OneSavings Bank plc

Annual Report And Financial Statements
For The Year Ended 31 December 2013
Company number: 07312896

OneSavings Bank plc
Contents
For the year ended 31 December 2013

OneSavings Bank plc
Strategic Report – Performance Highlights
For the year ended 31 December 2013

£3.0bn **(2012: £2.2bn)**	**Strong balance sheet growth** Net loans and advances grew by 38%
211bps **(2012: 57bps)**	**Strong margin growth** More than threefold increase in net interest margin[1]
£31.4m **(2012: £8.1m[2])**	**Strong profit growth** 289% growth in profit before tax
22% **(2012: 9%[2])**	**High return to shareholders** 138% increase in return on shareholders' equity[3]
38% **(2012: 133%)**	**Low cost : income ratio[1]** Due to efficient operating platform with Indian back office
93% **(2012: 79%)**	**Strong loan to deposit ratio** Predominantly retail funded
32.4% **(2012: 10.9%)**	**Strong net promoter score** Demonstrating high level of customer satisfaction
9.3% **(2012: 8.5%[2])**	**Increased Core Tier 1 ratio** Reflecting growth in shareholders' funds through profitability and £15m capital injection

1 After deduction of coupons on perpetual subordinated bonds ('PSB's') classified as equity

2 Restated due to a change in accounting policy for FSCS levies in light of IFRIC 21's interpretation of IAS 37

3 Profit after taxation, less coupons on PSB's classified as equity, as a percentage of average shareholders' equity (£133.2m excluding £22m of PSB's classified as equity)

2013 was an excellent year for OneSavings Bank plc ('OSB', the 'Bank' or the 'Group') as is clear from the greatly improved results with profit after taxation of £26.8m for the year generating a 22% ROE. These results, unlike those of 2012, do not include any one-off negative goodwill. Our organic brands are performing well with strong increases in origination volumes, and our inorganically acquired portfolios continue to perform ahead of expectation, including the Northern Rock consumer loan portfolio acquired in 2013 from UK Asset Resolution Limited.

This year, for the first time, we are providing a segmental breakdown in our annual accounts, as our business has grown. We have chosen to organise our segments around our customers: individuals borrowing against their own home are captured in the Residential Mortgages segment, whereas individuals and SMEs borrowing against property for investment or commercial purposes are classed as Buy-to-Let/SME*. The consumer loans portfolio is reported separately as a third segment, Personal Loans.

OSB celebrated its third anniversary on 1 February, 2014, although our savings franchise has mutual roots going back to the 1800s in Kent. We continue to nurture the longstanding Kent Reliance brand and savings franchise through a product approach which rewards customer loyalty rather than taking advantage of it, and a branch rejuvenation programme. The result is high customer satisfaction, continued customer loyalty and a low level of complaints.

On the lending side our access to capital from JC Flowers** has allowed us to be one of the few banks in the UK to grow rapidly, both organically and inorganically. It is pleasing that we have now reached a level of profitability and therefore organic capital generation that enables OSB to fund its ambitious growth plans without requiring further capital injections from JC Flowers.

We consider that the legacy issues of the old Kent Reliance Building Society are now substantially behind us. The accelerated work-out of the small concentrated legacy problem loan book has now reduced this to £43.8m, contributing to relatively high loan loss provisions in our BTL/SME* segment in 2013. The new business being written in this segment is very different in kind to these legacy loans, and their credit performance to date has been very pleasing. The low margin back book has been balanced by the purchase of long duration high margin run-off portfolios, all of which are performing better than expected at acquisition. Our business is now run by a management team led by Andy Golding with many years of operating experience in UK retail and SME lending and deposit taking, complemented by risk, credit, finance and compliance professionals from the likes of Goldman Sachs, Morgan Stanley, Oliver Wyman and the HMT Asset Protection Agency.

Andy Golding and his team should be justly proud of their achievements, and I want to thank all our staff for their valued contribution towards a record year.

Outlook and current trading

All our mortgage lending brands are continuing to grow their new originations as the economy is at last recovering and confidence is returning to our lending segments. While the Board does not expect any adverse economic developments in the near future, it is worth noting that we are entering 2014 with a very strong balance sheet. The collateral quality of our lending is very high compared to the peers we benchmark ourselves against with a minimal proportion of mortgage assets on our balance sheet not covered 100% by property and very low exposures above 90% LTV.

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* Small and medium enterprise
** Funds advised by private equity firm J.C. Flowers & Co, LLP

In addition, the duration of our assets, and therefore our asset margins, is very long. Our profitability therefore has a significant recurring element, subject to our cost of funding. While deposits are still extremely expensive relative to LIBOR by long term historical standards, they have become cheaper over the past year, as the unprecedented deposit price competition between banks during the financial crisis eased once regulators decided that UK banks had amassed enough liquidity and could access cheap marginal liquidity through the Funding for Lending Scheme (FLS). The lowering of deposit pricing seen during 2013 is not yet fully reflected in our 2013 results as significant portions of our balance sheet are one and two year fixed-term deposits with a commensurate lag in re-pricing.

Consensus forecasts and guidance from the Bank of England point towards gently rising interest rates over the coming years. Historically, deposit rates have been above the Bank of England Base Rate when the latter was low, while generally being below the Base Rate when interest rates have been high.

Once interest rates start to rise, we expect history to repeat itself and deposit margins relative to LIBOR to normalise, boosting net interest margins across the banking system.

Stephan Wilcke
Chairman

I am pleased to report on the OneSavings Bank plc group (the 'Group') accounts for 2013.

The performance highlights on page 3 reflect the Group's very strong performance in 2013, with significant improvement in all key measures. The Group is now profitable on a sustainable basis, thanks to the work we have undertaken to grow our balance sheet whilst maintaining rigorous control over our cost base.

In my 2012 report I talked about the recruitment I had undertaken in the year to bolster the senior management of the Bank. The focus on hiring quality people has continued during 2013, further strengthening the business in the areas of credit, technology, risk, compliance and human resources.

In market terms 2013 was without doubt a game of two halves. Less than 12 months ago the industry was discussing mortgage famine and the Government was announcing more and more ways to stimulate the housing market and in turn the economy. By quarter four the conversation had turned to housing market bubbles and a desire to reduce some of that stimulus to prevent the market from overheating.

During the year inflation returned to more acceptable levels, a new Governor at the Bank of England announced forward guidance on future triggers for interest rate rises and the Funding for Lending Scheme (FLS) had a major impact on the cost of retail funding as it pushed significant liquidity into the various mortgage markets.

It is clear that the economic environment will continue to shape the housing market and the landscape for savers, who are suffering with very low rates on all but the longest-term savings accounts. The continuing low interest rate environment, falling unemployment levels and the now evident economic recovery provide a challenging but different context in which to operate than has been present in recent years.

Despite the well-publicised operational, financial and reputational problems that a number of banks have encountered over the past 12 months, there is now evident political and regulatory warmth towards smaller or newer entrants to the financial landscape. This presents an opportunity for "challenger banks" such as OSB to offer quality products, flexibility and, most of all, a personalised service to help re-build trust and confidence in the UK's financial services sector. The Group's Board and I take this responsibility extremely seriously.

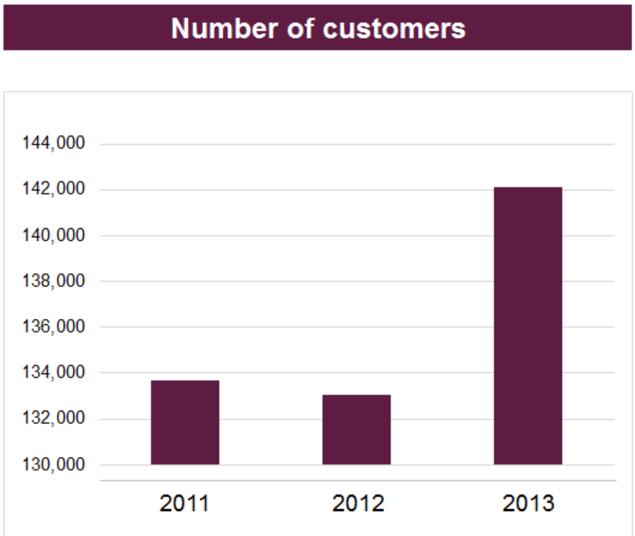
In this context the overall performance of the Group, of which financial results are just a part, is even more important. OneSavings Bank has a simple and transparent business model. We pride ourselves on our award winning range of retail savings products and our commitment to providing our depositors with long-term value for money - not the introductory bonus rates that fall away after an initial period, but accounts that can always be compared to current "best buy" offerings and leave our customers feeling reassured.

The funding we attract from savers through the Kent Reliance brand, enables the Bank to lend into a range of markets through the Group's various lending brands, helping homeowners and business customers with their mortgage and secured loan needs.

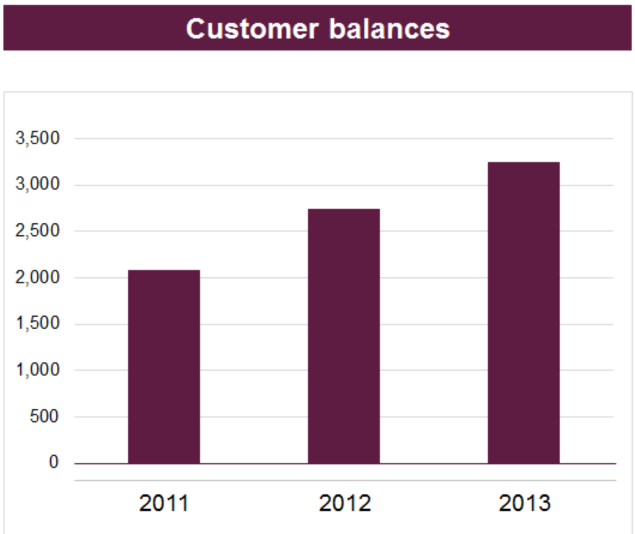
As I write this in early 2014, there is no doubt that the signs of economic improvement are stronger than they have been for many years now and it is against this backdrop that I present the balance of my report.

Retail Savings

The number of retail savings customers grew by over 9,000 in 2013.



Savings balances increased over the year by £507m to £3,252m and the average balance increased by 11% per account.



This is particularly pleasing given the backdrop of low rates for savers generally, and is a testament to our strategy of providing long-term value for money products. During the year Kent Reliance has been a regular sight in the national press best buy tables. In addition to our strategy of attracting new savers to the group, we have also worked hard on the retention offering for our existing savers, ensuring that what we offer existing customers is not only comparable with the best rates elsewhere, but in many cases better than our open market offering. During the year, this strategy helped us to retain 88% of maturing fixed term balances. This, together with successful efforts to spread bond maturities throughout the year, has enabled the Bank to manage its liquidity more effectively during the year.

This year more than ever I think it appropriate to refer to the difficult situation faced by many savers reliant on their interest to supplement income.

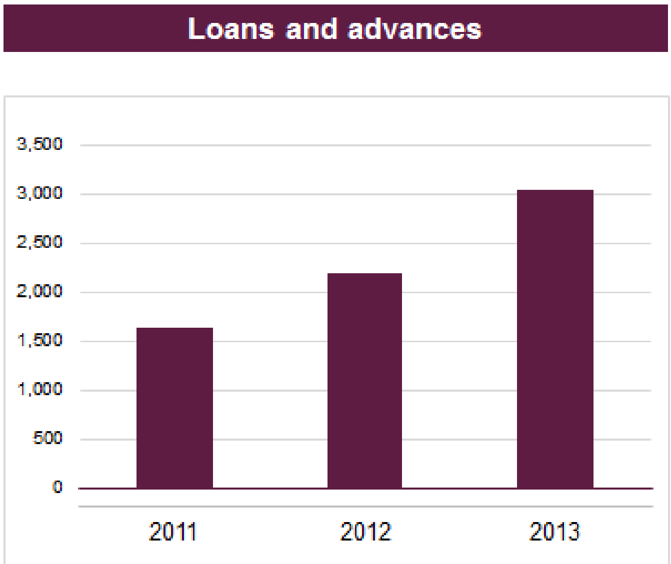
The Government's initiative the FLS was in existence for the entirety of 2013 with the stated intent of easing borrowing conditions to assist economic growth. The unforeseen consequence of the scheme has been a gradual reduction of retail savings rates across the board at a time of already historically low rates.

Whilst we are not large enough to ignore wider market pricing, we leveraged our strength to ensure that we have continuously offered leading or close to leading rates to our savers. This has resulted in inclusion in national best buy tables 11 out of 12 months during the year. Additionally we won Best ISA provider in the MoneyFacts awards 2013 for the consistency of our ISA offering.

This funding strategy complements our mutual roots, with a commitment to maintain our heartland branch network and, importantly, to play an active role in the communities we serve.

Loans to Customers

The lending performance of the Group and, most importantly, the consistency of this performance, is shown by the growth in overall loan balances year-on-year.



This growth has been achieved through a mixture of organic origination, and inorganically sourced loan portfolios. The Group increased total new lending by 58% during the year to £1,185m. Organic origination through Group brands, forward flow agreements and secured funding lines was up 121% to £794m whereas mortgage portfolio purchases reduced to £133m from £389m. In addition the Bank acquired a portfolio of consumer loans for £258m during the year.

Our Group-branded organic origination in the second half of 2013 generated returns on equity in excess of 40% in our Residential Mortgages and Buy-To-Let/SME segments based on our product pricing tools which take into account full loadings for cost, expected credit losses, CRD IV capital, and taxation.

Inorganically sourced loans represented 26% of the Group's loans and advances as at 31 December 2013 (2012: 23%).

The Group is a specialist mortgage lender focusing on markets often ignored by the larger banks and building societies or serviced by smaller lenders who display an inconsistency in terms of presence and product in such markets.

The Group operates under three segments:

Residential Mortgages

We increased our volume of organic residential lending in 2013 by 30% to £227m. Residential lending includes large mortgages for high net worth individuals, shared ownership loans to help people such as key workers get onto the property ladder and second charge mortgages through Prestige Finance (a platform we acquired in 2012) which offers an award winning range of specialist secured loans in the UK.

In addition we continued to make use of our balance sheet strength to acquire residential mortgage portfolios from other more constrained lenders, purchasing a number of portfolios for a total of £133m. With our experience in this arena we are able to ensure that the risk profile of the loans and the price we pay for them represents a strong contribution towards Group profitability and effectively provides us with an additional lending distribution channel.

Buy-to-Let/SME

Buy-to-let/SME has been a strong area of growth for the Group and will remain so in 2014. Organic origination increased three-fold to £567m during the year.

Demand for housing in the UK continues to increase, however, with the trend towards multiple-location living, coupled with the average age of the first-time home buyer on the increase, the private rented sector plays an important part in the housing supply chain.

Through Kent Reliance we specialise in lending to professional landlords with experience and in many cases extensive property portfolios. Our Interbay Commercial brand also provides buy-to-let loans, specialising in limited company buy-to-let, alongside its broader owner occupied and investor commercial mortgage offerings.

In December 2013 Heritable Development Finance Ltd ('Heritable') became part of the Group. Heritable will specialise in residential development finance for medium sized house builders to fund new developments. New housing starts in the UK are significantly below where they need to be to accommodate population growth and therefore this presents an opportunity to assist house builders and in turn the wider housing market.

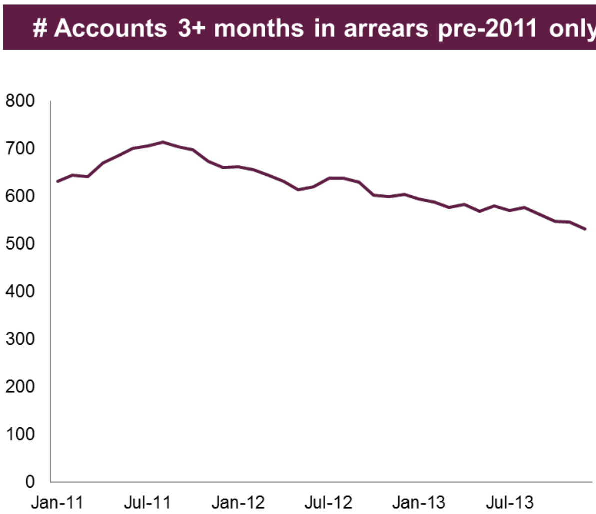
Personal Loans

During 2013 the Group acquired the former Northern Rock performing consumer loan portfolio of c. 70,000 customers from UK Asset Resolution Limited. We are currently assessing the potential to offer new loans and further advances to these customers.

Credit Risk

Overall the credit quality of the Group's loan book improved during 2013.

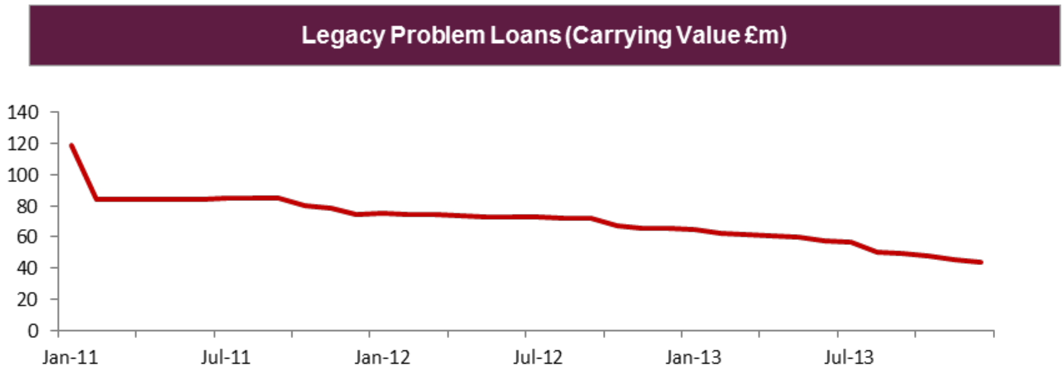
The following graph shows the number of accounts 3+ months in arrears in the inherited back book originated pre-2011.



Loans written since the creation of the Bank in February 2011 continue to exhibit low arrears with only 19 accounts 90 days past due as at 31 December 2013. This reflects the Group's strong underwriting practices.

For acquired books, 90 days past due levels are below initial forecasts. Furthermore, the Bank is protected against losses by the fact that these assets have been bought at a discount to par.

OSB inherited a back book of loans from KRBS that included a number of legacy problem loans. These have been actively worked out as shown below.



Wholesale funding

Whilst the Group is committed to remaining a majority retail-funded mortgage lender, some diversification of funding is an important part of our overall funding strategy.

This provides longer-term funding than traditional retail savings and therefore enables us to manage our liquidity more efficiently.

