

Loan to value analysis by band for Residential:

Group	**As at 31-Dec-16 First charge £m**	**Second charge £m**	**Funding lines £m**	**Total £m**
Band				
0%–50%	**579.6**	**154.5**	**27.6**	**761.7**
50%–60%	**166.4**	**103.1**	**9.2**	**278.7**
60%–70%	**173.3**	**102.3**	**7.1**	**282.7**
70%–80%	**188.3**	**64.0**	**4.8**	**257.1**
80%–90%	**168.3**	**27.2**	**1.4**	**196.9**
90%–100%	**31.9**	**16.0**	**0.1**	**48.0**
>100%	**14.3**	**20.1**	**0.4**	**34.8**
Total mortgages before provisions	**1,322.1**	**487.2**	**50.6**	**1,859.9**

Group	As at 31-Dec-15 First charge £m	Second charge £m	Funding lines £m	Total £m
Band				
0%–50%	616.4	152.7	2.2	771.3
50%–60%	217.8	111.8	2.1	331.7
60%–70%	205.3	116.6	42.2	364.1
70%–80%	210.8	85.5	7.0	303.3
80%–90%	137.8	31.7	2.5	172.0
90%–100%	31.9	11.3	–	43.2
>100%	13.2	8.2	0.1	21.5
Total mortgages before provisions	1,433.2	517.8	56.1	2,007.1

Bank	**As at 31-Dec-16 First charge £m**	**Second charge £m**	**Funding lines £m**	**Total £m**
Band				
0%–50%	**532.7**	**154.5**	**27.6**	**714.8**
50%–60%	**138.8**	**103.1**	**9.2**	**251.1**
60%–70%	**140.3**	**102.3**	**7.1**	**249.7**
70%–80%	**138.0**	**64.0**	**4.8**	**206.8**
80%–90%	**100.9**	**27.2**	**1.4**	**129.5**
90%–100%	**22.3**	**16.0**	**0.1**	**38.4**
>100%	**2.3**	**20.1**	**0.4**	**22.8**
Total mortgages before provisions	**1,075.3**	**487.2**	**50.6**	**1,613.1**

35. Risk management and financial instruments continued

Bank	First charge £m	Second charge £m	Funding lines £m	Total £m
	As at 31-Dec-15			
Band				
0%–50%	530.0	152.7	2.2	684.9
50%–60%	170.9	111.8	2.1	284.8
60%–70%	156.1	116.6	42.2	314.9
70%–80%	153.1	85.5	7.0	245.6
80%–90%	87.6	31.7	2.5	121.8
90%–100%	23.8	11.3	–	35.1
>100%	2.5	8.2	0.1	10.8
Total mortgages before provisions	1,124.0	517.8	56.1	1,697.9

Analysis of mortgage portfolio by arrears and collateral held

The tables below provide further information on collateral in the mortgage portfolio by payment due status. Capped collateral only recognises collateral to the value of each individual mortgage and does not recognise over-collateralisation. The collateral position by LTV bands is captured in the LTV analysis above.

In 2016 there was an update to the provision categorisation where collectively assessed provisions on loans greater than 3 months in arrears are now treated as specific, in addition to those that are individually assessed, as disclosed in note 16. The 2015 comparatives have not been restated.

Below is a summary of capped collateral:

	Group As at 31-Dec-16		Group[1] As at 31-Dec-15	
	Loan balance £m	**Capped collateral £m**	Loan balance £m	Capped collateral £m
Not past due and not impaired	**5,478.4**	**5,464.5**	4,678.1	4,658.6
Past due but not impaired	**395.9**	**395.8**	389.0	388.4
Impaired	**80.5**	**69.1**	45.5	40.4
Total mortgages before provisions	**5,954.8**	**5,929.4**	5,112.6	5,087.4
Personal loans	**9.4**		49.5	
Total loans before provisions	**5,964.2**		5,162.1	

	Bank As at 31-Dec-16		Bank[1] As at 31-Dec-15	
	Loan balance £m	**Capped collateral £m**	Loan balance £m	Capped collateral £m
Not past due and not impaired	**4,494.3**	**4,481.3**	3,770.3	3,751.3
Past due but not impaired	**349.1**	**349.0**	340.2	339.8
Impaired	**59.8**	**50.9**	29.9	26.1
Total mortgages before provisions	**4,903.2**	**4,881.2**	4,140.4	4,117.2
Personal loans	**9.4**		49.5	
Total loans before provisions	**4,912.6**		4,189.9	

1. During 2016 the Group received revised data for impairments and has subsequently restated the 2015 comparatives

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35. Risk management and financial instruments continued

A breakdown of the table above by payment due status is as follows:

	Group As at 31-Dec-16		Group As at 31-Dec-15	
	Loan balance £m	**Capped collateral £m**	Loan balance RESTATED £m	Capped collateral RESTATED £m
Not impaired:				
Not past due	**5,478.4**	**5,464.5**	4,678.1	4,658.6
Past due < 1 month	**183.5**	**183.5**	210.5	210.4
Past due 1 to 3 months	**168.2**	**168.2**	90.5	90.4
Past due 3 to 6 months	**24.4**	**24.3**	37.8	37.4
Past due 6 to 12 months	**12.8**	**12.8**	26.3	26.3
Past due over 12 months	**6.2**	**6.2**	22.6	22.6
Possessions[1]	**0.8**	**0.8**	1.3	1.3
	5,874.3	**5,860.3**	5,067.1	5,047.0
Impaired[2]:				
Not past due	**3.2**	**0.4**	13.5	13.0
Past due < 1 month	**1.0**	**1.0**	0.1	0.1
Past due 1 to 3 months	**1.2**	**1.2**	0.3	0.3
Past due 3 to 6 months	**14.8**	**14.8**	2.7	2.6
Past due 6 to 12 months	**16.3**	**16.2**	5.3	4.5
Past due over 12 months	**31.8**	**24.9**	12.5	9.7
Possessions	**12.2**	**10.6**	11.1	10.2
	80.5	**69.1**	45.5	40.4
Total mortgages before provisions	**5,954.8**	**5,929.4**	5,112.6	5,087.4
Personal loans	**9.4**		49.5	
Total loans before provisions	**5,964.2**		5,162.1	

	Bank As at 31-Dec-16		Bank As at 31-Dec-15	
	Loan balance £m	**Capped collateral £m**	Loan balance RESTATED £m	Capped collateral RESTATED £m
Not impaired:				
Not past due	**4,494.3**	**4,481.3**	3,770.3	3,751.3
Past due < 1 month	**162.2**	**162.2**	185.5	185.5
Past due 1 to 3 months	**146.8**	**146.7**	78.8	78.8
Past due 3 to 6 months	**21.5**	**21.5**	35.1	34.7
Past due 6 to 12 months	**12.1**	**12.1**	20.8	20.8
Past due over 12 months	**5.7**	**5.7**	19.1	19.1
Possessions[1]	**0.8**	**0.8**	0.9	0.9
	4,843.4	**4,830.3**	4,110.5	4,091.1
Impaired[2]:				
Not past due	**2.7**	**0.4**	13.0	12.6
Past due < 1 month	**0.5**	**0.5**	–	–
Past due 1 to 3 months	**–**	**–**	–	–
Past due 3 to 6 months	**12.5**	**12.5**	0.5	0.5
Past due 6 to 12 months	**12.9**	**12.9**	2.8	2.0
Past due over 12 months	**26.7**	**20.1**	9.2	6.6
Possessions	**4.5**	**4.5**	4.4	4.4
	59.8	**50.9**	29.9	26.1
Total mortgages before provisions	**4,903.2**	**4,881.2**	4,140.4	4,117.2
Personal loans	**9.4**		49.5	
Total loans before provisions	**4,912.6**		4,189.9	

1. Mortgages with properties in possession are not considered impaired if the fair value of collateral exceeds the value of debt
2. Impaired is defined as loans with a specific provision against them

35. Risk management and financial instruments continued

Analysis of mortgage portfolio by arrears for BTL/SME

Group	As at 31-Dec-16				
	Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Not impaired:					
Not past due	3,468.7	252.9	141.6	71.7	3,934.9
Past due < 1 month	62.5	3.3	–	–	65.8
Past due 1 to 3 months	56.5	1.1	–	–	57.6
Past due 3 to 6 months	2.0	0.3	–	–	2.3
Past due 6 to 12 months	0.4	0.7	–	–	1.1
Past due over 12 months	–	0.3	–	–	0.3
	3,590.1	258.6	141.6	71.7	4,062.0
Impaired:					
Not past due	2.5	0.1	–	–	2.6
Past due < 1 month	–	0.4	–	–	0.4
Past due 1 to 3 months	–	0.3	–	–	0.3
Past due 3 to 6 months	1.1	0.2	–	–	1.3
Past due 6 to 12 months	2.3	0.1	–	–	2.4
Past due over 12 months	9.0	6.0	–	–	15.0
Possessions	8.3	2.6	–	–	10.9
	23.2	9.7	–	–	32.9
Total mortgages before provisions	3,613.3	268.3	141.6	71.7	4,094.9

Group	As at 31-Dec-15				
	Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Not impaired:					
Not past due	2,593.0	214.7	95.0	69.8	2,972.5
Past due < 1 month	72.2	3.6	–	–	75.8
Past due 1 to 3 months	13.4	0.7	–	–	14.1
Past due 3 to 6 months	0.4	0.9	–	–	1.3
Past due 6 to 12 months	1.7	1.4	–	–	3.1
Past due over 12 months	0.7	0.4	–	–	1.1
	2,681.4	221.7	95.0	69.8	3,067.9
Impaired:					
Not past due	8.9	4.4	–	–	13.3
Past due < 1 month	–	0.1	–	–	0.1
Past due 1 to 3 months	–	0.1	–	–	0.1
Past due 3 to 6 months	0.4	0.5	–	–	0.9
Past due 6 to 12 months	3.4	–	–	–	3.4
Past due over 12 months	8.7	0.7	–	–	9.4
Possessions	7.7	2.7	–	–	10.4
	29.1	8.5	–	–	37.6
Total mortgages before provisions	2,710.5	230.2	95.0	69.8	3,105.5

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35. Risk management and financial instruments continued

Bank	As at 31-Dec-16 Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Not impaired:					
Not past due	**2,922.4**	**25.1**	**141.6**	**71.7**	**3,160.8**
Past due < 1 month	**53.6**	**1.4**	**–**	**–**	**55.0**
Past due 1 to 3 months	**50.2**	**0.3**	**–**	**–**	**50.5**
Past due 3 to 6 months	**0.6**	**–**	**–**	**–**	**0.6**
Past due 6 to 12 months	**0.4**	**–**	**–**	**–**	**0.4**
Past due over 12 months	**–**	**0.3**	**–**	**–**	**0.3**
	3,027.2	**27.1**	**141.6**	**71.7**	**3,267.6**
Impaired:					
Not past due	**2.6**	**0.1**	**–**	**–**	**2.7**
Past due < 1 month	**–**	**–**	**–**	**–**	**–**
Past due 1 to 3 months	**–**	**–**	**–**	**–**	**–**
Past due 3 to 6 months	**0.8**	**–**	**–**	**–**	**0.8**
Past due 6 to 12 months	**1.2**	**–**	**–**	**–**	**1.2**
Past due over 12 months	**8.5**	**4.9**	**–**	**–**	**13.4**
Possessions	**4.4**	**–**	**–**	**–**	**4.4**
	17.5	**5.0**	**–**	**–**	**22.5**
Total mortgages before provisions	**3,044.7**	**32.1**	**141.6**	**71.7**	**3,290.1**

Bank	As at 31-Dec-15 Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Not impaired:					
Not past due	2,151.2	23.5	95.0	69.8	2,339.5
Past due < 1 month	60.9	1.0	–	–	61.9
Past due 1 to 3 months	10.6	0.5	–	–	11.1
Past due 3 to 6 months	0.1	–	–	–	0.1
Past due 6 to 12 months	–	0.9	–	–	0.9
	2,222.8	25.9	95.0	69.8	2,413.5
Impaired:					
Not past due	8.8	4.2	–	–	13.0
Past due 6 to 12 months	2.8	–	–	–	2.8
Past due over 12 months	8.8	–	–	–	8.8
Possessions	4.4	–	–	–	4.4
	24.8	4.2	–	–	29.0
Total mortgages before provisions	2,247.6	30.1	95.0	69.8	2,442.5

35. Risk management and financial instruments continued

Analysis of mortgage portfolio by arrears for Residential

Group	As at 31-Dec-16 First charge £m	Second charge £m	Funding lines £m	Total £m
Not impaired:				
Not past due	**1,100.6**	**392.3**	**50.6**	**1,543.5**
Past due < 1 month	**99.8**	**17.9**	**–**	**117.7**
Past due 1 to 3 months	**80.2**	**30.4**	**–**	**110.6**
Past due 3 to 6 months	**12.8**	**9.3**	**–**	**22.1**
Past due 6 to 12 months	**5.0**	**6.7**	**–**	**11.7**
Past due over 12 months	**2.8**	**3.1**	**–**	**5.9**
Possessions	**0.8**	**–**	**–**	**0.8**
	1,302.0	**459.7**	**50.6**	**1,812.3**
Impaired:				
Not past due	**0.6**	**–**	**–**	**0.6**
Past due < 1 month	**0.6**	**–**	**–**	**0.6**
Past due 1 to 3 months	**0.9**	**–**	**–**	**0.9**
Past due 3 to 6 months	**6.0**	**7.5**	**–**	**13.5**
Past due 6 to 12 months	**5.8**	**8.1**	**–**	**13.9**
Past due over 12 months	**4.9**	**11.9**	**–**	**16.8**
Possessions	**1.3**	**–**	**–**	**1.3**
	20.1	**27.5**	**–**	**47.6**
Total mortgages before provisions	**1,322.1**	**487.2**	**50.6**	**1,859.9**

Group	As at 31-Dec-15 First charge £m	Second charge £m	Funding lines £m	Total £m
Not impaired:				
Not past due	1,255.1	394.4	56.1	1,705.6
Past due < 1 month	90.7	44.0	–	134.7
Past due 1 to 3 months	43.6	32.8	–	76.4
Past due 3 to 6 months	18.9	17.6	–	36.5
Past due 6 to 12 months	10.2	13.0	–	23.2
Past due over 12 months	5.5	16.0	–	21.5
Possessions	1.3	–	–	1.3
	1,425.3	517.8	56.1	1,999.2
Impaired:				
Not past due	0.2	–	–	0.2
Past due < 1 month	–	–	–	–
Past due 1 to 3 months	0.2	–	–	0.2
Past due 3 to 6 months	1.8	–	–	1.8
Past due 6 to 12 months	1.9	–	–	1.9
Past due over 12 months	3.1	–	–	3.1
Possessions	0.7	–	–	0.7
	7.9	–	–	7.9
Total mortgages before provisions	1,433.2	517.8	56.1	2,007.1