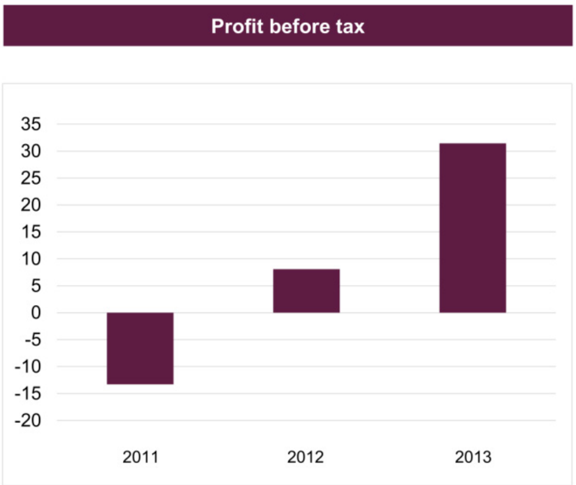
Whilst we have demonstrated our ability to fund significant growth through retail deposits we took the decision in 2013 to complement this with some access to wholesale markets.

In October 2013, we successfully issued our first residential mortgage backed securitisation

(RMBS), selling AAA and AA+ securities with a nominal value of £273 million which provided the Group with a diversified source of term funding at an attractive price. In January 2014 we also joined the Bank of England FLS and we have recently made our first drawdown of £98m under that scheme.

Financial performance

The Group's profit before tax increased 289% to £31.4m in 2013.



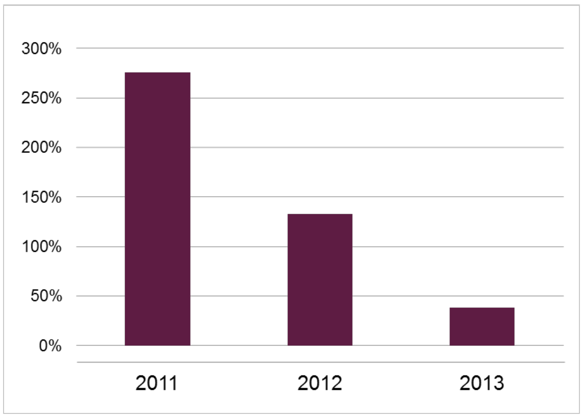
The increase in underlying profitability in 2013 was even greater given the one-off negative goodwill of £17.6m in 2012 relating to company acquisitions in that year.

2013 saw the Group attract more savings and borrowing customers whilst keeping costs well controlled and focusing on continuing to grow our net interest income. A strong performance in each of these key areas has resulted in a significant growth in profitability.

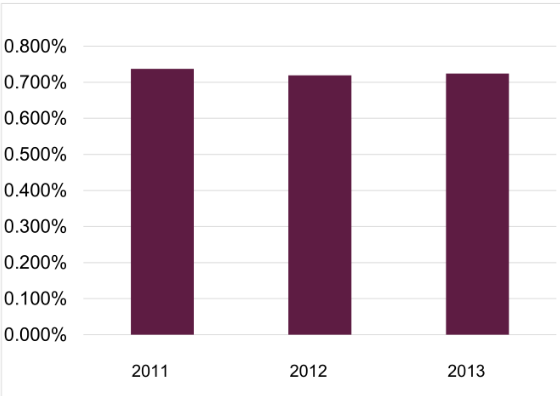
This profitability enables us not only to continue to grow in the future as it increases our capital base, but also to ensure that our offering to savers and borrowers really does provide value for money for our customers.

We have maintained rigorous control over our cost base, despite investment in growth and capability. As a result our cost to income ratio has continued to improve and our management expense ratio has remained relatively steady.

Cost : income ratio



Management expense ratio



The Group owns an offshore captive in India called EasiProcess. The Group staff based in Bangalore, access our network in the UK via secure links to undertake primary processing for the Kent Reliance and Jersey and Guernsey brands. Plans to extend the coverage to other brands are being developed.

This provides us with significant cost advantages over our competitors whilst giving the flexibility required to grow. Going forward this remains an integral part of our strategy.

Customers and Community

How our customers feel about the Group is something the Board and I take extremely seriously.

The Kent Reliance Provident Society, one of the Bank's parents, plays an important role for the Group. However its principal function is to act as the eyes, ears and voice of the Bank's customers and help us to shape our product and service offering in a way that meets the needs of both savers and borrowers.

The Society commenced this customer engagement process during 2013, recruiting active and interested customers to join management in a series of events, each one focused on learning how we can do a better job for our customer base as a whole. This is something that my entire team is behind, as we recognise that consumers have many choices and that communication is very much a two-way process. We have already started to implement changes recommended by our customers, including an IT project to improve our internet savings offering, which is targeted for launch mid-2014.

We track a number of customer satisfaction metrics including our Net Promoter Scores to understand how well we are doing and help identify areas for change.

We also track data for our key contact points such as our call centre and our branches and monitor trends carefully whilst seeking continuous improvement. I am pleased to say that we are tracking in the right direction, albeit at busy times we are still not perfect and further improvement work is scheduled for 2014.

The industry recognised metric for customer satisfaction is the Net Promoter Score (NPS), which at the year-end was +32.4%, up from 10.9% in 2012 with our branches scoring +47.2%. Our contact centre, based in India, registered an outstanding +17.1% NPS following significant investment in recruitment and staff training.

The Society also administers a charitable programme including donations to the Kent Community Foundation and the Medway 100 Club. It also runs a monthly draw for members, with a £1,000 prize going to one member each month.

In addition to the Society's charitable efforts, the Bank made charitable donations of £21,330 during the year including support for the Charlton Athletic Community Trust, Kent Football Association County Cup, Demelza Hospice and KMFM Christmas Heroes during the year. On a national level, the Bank has also continued its support for Great Ormond Street Children's Hospital, through a co-branded savings offering under which the Bank has made commission payments to the hospital in excess of £50,000 over the past two years.

Any organisation is only ever as good as its staff. The culture we endeavor to create at OneSavings Bank is one of hard work, customer first, challenge and fun.

Our staff engage in a series of activities outside of work, from running half marathons and wearing "dotty" clothing to raise money for Demelza Hospice to attending children's Christmas parties at Great Ormond Street Hospital and collecting parcels for the Medway Foodbank. These things are important and help connect a business to the community.

We have again taken a lead role in the Kent Excellence in Business Awards, providing a judging team for the award for Business Commitment to the Community in 2013.

Our customers tell us how great our staff are and their feedback is much appreciated and I would like to thank on record all Group staff for their commitment and contribution.

Summary

I noted at the outset that 2013 was a strong year for OneSavings Bank.

We are committed to being a great provider of retail savings products and a specialist mortgage lender providing solutions to borrowers where other lenders either do not have the skill or the capacity to do so.

We want to be seen as **specialist, flexible** and most of all **personal**. While we are growing fast we are still small enough to engage with our customers and industry colleagues in a way that the largest providers simply cannot.

As we move into 2014, the economic environment appears to be improving, however we will not be complacent. Competition for business may well intensify and we never forget our customers have choice. Therefore we will maintain our focus on the right products, the right service and the right people, doing the right thing for our markets and our customers.

Andy Golding
Group Chief Executive

Our Business

OneSavings Bank plc ('OSB', 'the Bank' or 'the Group') began trading as a bank on 1st February 2011 when the trade and assets of Kent Reliance Building Society ('KRBS') were transferred into the business. OSB is a specialist lending and retail savings group, authorised by the Prudential Regulation Authority, part of the Bank of England, and regulated by the Financial Conduct Authority and Prudential Regulation Authority.

OSB focuses on specialist lending activities in selected sub-sectors of the market where it has established expertise, platforms and capabilities, and which offer risk adjusted high returns and strong growth opportunities. OSB's specialist lending segments include Residential Mortgages (comprising first charge, second charge and shared ownership), Buy-to-Let/SME and Personal Loans. Participation in these specialist lending segments requires bespoke underwriting, experienced teams and strong relationships with specialist distributors; capabilities firmly established at OSB.

OSB originates organically through specialist brokers and independent financial advisors (for Group branded products) as well as through forward flow agreements and secured funding lines (for third-party branded products). OSB has also demonstrated its capability and expertise to successfully and profitably source loan portfolios inorganically.

The Bank is predominantly funded by retail savings originated through the established Kent Reliance franchise. Diversification of funding is currently provided by a securitisation.

A robust risk management framework is in place to support OSB's current and envisaged future requirements. Back-office functions are largely performed by the Bank's own staff in India, providing a scalable low-cost operating platform that delivers a high quality of service.

Our Savings Franchise

OSB's savings franchise includes a network of branches in the South East of England, as well as online and postal channels, all supported by a low-cost offshore processing platform.

OSB offers a variety of fixed, notice, easy access and regular savings products, including ISAs, but has made a deliberate decision not to offer current accounts.

Consistent with its mutual heritage, OSB operates a savings product strategy which avoids the use of both 'introductory bonuses' in favour of long-term value for money rates and 'new-customer only' offers that could create barriers to customers moving their money around within the Bank.

Our Lending Franchises

OSB segments its lending by product, focusing on the customer's need and reason for a loan.

Residential Mortgages

The Residential Mortgages segment comprises lending to customers who live in their own homes, secured either via first or second charges against the residential home.

OSB originates organically in the UK and Channel Islands through specialist brokers. The Bank utilises the Kent Reliance brand in the UK for first charge mortgages, the Prestige brand for second charge mortgages and the Jersey Home Loan (JHL) and Guernsey Home Loan (GHL) brands in the Channel Islands for first charge mortgages.

Under the Kent Reliance brand in the UK, OSB distributes specialist first charge mortgages through specialised, typically London-based, brokers. These high margin products include bespoke residential and shared ownership mortgages.

Bespoke residential lending includes lending to high net worth customers, non-UK citizens resident in the UK, near-prime customers (including credit repair) as well as lending to fund self-build and insurance-backed high LTV new build properties, in partnership with builders.

Shared ownership comprises lending to borrowers who are buying a residential property in conjunction with a housing association. Through a mortgage protection clause in the shared ownership lease, the Bank is able to recover losses from the Housing Association's share of equity in the event that there is a shortfall on sale of the property.

The Bank's lending platform for second charge mortgages is Prestige, acquired by OSB in 2012. Prestige operates through broker intermediaries typically specialising in second charge mortgages and other Consumer Credit Act regulated products, and has dedicated interactive broker IT systems and underwriting processes.

Lending in the Channel Islands requires specialist local market knowledge due to the different risk characteristics, tax and legal frameworks. JHL and GHL are separate subsidiaries of OSB with underwriting and liaison with local Channel Island mortgage brokers both staffed out of the UK.

OSB also originates organically through third-party forward flow agreements (under which it agrees to purchase third-party branded mortgages originated to order based on pre-agreed lending criteria) and secured funding lines to other lenders (heavily over-collateralised by third-party branded mortgages and subject to strict criteria for individual underwriting of the underlying loans).

The Bank also sources loans through selective portfolio purchases (where it uses the Reliance Property Loans brand to interact with customers after purchase). These portfolios are serviced by specialist third-party servicers. The Bank also acquired the Prestige and Swingcastle (a sister company of Prestige) mortgage back books through its acquisition of those companies in 2012.

Buy-to-Let / SME

The Buy-to-Let / SME segment comprises secured lending on property for investment and commercial purposes. OSB originates Group brand Buy-to-Let ('BTL') mortgages in the UK and Channel islands via mainstream and specialist intermediaries. The Bank utilises the Kent Reliance brand in the main UK BTL market and the JHL and GHL brands in the Channel Islands BTL market. OSB also lends in the semi-commercial and commercial UK market through the Interbay brand.

BTL lending comprises residential investment property lending to prime credit quality borrowers, often professional landlords with established portfolios, or to high net worth clients looking to diversify their investments. OSB's specialist BTL products also include HMOs (homes in multiple occupation) student accommodation and loans to expatriates.

Interbay, a separate subsidiary group acquired in 2012, focuses on the commercial broker community, lending to customers with investment properties, semi-commercial (part residential and part commercial properties) or small commercial properties.

In December 2013, the Group established Heritable Development Finance Ltd with the former management team of the structured property finance unit of Heritable Bank Plc. OSB will provide development loans to small and medium sized developers of residential property in the UK through the Heritable Development Finance brand.

Personal Loans

This segment covers all of OSB's unsecured lending, which currently comprises the former Northern Rock performing consumer loan portfolio acquired from UK Asset Resolution Limited in 2013. These are seasoned performing unsecured loans serviced by a third party servicer.

2013 Business highlights

OSB continued to make excellent progress during the year, significantly growing its balance sheet and profitability through a combination of high-margin organic origination and inorganic portfolio purchases. This new origination, together with the reduced cost of retail savings following the introduction of the FLS, further diluted the impact of the lower-yielding back book inherited from KRBS, increasing net interest margin ('NIM') more than three-fold compared to the prior year.

Total new lending was £1,185m in 2013 (2012: £749m).

Organic mortgage origination in 2013 was up 121% to £794m driven by higher volumes in both the Residential Mortgages and Buy-to-Let/SME segments, and ended the year with a very strong pipeline.

During the year the Bank purchased additional mortgage portfolios for £133m with a gross value of £182m (2012: £389m and £472m respectively including books acquired through company acquisitions). The substantial purchase discounts which are recognised through interest income over the life of the mortgages provide the Group with significant credit loss protection.

In addition, the Bank purchased the former Northern Rock performing consumer loan pool from UK Asset Resolution Limited in July 2013 at a discounted price of £258m securing an additional £15m capital injection from OSB Holdco Ltd, one of its shareholders, to help support the purchase. These are high-margin, seasoned, performing unsecured loans which have to date performed better than originally expected.

The Bank completed its inaugural mortgage backed securitisation, Rochester Financing No.1 Plc ('Rochester') in October 2013. The transaction provided funding diversification, reducing the Bank's reliance on retail savings at a comparable cost and established OSB's capability in the securitisation market. The securitised mortgages were originated through portfolio purchases and a forward flow agreement and are serviced by a third party. Rochester issued Investment Grade rated notes corresponding to 86.5% (4.5% cash reserves) of the nominal value of the mortgages, validating the credit quality and performance of the underlying assets. Securities (AAA and AA+ rated notes) with a nominal value of £273m were sold, raising secured term funding for the Group. OSB retained the remaining notes and residual certificate and as such did not transfer substantially all of the risks and rewards of the securitised mortgages. These mortgages therefore remain on the Bank's balance sheet and OSB consolidates Rochester Financing No.1 Plc.

Financial review

Summary financial information and key performance indicators

	Group 31/12/2013	Group 31/12/2012 (restated[5])
Summary Profit or Loss	**£m**	**£m**
Net interest income	70.8	16.2
Gains / (losses) on financial instruments	(0.9)	2.3
Net fees and commissions	(1.0)	(0.9)
External servicing fees	(3.5)	(1.6)
Administrative expenses[1]	(24.5)	(19.3)
Regulatory provisions	(2.2)	(0.9)
Impairment losses	(7.3)	(5.3)
Negative goodwill	0.0	17.6
Profit before tax	31.4	8.1
Profit after tax	26.8	9.1
Extracts from the Statement of Financial Position	**£m**	**£m**
Loans and advances	3,041.2	2,196.1
Retail deposits	3,251.6	2,744.6
Total assets	3,763.9	3,008.7
Key ratios		
Net interest margin[2]	211bps	57bps
Management expense ratio	0.72%	0.72%
Cost : income ratio[3]	38%	133%
Liquidity ratio	17.9%	25.4%
Core Tier 1 ratio[4]	9.3%	8.5%
Total capital ratio[4]	13.5%	14.3%

[1] Including depreciation and amortisation
[2] Net interest income, less coupons on perpetual subordinated bonds ('PSB's') classified as equity, as a percentage of average interest bearing assets
[3] After deduction of coupons on PSB's classified as equity
[4] Including full year earnings
[5] Restated due to a change in accounting policy for FSCS levies in light of IFRIC 21's interpretation of IAS 37
[6] Certain fee income and expense that forms an integral part of the effective interest rate of loans and advances previously reported in fees and commissions receivable and payable in 2012 has been reclassified to interest receivable and similar income

Strong profit growth

The Group reported very strong profit growth with profit before taxation of £31.4m for the year (2012: £8.1m). In comparison to 2012, this did not include any exceptional negative goodwill (2012: £17.6m) or gain on sales of financial instruments (2012: £2.9m).

Profit after taxation for the year of £26.8m also benefited from the recognition of a deferred tax asset of £4.7m in respect of trading losses in the Interbay Group, which resumed lending in late 2012 after its acquisition by the Bank, and which saw rapid growth in pipeline and completed loans during the year.

Net interest margin

The Group showed very strong growth in its net Interest margin (‘NIM’) during the year reporting net interest income of £70.8m (2012: £16.2m) and NIM of 211bps (2012: 57bps). The NIM improvement reflects the positive impact of organic origination and inorganic portfolio purchases in 2013 and the full year’s impact of new lending in the prior year, all of which provided the Group with higher returns than the low yielding back book. In addition, the cost of retail funds continued to fall during the year as competition declined as a result of the Funding for Lending Scheme.

Net fees and commission expense

Net fees and commission expense increased by £0.1m to £1.0m in 2013 primarily due to higher commission payable to one of the Bank’s parents, Kent Reliance Provident Society (‘KRPS’), for running a number of branches for the Bank on an agency basis, partially offset by the impact of a full year’s worth of servicing fee income in the Prestige Group acquired in 2012. The increase in KRPS commission was due to a one-off charge of £0.7m in December 2013 when the Bank bought out the agency agreement. The branches are now directly managed by the Bank and KRPS is focused principally on customer engagement on behalf of the Group.

External servicing fees

External servicing fees increased by £1.9m to £3.5m in 2013 due to the additional portfolio purchases and mortgages originated under forward flow agreements, all of which are serviced by specialist third-party servicers.

Efficient and scalable operating platform

Administrative expenses including depreciation were up 27% to £24.5m for the year (2012: £19.3m) reflecting the growth in the business, the demands of new regulations, enhancements to the resilience of the Bank’s IT infrastructure and upgrades to the Bank’s mortgage origination technology. Administrative expenses in 2013 also included a full year of costs for the subsidiary groups acquired in 2012. Average headcount for the Group increased to 342 (2012: 291).

The Group’s management expense ratio was 0.72% for the year (2012: 0.72%) and its cost: income ratio fell to 38% (2012: 133%) reflecting the Bank’s continued focus on cost control as it grows.

Regulatory provisions

Regulatory provisions, which are primarily in respect of FSCS levies, increased to £2.2m for the year (2012 restated: £0.9m) primarily reflecting the new levy to recover the estimated shortfall on capital loans.

The Bank changed its accounting policy for FSCS levies during the year in light of IFRIC 21’s interpretation of IAS 37 published on 20 May 2013 resulting in a restatement of FSCS levies for the prior year. Further details are set out in Note 33 to the financial statements.

Impairment losses

Impairment losses increased to £7.3m in the year (2012: £5.3m) reflecting the accelerated workout of the legacy problem loan book inherited from KRBS and prudent collective provisions on the consumer loan pool purchased from UKAR as a performing book during the year which were more than covered by the purchase discount.