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35. Risk management and financial instruments continued

Bank	As at 31-Dec-16 First charge £m	Second charge £m	Funding lines £m	Total £m
Not impaired:				
Not past due	**890.6**	**392.3**	**50.6**	**1,333.5**
Past due < 1 month	**89.3**	**17.9**	**–**	**107.2**
Past due 1 to 3 months	**65.9**	**30.4**	**–**	**96.3**
Past due 3 to 6 months	**11.6**	**9.3**	**–**	**20.9**
Past due 6 to 12 months	**5.0**	**6.7**	**–**	**11.7**
Past due over 12 months	**2.3**	**3.1**	**–**	**5.4**
Possessions	**0.8**	**–**	**–**	**0.8**
	1,065.5	**459.7**	**50.6**	**1,575.8**
Impaired:				
Not past due	**–**	**–**	**–**	**–**
Past due < 1 month	**0.5**	**–**	**–**	**0.5**
Past due 1 to 3 months	**–**	**–**	**–**	**–**
Past due 3 to 6 months	**4.2**	**7.5**	**–**	**11.7**
Past due 6 to 12 months	**3.6**	**8.1**	**–**	**11.7**
Past due over 12 months	**1.4**	**11.9**	**–**	**13.3**
Possessions	**0.1**	**–**	**–**	**0.1**
	9.8	**27.5**	**–**	**37.3**
Total mortgages before provisions	**1,075.3**	**487.2**	**50.6**	**1,613.1**

Bank	As at 31-Dec-15 First charge £m	Second charge £m	Funding lines £m	Total £m
Not impaired:				
Not past due	980.3	394.4	56.1	1,430.8
Past due < 1 month	79.6	44.0	–	123.6
Past due 1 to 3 months	34.9	32.8	–	67.7
Past due 3 to 6 months	17.4	17.6	–	35.0
Past due 6 to 12 months	6.9	13.0	–	19.9
Past due over 12 months	3.1	16.0	–	19.1
Possessions	0.9	–	–	0.9
	1,123.1	517.8	56.1	1,697.0
Impaired:				
Not past due	–	–	–	–
Past due < 1 month	–	–	–	–
Past due 1 to 3 months	–	–	–	–
Past due 3 to 6 months	0.5	–	–	0.5
Past due 6 to 12 months	–	–	–	–
Past due over 12 months	0.4	–	–	0.4
Possessions	–	–	–	–
	0.9	–	–	0.9
Total mortgages before provisions	1,124.0	517.8	56.1	1,697.9

35. Risk management and financial instruments continued

Analysis of personal loans by arrears

The arrears analysis of unsecured personal loans is provided in the table below:

Group and Bank	As at 31-Dec-16 £m	As at 31-Dec-15 £m
Not impaired:		
Not past due	**8.7**	40.9
Past due up to 3 months	**0.2**	1.1
Past due 3 to 6 months	**–**	1.0
Past due 6 to 12 months	**–**	1.5
Past due over 12 months	**–**	5.0
	8.9	49.5
Impaired:		
Past due 3 to 6 months	**0.2**	–
Past due 6 to 12 months	**0.3**	–
	0.5	–
Total personal loans before provisions	**9.4**	49.5

Geographical analysis by region

An analysis of loans by region is provided below:

	Group As at 31-Dec-16		Group As at 31-Dec-15	
Region	£m	%	£m	%
East Anglia	**182.2**	**3%**	146.9	3%
East Midlands	**204.5**	**3%**	173.6	3%
Greater London	**2,543.1**	**43%**	2,116.4	42%
Guernsey	**93.4**	**2%**	110.5	2%
Jersey	**282.0**	**5%**	340.2	7%
North East	**90.3**	**2%**	74.0	1%
North West	**273.2**	**5%**	247.9	5%
Northern Ireland	**16.8**	**–**	15.7	–
Scotland	**56.1**	**1%**	64.7	1%
South East	**1,278.5**	**21%**	1,020.6	21%
South West	**380.6**	**6%**	324.2	6%
Wales	**114.7**	**2%**	105.6	2%
West Midlands	**308.6**	**5%**	257.0	5%
Yorks and Humberside	**130.8**	**2%**	115.3	2%
Total mortgages before provisions	**5,954.8**	**100%**	5,112.6	100%
Personal loans	**9.4**		49.5	
Total loans before provisions	**5,964.2**		5,162.1	

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35. Risk management and financial instruments continued

Region	Bank As at 31-Dec-16 £m	Bank As at 31-Dec-16 %	Bank As at 31-Dec-15 £m	Bank As at 31-Dec-15 %
East Anglia	**159.7**	**3%**	131.9	3%
East Midlands	**164.8**	**3%**	140.7	3%
Greater London	**2,234.3**	**46%**	1,872.1	45%
North East	**74.6**	**2%**	65.1	2%
North West	**228.4**	**5%**	213.5	5%
Northern Ireland	**16.4**	**–**	15.2	–
Scotland	**55.3**	**1%**	63.7	2%
South East	**1,161.7**	**24%**	938.3	23%
South West	**335.4**	**7%**	288.4	7%
Wales	**102.2**	**2%**	95.3	2%
West Midlands	**272.7**	**5%**	230.7	6%
Yorks and Humberside	**97.7**	**2%**	85.5	2%
Total mortgages before provisions	**4,903.2**	**100%**	4,140.4	100%
Personal loans	**9.4**		49.5	
Total loans before provisions	**4,912.6**		4,189.9	

Credit risk – investment securities and loans and advances to credit institutions

The Group holds treasury instruments in order to meet liquidity requirements and for general business purposes. The credit risk arising from these investments is closely monitored and managed by the Group's treasury department. In managing these assets, Group treasury operates within guidelines laid down in the treasury policy approved by the Board and performance is monitored and reported to ALCO monthly, including through the use of an internally developed rating model based on counterparty credit default swap spreads.

The Group has limited exposure to emerging markets (Indian operations) and non-investment-grade debt. The ALCO is responsible for approving treasury counterparties.

During the year, the average balance of cash in hand, loans and advances to credit institutions and investment securities on a monthly basis was £678.8m (2015: £703.0m).

As at 31-Dec-16	**Group AAA £m**	**AA £m**	**A+ £m**	**A £m**	**Less than A rating £m**	**Unrated £m**	**Total £m**
Bank of England[1]	**–**	**401.0**	**–**	**–**	**–**	**–**	**401.0**
Call accounts	**–**	**1.5**	**0.5**	**4.4**	**10.4**	**–**	**16.8**
Floating rate notes	**29.1**	**–**	**–**	**–**	**–**	**–**	**29.1**
Treasury bills	**–**	**112.6**	**–**	**–**	**–**	**–**	**112.6**
Total	**29.1**	**515.1**	**0.5**	**4.4**	**10.4**	**–**	**559.5**

As at 31-Dec-15	Group AAA £m	AA £m	A+ £m	A £m	Less than A rating £m	Unrated £m	Total £m
Bank of England[1]	311.5	–	–	–	–	–	311.5
Call accounts	–	29.4	–	2.5	9.9	1.4	43.2
Floating rate notes	34.1	–	–	–	–	–	34.1
Treasury bills	359.3	–	–	–	–	–	359.3
Total	704.9	29.4	–	2.5	9.9	1.4	748.1

35. Risk management and financial institutions continued

As at 31-Dec-16	Bank						
	AAA £m	AA £m	A+ £m	A £m	Less than A rating £m	Unrated £m	Total £m
Bank of England[1]	–	401.0	–	–	–	–	401.0
Call accounts	–	1.5	0.5	4.4	6.1	–	12.5
Floating rate notes	29.1	–	–	–	–	–	29.1
Treasury bills	–	112.6	–	–	–	–	112.6
Total	29.1	515.1	0.5	4.4	6.1	–	555.2

As at 31-Dec-15	Bank						
	AAA £m	AA £m	A+ £m	A £m	Less than A rating £m	Unrated £m	Total £m
Bank of England[1]	311.5	–	–	–	–	–	311.5
Call accounts	–	–	–	2.5	9.4	–	11.9
Floating rate notes	34.1	–	–	–	–	–	34.1
Treasury bills	359.3	–	–	–	–	–	359.3
Total	704.9	–	–	2.5	9.4	–	716.8

1. Balances with the Bank of England include £9.1m (2015: £8.2m) held in the cash ratio deposit

Industry sector/asset class

	Group As at 31-Dec-16		Group As at 31-Dec-15	
	£m	%	£m	%
Bank of England[1]	401.0	72%	311.5	42%
Other banks	16.8	3%	43.2	6%
Central government	112.6	20%	359.3	47%
Supranationals	29.1	5%	34.1	5%
Total	559.5	100%	748.1	100%

	Bank As at 31-Dec-16		Bank As at 31-Dec-15	
	£m	%	£m	%
Bank of England[1]	401.0	73%	311.5	43%
Other banks	12.5	2%	11.9	2%
Central government	112.6	20%	359.3	50%
Supranationals	29.1	5%	34.1	5%
Total	555.2	100%	716.8	100%

1. Balances with the Bank of England include £9.1m (2015: £8.2m) held in the cash ratio deposit

Geographical exposure

	Group As at 31-Dec-16		Group As at 31-Dec-15	
	£m	%	£m	%
United Kingdom	525.6	94%	683.2	91%
Rest of Europe	29.1	5%	34.1	5%
Canada	1.5	–	–	–
Australia	–	–	29.4	4%
India	3.3	1%	1.4	–
Total	559.5	100%	748.1	100%

NOTES TO THE FINANCIAL STATEMENTS CONTINUED
FOR THE YEAR ENDED 31 DECEMBER 2016

35. Risk management and financial institutions continued

	Bank As at 31-Dec-16		Bank As at 31-Dec-15	
	£m	%	£m	%
United Kingdom	**524.6**	**95%**	682.7	95%
Rest of Europe	**29.1**	**5%**	34.1	5%
Canada	**1.5**	**–**	–	–
Total	**555.2**	**100%**	716.8	100%

The Group monitors exposure concentrations against a variety of criteria, including asset class, sector and geography. To avoid refinancing risks associated with any one counterparty, sector or geographical region, the Board has set appropriate limits. These are contained in the treasury policy.

Liquidity risk

Liquidity risk is the risk of having insufficient liquid assets to fulfil obligations as they become due or the cost of raising liquid funds becoming too expensive.

The Group's approach to managing liquidity risk is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding in order to retain full public confidence in the solvency of the Group and to enable the Group to meet its financial obligations. This is achieved through maintaining a prudent level of liquid assets and control of the growth of the business. The Group has established a reserve account with the Bank of England and has access to its contingent liquidity facilities.

Liquidity management is the responsibility of the ALCO, with day-to-day management delegated to treasury as detailed in the treasury policy. The ALCO is responsible for setting limits over the level and maturity profile of wholesale funding and for monitoring the composition of the Group financial position.

For each material class of financial liability a contractual maturity analysis is provided in notes 24 to 30.

The Group also monitors a range of numeric triggers, defined in the contingency funding plan ('CFP') and Recovery and Resolution Plan ("RRP"), which are designed to capture liquidity stresses in advance in order to allow sufficient time for management action to take effect.

These are monitored daily by the risk team, with breaches immediately reported to the Chief Risk Officer, Deputy Chief Risk Officer, CEO, CFO and Head of Treasury.

The following table provides an analysis of the Group's gross contractual cash flows payable under financial liabilities:

	Group				
As at 31-Dec-16	**Up to 3 months £m**	**3–12 months £m**	**1–5 years £m**	**More than 5 years £m**	**Total £m**
Amounts owed to retail depositors	**2,648.9**	**2,026.0**	**1,418.8**	**–**	**6,093.7**
Amounts owed to credit institutions and other customers	**4.6**	**0.2**	**101.8**	**–**	**106.6**
Derivative financial instruments	**1.3**	**4.9**	**9.9**	**9.5**	**25.6**
Other liabilities	**18.6**	**–**	**–**	**–**	**18.6**
Subordinated liabilities	**3.0**	**8.6**	**7.2**	**6.8**	**25.6**
Perpetual subordinated bonds	**0.4**	**0.4**	**3.6**	**15.0**	**19.4**
Total liabilities	**2,676.8**	**2,040.1**	**1,541.3**	**31.3**	**6,289.5**
Off balance sheet loan commitments	**365.4**	**–**	**–**	**–**	**365.4**

35. Risk management and financial institutions continued

As at 31-Dec-15	Group				
	Up to 3 months £m	3–12 months £m	1–5 years £m	More than 5 years £m	Total £m
Amounts owed to retail depositors	2,304.5	1,974.4	1,182.6	–	5,461.5
Amounts owed to credit institutions and other customers	6.9	–	0.1	–	7.0
Debt securities in issue	9.6	37.7	146.6	–	193.9
Derivative financial instruments	0.7	5.3	7.2	8.3	21.5
Other liabilities	18.9	–	–	–	18.9
Subordinated liabilities	0.3	8.8	16.7	0.7	26.5
Perpetual subordinated bonds	0.3	0.9	4.7	15.0	20.9
Total liabilities	2,341.2	2,027.1	1,357.9	24.0	5,750.2
Off balance sheet loan commitments	339.0	–	–	–	339.0

As at 31-Dec-16	**Bank**				
	Up to 3 months £m	**3–12 months £m**	**1–5 years £m**	**More than 5 years £m**	**Total £m**
Amounts owed to retail depositors	**2,648.9**	**2,026.0**	**1,418.8**	**–**	**6,093.7**
Amounts owed to credit institutions and other customers	**4.6**	**0.2**	**101.8**	**–**	**106.6**
Derivative financial instruments	**1.3**	**4.9**	**9.9**	**9.5**	**25.6**
Other liabilities	**7.4**	**–**	**–**	**–**	**7.4**
Subordinated liabilities	**3.0**	**8.6**	**7.2**	**6.8**	**25.6**
Perpetual subordinated bonds	**0.4**	**0.4**	**3.6**	**15.0**	**19.4**
Total liabilities	**2,665.6**	**2,040.1**	**1,541.3**	**31.3**	**6,278.3**
Off balance sheet loan commitments	**297.2**	**–**	**–**	**–**	**297.2**

As at 31-Dec-15	Bank				
	Up to 3 months £m	3–12 months £m	1–5 years £m	More than 5 years £m	Total £m
Amounts owed to retail depositors	2,304.5	1,974.4	1,182.6	–	5,461.5
Amounts owed to credit institutions and other customers	6.9	–	0.1	–	7.0
Derivative financial instruments	0.7	5.3	7.2	8.3	21.5
Other liabilities	9.5	–	–	–	9.5
Subordinated liabilities	0.3	8.8	16.7	0.7	26.5
Perpetual subordinated bonds	0.3	0.9	4.7	15.0	20.9
Total liabilities	2,322.2	1,989.4	1,211.3	24.0	5,546.9
Off balance sheet loan commitments	317.3	–	–	–	317.3

The actual repayment profile of retail deposits may differ from the analysis above due to the option of early withdrawal with a penalty.