Strong balance sheet growth

Loans and advances grew by 38% during the year to £3,041m due to the new organic origination and inorganic portfolio purchases during the year. Total assets grew by 25% reflecting the increase in loans and advances, offset by a reduction in liquid assets due to improved efficiencies.

Liquidity

OSB operates under the PRA's Individual Liquidity Adequacy Assessment (ILAA) regime. The Bank operates within a target liquidity runway in excess of the minimum regulatory requirement. The Bank is now able to manage its liquidity more efficiently having successfully spread savings maturities throughout the year and demonstrated a strong retention track record with an average retention rate of 88% on bond maturities during the year. The Group's liquidity ratio as at 31 December 2013 was 17.9% (2012: 25.4%) and was within its current target liquidity range of 17% to 20% of liabilities.

Capital

The Bank's Core Tier 1 and Total Capital ratios as at 31 December 2013 were 9.3% and 13.5% respectively (31 December 2012: 8.5% and 14.3%). Further details on capital management are provided in note 31 to the financial statements.

Impact of CRD IV

The PRA issued Policy Statement PS7/13 in December 2013 containing the final rules and supervisory statements implementing the Capital Requirements Directive (2013/36/EU) (CRD) and the Capital Requirements Regulation (575/2013) (CRR), jointly CRD IV, effective from 1 January 2014.

The primary impact of CRD IV as implemented by PS7/13 on the Bank's current capital position is the requirement to deduct the Bank's deferred tax asset ('DTA') in full from Core Tier 1 ('CT1') capital. The DTA was previously 100% risk weighted.

The Bank has received legal advice that its perpetual subordinated bonds ('PSB's') should remain eligible as Tier 2 capital under CRD IV as there is no incentive to redeem them. This is because at the time of issue in 2011 the interest rate reset included in the conditions attaching to the PSB's implied a step-down on a call.

A portion of the Bank's other subordinated debt is not eligible as Tier 2 capital under CRD IV but is eligible for grandfathering and as such will be phased out at 10% pa under the grandfathering rules.

In addition, CRD IV transitions in a Capital Conservation Buffer ('CCoB') of 2.5% of risk weighted assets ('RWA's') between 2016 and 2019 to replace the current Capital Planning Buffer.

The primary impact of CRD IV on the Bank's risk weighted assets is an increase in the risk weighting for BTL mortgages in the Channel Islands (which are not part of the EU) and a decrease in risk weightings for SME exposures due to the SME support factor introduced by CRD IV to encourage SME lending.

Segmental Business and Financial Review

The following table shows the Group's loans and advances and contribution to profit by segment*:

	2013, £m		
	Residential mortgages	**BTL/SME**	**Personal loans**
Balances at the reporting date			
Gross loans to customers	1,764.6	1,098.8	205.3
Provision for impairment losses	(3.1)	(22.4)	(2.1)
Net loans to customers	1,761.6	1,076.5	203.2
Risk weighted assets	722.8	513.2	162.6
Contribution to profit			
Net interest income	42.3	17.2	11.2
Other income / (expense)	(4.0)	(0.5)	(0.8)
Total income	38.3	16.7	10.4
Impairment losses	(0.5)	(4.7)	(2.1)
Contribution to profit	37.8	12.0	8.3
Pro-forma contribution to profit**	38.8	15.1	8.3

	2012, £m		
	Residential mortgages	**BTL/SME**	**Personal loans**
Balances at the reporting date			
Gross loans to customers	1,614.5	612.6	-
Provision for impairment losses	(2.5)	(28.4)	-
Net loans to customers	1,611.9	584.1	-
Risk weighted assets	715.1	337.7	-
Contribution to profit			
Net interest income	13.0	3.2	-
Other income / (expense)	(2.7)	(0.3)	-
Total income	10.2	2.9	-
Impairment losses	(1.6)	(3.7)	-
Contribution to profit	8.6	(0.8)	-
Pro-forma contribution to profit**	8.8	2.1	-

Residential Mortgages

This segment comprises lending to customers who live in their own homes, secured either via first or second charges against the residential home.

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* Operating segments only. Full segmental analysis of Group numbers is presented in Note 32 to the Financial Statements

** Proforma contribution to profit excludes impairment losses relating to the workout of the legacy problem loan book

During the year the Group increased its volume of organically-originated residential lending to £227m (2012: £175m). This included completions under Group brands (which ended the year with a very strong pipeline), as well as completions under uncommitted funding lines to two established lenders (a second charge lender and a bridge lender) and two third-party forward flow agreements.

During the year the Bank purchased residential mortgages through a number of portfolio purchases for £133m with a gross value of £182m (2012: £338m and £419m respectively including the mortgages acquired through the Prestige acquisition). The substantial purchase discounts which are recognised through interest income over the life of the mortgages provide significant credit loss protection.

OSB's total residential loan portfolio grew during 2013, ending the year with a net carrying value of £1,761.6m (2012: £1,611.9m).

New organic origination and inorganic portfolio purchases since 2011 have helped dilute the impact of the low-yielding back book and the residential portfolio made a contribution to profit of £37.8m (2012: £8.6m).

The Residential Mortgages segment's contribution to profit on a pro-forma basis, excluding impairment losses of £1.0m (2012: £0.2m) on the ring-fenced legacy problem book inherited from KRBS was £38.8m in 2013 (2012: £8.8m).

Buy-to-Let/SME

This segment comprises secured lending on property for investment and commercial purposes.

During the year, the Group significantly increased its volumes of new lending in this segment originating £567m of new organic lending under its Kent Reliance, Interbay, GHL and JHL brands (2012: £185m). This included strong growth in Buy-to-Let ('BTL') lending in the UK particularly in London and the South East through the Kent Reliance brand.

The Interbay Group, which resumed SME lending in late 2012 after its acquisition by the Bank, also saw rapid growth in pipeline and completed loans during the year. The Group acquired Interbay's back book of loans in 2012 with a fair value of £51m and a gross value of £53m.

OSB acquired the operating infrastructure, systems and staff of Heritable Partners Ltd in December 2013, ending the year with a pipeline of development finance lending for completion in 2014. Heritable Partners Ltd was established in 2012 by the former management team of the structured property finance unit of Heritable Bank Plc to work out and recover the structured property finance loan book of Heritable Bank which went into administration in 2008, following the failure of its Icelandic parent bank, Landsbanki. The team have a long and proven track record in the development finance market.

OSB's BTL/SME loan portfolio grew during 2013, ending the year with a net carrying value of £1,076.5m (2012: £584.1m).

New origination since 2011 has helped dilute the impact of the low-yielding back book and the BTL/SME segment made a contribution to profit of £12.0m in 2013 (2012: loss of £0.8m).

The Buy-to-Let/SME segment's contribution to profit on a pro-forma basis, excluding impairment losses of £3.1m in 2013 (2012: £2.9m) on the ring-fenced legacy problem book inherited from KRBS was £15.1m in 2013 (2012: £2.1m). Loan losses on this book reflect the accelerated workout of the book.

Personal Loans

OSB acquired the performing former Northern Rock consumer loan portfolio from UKAR in July 2013 for £258m. This portfolio of high-margin, seasoned, performing loans currently represents OSB's only unsecured lending. The portfolio which was purchased at a discount has a net carrying value after collective provisions of £203.2m as at 31 December 2013. The portfolio made a contribution to profit of £8.3m in 2013.

Principal risks and uncertainties

The Group considers a range of stress scenarios as part of its business planning and risk management. The principal risks facing the Group include credit, interest rate, liquidity, operational and conduct risk. A more detailed review of these risks and others faced by the Group and the actions taken to mitigate them are set out in the Risk Management Report on pages 26 to 31.

Key market and economic factors affecting the business

The mortgage market showed signs of recovery in 2013 with rising House Price Indices ('HPI') and government stimulus in the form of the FLS and Help-to-Buy Scheme, but is still some way from returning to pre-crisis lending levels. The savings market remains uncertain as household incomes continue to be squeezed due to slow economic growth, government spending cuts and limited wage growth. Competition for retail savings declined following the introduction of the Funding for Lending Scheme, significantly reducing rates, and narrowing the spread between retail savings rates and LIBOR. This tightening helped improve profitability by reducing the strain from the Bank's low-yielding back book. The spread remains high compared to historical levels and should narrow further when interest rates start to rise.

Inflation (CPI) finished the year at the Bank of England's ('BoE') target level of 2%, relieving pressure on the BoE to raise interest rates despite recent increases in HPI. Unemployment levels also fell during the year from a high of 7.9% to 7.2% in December. The market is predicting the first BoE rate rise in the first half of 2015, although the BoE has indicated that it will not raise rates until further spare capacity within the economy is absorbed and even then the rates are expected to rise only gradually.

The economic recovery characterised by strong GDP growth, rising HPI and low inflation and falling unemployment should lessen the impact of rising interest rates on affordability and repossessions. In addition, when underwriting new lending, the Bank uses stressed interest rates when assessing affordability.

The strategic report on pages 3 to 23 was approved by the Board of Directors and signed on behalf of the Board.

Stephan Wilcke
Chairman
13 March 2014

The Directors present their report and accounts for the year ended 31 December 2013. The Group made a profit after taxation of £26.8m (2012: £9.1m).

Principal activities

OneSavings Bank plc ('OSB' or 'the Bank' or together with its subsidiaries, the 'Group') began trading as a bank on 1 February 2011 when the trade and assets of Kent Reliance Building Society ('KRBS') were transferred into the business.

OSB is a specialist lending and retail savings group, authorised by the Prudential Regulation Authority, part of the Bank of England, and regulated by the Financial Conduct Authority and Prudential Regulation Authority.

See Business Review on pages 15 to 23 for further details.

Financial risk management objectives and policies

OSB has formal structures in place to monitor, report upon and manage the risks associated with the activities of the Group. Further details are set out in the Risk Management Report on pages 26 to 31. The financial instruments used by the Group to manage the structure of its financial position and to mitigate risks are disclosed in note 29 to the financial statements.

Charitable donations

Charitable donations made during the year amounted to £21,330 (2012: £2,870). The Group has made donations to various Kent charities. No political donations were made during the year (2012: £nil).

Directors

The full list of Directors serving on the Board during the year to 31 December 2013 was as follows:

R Duke (Independent Director and Chair of the Risk Committee)

A Golding (Chief Executive)

T Hanford

M McCaig (Chairman of the Audit Committee)

Sir C McCarthy

D Mills (Senior Independent Director)

Dr D Morgan

A Talintyre (Finance Director)

S Wilcke (Executive Chairman of the Board)

P Williams (Resigned 31 December 2013)

Going concern

In preparing the financial statements the Directors must satisfy themselves that it is reasonable for them to consider whether it is appropriate to adopt the going concern basis.
The Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. Projections for the Group have been prepared covering its future performance, capital and liquidity for a period in excess of 12 months from the date of approval of these accounts including stress scenarios. These projections show that the Group has sufficient capital to continue to meet its regulatory capital requirements as set out by the Prudential Regulation Authority. Therefore, the going concern basis of accounting has been used to prepare the financial statements.

Auditors

Our auditors, KPMG Audit Plc has instigated an orderly wind down of business as part of a simplification of their corporate structure and is not seeking reappointment. The Board has decided to put KPMG LLP forward to be appointed as auditors and resolution concerning their appointment will be put to the forthcoming AGM of the Bank.

On behalf of the Board

Stephan Wilcke
Chairman

13 March 2014

Introduction

A core objective for the Group is the effective management of risk in order to protect depositors, borrowers and shareholders, and to ensure that the Group at all times has adequate capital and liquidity resources.

The principal risks facing the Group are as discussed in this section: credit risk, market risk (including interest rate risk), liquidity risk, operational risk and conduct risk with some ancillary risks including regulatory risk and taxation risk. The Group's Chief Risk Officer is responsible for ensuring each risk is adequately identified, monitored, managed and/or mitigated.

Over the course of 2013 the risk profile of the Group and its ability to control and manage risk has evolved favourably in many aspects. The improved financial performance of the Group is an important factor as it allows the bank to continue along its fast growth trajectory whilst maintaining robust capital levels. Some further highlights are listed below:

- Balances 3+ months in arrears make up 1.6% of the originated book (excluding legacy problem loans) at end-2013, down from 2.2% at end-2012.
- Balances 3+ months in arrears make up 7.8% of the acquired books at end-2013, down from 11.0% at end-2012, and with acquired portfolios performing favourably to forecasts made at the time of acquisition. Average LTV (excluding Personal Loans) was 57.8% on a look-through basis (based on carrying value after purchase discount/premium and impairment provisions), providing significant credit protection.
- Legacy problem loans have been reduced to £43.8m at end-2013, which is down from £65.2m at end-2012.
- Interest rate and basis risk were managed well within Board-approved limits during 2013 with enhanced measurement of interest rate risk implemented to account for non-parallel movements of the yield curve.
- Liquidity forecasting and management improved enabling the Group to manage liquidity more efficiently, adjusting more quickly to changing liquidity needs and market conditions.
- The launch of the Group's inaugural securitisation raised £273m of term funding and diversified the Group's sources of funding.
- A web based operational risk management system was rolled out to all staff improving the Group's ability to capture information about operational incidents and informing process enhancements.

The following section provides an overview of the Group's risk management framework followed by a more detailed discussion of the key risks facing the Group and how these risks are managed.

Risk Management Framework

The Board is responsible for ensuring that an effective risk management framework is in place. The risk management framework consists of five key components:

1. **Strategy and Risk Appetite**: The Board's articulation of strategic intent and risk appetite, complemented by targets and risk limits set by executive management.
2. **Organisation:** Clear roles, responsibilities, reporting lines, committees and mandates.
3. **Policies and Procedures:** A comprehensive set of risk policies, processes and control procedures.
4. **Reporting and Analytics:** Comprehensive and timely management reporting of risk exposures.
5. **IT, Systems and Data:** Robust IT systems and data quality.

To support the risk management framework, the Group operates a "three lines of defence" model:

- The first line of defence comes through the operational management in the business, which maintains appropriate systems and controls on a day-to-day basis.
- The second line of defence comprises risk and compliance as well as the governance and oversight carried out by the committees shown in Figure 1.
- The third line of defence is independent review, challenge and assurance. This is provided by internal audit and the external audit assurance reviews. Assurance reporting is provided to the Audit Committee.

The Group's risk committee structure ensures proper governance and oversight and is illustrated in Figure 1.

Figure 1: Risk oversight and committee structure

	Board				
	Risk Committee, Audit Committee, Nominations Committee and Remuneration Committee				
	Executive Committee				
Risk theme	Credit Risk	Solvency, Market Risk (incl. Interest Rate Risk)	Liquidity and Funding Risk	Operational Risk	M&A
Governance	Credit Committee	Asset and Liability Committee	Asset and Liability Committee	Operational Risk Committee*	Executive M&A Committee (EMAC)
Key control documents	Lending, Arrears Handling and Provisions Policies	Interest Rate Risk and Treasury Policies	Treasury Policy and ILAA document	Operational Risk Policy	M&A procedure
Management information	Credit MI Pack	ALCO MI Pack	ALCO MI Pack	Operational Risk Update	Deal Qualification Memos

** A sub-committee of the Operations Committee*

Inorganic growth, through acquisition of both mortgage portfolios and whole secured lending businesses, is an important part of the Group's strategy. Reflecting this and as shown in the preceding diagram the Group has established an Executive Mergers and Acquisitions Committee (EMAC), which meets regularly to coordinate internal stakeholders, ensure due diligence covers all relevant aspects and oversee delivery of integration plans for completed deals. EMAC is chaired by the Chief Risk Officer.

Credit risk

Credit risk is the risk that losses are incurred as a result of the Group's borrowers or market counterparties failing to meet their obligations. The Group's exposure to retail and commercial credit risk is managed by the Credit Committee which reports to the Executive Committee and the Risk Committee. The Group's exposure to wholesale and counterparty credit risk is managed by the Asset and Liability Committee (ALCO) which reports to the Risk Committee and the Board.

Retail and wholesale credit risk

Credit risk is managed within the Group's underwriting process, which seeks to ensure that borrowers only take on debt that they can afford to repay, safeguarding both the borrower and the Group. On occasions, borrowers find themselves in financial difficulties which impact their ability to meet their mortgage or loan service obligations. The Group has established procedures to manage such situations to a satisfactory conclusion, which adhere to the principle of treating customers fairly. Usually this involves working with the borrower to clear arrears or making other arrangements commensurate with the borrower's circumstances. In some cases where the situation deteriorates significantly and irreparably, the Group takes legal action to gain possession or control of the underlying security.

In situations where the Group determines that it is appropriate in order to meet borrower needs, it applies a policy of forbearance and may grant a concession. The Group considers forbearance on a case-by-case basis. This may arise where the Group considers that the financial stress of the customer is temporary and potentially recoverable. Such a concession, which will only be implemented after obtaining the borrower's consent, may involve capitalisation of arrears, temporary or permanent conversion to an interest only repayment basis, a reduced monthly payment or a mortgage term extension. By dealing with arrears at an early stage and monitoring continuously, it is anticipated that a lower level of long-term arrears will be achieved, resulting in a more favourable outcome for both the customer and the business. Forbearance measures are considered in the review of loan impairment provisions. Table 1 summarises forbearance measures taken. There is a total collective provision of £50,164 on these accounts and no specific provisions.

Table 1: Forbearance measures undertaken during the financial year (balances 31 December 2013)

	Number	Loan balance, £'000	Arrears balances, £'000
Capitalisation	3	£400	£0
Temporary or Permanent Switch to Interest Only	80	£8,118	£676
Reduced Monthly Payments	17	£1,004	£36
Assistance with Voluntary Sale of Property	6	£0	£0
Loan Term Extension	30	£1,392	£0
Payment Holiday	18	£4,412	£4
Total	**154**	**£15,326**	**£717**
Total forborne as percentage of total lending book	**0.17%**	**0.79%**	**1.44%**
Total Kent Reliance	**88,459**	**£1,949,500**	**£49,800**

The six accounts on which the group assisted in voluntary sale of property carried a balance of £331,747 before the sale.

Wholesale and counterparty credit risk

Wholesale and counterparty credit risk arises from the risk that counterparties will be unable to repay loans and other financial instruments that the Group holds as part of its liquidity portfolio or for hedging purposes. This risk is managed by restrictions on the type of assets held, assessment of the creditworthiness of counterparties, maintenance of exposure limits with each counterparty, sector limits and collateral posting for derivatives and repo transactions. The Group has no exposure to the countries most affected by the Eurozone crisis (i.e. Portugal, Ireland, Italy, Greece and Spain). The Group has limited exposure to emerging markets (Indian operations) and non-investment grade debt.

The Group's exposure to wholesale and counterparty credit risk is centrally managed by Treasury and overseen by ALCO, which reports to the Risk Committee and the Board. This includes the Group's exposure undertaken by the subsidiary companies and the Rochester Financing No1 PLC securitisation vehicle.

Further analysis of the Group's exposure to credit risk is provided in note 29 to the accounts.

Market risk (including interest rate 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 of 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 customer value.

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. The Group manages its interest risk exposure on a continuous basis through the use of derivatives within limits set by the ALCO and the Board.

The secondary market risk faced by the Group is basis risk. Basis risk arises when the Group finances an asset with a liability that re-prices from a different interest rate index. The Group manages this exposure on a continuous basis within limits set by the ALCO. The Board-approved risk appetite limits for interest rate and basis risk are reviewed annually through the ICAAP process.

The Group holds Treasury assets that are classified as 'available-for-sale' and valued monthly, with the fair value recognised in the separate Available-for-Sale Reserve Account in accordance with accounting standards.

Further analysis of the Group's exposure to interest rate risk is provided in note 29 to the accounts.

Liquidity risk

Liquidity risk is the risk of having insufficient liquid assets to fulfil obligations as they become due or of 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, through wholesale funding facilities and control of the growth of the business.

In October 2013 the Group securitised c. £400m of mortgage assets that it had acquired from third-parties between 2011 and 2013. The Group retained all but the most senior tranches and therefore continues to bear the economic risk associated with the mortgages and consolidates the securitisation special purpose vehicle onto its balance sheet for Group accounting purposes. At inception the securitisation raised £273m of amortising term funding, which has therefore significantly diversified the Group’s sources of funding.

Liquidity management is governed by the Treasury Policy, which is developed, implemented and monitored by the ALCO, which also sets limits over the level and maturity profile of wholesale funding and monitors the composition of the Group balance sheet. A series of liquidity stress tests are performed daily to confirm that the limits are not at risk of being breached. Day-to-day management is delegated to the Treasury function. The Group conducts at least annually a detailed assessment of its liquidity risk known as the Internal Liquidity Adequacy Assessment (ILAA), which is approved by the Board.

Further analysis of the Group’s exposure to liquidity risk is provided in note 29 to the accounts.

Operational risk

Operational risk, which is inherent in all business activities, is the risk of direct or indirect loss resulting from inadequate or failed internal processes, people, or systems or from external events. It can occur in any of the Group’s businesses and includes errors, omissions, natural disasters and deliberate acts such as fraud. The Group manages this risk within an overall governance and control strategy. Within this structure, risk exposures are assessed to determine the appropriate controls to be applied. It is recognised that such risks can never be entirely eliminated and that the cost of controls to minimise these risks may outweigh the potential benefits. However, where appropriate, the Group continues to invest in risk management and mitigation such as business continuity management and incident management. Each business area or function has appointed an operational risk champion who is responsible for the day-to-day identification and reporting of operational incidents and regularly undertaking a forward-looking risk assessment. The Operational Risk Committee is responsible for the development, implementation and monitoring of the Operational Risk Policy.

Conduct risk

Conduct risk relates to the risk that a firm’s culture, organisation, behaviours and actions result in poor customer outcomes and customer detriment. Conduct risk can arise across all aspects of the Group’s operations including pre-sale, sale processes, post-sale processes and governance and control. The conduct regulatory environment changed significantly during 2013 with the transition to the FCA. Conduct risk has become the subject of increased scrutiny. Firms are expected to demonstrate that their conduct and culture result in appropriate and fair outcomes for their customers.

Conduct risk is a priority for the Group. We seek first to avoid conduct risk by putting customers at the heart of everything we do, and ensuring that the Group's culture reflects this. In addition we seek to manage the conduct risk which is inescapable, and have increased the resources we devote to this.

OSB is developing a robust, group-wide, conduct risk framework consisting of appropriate control, monitoring, policies and standards, which support fair and appropriate outcomes for customers by increasing our ability to manage conduct risks both in terms of identifying and mitigating emerging conduct risks and dealing with any customer detriment that may occur in a timely, fair and proportionate way. The framework is designed to cover all aspects of the product life-cycle, and past, current and future customer groups.

Regulatory risk

Regulatory risk is the risk of regulatory changes and enforcement, with the potential for fines and/or restrictions in business activities. Over recent years the financial services industry has seen increased regulatory scrutiny and supervision around governance, capital, liquidity and remuneration. There has also been focus on conduct and treating customers fairly. The Group regularly engages with the PRA, FCA and other industry bodies to proactively manage this risk.

Taxation risk

Taxation risk is the risk associated with changes in taxation law or in the interpretation of taxation law. It also includes the risk of changes in taxation rates and the risk of failure to comply with procedures required by taxation authorities. Failure to manage taxation risks could lead to an additional taxation charge.

Internal control

The internal control processes and effectiveness are reviewed by the Board, executive management, and the Bank's internal audit team.

Capital management

The Basel Committee on Banking Supervision introduced the Basel II and III framework for determining minimum capital and liquidity requirements, the definition of capital resources and other matters related to improving the resilience of the global financial system and to ensure a level playing field across the industry. The CRD IV package which transposes – via a Regulation and a Directive – the new global standards on bank capital (commonly known as the Basel III agreement) into the EU legal framework, entered into force on 17 July 2013.

The regulatory framework encourages a risk-based approach to determining capital adequacy. By adopting more sophisticated analytical approaches, financial institutions may be able to carry less regulatory capital for credit and operational risk. The Group has calculated its Pillar 1 minimum credit risk capital requirement based on the Standardised Approach and the minimum operational risk capital requirement using the Basic Indicator Approach.

The Group conducts at least annually a detailed assessment of its capital and financial resources, known as its Internal Capital Adequacy Assessment Process (ICAAP), which is approved by the Board. An analysis of the components of the Group's capital is provided in note 31 to the accounts.

Rod Duke
Chairman of the Risk Committee

Introduction

OneSavings Bank plc ("the Bank" or "Group") is a specialist lending and retail savings group. The Bank does not have an equity listing on the London Stock Exchange and therefore the UK Code of Corporate Governance does not apply in full to the Bank. However, the Bank remains committed to the achievement of high standards of corporate governance which it considers to be central to the effective management of the Group and to maintaining the confidence of its stakeholders. The Board therefore considers the UK Code on Corporate Governance to be a useful guide to achieving the high standards it aspires to and applies the Code in a proportionate manner, taking into account its various shareholders interests.

The Board of Directors

During the period of these accounts, the Board comprised the Chairman, two Executive Directors (A Directors), two independent Non-Executive Directors, three Non-Executive Directors appointed by OSB Holdco Ltd (B Directors) and two Non-Executive Directors appointed by KRPS (A Directors). P Williams (an A Director) retired from the Board on 31 December 2013.

The structure of the Board ensures that the Board as a whole has a deep understanding of the views of its shareholders.

The Board meets formally monthly (with the exception of July and December in 2013), 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.

The Board is responsible for setting the strategy for the Bank along with establishing the Bank's risk appetite and balance sheet strategy. The Board is also responsible for ensuring that there are appropriate financial and business systems and controls in place to safeguard the interests of the Bank's stakeholders. The Board is also responsible for ensuring the Bank's continuing commitment to carrying out its business fairly, honestly and openly, with a commitment to zero tolerance towards bribery.

The Board's Terms of Reference include a schedule of Matters Reserved for the Board which has formally delegated authority to a number of committees, which are constituted under Board approved terms of reference. Day-to-day management of the business has been delegated to the Chief Executive Officer through the Executive Committee.

The Board has oversight of how management implements the strategy and retains control through challenge at the Board and committee meetings. All Board members receive accurate, timely and clear information to enable them to make an effective contribution to Board discussions. The scope and nature of such information is reviewed on an ongoing basis to ensure that it remains relevant and concise.

Directors have access to the advice and services of the Company Secretary, whose appointment is a matter for the Board and who is responsible for ensuring Board procedures are followed and for advising the Board, through the Chairman, on matters relating to governance.

Board and Board Committee attendance record

A table showing attendance at scheduled meetings is shown below. Against each Director's name is shown the number of meetings he or she attended in the year to 31 December 2013. The number in brackets is the maximum number of scheduled meetings that the Director was eligible to attend.

Directors	Board	Audit	Risk	Remuneration	Nomination
R Duke	11(11)	3(4)	13(13)	-	-
A Golding	11(11)	-	-	-	-
T Hanford	10(11)	-	11(13)	2(2)	-
M McCaig	11(11)	4(4)	-	-	1(1)
Sir C McCarthy	9(11)	4(4)	-	-	-
D Mills	11(11)	4(4)	-	2(2)	1(1)
D Morgan	9(11)	-	-	-	1(1)
A Talintyre	11(11)	-	13(13)	-	-
S Wilcke	11(11)	-	12(13)	-	1(1)
P Williams	10(11)	-	-	2(2)	-

Board balance and independence

The Board consists of the Chairman, two Executive Directors and seven Non-Executive Directors, two of which were considered by the Board to be independent in accordance with the criteria of the UK Code on Corporate Governance during the period, R Duke and D Mills. The size and composition of the Board is kept under review to ensure an appropriate balance of skills and experience is represented on the Board. Non-Executive Directors play a vital role in challenging and helping develop strategy, while providing independent judgement, experience and knowledge.

In addition to his responsibilities as Chairman, S Wilcke is the Bank's executive lead on mergers and acquisitions activity.

The Board appointed D Mills to fulfil the role of Senior Independent Director.

Chairman and Chief Executive

The roles of Chairman and Chief Executive are held by different persons and their respective purposes are clear and distinct. The role of each is set out in their contracts and further detailed in the Governance Manual. The Chairman is responsible for leading the Board and ensuring it acts effectively and communicates with shareholders; the Chief Executive has overall responsibility for managing the Group and for implementing the strategies and policies agreed by the Board. The Chairman is elected by the Board and the Board is satisfied that during the period the Chairman was able to commit sufficient time to the Bank.

Appointments to the Board

Page 24 of the Directors' Report details the appointments to and resignations from the Board.

The Board has a Nominations Committee to lead the process for Board appointments and succession planning. At least annually the Committee reviews the structure, size and composition of the Board to ensure that it contains the required balance of skills, knowledge and experience relevant to the business. The Nominations Committee is also responsible for assessing potential Executive candidates identified by the CEO.

When searching for suitable Board candidates, the Nominations Committee will have regard to the existing skills matrix of the Board and look for candidates whose skills complement and enhance those already in place. The Nominations Committee will also have regard to the benefits of having a diverse Board, both in terms of ethnicity and gender. All Directors must meet the PRA's fit and proper standards and be registered with the PRA as an approved person to carry out the Controlled Function of a Director. Candidates for Board positions are identified in a number of ways, including the use of external search consultants and, where appropriate, open advertising.

Re-election

Directors are required to submit themselves for re-election at the first Annual General Meeting after their appointment and at least once in every three years thereafter. Succession planning for both Executive and Non-Executive members is reviewed and updated annually.

Performance evaluation

The Board undertakes an annual evaluation of its own performance and that of its Committees and individual Directors. Individual Non-Executive Directors are assessed on a one to one basis by the Chairman. The Chairman evaluates the Chief Executive's performance and the Senior Independent Director evaluates the Chairman's performance.

Board committees

The Board has established a number of committees with their own terms of reference, which are reviewed at least annually. The principal Board committees are set out below.

- The Audit Committee, chaired by M McCaig, met quarterly to consider all Group audit matters, the systems of internal control, financial reporting and whistle blowing.
- The Risk Committee, chaired by R Duke, met monthly or as required to monitor the Group's overall exposure to risk. It oversaw the identification and management of risks across the Group and the monitoring of operational, credit, liquidity and market risks.
- The Remuneration Committee, chaired by T Hanford, considered the Remuneration Policy and individual awards to Executive Directors and Senior Management.
- The Nominations Committee, chaired by D Mills, was responsible for keeping under review the size, structure and composition of the Board; nominating candidates to fill Board and Executive vacancies, taking into account the balance of skills, knowledge and experience on the Board; and for making appropriate recommendations to the Board.

Each of the newly acquired subsidiaries has monthly management meetings, attended by key members of the Bank's Executive team and quarterly Board meetings. At least one of the Bank's Executive team is a member of each subsidiary Board to ensure appropriate oversight and control.

System of internal controls

The Board is responsible for determining the Group's strategy for managing risk and overseeing its systems of internal control, and is committed to embedding internal control and risk management into the operation of the Bank. The Board has delegated oversight of internal control to the Audit Committee. The Chief Executive Officer and the Executive management are responsible for designing, operating and monitoring risk management and internal controls.

The Board formally approves the Bank's risk appetite and management policy framework. The systems are designed to manage the risk within the Bank's risk appetite rather than eliminate the risk that the Bank does not meet its business objectives. The key risks facing the Bank, and the systems it has in place to manage those risks, are set out in the Risk Management Report on pages 26 to 31.

The Bank has a Chief Risk Officer who heads up the Bank's Risk Function. The Chief Risk Officer provides monthly reports to the Board on key risks within the business and the effectiveness of controls in place to mitigate such risks.

The Bank has a Group General Counsel and Company Secretary who heads up the Bank's Compliance Function, supported by the Head of Compliance. The Group General Counsel and Company Secretary provides monthly reports to the Board on key compliance issues identified through thematic reviews and ongoing monitoring, along with an update on key regulatory developments. The Compliance Department also ensures that there is a framework of key controls within the business and that these are tracked and reported against.

Following a retender process carried out in 2013, Grant Thornton have been appointed to provide an internal audit function to the Group. The internal audit function is responsible for independently reviewing and reporting on the adequacy and effectiveness of internal controls put in place by management. The internal audit function agrees an internal audit plan annually with the Audit Committee. The internal audit reports assist management to evaluate and improve the effectiveness of risk management, regulatory compliance, control and governance processes and assist the Audit Committee to oversee the effectiveness of internal controls. The Board is satisfied that during the period the Group maintained an adequate and appropriate system of internal control.

Audit Committee and auditors

The role of the Audit Committee includes a review of the Group's accounting policies at least annually, a review of the financial statements including any significant financial reporting judgements on which they are based and monitoring the systems of internal control.

The Group has a policy on the use of the external auditors for non-audit work, which has been approved by the Audit Committee. The purpose of this policy, which requires the formal prior approval of the Audit Committee for any ancillary services, is to ensure the continued independence and objectivity of the external auditors. The Audit Committee reviews annually the relationship with external and internal auditors and approves their terms of engagement and remuneration.

In evaluating the Group's financial statements for the year ended 31 December 2013 the Committee considered in particular:

- Changes to accounting policies;
- The levels of impairment provisions against financial assets;
- The calculation of interest receivable and similar income under the Effective Interest Rate method;
- The recoverability of the Group's deferred tax assets; and
- The Group's capital and funding position and forecasts.

The Committee received papers on each of these topics which detailed the position in the Financial Statements, and assumptions and methodologies used. These were reviewed and discussed with executive management and the external auditors in detail. The Committee also considered whether this Annual Report taken as a whole, is fair, balanced and clear and provides the information necessary for a reader to assess the Group's performance, business model and strategy.

The Committee was able to reach satisfactory conclusions on all of the above matters and therefore resolved to recommend the Annual Report to the Board for approval.

Financial reporting

The responsibilities of the Directors in preparing the Group's accounts are set out on pages 40 to 41.

Stephan Wilcke
Chairman

Introduction

The purpose of this report is to outline the Board's policy for the remuneration of the Group's Executive team and its Non-Executive Directors and explain the process for setting Directors' remuneration. The Remuneration Committee applies the principles of the PRA's Remuneration Code as applicable to Tier III firms.

Remuneration Committee

The Remuneration Committee comprises three Non-Executive Directors, with attendance by the Chief Executive as appropriate. The members of the Committee for the period of these accounts were Tim Hanford (Chairman), David Mills and Peter Williams. Following Peter Williams' retirement from the Board on 31 December 2013, Malcolm McCaig has been appointed to the Committee from 1 January 2014. The Chief Executive withdraws from the meeting when his own remuneration is considered.

The Remuneration Committee has responsibility for determining and monitoring policy on and setting levels of remuneration, termination, performance-related pay, pension arrangements, reporting and disclosure, share incentive plans for each of the Executive Directors and certain senior executives of the Group, as well as the appointment of remuneration consultants.

The Committee is provided with executive remuneration and benefits data from comparative organisations across the financial services industry and banking sector and procures such other relevant data from independent expert sources as appropriate.

During 2013 the Group implemented all the provisions of the PRA's Remuneration Code as applicable to the Group.

Remuneration Policy

The Remuneration Policy of the Group seeks to attract and retain employees of appropriate calibre to execute its strategy, while benchmarking ensures that fixed remuneration is within market levels, given the size, nature, location and complexity of the business. The Policy aligns discretionary rewards with the performance of the business against Board approved budget and objectives, and the individual performance that is measured on a balanced business scorecard basis, including consideration of the Bank's stated values. The Remuneration Policy ensures that remuneration practices promote effective and sound risk management.

The Executive Remuneration package can comprise the following elements:

Basic salary

- Basic salary is determined by levels of responsibility, external market competitiveness and individual performance in the role. The Group's policy is to position salaries so that, on average, they are in line with salary packages for comparable positions in similarly performing financial institutions, taking account of the level of other benefits provided;

Medium Term Incentive Plan

- The Executive Directors, Chairman (in his role as the Bank's executive lead on merger and acquisition activity) and other Executives participate in a non-pensionable medium term incentive plan under which cash bonuses are awarded at the discretion of the Board, when determined appropriate, according to success in the delivery of corporate and individual objectives. Cash bonuses are all capped at less than 100%

of basic salary. A proportion of the cash bonuses are deferred over a three-year period and are subject to claw back in the event that financial targets are not met or if there is a material financial downturn or failure of risk management before the end of the deferral period.

- **Long Term Incentive Plan**

  The purpose of the scheme is to reward execution of the Bank's strategy and growth in shareholder value over a multi year period. The participants include the Executive Directors, the Chairman and executive management of the Group who make a co-investment in the B Shareholder of the Bank (OSB Holdco Limited) and, subject to vesting conditions, receive Growth Shares in the B Shareholder that entitle the participants to share in the profit realised by funds advised by JC Flowers, but carry no dividend rights.

  There are no performance conditions attached to the vesting or participation of the Shares, however there are leaver provisions which dictate what proportion of vested or unvested shares will be forfeited.

  The terms of the Scheme have been approved by the Remuneration Committee and by the Shareholders.

- **Benefits**

  All of the executive management team receive car allowances and are members of a contributory defined contribution pension scheme. Some Executives also received relocation allowances when taking up their appointments.

Directors Service Contracts

Standard contractual terms for Executive level appointments include notice periods of between 3 and 12 months. The remuneration of each Executive Director is set out in note 7 to the report and accounts.

Non-Executive Directors' fees

Fees for each Non-Executive Director are set out in note 7 to the report and accounts. Non-Executive Directors are remunerated solely by fees. They do not receive any salary, performance incentive, pension contribution or other taxable benefit for their services as non-Executive Directors. S Wilcke received a salary, performance incentive and pension contribution in respect of his role as the Bank's lead on merger and acquisition activity, as set out in note 7 to the report and accounts.

The Group's policy is to position fees so that they are in line with fees paid by similarly performing financial services organisations. Enhanced fees are paid to the chairmen of the Audit and Risk Committees commensurate with the additional responsibilities inherent in these roles.