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35. Risk management and financial institutions continued
Asset encumbrance levels are monitored monthly at ALCO. The following table provides an analysis of the Group's encumbered and unencumbered assets:

	Group		Group	
	As at 31-Dec-16		As at 31-Dec-15	
	Encumbered £m	Unencumbered £m	Encumbered £m	Unencumbered £m
Cash in hand	–	0.4	–	0.4
Loans and advances to credit institutions	15.5	402.3	39.0	315.7
Investment securities	–	141.7	–	393.4
Loans and advances to customers	1,435.3	4,503.9	749.3	4,385.5
Derivative assets	–	1.8	–	1.0
Fair value hedges – assets	–	46.9	–	58.2
Deferred taxation asset	–	3.4	–	3.4
Intangible assets	–	4.7	–	3.1
Property, plant and equipment	–	13.1	–	9.6
Other assets	–	11.9	–	11.8
	1,450.8	5,130.1	788.3	5,182.1

	Bank		Bank	
	As at 31-Dec-16		As at 31-Dec-15	
	Encumbered £m	Unencumbered £m	Encumbered £m	Unencumbered £m
Cash in hand	–	0.4	–	0.4
Loans and advances to credit institutions	15.5	398.0	9.6	313.8
Investment securities	–	141.7	–	393.4
Loans and advances to customers	1,435.3	3,458.2	749.3	3,417.3
Derivative assets	–	1.8	–	1.0
Fair value hedges – assets	–	46.9	–	58.2
Deferred taxation asset	–	0.8	–	0.7
Intangible assets	–	4.1	–	2.7
Property, plant and equipment	–	9.9	–	7.0
Investments in subsidiaries and intercompany loans	–	984.0	–	944.5
Other assets	–	3.8	–	5.4
	1,450.8	5,049.6	758.9	5,144.4

Market risk
Market risk is the risk of an adverse change in Group income or the Group's net worth arising from movement in interest rates, exchange rates or other market prices. Market risk exists, to some extent, in all the Group's businesses. The Group recognises that the effective management of market risk is essential to the maintenance of stable earnings and preservation of shareholder value.

Interest rate risk
The primary market risk faced by the Group is interest rate risk. Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. It is most prevalent in mortgage lending where fixed rate mortgages are not funded by fixed rate deposits of the same duration, or where the fixed rate risk is not hedged by a fully matching interest rate derivative.

The Group is exposed to movements in interest rates reflecting the mismatch between the dates on which interest receivable on assets and interest payable on liabilities are next reset to market rates or, if earlier, the dates on which the instruments mature. Exposure is mitigated on a continuous basis through the use of derivatives and reserve allocations within limits set by the ALCO and the Board (currently 1.5% of common equity tier 1 capital ('CET1')).

The Group measures interest rate risk using 14 different interest rate curve shift scenarios designed to emulate a full range of market movements. These 14 scenarios are defined by ALCO and are based on three 'shapes' of curve movement (shift, twist and flex) with movements in rates scaled to approximate the potential move over one year at 99.9% two-tailed confidence interval with interest rates floored to zero. In addition, the regulatory scenario of an un-floored parallel shift of 200bps in both directions

35. Risk management and financial institutions continued

is applied. After taking into account the derivatives entered into by the Group, the maximum loss under these scenarios as at 31 December 2016 would have been £1.9m and the maximum gain £2.1m. Against a parallel interest rate movement of 2%, the impact would have been a £3.9m gain (2015: £0.2m gain) recognised in the statement of profit or loss.

There is no material difference between the interest rate risk profile for the Group and that for the Bank.

Foreign exchange rate risk

The Group has limited exposure to foreign exchange risk in respect of its Indian operations. A 5% movement in exchange rates would result in £0.1m (2015: £0.1m) effect in profit or loss and £0.2m (2015: £0.2m) in equity.

The Bank is not exposed to foreign exchange risk since all its assets and liabilities are expressed in Pounds Sterling.

Structured entities

The Group had no structured entities as at 31 December 2016, following the disposal of Rochester 1 during the year. Rochester 1 held legal title to a pool of mortgages which were used as a security for issued debt. The transfer of mortgages failed derecognition criteria because the Bank retained the remaining notes and residual certificates issued and as such did not transfer substantially the risks and rewards of ownership of the securitised mortgages. Therefore, the Group was exposed to the credit, interest rate and other risks on the securitised mortgages to the same extent as on the other mortgages. It mitigates these risks on a Group basis as discussed throughout this note.

Cash flows generated from the mortgages securitised within Rochester 1 were ring-fenced, i.e. could only be used to pay interest and principal of the issued debt securities in a waterfall order according to the seniority of bonds. The securitisation vehicle was self-funded and the Group was not contractually or constructively obliged to provide it further liquidity or financial support. The maximum loss exposure at any point in time was the amount of cash and cash equivalents held in Rochester 1.

Fair value adjustments for hedged items

This represents the fair value adjustments to the carrying value of financial assets and liabilities as a result of portfolio hedging.

Fair values of financial assets and financial liabilities

The following tables give a comparison of book and fair values of the Group's financial assets and liabilities at the reporting date.

	Carrying amount	Principal amount	Fair value			
Group 2016	£m	£m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial instruments measured at fair value						
Financial assets						
Investment securities	141.7	141.6	141.7	–	–	141.7
Derivative assets	1.8	2,267.1	–	1.8	–	1.8
	143.5	2,408.7	141.7	1.8	–	143.5
Financial liabilities						
Derivative liabilities	(24.4)	(612.4)	–	(24.4)	–	(24.4)
Financial instruments not measured at fair value						
Financial assets						
Cash in hand	0.4	0.4	–	0.4	–	0.4
Loans and advances to credit institutions	417.8	417.8	–	417.8	–	417.8
Loans and advances to customers	5,939.2	6,069.4	–	–	6,259.1	6,259.1
	6,357.4	6,487.6	–	418.2	6,259.1	6,677.3
Financial liabilities						
Amounts owed to retail depositors	(5,952.4)	(5,906.5)	–	(5,992.4)	–	(5,992.4)
Amounts owed to credit institutions	(101.7)	(101.6)	–	(101.7)	–	(101.7)
Amounts owed to other customers	(4.0)	(4.0)	–	(4.0)	–	(4.0)
Subordinated liabilities	(21.6)	(20.7)	–	(24.0)	–	(24.0)
Perpetual subordinated bonds	(15.3)	(15.0)	–	(17.2)	–	(17.2)
	(6,095.0)	(6,047.8)	–	(6,139.3)	–	(6,139.3)

NOTES TO THE FINANCIAL STATEMENTS CONTINUED
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35. Risk management and financial institutions continued