Fees are determined annually by the Board on the basis of recommendations by the Remuneration Committee. The Committee is provided with fee data from comparative organisations across the financial services industry and banking sector and procures such other relevant data from independent expert sources as appropriate.

OneSavings Bank plc
Directors' Remuneration Report
For the year ended 31 December 2013

Summary

This report, together with the disclosures in note 7 to the Report and Accounts, is provided to give members a full explanation of the policy and application of Directors' remuneration.

Tim Hanford
Chairman of the Remuneration Committee

OneSavings Bank plc
Statement of Directors' Responsibilities
For the year ended 31 December 2013

The Directors are responsible for preparing the Annual Report and Financial Statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and parent company financial statements for each financial year. Under that law they have elected to prepare both the Group and the parent company financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and applicable law.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent company and of their profit or loss for that period. In preparing each of the Group and parent company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- 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 Group and the Bank's transactions and disclose with reasonable accuracy at any time the financial position of the Group and the Bank and enable them to ensure that its 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.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement of the Directors in respect of the Annual Report and Financial Statements

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 Directors' report includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

Disclosure of information to Auditors

The Directors who held office at the date of approval of this Report and Financial Statements confirm that:

- so far as they are aware, there is no relevant audit information of which the Company's Auditors are unaware and
- each Director has taken all the steps that they ought to have taken as a Director to make themselves aware of any relevant audit information and to establish that the Company's Auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

Stephan Wilcke
Chairman

Independent Auditor's Report to the members of OneSavings Bank Plc

We have audited the financial statements of OneSavings Bank Plc for the year ended 31 December 2013 set out on pages 44 to 106. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on pages 40 and 41, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

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.

Opinion on financial statements

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 2013 and of the group's profit for the year then ended;

- the group financial statements have been properly prepared in accordance with 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.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us 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 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.

Richard Gabbertas (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
1 The Embankment
Neville Street
Leeds LS1 4DW
13 March 2014

OneSavings Bank plc
Statement of Profit or Loss
For the year ended 31 December 2013

	Notes	Group Year ended 31-Dec-13 £'000	Group Year ended 31-Dec-12 (restated) £'000
Interest receivable and similar income	2	**150,607**	**87,293**
Interest payable and similar charges	3	**(79,841)**	**(71,132)**
Net interest income		**70,766**	**16,161**
Fair value losses on financial instruments	4	**(840)**	**(561)**
Gains / (losses) on sales of financial instruments	5	**(24)**	**2,893**
Fees and commissions receivable		**728**	**241**
Fees and commissions payable		**(1,696)**	**(1,140)**
External servicing fees		**(3,503)**	**(1,601)**
Total income		**65,431**	**15,993**
Administrative expenses	6	**(23,986)**	**(18,836)**
Depreciation and amortisation	15,16	**(547)**	**(460)**
Operating profit / (loss)		**40,898**	**(3,303)**
Regulatory provisions	27	**(2,152)**	**(930)**
Impairment losses	13	**(7,329)**	**(5,301)**
Profit / (Loss) before negative goodwill		**31,417**	**(9,534)**
Negative goodwill		**-**	**17,603**
Profit before taxation		**31,417**	**8,069**
Taxation	8	**(4,646)**	**996**
Profit for the year		**26,771**	**9,065**

The above results are derived wholly from continuing operations.

The notes on pages 50 to 106 form part of these accounts.

The financial statements on pages 44 to 106 were approved by the Board of Directors on 13 March 2014.

OneSavings Bank plc

Statement of Other Comprehensive Income

For the year ended 31 December 2013

	Group Year ended 31-Dec-13 £'000	Group Year ended (restated) 31-Dec-12 £'000
Other comprehensive income:		
Fair value changes on available-for-sale securities	**(1,836)**	**(467)**
Revaluation of foreign operations	**372**	**31**
Deferred tax taken to other comprehensive income	**395**	**(70)**
Other comprehensive income for the year	**(1,069)**	**(506)**
Profit for the year	**26,771**	**9,065**
Total comprehensive income for the year	**25,702**	**8,559**

The notes on pages 50 to 106 form part of these accounts.

OneSavings Bank plc

Statement of Financial Position

As at 31 December 2013

	Note	Group 31-Dec-13 £'000	Bank 31-Dec-13 £'000	Group 31-Dec-12 (restated) £'000	Bank 31-Dec-12 (restated) £'000
Assets					
Liquid assets					
Cash in hand and balances with the Bank of England		**267**	**267**	**282**	**282**
Loans and advances to credit institutions	9	**269,101**	**247,648**	**291,700**	**289,511**
Investment securities	10	**361,045**	**361,045**	**410,339**	**410,339**
		630,413	**608,960**	**702,321**	**700,132**
Loans and advances to customers	11	**3,041,248**	**2,322,268**	**2,196,050**	**1,496,853**
Derivative assets	29	**757**	**757**	**-**	**-**
Fair value hedges - assets		**67,863**	**67,863**	**86,501**	**86,501**
Deferred taxation asset	17	**10,901**	**7,260**	**15,472**	**13,257**
Intangible assets	15	**1,117**	**1,117**	**910**	**910**
Property, plant and equipment	16	**4,955**	**1,812**	**4,231**	**1,691**
Investments in subsidiaries and intercompany loans	14	**-**	**713,105**	**-**	**703,683**
Other assets	18	**6,632**	**6,326**	**3,175**	**1,423**
Total assets		**3,763,886**	**3,729,468**	**3,008,660**	**3,004,450**
Liabilities					
Amounts owed to retail depositors	19	**3,251,576**	**3,251,576**	**2,744,646**	**2,744,646**
Amounts owed to credit institutions	20	**1,438**	**1,438**	**3,190**	**3,190**
Amounts owed to other customers	21	**2,351**	**2,351**	**21,763**	**21,763**
Debt securities in issue	22	**273,759**	**-**	**-**	**-**
Derivative liabilities	29	**22,566**	**22,566**	**63,949**	**63,949**
Fair value hedges - liabilities		**-**	**-**	**3,475**	**3,475**
Current taxation liability		**69**	**-**	**-**	**-**
Deferred taxation liability	17	**-**	**-**	**389**	**389**
Intercompany loans	14	**-**	**254,875**	**-**	**-**
Other liabilities	23	**12,826**	**10,486**	**10,241**	**9,308**
FSCS and other provisions	27	**1,281**	**1,281**	**2,316**	**2,316**
Subordinated liabilities	24	**27,579**	**27,579**	**27,576**	**27,576**
Perpetual subordinated bonds	25	**15,263**	**15,263**	**15,189**	**15,189**
		3,608,708	**3,587,415**	**2,892,734**	**2,891,801**
Equity					
Equity		**155,178**	**142,053**	**115,926**	**112,649**
Total equity and liabilities		**3,763,886**	**3,729,468**	**3,008,660**	**3,004,450**

The notes on pages 50 to 106 form part of these accounts.
The financial statements on pages 44 to 106 were approved by the Board of Directors on 13 March 2014.

Andy Golding
Chief Executive
13 March 2014

April Talintyre
Finance Director
13 March 2014

OneSavings Bank plc
Statement of Changes in Equity
For the year ended 31 December 2013

Group 2013	Share capital £'000	Capital contribution £'000	Share premium £'000	Foreign exchange reserve £'000	Transfer reserve £'000	Available-for-sale reserve £'000	Retained earnings £'000	Equity bonds* £'000	Total £'000
Balance at 1st January 2013	1,001	3,326	105,149	31	(12,818)	1,285	(4,048)	22,000	115,926
Profit for the year	-	-	-	-	-	-	26,771	-	26,771
Coupon paid on equity bonds	-	-	-	-	-	-	(1,450)	-	(1,450)
Other comprehensive income	-	-	-	372	-	(1,441)	-	-	(1,069)
Capital injections	264	-	14,736	-	-	-	-	-	15,000
Balance at 31 December 2013	1,265	3,326	119,885	403	(12,818)	(156)	21,273	22,000	155,178

Bank 2013	Share capital £'000	Capital contribution £'000	Share premium £'000	Foreign exchange reserve £'000	Transfer reserve £'000	Available-for-sale reserve £'000	Retained earnings £'000	Equity bonds* £'000	Total £'000
Balance at 1st January 2013	1,001	-	105,149	-	(15,231)	1,285	(1,555)	22,000	112,649
Profit for the year	-	-	-	-	-	-	17,295	-	17,295
Coupon paid on equity bonds	-	-	-	-	-	-	(1,450)	-	(1,450)
Other comprehensive income	-	-	-	-	-	(1,441)	-	-	(1,441)
Capital injections	264	-	14,736	-	-	-	-	-	15,000
Balance at 31 December 2013	1,265	-	119,885	-	(15,231)	(156)	14,290	22,000	142,053

* Equity bonds comprise £22m of 6.591% perpetual subordinated bonds. See note 26 for more detail.

The reserves are further disclosed in note 26.

OneSavings Bank plc
Statement of Changes in Equity
For the year ended 31 December 2013

Group 2012 (restated)	Share capital £'000	Capital contribution £'000	Share premium £'000	Foreign exchange reserve £'000	Transfer reserve £'000	Available-for-sale reserve £'000	Retained earnings £'000	Equity bonds* £'000	Total £'000
Balance at 1st January 2012	361		90,639	-	(12,818)	1,822	(11,663)	22,000	90,341
Profit for the year	-	-	-	-	-	-	9,065	-	9,065
Coupon paid on equity bonds	-	-	-	-	-	-	(1,450)	-	(1,450)
Other comprehensive income	-	-	-	31	-	(537)	-	-	(506)
Capital injection 28 June 2012	490	-	14,510	-	-	-	-	-	15,000
Capital contribution	-	2,054	-	-	-	-	-	-	2,054
Ordinary B shares issued	-	1,272	-	-	-	-	-	-	1,272
Ordinary E shares issued	150		-	-	-	-	-	-	150
Balance at 31 December 2012	1,001	3,326	105,149	31	(12,818)	1,285	(4,048)	22,000	115,926

Bank 2012 (restated)	Share capital £'000	Capital contribution £'000	Share premium £'000	Foreign exchange reserve £'000	Transfer reserve £'000	Available-for-sale reserve £'000	Retained earnings £'000	Equity bonds* £'000	Total £'000
Balance at 1st January 2012	361		90,639	-	(15,231)	1,822	(7,122)	22,000	92,469
Profit for the period	-	-	-	-	-	-	7,017	-	7,017
Coupon paid on equity bonds	-	-	-	-	-	-	(1,450)	-	(1,450)
Other comprehensive income	-	-	-	-	-	(537)	-	-	(537)
Capital injection 28 June 2012	490	-	14,510	-	-	-	-	-	15,000
Ordinary B shares issued	-	-	-	-	-	-	-	-	-
Ordinary E shares issued	150	-	-	-	-	-	-	-	150
Balance at 31 December 2012	1,001	-	105,149	-	(15,231)	1,285	(1,555)	22,000	112,649

* Equity bonds comprise £22m of 6.591% perpetual subordinated bonds. See note 26 for more detail.

The reserves are further disclosed in note 26.

OneSavings Bank plc
Statement of Cash Flows
For the year ended 31 December 2013

	Group Year ended 31-Dec-13	Group Year ended 31-Dec-12 (restated)
	£'000	£'000
Cash flows from operating activities		
Profit before tax	31,417	8,069
Adjustments for:		
Depreciation and amortisation	547	460
Negative goodwill	-	(17,603)
Interest on subordinated liabilities	1,256	1,299
Interest on perpetual subordinated bonds	1,255	1,254
Net impairment charge on loans and advances	7,329	5,301
(Gain) / loss on sale of financial instruments	24	(2,893)
FSCS and other provisions	2,152	930
Fair value losses on financial instruments	840	561
Exchange differences on foreign operations	452	-
FSCS provision paid	(3,187)	-
Tax (paid) received	(489)	996
	41,596	(1,626)
Changes in operating assets and liabilities		
Decrease (increase) in loans and advances to credit institutions	87,024	(41,880)
(Increase) in loans to customers	(852,528)	(452,215)
Increase in retail deposits	506,930	663,056
(Increase) in other assets	(3,964)	(1,529)
(Decrease) in derivatives and hedged items	(27,817)	(21,773)
(Decrease) in bank and other deposits	(21,164)	(14,272)
Net increase in other liabilities	3,586	5,511
Cash (used in) / generated from operating activities	(266,337)	135,272
Cash flows from investing activities		
Net sales (purchases) of investment securities	47,434	(47,328)
Purchases of equipment and intangible assets	(1,559)	(3,248)
Acquisition of subsidiaries, net of cash acquired	-	(1,209)
Cash (used in) / generated from investing activities	45,875	(51,785)
Cash flows from financing activities		
Coupon paid on equity bonds	(1,450)	(1,450)
Interest paid on bonds and subordinated debt	(2,437)	(2,453)
Share issues	15,000	15,000
Net issue of debt	273,759	-
Refinancing of acquisitions	-	(84,396)
Cash generated from / (used in) from financing activities	284,872	(73,299)
Net increase in cash and cash equivalents	64,410	10,188
Cash and cash equivalents at the beginning of the period		
Cash in hand and balances with the Bank of England	282	253
Loans and advances to credit institutions repayable on demand	204,676	194,517
	204,958	194,770
Cash and cash equivalents at the end of the period		
Cash in hand and balances with the Bank of England	267	282
Loans and advances to credit institutions repayable on demand	269,101	204,676
	269,368	204,958
Movement in cash and cash equivalents	64,410	10,188

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 (IFRSs) as adopted by the European Union (EU); and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC).

The financial statements have been prepared on historical cost basis, as modified by the revaluation of available for sale financial assets, derivative contracts and financial assets held at fair value through profit or loss.

During the year the Bank changed its accounting policy for FSCS levies based on IFRIC 21's interpretation of IAS 37. This has caused the trigger date for the FSCS levy to change from 31 December each year to the following 1 April. IFRIC 21 requires the total liability to be recognised at the trigger date, therefore the change has resulted in a restatement of the comparatives for 2012. Details of the restatement are included in note 33.

As permitted by section 408 of the Companies Act 2006, no statement of profit or loss is presented for the Bank.

b) Going concern

The Board undertakes regular rigorous assessments of whether the Bank 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 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 to continue to meet its regulatory capital requirements as set out by the Prudential Regulatory Authority.

The Board has therefore concluded that the Group has sufficient resources to continue in operational existence for the foreseeable future 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 inter-company transactions, balances and unrealised gains on transactions are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

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.

The assets and liabilities of foreign operations with functional currencies other than sterling, including goodwill and consolidation fair value adjustments, 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. When a foreign operation is wholly or partly disposed of with loss of control, the relevant accumulated exchange differences are reclassified to profit or loss as part of gain or loss on disposal. In a partial disposal without loss of control, the proportionate share of cumulative exchange differences is reattributed to non-controlling interest.

e) Segmental reporting

IFRS 8 requires operating segments to be identified on the basis of internal reports and components of the Group 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 operates solely within the UK and the Channel Islands and as such no geographical analysis is required.

The Group has historically assessed the performance of the Group as a whole, but segmented its business for the first time in 2013.

The Group segments its lending by product, focusing on the customer need and reason for a loan. It operates under three segments; Residential Mortgages, Buy-to-Let/SME and Personal Loans.

f) Taxation

Income tax comprises current and deferred tax. It is recognised in profit or loss except to the extent that it relates to items recognised directly in other comprehensive income, in which case it is correspondingly recognised in other comprehensive income.

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 for unused tax losses, unused tax credits and deductible temporary differences to the extent that future taxable profits will be available to utilise them. Deferred tax assets are reviewed at each reporting date and reduced where it is no longer probable that the tax benefit will be realised.

Deferred tax is determined using the taxation rates and laws that have been enacted or substantively enacted at the reporting date and are expected to apply when the related temporary differences reverse.

Deferred tax assets and liabilities are offset where the Group has a legally enforceable right to offset and where they relate to income taxes levied by the same taxation authority either on an individual Group company or on Group companies in the same tax group that intend, in future periods, to settle current tax liabilities and assets on a net basis or on a gross basis simultaneously.

g) 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.

In calculating the EIR the Group estimates the cash flows considering all contractual terms but not future credit losses. Potential early repayment charges, origination fees received and paid on loans to customers, together with premium / discount paid on / received on acquired loan books and acquisition costs on loan books are included within loans and advances to customers and are amortised over the expected life of those assets using the EIR method.

Interest income on available for sale 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.

h) 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.

Certain fees that form an integral part of the EIR of loans and advances previously reported as fees and commissions receivable and payable in 2012 have been reclassified to interest receivable and similar income.

i) 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.

j) 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.

k) 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
Equipment, fixtures and vehicles	5 years

Leased assets are depreciated over the shorter of the lease term and their useful lives. Land is not depreciated.

The cost of repairs and renewals is charged to profit or loss in the period in which the expenditure is incurred.

l) Financial assets and liabilities

The Group initially recognises loans and advances, deposits, debt securities issued and subordinated liabilities on the date on which they 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. Financial assets are de-recognised when the rights to receive the cash flows have expired or the Group has transferred substantially all the risks and rewards of the ownership and does not retain control. Financial liabilities are de-recognised when the contractual obligations are discharged or cancelled, or expire.

The Group classifies its financial assets and liabilities in accordance with IAS 39 into the following categories:

(i) Loans and receivables: which are predominantly mortgage loans, advances to customers and money market advances 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 carrying value of the loans and advances so hedged includes a fair value adjustment for the hedged risk only.

(ii) Financial assets at fair value through profit or loss: are instruments:

- which upon initial recognition are designated at fair value through profit or loss to eliminate or significantly reduce a measurement recognition inconsistency or;
- which are acquired principally for the purpose of selling in the near term or forming part of the portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking.

Financial assets in this category are initially recognised and subsequently 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 as part of net income in profit or loss. The fair values are quoted market prices (where there is an active market) or are based on valuation techniques (where there is no active market or the securities are unlisted). Valuation techniques include the use of recent arm's length transactions, discounted cash flow analysis and other commonly used valuation methods. During the current and prior year no financial assets were designated at fair value through profit or loss.

(iii) Available-for-sale financial assets: comprise securities held for liquidity purposes (certificates of deposit, treasury bills and money market instruments in the nature of loans and advances to credit institutions). These assets are non-derivatives that are designated as available-for-sale and not categorised in any other financial asset categories. These are held at fair value with movements being taken to other comprehensive income and subsequently 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) Held-to-maturity investments: are non-derivative financial assets with fixed or determinable payments and fixed maturity where the Group intends to hold to maturity. These assets are held at amortised cost using the EIR method less any impairment.

(v) Financial liabilities: comprise deposits, debt securities and subordinated liabilities used as sources of funding. They include the 7.875% Perpetual Subordinated Bond where the terms allow no discretion over the payment of interest. The Group has no financial liabilities held for trading or designated at fair value through profit or loss.

Financial liabilities are initially measured at fair value less direct transaction costs, and subsequently held at amortised cost using the EIR method.

The 6.591% Perpetual Subordinated Bond is classified as equity as it was issued with terms that include discretion over the payment of interest.

(vi) Derecognition of financial assets and liabilities: Financial assets are derecognised when the contractual rights to receive cash flows have expired or 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.

(vii) Sale and repurchase agreements: Securities sold subject to repurchase agreements are retained in the financial statements when required under the de-recognition criteria of IAS 39. The securities 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. Securities purchased under agreements to resell at a pre-determined price 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.

m) Derivative financial instruments and hedge accounting

The Group uses derivative financial instruments (interest rate swaps) for the purpose of reducing fair value interest rate risk to hedge its exposure to the interest rate risk arising from financing and investment activities. In accordance with its treasury policy, the Group does not hold or issue derivative financial instruments for trading.

Derivative financial instruments are recognised at their fair value with changes in their fair value 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.

Certain derivatives embedded in financial instruments are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value. These embedded derivatives are separately measured at fair value with changes in fair value recognised in profit or loss.

The Group designates certain derivatives as a hedge of fair value of a portfolio of recognised assets or liabilities (macro fair value hedge). Hedge accounting is used for derivatives designated in this way provided the criteria specified in IAS 39 are met.

Where there is an effective hedge relationship for fair value hedges, the changes in fair value of the hedged item arising from the hedged risk are taken to profit or loss. The fair value changes of both the hedged item and the derivative substantially offset each other to reduce profit volatility. To qualify for hedge accounting at inception, the hedge relationship must be 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 or sale or the underlying hedged item matures, is sold or is repaid.

If a derivative no longer meets the criteria for hedge accounting the cumulative fair value hedging adjustment is amortised over a period up to the maturity of the previously designated hedge relationship. If the underlying item is sold or repaid the unamortised fair value adjustment is immediately reflected in profit or loss.

n) Impairment of financial assets

The Group regularly assesses whether there is evidence that a financial asset or a portfolio of financial assets not carried at fair value through profit or loss is impaired. A financial asset or portfolio of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of the asset and prior to the reporting date ('a loss event'), and that loss event or events has / or have had an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment. An individual provision is also made where an account is not in arrears but the Group has exercised forbearance in the conduct of the account. Any provision is based on a management assessment of the propensity for the account to realise a loss had forbearance not been shown taking account of the amount recoverable on mortgage indemnity cover and additional security.

For financial assets carried at amortised cost, the amount of impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original EIR.

Impairment losses on available-for-sale assets are recognised by transferring the cumulative loss that has been recognised directly in equity to the Income Statement. The cumulative loss that is removed from equity and recognised in the Income Statement is measured as the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss on that asset previously recognised in the Income Statement.

If, in a subsequent period, the fair value of the debt security classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the Income Statement, the impairment loss is reversed through the Income Statement.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure and any costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar risk characteristics, taking into account asset type, industry, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the counterparty's ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Group and historical loss experience for assets with credit risk characteristics similar to those in the Group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist. In addition, the Group uses its experienced judgement to estimate the amount of an impairment loss. This incorporates amounts calculated to overcome model deficiencies and systemic risks where appropriate and supported by historic loss experience data. The use of such judgements and reasonable estimates is considered by management to be an essential part of the process and does not impact reliability.

Impairment losses and any subsequent reversals are recognised in profit or loss. Following impairment, interest income is recognised using the original EIR which was used to discount the future cash flows for the purpose of measuring the impairment loss.

When a loan is uncollectible, it is written off against the related provision. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are taken through profit or loss.

The Bank's objective in restructuring a loan will primarily be to maximise the potential recovery of its outstanding debt. A loan restructuring is the modification or elimination of a loan prior to or at its maturity date by means other than those prescribed under the contractual terms of the loan agreement. This may involve extending the payment arrangements and the agreement of new loan conditions. When the terms of the loan have been re-negotiated, the loan is no longer considered past due. The Bank continually reviews re-negotiated loans to ensure that all criteria are met and future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original EIR.

o) Debt valuation adjustment

The debt valuation adjustment (DVA) is based on the expected loss (EL) a counterparty faces due to the risk of the Group’s default. The methodology is based on a standard calculation, taking into account

- the one-year probability of default,
- the expected exposure at default,
- the expected loss given default, and
- the average maturity of the swaps.

p) 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.

q) Employee benefits – defined contribution scheme

Obligations for contributions to defined contribution pension arrangements are recognised as an expense in profit or loss as incurred.

r) Business combinations and goodwill

Business combinations are accounted for using the purchase method of accounting. On acquisition of a subsidiary, its identifiable assets, liabilities and contingent liabilities are included in the consolidated accounts at their fair values. Any excess of the cost of acquisition over the fair values of the identifiable net assets is recognised as goodwill. If the cost of acquisition is less than the fair values of the identifiable net assets, the difference is treated as negative goodwill which is recognised directly in profit or loss in the year of acquisition.

Changes in ownership that do not result in loss of control are accounted for as equity transactions.

s) Securitisation

Special purpose entities (SPEs) used to raise funds through securitisation transactions are consolidated into the Group's operations under SIC 12 and IAS 27 as if they were wholly owned subsidiaries. Loans transferred to SPEs under securitisation agreements are not derecognised by the Bank because it retains risks and rewards of ownership.

t) 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) Impairment of financial assets: Financial assets held at amortised cost are assessed for impairment as described above. Specific provision assessment involves judgement in relation to future cash flows including the cost of obtaining and selling the collateral, the likely sale proceeds and any rental income prior to sale. The most critical estimate is of the level of house prices where a variance of 10% equates to a change of £4.2m (2012: £5.4m) in the provision.

Collective provisions are calculated using twelve month delinquency roll rates and one year probability of defaults on different segments of the mortgage book. These rates, along with forced sale discounts, are applied to calculate the expected losses. Judgement needs to be exercised in deciding how to apply historic experience to current market conditions. The most critical estimate is of the level of house prices where a variance of 10% equates to a change of £1.9m (2012: £2.3m) in the provision.

(ii) Fair values: The fair values used in the financial statements, including those for financial instruments, are, where market values are not available, calculated using valuation techniques utilising discounted cash flow models using yield curves based on observable market data. The fair values of mortgage assets acquired through company acquisitions are calculated utilising techniques including discounted cash flow models, which include assumptions based on loan and portfolio level attributes as well as macroeconomic assumptions, including HPI, unemployment levels and interest rates, to derive prepayment rates, the probability and timing of defaults and amount of expected losses.

(iii) Effective interest rate: To calculate the appropriate EIR the Group makes a number of assumptions relating to the expected lives of financial instruments, likely redemption profiles and the anticipated level of early repayment charges. For acquired mortgage books EIRs are calculated utilising 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 to derive prepayment rates, the probability and timing of defaults and the amount of incurred losses. Estimates are reviewed in each reporting period to ensure they reflect current and expected future performance.

(iv) Deferred taxation: 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 Board's projections of future taxable income are based on business plans, future capital requirements and ongoing tax planning strategies. These assumptions include the impact of credit losses, capital requirements and assumptions about the UK macroeconomic environment. The assumptions surrounding future expected credit losses represent the most subjective areas of judgement in the Board's projections of future taxable income. The Board's forecast supports the assumption that it is probable that the results of future operations will generate sufficient taxable income to utilise the deferred tax asset. The current estimates assume that the Group will utilise its deferred tax asset within the next 5 years.

2. Interest receivable and similar income

	Group Year ended 31-Dec-13 £'000	Group Year ended 31-Dec-12 £'000
On residential mortgages	100,135	73,494
On BTL/SME mortgages	42,729	23,262
On personal loans	14,488	-
On reverse repo transactions	39	-
On investment securities	3,386	4,291
On other liquid assets	1,942	2,787
Net expense on derivative financial instruments	(12,112)	(16,541)
	150,607	87,293

Included within interest receivable is £1,888k (2012: £1,817k) in respect of interest accrued on accounts with a specific provision.

3. Interest payable and similar charges

	Group Year ended 31-Dec-13 £'000	Group Year ended 31-Dec-12 £'000
On retail deposits	77,987	70,033
On Perpetual Subordinated Bonds	1,255	1,254
On subordinated liabilities	1,256	1,299
On wholesale borrowings	1,550	530
Net income on derivative financial instruments	(2,207)	(1,984)
	79,841	71,132

4. Fair value gains and losses on financial instruments

	Group Year ended 31-Dec-13 £'000	Group Year ended 31-Dec-12 £'000
Ineffective portion of hedges	673	1,340
Amortisation of cancelled swaps	(2,755)	(841)
Net gains / (losses) on unmatched swaps	1,135	(1,060)
Debt valuation adjustment	107	-
	(840)	(561)

Unmatched swaps are derivatives that do not form part of a hedging relationship.

The debt valuation adjustment (DVA) is calculated on the Group's derivative liabilities and represents exposure of their holders to the risk of the Group's default.

5. Gain on sales of financial instruments

The Bank routinely buys and sells liquidity assets in order to confirm the ease with which cash can be realised and the robustness of the valuations assigned to such assets. During the year, transactions in liquid assets led to the realisation of a net loss of £24k (2012: gain of £2,893k).

6. Administrative expenses

	Group Year ended 31-Dec-13 £'000	Group Year ended 31-Dec-12 (restated) £'000
Staff costs	13,421	8,522
Facilities costs	1,296	706
Marketing costs	661	462
Support costs	2,441	1,848
Professional fees	2,386	4,450
Other costs	3,781	2,848
	23,986	18,836

* A more meaningful split of administrative expenses has been presented this year and accordingly the comparatives have been restated. This includes reclassifying staff related costs in subsidiaries acquired in 2012 previously reported in other admin expenses.

Included in professional fees are amounts paid to the auditors of the Group, further analysed below:

Auditors remuneration:	Group Year ended 31-Dec-13 £'000	Group Year ended 31-Dec-12 £'000
Audit of the Bank and Group accounts	180	132
Audit of the Group's subsidiary undertakings pursuant to legislation	60	68
Tax advisory services	34	137
Tax compliance services	27	-
Audit related assurance services	36	23
All other non-audit services	46	238
	383	598

Staff numbers and costs

Staff costs comprise the following categories

	Group Year ended 31-Dec-13 £'000	Group Year ended 31-Dec-12 £'000
Salaries, incentive pay and other benefits	11,644	7,481
Social security costs	1,132	562
Other pension costs	645	479
	13,421	8,522

The average number of persons employed by the Group (including executive Directors) during the period was 342 (2012: 291).

7. Directors' emoluments and transactions

Executive Directors' emoluments – 2013

	Salary & fees £'000	Incentive pay* £'000	Other benefits £'000	Contribution to personal pension policy £'000	Year ended 31-Dec-13 Total £'000
A Golding	306	142	30	40	518
A Talintyre	230	86	8	30	354
Total executive emoluments	536	228	38	70	872

Executive Directors' emoluments – 2012

	Salary & fees £'000	Incentive pay * £'000	Other benefits £'000	Contribution to personal pension policy £'000	Year ended 31-Dec-12 Total £'000
A Golding	**300**	**115**	**22**	**29**	**466**
A Talintyre	**145**	**50**	**5**	**20**	**220**
J Wood	**14**	**-**	**-**	**-**	**14**
Total executive emoluments	**459**	**165**	**27**	**49**	**700**

* Incentive pay comprises cash bonuses. A proportion of these are deferred over a three-year period and subject to claw back in the event that financial targets are not met or if there is a material financial downturn or failure of risk management before the end of the deferral period.

Non-Executive Directors' emoluments

	Year ended 31-Dec-13 £'000	Year ended 31-Dec-12 £'000
R Duke	**50**	**25**
T Hanford	**40**	**38**
M McCaig	**50**	**47**
Sir C McCarthy	**40**	**38**
D Mills	**50**	**47**
Dr D Morgan	**40**	**38**
A Newell	**-**	**21**
S Wilcke	**364**	**346**
P Williams	**40**	**38**
	674	**638**
Total Directors' emoluments	**1,546**	**1,338**

S Wilcke’s remuneration is in respect of both his role as Chairman and as executive lead for M&A activity and comprises salary of £225k (2012: £261k), performance incentive pay of £110k (2012: £65k) and pension contributions of £29k (2012: £20k). During 2012 S Wilcke devoted the majority of his time to the Group, reducing to three days per week in 2013.

In addition, during 2013 A Golding, A Talintyre and S Wilcke subscribed for Growth Shares in OSB Holdco Ltd (‘Holdco'), one of the Bank's shareholders, under a long-term incentive plan ('LTIP') at nominal value. The purpose of the scheme is to reward executive management for execution of the Bank’s strategy and growth in shareholder value over a multi-year period, and is linked to the exit value attained by Holdco on exit.

The difference between the unrestricted market value and nominal value of the Growth Shares, grossed up for income tax and national insurance covered by the Bank, was £23k for A Golding, £9k for A Talintyre and £18k for S Wilcke. The Shares are subject to a vesting schedule and leaver provisions. A portion of the shares vested during 2013.

The figures above include £nil (2012: £nil) compensation for loss of office during the period.

The Directors' Remuneration Report explains the Board's policy on Directors' Remuneration and describes the process through which remuneration is determined.

At 31 December 2013 there were no outstanding loans granted in the ordinary course of business to Directors and their connected persons (2012: £nil)

8. Taxation

	Note	Year ended 31-Dec-13 £'000	Year ended 31-Dec-12 £'000
Prior year adjustments in subsidiaries		-	23
Corporation tax		(69)	-
Total current taxation		(69)	23
Deferred taxation	17	(4,577)	973
Total taxation		(4,646)	996

The taxation on the Group's profit / (loss) before taxation differs from the theoretical amount that would arise using the weighted average taxation rate applicable to profits / (losses) of the Group as follows:

Profit before taxation	31,417	8,069
Profit multiplied by the weighted average rate of corporation taxation in the UK during 2013 of 23.25% / 2012 - 24.5%	(7,304)	(1,978)
Taxation effects of:		
Expenses not deductible for taxation purposes	(147)	(234)
Negative goodwill	-	4,313
Adjustments in respect of earlier years	(1,330)	24
Coupon on PSBs	337	355
Capital allowances	29	55
Recognition of deferred taxation - Interbay group	4,185	-
Re-measurement of deferred taxation - change in taxation rate	(416)	(1,539)
Total taxation (charge) / credit	(4,646)	996

9. Loans and advances to credit institutions

	Group 31-Dec-13 £'000	Bank 31-Dec-13 £'000	Group 31-Dec-12 £'000	Bank 31-Dec-12 £'000
Loans and advances to credit institutions have remaining maturities as follows:				
Repayable on demand	102,185	80,732	204,676	202,487
Less than three months	166,916	166,916	87,024	87,024
	269,101	247,648	291,700	289,511

Of the above balance £166.9m (2012: nil) are short-term investments in securities purchased under agreements to resell (reverse repos). These securities have been included within cash equivalents in the statement of cash flows as they satisfy relevant recognition criteria.

10. Investment securities

	Group and Bank 31-Dec-13 £'000	Group and Bank 31-Dec-12 £'000
Government investment securities	339,171	367,870
Other investment securities:		
Listed	21,442	21,941
Unlisted	432	20,528
	361,045	410,339
Investment securities have remaining maturities as follows:		
Less than three months	144,935	120,410
Three months to one year	122,602	114,754
One to five years	72,066	69,606
More than five years	21,442	105,569
	361,045	410,339

The Directors of the Bank 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 Bank's activities and hence are classified as financial assets available-for-sale, loans and receivables or held-to-maturity as appropriate.

Movements during the year of investment securities classified as available-for-sale are analysed as follows:

	Group and Bank 31-Dec-13 £'000	Group and Bank 31-Dec-12 £'000
At 1 January	320,158	350,571
Additions	846,170	671,245
Disposals and maturities	(830,327)	(703,332)
Reclassifications	5,438	-
Changes in fair value	(1,836)	1,674
At 31 December	339,603	320,158

Movements during the year of investment securities classified as held-to-maturity are analysed as follows:

	Group and Bank 31-Dec-13 £'000	Group and Bank 31-Dec-12 £'000
At 1 January	68,240	10,766
Additions	167,000	62,705
Disposals and maturities	(229,802)	(5,231)
Reclassifications	(5,438)	-
At 31 December	-	68,240

During the year the Group sold more than an insignificant part of securities held-to-maturity. Under IAS 39, this triggered reclassification of the remaining securities to assets available-for-sale.

Movements during the period of investment securities classified as loans and receivables are analysed as follows:

	Group and Bank 31-Dec-13 £'000	Group and Bank 31-Dec-12 £'000
At 1 January	21,941	21,941
Disposals and maturities	(499)	-
At 31 December	21,442	21,941

11. Loans and advances to customers

	Group 31-Dec-13 £'000	Bank 31-Dec-13 £'000	Group 31-Dec-12 £'000	Bank 31-Dec-12 £'000
Residential mortgages	1,761,564	1,318,492	1,611,927	1,128,723
BTL/SME mortgages	1,076,474	800,566	584,123	368,130
Personal loans	203,210	203,210	-	-
	3,041,248	2,322,268	2,196,050	1,496,853

Maturity analysis

Loans and advances to customers are repayable from the reporting date as follows:

	Group 31-Dec-13 £'000	Bank 31-Dec-13 £'000	Group 31-Dec-12 £'000	Bank 31-Dec-12 £'000
Less than three months	48,854	44,100	42,883	41,395
Three months to one year	36,434	28,642	14,257	9,345
One to five years	361,562	300,745	136,476	96,635
More than five years	2,621,931	1,970,574	2,033,406	1,376,015
	3,068,781	2,344,061	2,227,022	1,523,390
Less: provision for impairment losses on loans and advances (see Note 12)	(27,533)	(21,793)	(30,972)	(26,537)
	3,041,248	2,322,268	2,196,050	1,496,853

The above analysis may not reflect actual experience of repayments, since many mortgage loans are repaid early.

During the year the Bank purchased a number of loan books from other financial institutions with a gross value of £182m for a total of £133m (2012: gross value £472m, purchase price £389m), and a portfolio of personal loans for £258m.