Group 2015	Carrying amount £m	Principal amount £m	Fair value Level 1 £m	Fair value Level 2 £m	Fair value Level 3 £m	Fair value Total £m
Financial instruments measured at fair value						
Financial assets						
Investment securities	393.4	394.0	393.4	–	–	393.4
Derivative assets	1.0	469.4	–	1.0	–	1.0
	394.4	863.4	393.4	1.0	–	394.4
Financial liabilities						
Derivative liabilities	(19.8)	(2,022.9)	–	(19.8)	–	(19.8)
Financial instruments not measured at fair value						
Financial assets						
Cash in hand	0.4	0.4	–	0.4	–	0.4
Loans and advances to credit institutions	354.7	350.5	–	354.7	–	354.7
Loans and advances to customers	5,134.8	5,307.4	–	–	5,459.3	5,459.3
	5,489.9	5,658.3	–	355.1	5,459.3	5,814.4
Financial liabilities						
Amounts owed to retail depositors	(5,363.8)	(5,317.3)	–	(5,405.3)	–	(5,405.3)
Amounts owed to credit institutions	(1.5)	(1.4)	–	(1.4)	–	(1.4)
Amounts owed to other customers	(5.9)	(5.6)	–	(5.6)	–	(5.6)
Debt securities in issue	(188.4)	(187.8)	–	–	(188.5)	(188.5)
Subordinated liabilities	(24.6)	(24.3)	–	(25.1)	–	(25.1)
Perpetual subordinated bonds	(15.3)	(15.0)	–	(17.8)	–	(17.8)
	(5,599.5)	(5,551.4)	–	(5,455.2)	(188.5)	(5,643.7)

Bank 2016	Carrying amount £m	Principal amount £m	Fair value Level 1 £m	Fair value Level 2 £m	Fair value Level 3 £m	Fair value Total £m
Financial instruments measured at fair value						
Financial assets						
Investment securities	141.7	141.6	141.7	–	–	141.7
Derivative assets	1.8	2,267.1	–	1.8	–	1.8
	143.5	2,408.7	141.7	1.8	–	143.5
Financial liabilities						
Derivative liabilities	(24.4)	(612.4)	–	(24.4)	–	(24.4)
Financial instruments not measured at fair value						
Financial assets						
Cash in hand	0.4	0.4	–	0.4	–	0.4
Loans and advances to credit institutions	413.5	413.5	–	413.5	–	413.5
Loans and advances to customers	4,893.5	5,015.0	–	–	5,167.7	5,167.7
Investments in group undertakings	984.0	984.0	–	984.0	–	984.0
	6,291.4	6,412.9	–	1,397.9	5,167.7	6,565.6
Financial liabilities						
Amounts owed to retail depositors	(5,952.4)	(5,906.5)	–	(5,992.4)	–	(5,992.4)
Amounts owed to credit institutions	(101.7)	(101.6)	–	(101.7)	–	(101.7)
Amounts owed to other customers	(4.0)	(4.0)	–	(4.0)	–	(4.0)
Subordinated liabilities	(21.6)	(20.7)	–	(24.0)	–	(24.0)
Perpetual subordinated bonds	(15.3)	(15.0)	–	(17.2)	–	(17.2)
	(6,095.0)	(6,047.8)	–	(6,139.3)	–	(6,139.3)

35. Risk management and financial institutions continued

Bank 2015	Carrying amount £m	Principal amount £m	Fair value Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial instruments measured at fair value						
Financial assets						
Investment securities	393.4	394.0	393.4	–	–	393.4
Derivative assets	1.0	469.4	–	1.0	–	1.0
	394.4	863.4	393.4	1.0	–	394.4
Financial liabilities						
Derivative liabilities	(19.8)	(2,022.9)	–	(19.8)	–	(19.8)
Financial instruments not measured at fair value						
Financial assets						
Cash in hand	0.4	0.4	–	0.4	–	0.4
Loans and advances to credit institutions	323.4	319.2	–	323.4	–	323.4
Loans and advances to customers	4,166.6	4,331.5	–	–	4,462.0	4,462.0
Investments in group undertakings	944.5	944.5	–	944.5	–	944.5
	5,434.9	5,595.6	–	1,268.3	4,462.0	5,730.3
Financial liabilities						
Amounts owed to retail depositors	(5,363.8)	(5,317.3)	–	(5,405.3)	–	(5,405.3)
Amounts owed to credit institutions	(1.5)	(1.4)	–	(1.4)	–	(1.4)
Amounts owed to other customers	(5.9)	(5.6)	–	(5.6)	–	(5.6)
Debt securities in issue	–	–	–	–	–	–
Subordinated liabilities	(24.6)	(24.3)	–	(25.1)	–	(25.1)
Perpetual subordinated bonds	(15.3)	(15.0)	–	(17.8)	–	(17.8)
	(5,411.1)	(5,363.6)	–	(5,455.2)	–	(5,455.2)

At the reporting date, all derivatives were covered by master netting agreements. In the absence of such agreements, a grossing up adjustment of £1.6m (2015: £2.4m) would be required.

Fair values are determined using the following fair value hierarchy that reflects the significance and observability of the inputs used in making the measurements:

Level 1
These are valuation techniques that are based entirely on quoted market prices (unadjusted) in an actively traded market for identical assets and liabilities that the Group has the ability to access. Valuation adjustments and block discounts are not applied to Level 1 instruments. Since valuations are based on readily available observable market prices, this makes them most reliable, reduces the need for management judgement and estimation and also reduces the uncertainty associated with determining fair values.

Level 2
These are valuation techniques based on one or more quoted prices in markets that are not active or for which all significant inputs are taken from directly or indirectly observable market data. These include valuation models used to calculate the present value of expected future cash flows and may be employed either when no active market exists or when there are quoted prices available for similar instruments in active markets.

The Group uses LIBOR curves to value its derivatives, however, using OIS curves would not materially change their value. The fair value of the Group's derivative financial instruments incorporates CVA and DVA. The DVA and CVA take into account the respective credit ratings of the Bank and counterparty and whether the derivative is collateralised or not. In considering which similar instruments to use, management takes into account the sensitivity of the instrument to changes in market rates and the credit quality of the instrument. Basis risk derivatives are valued using discounted cash flow models and observable market data and will be sensitive to benchmark interest rate curves.

The fair value of loans and advances to credit institutions, which is predominantly placements with the Bank of England; and investments in group undertakings, is estimated to be their carrying value.

The fair value of amounts owed to retail depositors, credit institutions and other customers, together with the Group's subordinated liabilities and perpetual subordinated bonds is estimated using discounted cash flow techniques, applying the rates that are offered for deposits of similar maturities and terms. The fair value of deposits payable on demand is the amount payable at the reporting date.

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35. Risk management and financial institutions continued

Level 3

These are valuation techniques for which any one or more significant input is not based on observable market data and the unobservable inputs have a significant effect on the instrument's fair value. Valuation models that employ significant unobservable inputs require a higher degree of management judgement and estimation in determining the fair value. Management judgement and estimation are usually required for the selection of the appropriate valuation model to be used, determination of expected future cash flows on the financial instruments being valued, determination of the probability of counterparty default and prepayments, determination of expected volatilities and correlations and selection of appropriate discount rates.

Valuation techniques for level 3 instruments may include net present value models, comparison to similar instruments with observable prices, Black-Scholes and other methods.

As disclosed in the tables above, financial instruments with fair value measured at level 3 include loans and advances to customers and debt securities in issue. Neither loans to customers nor debt securities in issue are measured at fair value in the statement of financial position.