12. Provision for impairment losses on loans and advances

Movement in provision for impairment losses on loans and advances to customers is as follows:

Individual	**Residential mortgages £'000**	**BTL/SME £'000**	**Personal loans £'000**	**Total £'000**
Group				
At 1st January 2013	**1,179**	**27,249**	**-**	**28,428**
Write offs in year	**(3)**	**(10,765)**	**-**	**(10,768)**
Charge/(credit) for the year net of recoveries	**1,041**	**5,761**	**-**	**6,802**
At 31 December 2013	**2,217**	**22,245**	**-**	**24,462**
Bank				
At 1st January 2013	**524**	**23,781**	**-**	**24,305**
Write offs in year	**(3)**	**(9,611)**	**-**	**(9,614)**
Recoveries of amounts previously provided	**-**	**-**	**-**	**-**
Charge/(credit) for the year net of recoveries	**210**	**3,990**	**-**	**4,200**
At 31 December 2013	**731**	**18,160**	**-**	**18,891**

Collective	**Residential mortgages £'000**	**BTL/SME £'000**	**Personal loans £'000**	**Total £'000**
Group				
At 1st January 2013	**1,356**	**1,188**	**-**	**2,544**
Write offs in year	**-**	**-**	**-**	**-**
Charge/(credit) for the year net of recoveries	**(498)**	**(1,073)**	**2,098**	**527**
At 31 December 2013	**858**	**115**	**2,098**	**3,071**
Bank				
At 1st January 2013	**1,260**	**972**	**-**	**2,232**
Write offs in year	**-**	**-**	**-**	**-**
Charge/(credit) for the year net of recoveries	**(480)**	**(948)**	**2,098**	**670**
At 31 December 2013	**780**	**24**	**2,098**	**2,902**

Total	**Residential mortgages**	**BTL/SME**	**Personal loans**	**Total**
	£'000	**£'000**	**£'000**	**£'000**
Group				
At 1st January 2013	**2,535**	**28,437**	**-**	**30,972**
Write offs in year	**(3)**	**(10,765)**	**-**	**(10,768)**
Charge/(credit) for the year net of recoveries	**543**	**4,688**	**2,098**	**7,329**
At 31 December 2013	**3,075**	**22,360**	**2,098**	**27,533**
Bank				
At 1st January 2013	**1,784**	**24,753**	**-**	**26,537**
Write offs in year	**(3)**	**(9,611)**	**-**	**(9,614)**
Charge/(credit) for the year net of recoveries	**(270)**	**3,042**	**2,098**	**4,870**
At 31 December 2013	**1,511**	**18,184**	**2,098**	**21,793**

Individual	**Residential mortgages**	**BTL/SME**	**Personal loans**	**Total**
	£'000	**£'000**	**£'000**	**£'000**
Group				
At 1st January 2012	**2,340**	**28,692**	**-**	**31,032**
Write offs in year	**(1,415)**	**(5,206)**	**-**	**(6,621)**
Charge/(credit) for the year net of recoveries	**254**	**3,763**	**-**	**4,017**
At 31 December 2012	**1,179**	**27,249**	**-**	**28,428**
Bank				
At 1st January 2012	**727**	**25,855**	**-**	**26,582**
Write offs in year	**(1,415)**	**(5,206)**	**-**	**(6,621)**
Charge/(credit) for the year net of recoveries	**1,212**	**3,132**	**-**	**4,344**
At 31 December 2012	**524**	**23,781**	**-**	**24,305**

Collective	**Residential mortgages £'000**	**BTL/SME £'000**	**Personal loans £'000**	**Total £'000**
Group				
At 1st January 2012	**-**	**1,260**	**-**	**1,260**
Write offs in year	**-**	**-**	**-**	**-**
Charge/(credit) for the year net of recoveries	**1,356**	**(72)**	**-**	**1,284**
At 31 December 2012	**1,356**	**1,188**	**-**	**2,544**
Bank				
At 1st January 2012	**-**	**864**	**-**	**864**
Write offs in year	**-**	**-**	**-**	**-**
Charge/(credit) for the year net of recoveries	**1,260**	**108**	**-**	**1,368**
At 31 December 2012	**1,260**	**972**	**-**	**2,232**

Total	**Residential mortgages £'000**	**BTL/SME £'000**	**Personal loans £'000**	**Total £'000**
Group				
At 1st January 2012	**2,340**	**29,952**	**-**	**32,292**
Write offs in year	**(1,415)**	**(5,206)**	**-**	**(6,621)**
Recoveries of amounts previously provided	**-**	**-**	**-**	**-**
Charge/(credit) for the year net of recoveries	**1,610**	**3,691**	**-**	**5,301**
At 31 December 2012	**2,535**	**28,437**	**-**	**30,972**
Bank				
At 1st January 2012	**727**	**26,719**	**-**	**27,446**
Write offs in year	**(1,415)**	**(5,206)**	**-**	**(6,621)**
Recoveries of amounts previously provided	**-**	**-**	**-**	**-**
Charge/(credit) for the year net of recoveries	**2,472**	**3,240**	**-**	**5,712**
At 31 December 2012	**1,784**	**24,753**	**-**	**26,537**

13. Impairment losses

	Group 31-Dec-13 £'000	Group 31-Dec-12 £'000
Impairment losses on loans and advances to customers (see note 12)	**7,329**	**5,301**
	7,329	**5,301**

14. Related parties and investments in group undertakings

The Bank has the following subsidiary undertakings:

2013

	Class of shares	Activity	Country of registration	Owner ship	Inter company interest £000	Balance due to (by) the Bank £000
EasiOption BPO Services Private Ltd	Ordinary	Back office processing	India	100%	**-**	**-**
Easioption Ltd	Ordinary	Holding company	England	100%	**-**	**-**
Easiprocess Private Ltd	Ordinary	Back office processing	India	100%	**-**	**(575)**
Guernsey Home Loans Ltd	Ordinary	Mortgage provider	England	100%	**1,292**	**34,920**
Guernsey Home Loans Ltd	Ordinary	Mortgage provider	Guernsey	100%	**3,427**	**109,324**
Heritable Development Finance Ltd[1]	Ordinary	Mortgage originator and servicer	England	85%	**-**	**-**
Interbay Group Holdings Ltd[2]	Ordinary	Mortgage provider	England	99%	**-**	**120,047**
Jersey Home Loans Ltd	Ordinary	Mortgage provider	England	100%	**416**	**7,072**
Jersey Home Loans Ltd	Ordinary	Mortgage provider	Jersey	100%	**14,838**	**434,897**
Prestige Finance Ltd	Ordinary	Mortgage originator and servicer	England	100%	**2,273**	**1,785**
Reliance Property Loans Ltd	Ordinary	Mortgage provider	England	100%	**163**	**4,882**
Rochester Financing No.1 Plc[3]	Ordinary	Securitisation entity	England	0%[3]	**(1,309)**	**(254,875)**
Swingcastle Limited	Ordinary	Dormant entity	England	100%	**-**	**-**

[1] Heritable Development Finance Ltd was set up in December 2013 with Heritable Capital Ltd as a business development partnership. The entity is majority owned and controlled by the Bank.

[2] Interbay Group Holdings Ltd (OSB IGH Ltd) is the Interbay group holding company.

[3] Rochester Financing No. 1 Plc is a securitisation entity established by the Bank in October 2013 to raise diversified funds. Although not legally owned by the Group, it is fully controlled and consequently consolidated as a 100% subsidiary.

2012

	Class of shares	Activity	Country of registration	Owner ship	Inter company interest	Balance due to the Bank
					£'000	**£'000**
Easioption BPO Services Private Ltd	Ordinary	Back office processing	India	100%	**-**	**-**
Easioption Ltd	Ordinary	Holding company	England	100%	**-**	**-**
Easiprocess Private Ltd	Ordinary	Back office processing	India	100%	**-**	**-**
Guernsey Home Loans Ltd	Ordinary	Mortgage provider	England	100%	**1,546**	**43,420**
Guernsey Home Loans Ltd	Ordinary	Mortgage provider	Guernsey	100%	**2,657**	**102,128**
Jersey Home Loans Ltd	Ordinary	Mortgage provider	England	100%	**503**	**12,966**
Jersey Home Loans Ltd	Ordinary	Mortgage provider	Jersey	100%	**15,623**	**483,721**
OSB IGH Ltd	Ordinary	Holding company	England	99%	**1,651**	**50,677**
Prestige Finance Ltd	Ordinary	Mortgage provider	England	100%	**2,427**	**2,296**
Reliance Property Loans Ltd	Ordinary	Mortgage provider	England	100%	**108**	**4,999**
Swingcastle Ltd	Ordinary	Mortgage provider	England	100%	**-**	**-**

All the above investments are reviewed annually for impairment. All the subsidiaries are actively trading (with the exception of Swingcastle) or 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), the majority shareholder. KRPS provides branch agency services to the Bank, whilst the Bank provides ancillary services including IT, finance and other support functions to KRPS. The net amount charged to and payable by the Bank as at 31 December 2013 was £1.0m (2012 £1.04m). Effective from October 2013, the Bank agreed to pay a consideration of £0.7m to buy out the agency agreement from KRPS. The Bank now manages the branches directly.

All related party transactions were made on terms equivalent to those that prevail in arm's length transactions. During the period there were no related party transactions between the key management personnel and the Bank.

Investments in subsidiaries are classified as financial assets. The net movement during the year is as follows:

	2013 £'000		
	Shares in subsidiary undertakings	Loans to subsidiary undertakings	Total
At 1st January	3,476	700,207	703,683
Additions	-	9,422	9,422
Securitisation*	-	(254,875)	(254,875)
At 31 December	3,476	454,754	458,230

* Balance payable to Rochester Financing No.1 Plc as a result of the securitisation transaction.

	2012 £'000		
	Shares in subsidiary undertakings	Loans to subsidiary undertakings	Total
At 1 January	-	640,920	640,920
Additions	3,476	95,539	99,015
Repayments	-	(36,252)	(36,252)
At 31 December	3,476	700,207	703,683

Transactions with Key Management Personnel

The Board considers the key management personnel to comprise Executive and Non-Executive Directors. Details of remuneration paid and mortgage loans made to key management personnel and connected persons are set out in note 7.

Key management personnel held deposits and shares with the Group of £2k (2012: £2k).

2012 acquisitions, negative goodwill

Interbay Group acquisition

On 28 August 2012 the Bank purchased the Interbay Group, a specialist SME mortgage lender. A new subsidiary was set up by OSB for the purchase called OSB IGH Limited, which then purchased 100% of the shares and voting rights in Interbay Financial I Ltd and Interbay Financial II Ltd. The seller received 1% of the shares in OSB IGH Limited, leaving OSB as the majority shareholder with a 99% shareholding.

The impact of the Interbay purchase on the Group's assets and liabilities was as follows:

	Fair values on acquisition £000
Acquiree's net assets	
Loans and advances to customers	**50,955**
Borrowings and loan notes	**(46,254)**
Other net assets	**1,807**
Net identifiable assets and liabilities	**6,508**
Consideration transferred	
Cash	**869**
B Shares in OSB IGH Limited	**1,272**
Total consideration	**2,141**
Negative goodwill on acquisition	**4,367**

None of the goodwill on acquisition recognised was or is expected to be taxable.

The B shares carry the rights to a dividend however payment is subject to the Bank's consent. OSB Holdco Ltd, one of the Bank's shareholders owned by funds advised by J.C. Flowers & Co. LLP, provided certain dividend protection on the B shares and additionally enhanced the value of the shares above their nominal value via a bilateral put/call agreement with the seller, which also included first loss protection from the seller. The resulting net enhancement is reflected in the value of the B shares shown above. The fair value of the total consideration paid was lower than the fair value of net assets acquired primarily as a result of the first loss protection provided by the seller.

Prestige and Swingcastle acquisition

On 14 September 2012 the Bank purchased 100% of the shares and voting rights of Prestige Finance Ltd and its sister company Swingcastle Ltd (the Prestige Group), both of whom are specialist second charge lenders.

The impact of the Prestige Group purchase on the Group's assets and liabilities was as follows:

	Fair values on acquisition £000
Acquiree's net assets	
Loans and advances to customers	**55,000**
Borrowings and loan notes	**(38,142)**
Other net liabilities	**(1,078)**
Net identifiable assets and liabilities	**15,780**

Consideration transferred	
Cash	**340**
E shares in OSB	**2,204**
Total consideration	**2,544**
Negative goodwill on acquisition	**13,236**

None of the goodwill on acquisition recognised was or is expected to be taxable.

The ordinary E shares are non-voting and have no entitlement to a dividend. The E shares issued have had their value enhanced over and above their nominal value by a bilateral put/call agreement between the holders and OSB Holdco Ltd, one of the Bank's shareholders. This enhancement is reflected in the value of the E shares shown above.

The negative goodwill on the purchase arose due to the distressed sale of the company owing to the non-extension of its funding line.

15. Intangible assets

	Group and Bank 31-Dec-13 £'000	Group and Bank 31-Dec-12 £'000
Cost		
At 1st January	3,272	2,678
Additions	455	594
At 31 December	3,727	3,272
Amortisation		
At 1st January	2,362	2,183
Charged in year	248	179
At 31 December	2,610	2,362
Net book value		
At 31 December	1,117	910

Intangible assets consist of computer software. There were no capitalised costs related to the internal development of software during the period.

16. Property, plant and equipment

Group 2013	**Freehold land and buildings £'000**	**Equipment, fixtures and vehicles £'000**	**Total £'000**
Cost			
At 1st January 2013	1,419	8,540	9,959
Additions	-	1,150	1,150
Disposals	-	(63)	(63)
Translation difference	-	(176)	(176)
At 31 December 2013	1,419	9,451	10,870
Depreciation			
At 1st January 2013	219	5,509	5,728
Charged in year	22	277	299
Disposals	-	(17)	(17)
Translation difference	-	(95)	(95)
At 31 December 2013	241	5,674	5,915
Net book value			
At 31 December 2013	1,178	3,777	4,955

Bank 2013	**Freehold land and buildings £'000**	**Equipment, fixtures and vehicles £'000**	**Total £'000**
Cost			
At 1st January 2013	1,419	4,729	6,148
Additions	-	313	313
At 31 December 2013	1,419	5,042	6,461
Depreciation			
At 1st January 2013	219	4,238	4,457
Charged in year	22	170	192
At 31 December 2013	241	4,408	4,649
Net book value			
At 31 December 2013	1,178	634	1,812

	Group 2012		
	Freehold land and buildings £'000	Equipment, fixtures and vehicles £'000	Total £'000
Cost			
At 1 January 2012	1,259	6,046	7,305
Additions on acquisition	-	2,367	2,367
Additions	160	127	287
At 31 December 2012	1,419	8,540	9,959
Depreciation			
At 1 January 2012	200	5,247	5,447
Charged in period	19	262	281
At 31 December 2012	219	5,509	5,728
Net book value			
At 31 December 2012	1,200	3,031	4,231

	Bank 2012		
	Freehold land and buildings £'000	Equipment, fixtures and vehicles £'000	Total £'000
Cost			
At 1 January 2012	1,259	4,465	5,724
Additions	160	264	424
At 31 December 2012	1,419	4,729	6,148
Depreciation			
At 1 January 2012	200	4,107	4,307
Charged in period	19	131	150
At 31 December 2012	219	4,238	4,457
Net book value			
At 31 December 2012	1,200	491	1,691

17. Deferred taxation

Deferred taxation asset	Group 31-Dec-13	Bank 31-Dec-13	Group 31-Dec-12 (restated)	Bank 31-Dec-12 (restated)
	£'000	£'000	£'000	£'000
At 1st January	15,472	13,257	14,672	12,086
Tax on acquisition of Prestige	-	-	-	226
Profit or loss (charge) / credit	(4,577)	(6,003)	800	945
Reclassification from liabilities	6	6	-	-
At 31 December	10,901	7,260	15,472	13,257
Analysed as:				
Losses carried forward	10,805	7,181	15,291	13,245
Accelerated depreciation	96	79	181	12
	10,901	7,260	15,472	13,257
Deferred taxation liability				
At 1st January	389	389	562	562
Tax taken directly to equity	(395)	(395)	(173)	(173)
Reclassification to assets	6	6	-	-
At 31 December	-	-	389	389

The UK Government announced that the main rate of corporation tax for the year beginning 1 April 2013 would reduce from 24% to 23% to be followed by a further 2% reduction to 21% for the year beginning 1 April 2014 and a further 1% reduction to 20% for the year beginning 1 April 2015. The reduction in the corporation tax rate to 23% was substantially enacted through the 2012 Finance Act and this results in a weighted average rate of 23.25% for 2013 (2012: 24.5%). The reductions to 21% and 20% that were announced in the 2012 Autumn Statement and 2013 Budget respectively became substantially enacted through the 2013 Finance Act on 17 July 2013.

The deferred tax asset as at 31st December 2013 has been calculated using the rates substantially enacted for the expected periods of utilisation.

18. Other assets

	Group 31-Dec-13	Bank 31-Dec-13	Group 31-Dec-12	Bank 31-Dec-12
	£'000	£'000	£'000	£'000
Prepayments	4,237	4,105	1,416	1,417
VAT receivable	13	13	6	6
Other assets	2,382	2,208	1,753	-
	6,632	6,326	3,175	1,423

19. Amounts owed to retail depositors

	Group and Bank 31-Dec-13 £'000	Group and Bank 31-Dec-12 £'000
Amounts owed to retail depositors	3,251,576	2,744,646

Repayable in the ordinary course of business as follows:

	Group and Bank 31-Dec-13	Group and Bank 31-Dec-12
On demand	1,252,674	1,195,956
Less than three months	187,850	261,910
Three months to one year	827,742	743,346
One to five years	983,310	543,434
	3,251,576	2,744,646

20. Amounts owed to credit institutions

Repayable in the ordinary course of business as follows:

	Group and Bank 31-Dec-13 £'000	Group and Bank 31-Dec-12 £'000
Less than three months	1,438	3,190
	1,438	3,190

21. Amounts owed to other customers

Repayable in the ordinary course of business as follows:

	Group and Bank 31-Dec-13 £'000	Group and Bank 31-Dec-12 £'000
Less than three months	851	7,317
Three months to one year	1,000	13,943
One to five years	500	503
	2,351	21,763

22. Debt securities in issue

	Group 31-Dec-13 £'000	Bank 31-Dec-13 £'000	Group and Bank 31-Dec-12 £'000
One to five years	273,759	-	-
	273,759	-	-

Debt securities in issue comprise AAA and AA+ rated notes issued by Rochester Financing No. 1 Plc (‘Rochester’) and sold to third-party investors during the year. Rochester is a mortgage securitisation entity established by the Bank in 2013. The Bank retained the remaining notes and residual certificates issued by Rochester and as such did not transfer substantially all of the risks and rewards of the securitised mortgages. These mortgages therefore remain on the Bank’s balance sheet and the Group consolidates Rochester.

The notes sold have a nominal value of £273m and a final maturity date of July 2046, however the interest payable on the notes steps up from January 2018, with the holder of the majority of the residual certificates (currently the Bank) having the right to redeem the outstanding notes from this date. The Bank has an incentive to call at the step up date and the debt securities have accordingly been classified as having an expected maturity at that date in the table above. The actual repayment profile of the notes cannot be determined as quarterly repayments depend on, amongst other factors, the schedule of principal receipts on the securitised mortgages.