Loans to customers belong to this level because their valuation uses unobservable inputs on collectability rates and redemption profiles. Their fair value is calculated using modelled receipts of interest and principal which are discounted at market rates.

Debt securities in issue are classified as level 3 because their principal is repaid using the cash flows from the underlying securitised mortgages, which in turn use the same unobservable inputs on collectability rates and redemption profiles. The fair value of issued debt securities is calculated using modelled payments of interest and principal discounted at market rates for similar instruments.

Loans to customers belong to this level because their valuation uses unobservable inputs on collectability rates and redemption profiles. Their fair value is calculated using modelled receipts of interest and principal which are discounted at market rates.

Debt securities in issue are classified as level 3 because their principal is repaid using the cash flows from the underlying securitised mortgages, which in turn use the same unobservable inputs on collectability rates and redemption profiles. The fair value of issued debt securities is calculated using modelled payments of interest and principal discounted at market rates for similar instruments.

36. Pension scheme

Defined contribution scheme

The amount charged to profit or loss in respect of contributions to the Group's defined contribution and stakeholder pension arrangements is the contribution payable in the period. The total pension cost in the year amounted to £1.1m (2015: £1.1m).

Defined benefit scheme

KRBS operated a defined benefit pension scheme (the 'Scheme') funded by the payment of contributions to a separately administered fund for nine retired members. The Society's Board decided to close the Scheme with effect from 31 December 2001 and introduced a new defined contribution scheme to cover service of Scheme members from 1 January 2002.

The Scheme Trustees, having taken actuarial advice, decided to wind up the Scheme rather than continue to operate it on a 'paid up' basis. The winding up is largely complete. As at 31 December 2016 the liability to remaining members is £2k (31 December 2015: £2k) matched by Scheme assets.

37. Capital management

The Group is governed by its capital management policy. The objectives of the Bank's capital management policy are to efficiently manage the capital base to optimise shareholder returns whilst maintaining capital adequacy and satisfying key stakeholders such as customers and regulators.

The Bank's prime objectives in relation to the management of capital are to comply with the requirements set out by the PRA, the Bank's primary prudential supervisor, to provide a sufficient capital base to cover business risks and support future business development.

Capital management is based on the three 'pillars' of Basel II. Under Pillar 1, the Bank calculates its minimum capital requirements based on 8% of risk weighted assets. The PRA then applies a multiplier to this amount to cover risks under Pillar 2 of Basel II and generates an individual capital guidance ('ICG'). As instructed by the PRA, the Bank manages and reports its capital on a solo consolidated basis and hence the Bank's capital position is not disclosed separately.

The Group's Pillar 1 capital information is presented in this note. To comply with Pillar 2, the Group completes an annual self-assessment of risks known as the internal capital adequacy assessment process ('ICAAP') reviewed by the PRA. Pillar 3 requires firms to publish a set of disclosures which allow market participants to assess information on that firm's capital, risk exposures and risk assessment process. The Group's Pillar 3 disclosures can be found on the Group's website.

On 1 January 2014, a new set of rules, Basel III came into force through the Capital Requirements Directive and Regulation ('CRD IV'). Basel III complements and enhances Basel I and II with additional safety measures. Basel III changed definitions of regulatory capital, introduced new capital buffers and liquidity ratios, and modified the way regulatory capital is calculated.

The ultimate responsibility for capital adequacy rests with the Board of Directors. The Bank's ALCO, which consists of the CEO, CFO and other senior executives, is responsible for the management of the capital process including approving policy, overseeing internal controls and setting internal limits over capital ratios.

The Bank actively manages its capital position and reports this on a regular basis to senior management via the ALCO and other governance committees. Capital requirements are included within budgets, reforecast and strategic plans with initiatives being executed against this plan.

During the period the Group complied with the capital requirements set out by the PRA.

	As at 31-Dec-16 £m	As at 31-Dec-15 £m
Common equity tier 1 capital		
Called up share capital	**2.4**	2.4
Share premium, capital contribution and share-based payment reserve	**166.0**	164.4
Retained earnings[1]	**217.0**	122.9
Transfer reserve	**(12.8)**	(12.8)
Other reserves	**–**	(0.1)
Deductions from common equity tier 1 capital		
Intangible assets	**(4.7)**	(2.9)
Deferred tax asset	**(2.3)**	(1.9)
Common equity tier 1 capital	**365.6**	272.0
Additional tier 1 capital	**–**	–
Total tier 1 capital	**365.6**	272.0
Tier 2 capital		
Subordinated debt and PSBs	**48.5**	50.6
Collective provisions	**1.6**	9.1
Deductions from tier 2 capital	**(2.0)**	(3.0)
Total tier 2 capital	**48.1**	56.7
Other regulatory adjustments	**–**	–
Total regulatory capital	**413.7**	328.7
Risk weighted assets (unaudited)	**2,743.0**	2,339.5

1. Within retained earnings, foreseeable dividends in the period are deducted in-line with the Group's dividend policy

The Bank has solo consolidation waivers for most of its subsidiaries. The impact of this has been included in the above table.

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38. Operating segments

The Group operates under three segments:

1. **BTL/SME;** secured lending on property for investment and commercial purposes,
2. **Residential mortgages;** lending to customers who live in their own homes, secured either via first or second charges against the residential home, and
3. **Personal Loans;** unsecured lending, which currently comprises solely the acquisition of the former Northern Rock performing consumer finance portfolio of c.70,000 customers from UK Asset Resolution in 2013.

The financial position and results of operations of the above segments are summarised below:

Year ended 31-Dec-16	BTL/SME £m	Residential mortgages £m	Personal loans £m	Central[1] £m	Total £m
Balances at the reporting date					
Gross loans and advances to customers	4,094.9	1,859.9	9.4	–	5,964.2
Provision for impairment losses on loans and advances	(16.9)	(7.8)	(0.3)	–	(25.0)
Loans and advances to customers	4,078.0	1,852.1	9.1	–	5,939.2
Capital expenditure	5.3	2.4	–	–	7.7
Profit or loss for the period					
Net interest income	132.0	71.4	3.2	–	206.6
Other income/(expense)	0.3	(4.7)	(0.8)	–	(5.2)
Total income	132.3	66.7	2.4	–	201.4
Impairment (losses)/gains	(2.1)	(7.2)	0.3	–	(9.0)
Contribution to profit	130.2	59.5	2.7	–	192.4
Operating expenses					(53.7)
FSCS and other provisions					(0.5)
Exceptional items					24.9
Profit before taxation					163.1
Taxation					(42.2)
Profit for the year					120.9

Year ended 31-Dec-15	BTL/SME £m	Residential mortgages £m	Personal loans £m	Central[1] £m	Total £m
Balances at the reporting date					
Gross loans and advances to customers	3,105.5	2,007.1	49.5	–	5,162.1
Provision for impairment losses on loans and advances	(17.7)	(2.2)	(7.4)	–	(27.3)
Loans and advances to customers	3,087.8	2,004.9	42.1	–	5,134.8
Capital expenditure	5.5	3.6	–	–	9.1
Profit or loss for the year	–	–	–	–	–
Net interest income	95.2	69.0	5.6	–	169.8
Other income/(expense)	(0.6)	(5.9)	(1.4)	0.6	(7.3)
Total income	94.6	63.1	4.2	0.6	162.5
Impairment losses	(5.3)	(2.4)	(2.9)	–	(10.6)
Contribution to profit	89.3	60.7	1.3	0.6	151.9
Operating expenses					(41.1)
FSCS and other provisions					(3.4)
Exceptional items					(2.1)
Profit before taxation					105.3
Taxation					(21.2)
Profit for the year					84.1

1. Other income in the central segment represents gains on sales of investment securities

39. Country by country reporting

Country by Country Reporting ('CBCR') was introduced through Article 89 of CRD IV, aimed at the banking and capital markets industry.

From 1 January 2015, all institutions within the scope of CRD IV should publish annually, on a consolidated basis, by country where they have an establishment:

a) their name, nature of activities and geographic location
b) number of employees
c) their turnover
d) pre-tax profit or loss
e) corporation tax paid, and
f) any public subsidies received

The ongoing reporting deadline is 31 December each year, starting from 31 December 2015, and disclosures should relate to the most recently ended accounting period.

The name, nature of activities and geographic location of the Group's companies are presented below:

Jurisdiction	Country	Name	Activities
UK[1]	England	OneSavings Bank Plc	Commercial banking
		Easioption Ltd	
		Guernsey Home Loans Ltd	
		Heritable Development Finance Ltd	
		Interbay Group Holdings Ltd	
		Jersey Home Loans Ltd	
		Prestige Finance Ltd	
		Cavenham Financial Services Ltd	
		Reliance Property Loans Ltd	
		Rochester Mortgages Limited	
		5D Finance Ltd	
		5D Lending Ltd	
		Interbay Funding Ltd	
		Interbay Financial I Ltd	
		Interbay Financial II Ltd	
		Interbay Holdings Ltd	
		Interbay ML Ltd	
	Guernsey	Guernsey Home Loans Ltd (Guernsey)	
	Jersey	Jersey Home Loans Ltd (Jersey)	
India[2]	India	OSB India Private Ltd	Back office processing

1. Guernsey Home Loans Ltd (Guernsey) and Jersey Home Loans Ltd (Jersey) are incorporated in Guernsey and Jersey respectively but are considered to be located in the UK as they have no employees, are tax resident and centrally managed and controlled in the UK
2. The Group had two Indian subsidiaries, Easioption BPO Services Private Ltd and Easiprocess Private Ltd, providing back office processing and earning a management fee from OneSavings Bank plc. During 2015, they merged into one entity, OSB India Private Ltd

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FOR THE YEAR ENDED 31 DECEMBER 2016

39. Country by country reporting continued
Other disclosures required by the CBCR directive are provided below:

2016	**UK**	**India**	**Consolidation[2]**	**Total**
Average number of employees	**431**	**243**	**–**	**674**
Turnover[1], £m	**201.2**	**3.9**	**(3.7)**	**201.4**
Profit/(loss) before tax, £m	**162.9**	**1.0**	**(0.8)**	**163.1**
Corporation tax paid, £m	**29.4**	**0.2**	**–**	**29.6**

2015	UK	India	Consolidation[2]	Total
Average number of employees	349	195	–	544
Turnover[1], £m	162.4	2.8	(2.7)	162.5
Profit/(loss) before tax, £m	105.2	0.5	(0.4)	105.3
Corporation tax paid, £m	13.5	0.1	–	13.6

1. Turnover represents total income before impairment losses, regulatory provisions and operating costs, but after net interest, net commissions and fees, gains and losses on financial instruments and external servicing fees
2. Relates to a management fee from Indian subsidiaries to OneSavings Bank plc for providing back office processing

The tables below reconcile tax charged and tax paid during the year.

2016	**UK £m**	**India £m**	**Total £m**
Tax charge	**41.9**	**0.3**	**42.2**
Effects of:			
Other timing differences	**0.2**	**–**	**0.2**
Tax outside of profit and loss	**(0.3)**	**–**	**(0.3)**
Prior year tax paid during the year	**9.2**	**–**	**9.2**
Current year tax to be paid after the reporting date	**(21.6)**	**(0.1)**	**(21.7)**
Tax paid	**29.4**	**0.2**	**29.6**

2015	UK £m	India £m	Total £m
Tax charge	21.1	0.1	21.2
Effects of:			
Relief for losses brought forward	(0.6)	–	(0.6)
Other timing differences	0.2	–	0.2
Tax outside of profit and loss	(1.2)	–	(1.2)
Prior year tax paid during the year	2.9	0.3	3.2
Current year tax to be paid after the reporting date	(8.8)	(0.4)	(9.2)
Tax paid	13.6	–	13.6

40. Events after the reporting date.
There are no material events after the reporting date.

41. Controlling party
As at 31 December 2016, OSB Holdco Limited had notified the Company that it held 53.78% of the ordinary shares in issue. The Company has entered into a Relationship Agreement with OSB Holdco Limited following admission to the London Stock Exchange in June 2014. A summary of the Relationship Agreement is set out on page 63. OSB Holdco Limited is a Company controlled by funds advised by J.C. Flowers & Co LLC.

GLOSSARY

AGM	Annual General Meeting
ALCO	Assets and Liabilities Committee
AT1	Additional Tier 1 Capital
BoE	Bank of England
CCO	Chief Credit Officer
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CFP	Contingency Funding Plan
CML	Council of Mortgage Lenders
CRD IV	Capital Requirement Directive and Regulation
CRO	Chief Risk Officer
DSBP	Deferred Share Bonus Plan
DTR	Disclosure Guidance and Transparency Rules
EIR	Effective Interest Rate
EPS	Earnings Per Share
EU	European Union
FCA	Financial Conduct Authority
FLS	Funding for Lending Scheme
FRC	Financial Reporting Council
FSCS	Financial Services Compensation Scheme
FTE	Full Time Equivalent Employees
FTSE	Financial Times Stock Exchange
GDP	Gross Domestic Product
GOSH	Great Ormond Street Hospital
HDF	Heritable Development Finance
HMRC	Her Majesty Revenue and Customs
HPI	House Price Inflation
HR	Human Resources
IAS	International Accounting Standards
ICAAP	Internal Capital Adequacy Assessment Process
ICR	Interest Coverage Ratio
IFRS	International Financial Reporting Standards
ILAAP	Individual Liquidity Adequacy Assessment Process
IPO	Initial Public Offering
IRB	Internal Ratings-Based Approach Bank
ISA	Individual Savings Account
JCF	J.C.Flowers
KRBS	Kent Reliance Building Society
KRPS	Kent Reliance Provident Society
LCR	Liquidity Coverage Ratio
LIBOR	London Inter Bank Offered Rate
LTIP	Long Term Incentive Plan
LTV	Loan to Value
MI	Management Information
MMR	Mortgage Market Review
NIM	Net Interest Margin
NPS	Net Promoter Score
ONS	Office of National Statistics
PRA	Prudential Regulatory Authority
PRS	Private Rented Sector
PSBs	Perpetual Subordinated Bonds
PSP	Performance Share Plan
RMBS	Residential Mortgage Backed Securities
RoE	Return on Equity
RWA	Risk Weighted Assets
SAYE	Save As You Earn
SDLT	Stamp Duty Land Tax
SID	Senior Independent Director
SME	Small Medium Enterprises
SREP	Supervisory Review and Evaluation Process
SRMF	Strategic Risk Management Framework
TFS	Term Funding Scheme

COMPANY INFORMATION

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Private shareholders are welcome to contact the Company Secretary if they have any questions or concerns they wish to be raised with the Board.

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