23. Other liabilities

	Group 31-Dec-13 £'000	Bank 31-Dec-13 £'000	Group 31-Dec-12 £'000	Bank 31-Dec-12 £'000
Falling due within one year				
Tax deducted at source from interest paid	1,822	1,822	2,480	2,480
Accruals and deferred income	7,869	7,608	5,852	5,468
Other creditors	3,135	1,056	1,909	1,360
	12,826	10,486	10,241	9,308

24. Subordinated liabilities

	Group and Bank 31-Dec-13 £'000	Group and Bank 31-Dec-12 £'000
Linked to LIBOR (London Interbank Offered Rate):		
Floating rate Subordinated Liabilities 2015	3,002	3,002
Floating rate Subordinated Liabilities 2016	3,003	3,003
Floating rate Subordinated Liabilities 2017	5,656	5,656
Floating rate Subordinated Loans 2022	706	703
Linked to the average standard mortgage rate of the five largest building societies:		
Floating rate Subordinated Liabilities 2017	5,049	5,049
Fixed rate:		
6.45% Subordinated Liabilities 2024	10,163	10,163
	27,579	27,576

Subordinated liabilities are repayable at the dates stated or earlier at the option of the Group with the prior consent of the Prudential Regulation Authority. All Subordinated Liabilities are denominated in sterling.

The rights of repayment of the holders of these issues are subordinated to the claims of all depositors and all creditors.

25. Perpetual Subordinated Bonds

	Group and Bank 31-Dec-13 £'000	Group and Bank 31-Dec-12 £'000
7.875% sterling perpetual subordinated bonds	15,263	15,189

The bonds were issued with no discretion over the payment of interest and therefore classified as financial liabilities.

26. Share Capital

Group and Bank 2013	Number of Shares			
	Ordinary A shares	Ordinary B shares	Ordinary E shares	Convertible Preference shares
As at 1st January	26,000	20,897	1,000	804,154
Capital injections	-	765	-	262,986
As at 31 December	26,000	21,662	1,000	1,067,140

Group and Bank 2013	£000's		
	Value	Premium	Total
Ordinary A shares	26	25,974	26,000
Ordinary B shares	22	93,241	93,263
Ordinary E shares	150	-	150
Convertible Preference shares	1,067	670	1,737
As at 31 December	1,265	119,885	121,150

	Group and Bank 31-Dec-12 Number of Shares			
	Ordinary A shares	Ordinary B shares	Ordinary E shares	Convertible preference shares
As at 1 January 2012	26,000	19,997	-	314,814
Capital injections	-	900	1,000	489,340
As at 31 December 2012	26,000	20,897	1,000	804,154

	Group and Bank 31-Dec-12 £000's		
	Value	**Premium**	**Total**
Ordinary A shares	**26**	**25,974**	**26,000**
Ordinary B shares	**21**	**78,393**	**78,414**
Ordinary E shares	**150**	**-**	**150**
Convertible Preference shares	**804**	**782**	**1,586**
As at 31 December 2012	**1,001**	**105,149**	**106,150**

At 31 December 2013, the share capital comprised 48,662 fully allotted and paid up ordinary shares and 1,067,140 convertible preference shares. The ordinary A, B and preference shares have a par value of £1. The ordinary E shares have a par value of £150.

Both A & B ordinary shares have veto rights appropriate for a participant in a joint venture arrangement providing they retain a certain percentage of the ordinary shares of the Bank. The convertible preference share holders have preferential rights in relation to any dividends that may be declared by the board of the Bank. The ordinary E shares are non-voting and have no entitlement to a dividend.

The 1,000 E shares issued on 14 September 2012 as consideration for the acquisition of the Prestige group (see note 14 for more details) have had their value enhanced over and above their nominal value by a bilateral put/call agreement between the holders and OSB Holdco Ltd.

Perpetual Subordinated Bonds

In addition to the PSBs in note 25, the Bank has issued £22m 6.591% 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 equity rather than through profit or loss.

Transfer reserve

The transfer reserve of £12.8m (Bank: £15.2m) represents the difference between the true value of net assets transferred as at the date of transfer and the value of shares issued to the A ordinary shareholders.

AFS reserve

The AFS reserve of £(156)k (2012: £1.3m) represents the cumulative net change in the fair value of investment securities measured at fair value through other comprehensive income net of deferred tax.

27. FSCS and other provisions

The Financial Services Compensation Scheme ('FSCS') has provided compensation to consumers following the collapse of a number of deposit takers. The compensation paid out to consumers is currently funded through loans from the Bank of England and HM Treasury which at 31 December 2013 stood at approximately £17 billion.

In order to repay the loan principal which is not expected to be recovered, the FSCS confirmed in February 2013 that it would levy approximately £363m in Scheme Year 2013/2014 and in the following two Scheme Years on participating financial institutions. In January 2014, the FSCS announced that the expected levy on participating financial institutions for Scheme Year 2014/2015 would be £399m.

The ultimate FSCS levy to the industry as a result of the collapses 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.

Group and Bank	FSCS	Other provisions	Total	FSCS (restated)	Other provisions	Total (restated)
	31-Dec-13	31-Dec-13	31-Dec-13	31-Dec-12	31-Dec-12	31-Dec-12
	£'000	£'000	£'000	£'000	£'000	£'000
As at 1st January	2,166	150	2,316	1,242	150	1,392
Paid during the year	(3,163)	(24)	(3,187)	-	(6)	(6)
Charge / (credit)	2,148	4	2,152	924	6	930
At 31 December	1,151	130	1,281	2,166	150	2,316

FSCS provision has been restated in accordance with IFRIC 21's interpretation of IAS 37. The impact of the restatement is disclosed further in note 33.

28. Financial commitments

a) There were no capital commitments for the Group contracted but not provided for as at 31 December 2013 (2012: Nil).

b) Operating leases

	Group	Bank	Group	Bank
	31-Dec-13	31-Dec-13	31-Dec-12	31-Dec-12
	£'000	£'000	£'000	£'000
Land and buildings: due within				
One year	507	286	274	16
Two to five years	967	707	299	-
More than five years	66	60	-	-
	1,540	1,053	573	16

c) Undrawn mortgage loan facilities	Group 31-Dec-13 £'000	Bank 31-Dec-13 £'000	Group 31-Dec-12 £'000	Bank 31-Dec-12 £'000
As at 31 December	156,920	133,986	132,704	81,368

29. 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

A financial instrument is one which gives rise to a financial asset or a financial liability. The Group is a retailer of financial instruments, mainly in the form of mortgages and savings products. The Group also uses wholesale financial instruments to invest liquid asset balances, to raise wholesale funding and to manage the risks arising from its operations. The Group does not operate a trading book.

The Group uses derivative instruments to manage various aspects of market risk. Instruments used for risk management purposes include derivative financial instruments ("derivatives"), which are contracts whose value is derived from one or more underlying prices, rates or indices defined in the contract or agreement, such as interest rates. Derivatives are solely used by the Group to reduce 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. These are used to protect the Group from exposures arising principally from fixed rate mortgage lending, deposit funding and subscribed capital. An interest rate swap is a contract to exchange one set of interest rate cash flows for another. Such swaps result in the economic exchange of interest rates. No exchange of principal takes place. Instead, interest payments are based on notional principal amounts agreed at the inception of the swap.

The following table describes the significant activities undertaken by the Group and the risks associated with such activities: derivatives in the form of interest rate swaps are used by the Group in managing such risks. Such risks may alternatively be managed using existing instruments as part of the Group's integrated approach to risk management.

Activity	Risk
Fixed rate savings products and fixed rate funding	Decrease in interest rates
Fixed rate mortgage lending and fixed rate asset investments	Increase in interest rates

Financial risks

The principal risks to which the Group is exposed are operational, credit, liquidity and market risk. Each of these is considered 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 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, and investment securities. The maximum exposure to credit risk is generally represented by the carrying amount of each financial asset plus any off-balance sheet credit commitments.

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 policy are approved by the Board, with mandates set for the approval of loan applications.

Credit Committee and the 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 Lending Policy are recommended to the Risk Committee and the Board.

The following table shows an analysis of the Group lending portfolio by borrower type at the reporting date:

	Group 31 December 2013		Bank 31 December 2013	
	£'000	**%**	**£'000**	**%**
Residential mortgages	**1,764,639**	**58%**	**1,332,419**	**57%**
BTL/SME mortgages	**1,098,834**	**36%**	**806,334**	**34%**
Personal loans	**205,308**	**6%**	**205,308**	**9%**
Gross loans	**3,068,781**	**100%**	**2,344,061**	**100%**

	Group		Bank	
	31 December 2012		31 December 2012	
	£'000	%	£'000	%
Residential mortgages	1,614,462	72%	1,130,946	74%
BTL/SME mortgages	612,560	28%	392,444	26%
Personal loans	-	0%	-	0%
Gross loans	2,227,022	100%	1,523,390	100%

Property values are updated to reflect changes in the house price index. A breakdown of the table above by indexed loan to value is as follows:

Loan to value analysis by band:

Group	31 December 2013			
	Residential	BTL/SME	Total	
Band	£'000	£'000	£'000	%
0 - 50%	638,991	82,482	721,473	25%
50% - 60%	288,537	85,115	373,652	13%
60% - 70%	301,181	188,264	489,445	17%
70% - 80%	275,245	443,220	718,465	25%
80% - 90%	203,137	240,205	443,342	15%
>90%	57,548	59,548	117,096	5%
Gross mortgages	1,764,639	1,098,834	2,863,473	100%
Personal loans			205,308	
Gross loans			3,068,781	

Bank	31 December 2013			
	Residential	BTL/SME	Total	
Band	£'000	£'000	£'000	%
0 - 50%	574,401	47,260	621,661	29%
50% - 60%	250,602	57,013	307,615	14%
60% - 70%	240,102	121,231	361,333	17%
70% - 80%	190,214	342,901	533,115	25%
80% - 90%	63,756	194,633	258,389	12%
>90%	13,344	43,296	56,640	3%
Gross mortgages	1,332,419	806,334	2,138,753	100%
Personal loans			205,308	
Gross loans			2,344,061	

Group	31 December 2012			
	Residential	BTL/SME	Total	
Band	£'000	£'000	£'000	%
0 - 50%	807,057	82,724	889,781	40%
50% - 60%	235,402	64,358	299,760	13%
60% - 70%	241,151	117,294	358,445	16%
70% - 80%	165,841	183,706	349,547	16%
80% - 90%	117,221	74,218	191,439	9%
>90%	47,790	90,260	138,050	6%
Gross mortgages	1,614,462	612,560	2,227,022	100%
Personal loans			-	
Gross loans			2,227,022	

Bank	31 December 2012			
	Residential	BTL/SME	Total	
Band	£'000	£'000	£'000	%
0 - 50%	693,882	37,258	731,140	48%
50% - 60%	165,362	32,564	197,926	13%
60% - 70%	159,741	71,859	231,600	15%
70% - 80%	78,092	133,288	211,380	14%
80% - 90%	28,788	42,107	70,895	5%
>90%	5,081	75,368	80,449	5%
Gross mortgages	1,130,946	392,444	1,523,390	100%
Personal loans			-	
Gross loans			1,523,390	

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 full collateral position is captured in the loan-to-value analysis above.

	Group 31 December 2013		Bank 31 December 2013	
	Loan balance £'000	Capped collateral £'000	Loan balance £'000	Capped collateral £'000
Not impaired:				
Not past due	2,485,653	2,484,326	1,828,268	1,826,971
Past due up to 3 months	256,369	256,088	222,181	221,900
Past due 3 to 6 months	24,572	23,945	19,113	18,860
Past due 6 to 12 months	18,550	18,380	14,013	13,843
Past due over 12 months	7,670	7,616	6,963	6,908
Possessions	2,366	2,365	1,273	1,273
	2,795,180	2,792,720	2,091,811	2,089,755
Impaired:				
Not past due	20,930	18,432	18,838	16,339
Past due up to 3 months	2,010	2,010	-	-
Past due 3 to 6 months	629	617	35	35
Past due 6 to 12 months	2,815	1,805	2,297	1,290
Past due over 12 months	20,159	15,300	17,008	14,516
Possessions	21,750	19,064	8,764	7,521
Gross mortgages	68,293	57,228	46,942	39,701
Personal loans	205,308		205,308	
Gross loans	3,068,781		2,344,061	

	Group		Bank	
	31 December 2012		31 December 2012	
	Loan balance £'000	Capped collateral £'000	Loan balance £'000	Capped collateral £'000
Not impaired:				
Not past due	**1,823,147**	**1,819,576**	**1,225,392**	**1,224,053**
Past due up to 3 months	**250,543**	**250,543**	**182,445**	**181,975**
Past due 3 to 6 months	**33,055**	**33,055**	**25,699**	**25,400**
Past due 6 to 12 months	**26,769**	**26,570**	**16,816**	**16,471**
Past due over 12 months	**19,862**	**18,515**	**10,528**	**9,769**
Possessions	**7,560**	**7,543**	**5,268**	**5,250**
	2,160,936	**2,155,802**	**1,466,148**	**1,462,918**
Impaired:				
Not past due	**2,184**	**663**	**2,184**	**663**
Past due up to 3 months	**94**	**94**	**94**	**94**
Past due 3 to 6 months	**-**	**-**	**-**	**-**
Past due 6 to 12 months	**1,776**	**1,410**	**918**	**910**
Past due over 12 months	**50,083**	**32,191**	**49,082**	**31,236**
Possessions	**11,949**	**10,241**	**4,964**	**3,770**
Gross mortgages	**66,086**	**44,599**	**57,242**	**36,673**
Personal loans	**-**		**-**	
Gross loans	**2,227,022**		**1,523,390**	

Note: Impaired is defined as loans that have a specific provision held against the loan at the year end.

Below is a summary of capped collateral:

	Group		Bank	
	31 December 2013		31 December 2013	
	Loan balance £'000	Capped collateral £'000	Loan balance £'000	Capped collateral £'000
Not past due and not impaired	**2,485,653**	**2,484,326**	**1,828,268**	**1,826,971**
Past due but not impaired	**309,527**	**308,394**	**263,543**	**262,784**
Impaired	**68,293**	**57,228**	**46,942**	**39,701**
Gross mortgages	**2,863,473**	**2,849,948**	**2,138,753**	**2,129,456**
Personal loans	**205,308**		**205,308**	
Gross loans	**3,068,781**		**2,344,061**	

	Group 31 December 2012		Bank 31 December 2012	
	Loan balance £'000	Capped collateral £'000	Loan balance £'000	Capped collateral £'000
Not past due and not impaired	1,823,147	1,819,576	1,225,392	1,224,053
Past due but not impaired	337,789	336,226	240,756	238,865
Impaired	66,086	44,599	57,242	36,673
Gross mortgages	2,227,022	2,200,401	1,523,390	1,499,591
Personal loans	-		-	
Gross loans	2,227,022		1,523,390	

Geographical analysis by region

An analysis of loans by region is provided below:

Region	Group 31 December 2013		Bank 31 December 2013	
	£'000	%	£'000	%
East Anglia	72,349	2.5%	67,311	3.1%
East Midlands	110,231	3.8%	103,102	4.8%
Greater London	777,121	27.2%	733,347	34.3%
Guernsey	147,790	5.2%	-	0.0%
Jersey	452,059	15.8%	-	0.0%
North	8,101	0.3%	8,101	0.4%
North East	39,825	1.4%	38,429	1.8%
North West	151,001	5.3%	139,701	6.5%
Northern Ireland	12,946	0.5%	12,481	0.6%
Scotland	52,150	1.8%	50,886	2.4%
South East	578,873	20.2%	562,288	26.3%
South West	177,713	6.2%	168,369	7.9%
Wales	70,009	2.4%	63,697	3.0%
West Midlands	132,758	4.6%	124,057	5.8%
Yorks & Humberside	80,547	2.8%	66,984	3.1%
Gross mortgages	2,863,473	100.0%	2,138,753	100.0%
Personal loans	205,308		205,308	
Gross loans	3,068,781		2,344,061	

Region	Group 31 December 2012 £'000	%	Bank 31 December 2012 £'000	%
East Anglia	**48,092**	**2.2%**	**45,285**	**3.0%**
East Midlands	**79,239**	**3.6%**	**75,080**	**4.9%**
Greater London	**451,851**	**20.3%**	**441,273**	**29.0%**
Guernsey	**146,959**	**6.6%**	**-**	**0.0%**
Jersey	**501,259**	**22.5%**	**-**	**0.0%**
Northern Ireland	**7,442**	**0.3%**	**6,963**	**0.5%**
North	**7,515**	**0.3%**	**7,515**	**0.5%**
North East	**29,158**	**1.3%**	**27,063**	**1.8%**
North West	**113,275**	**5.1%**	**106,173**	**7.0%**
Scotland	**39,749**	**1.8%**	**37,490**	**2.5%**
South East	**493,492**	**22.2%**	**485,761**	**31.9%**
South West	**113,638**	**5.1%**	**109,045**	**7.2%**
Wales	**50,450**	**2.3%**	**45,402**	**3.0%**
West Midlands	**91,364**	**4.1%**	**86,675**	**5.4%**
Yorks & Humberside	**53,539**	**2.3%**	**49,665**	**3.3%**
Gross mortgages	**2,227,022**	**100.0%**	**1,523,390**	**100.0%**
Personal loans	**-**		**-**	
Gross loans	**2,227,022**		**1,523,390**	

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 within the guidelines laid down in the Treasury Policy approved by the Board and reported to the ALCO monthly.

As at 31 December 2013 one of the Group's treasury portfolio exposures - Glitnir: £1.6m against which impairment provision has been made of £1.2m - was both past due and impaired (2012: £1.6m, provision £1.1m). There are no assets held as treasury instruments whose terms have been renegotiated.

The Group has limited exposure to emerging markets (Indian operations) and non-investment-grade debt. The ALCO is responsible for approving Treasury counterparties.

Ratings	Group 31 December 2013				
	AAA	AA	A	Less than A rating	Total
	£'000	£'000	£'000	£'000	£'000
Call accounts	-	28,282	73,903	-	102,185
Floating rate notes	4,986	-	-	-	4,986
Gilts	-	36,660	-	-	36,660
Reverse repos	-	166,916	-	-	166,916
RMBS	15,420	-	6,022	-	21,442
Treasury bills	96,663	200,862	-	-	297,525
Other securities	-	-	-	432	432
Total	117,069	432,720	79,925	432	630,146
Percentages	18.5%	68.7%	12.7%	0.1%	100.0%

Ratings	Bank 31 December 2013				
	AAA	AA	A	Less than A rating	Total
	£'000	£'000	£'000	£'000	£'000
Call accounts	-	9,862	70,870	-	80,732
Floating rate notes	4,986	-	-	-	4,986
Gilts	-	36,660	-	-	36,660
Reverse repos	-	166,916	-	-	166,916
RMBS	15,420	-	6,022	-	21,442
Treasury bills	96,663	200,862	-	-	297,525
Other securities	-	-	-	432	432
Total	117,069	414,300	76,892	432	608,693
Percentages	19.2%	68.1%	12.6%	0.1%	100.0%

Ratings	Group 31 December 2012				
	AAA	AA	A	Less than A rating	Total
	£'000	£'000	£'000	£'000	£'000
Certificates of deposit	-	15,004	-	-	15,004
Call accounts	1,804	-	202,871	524	205,199
Time deposits	-	-	65,020	22,003	87,023
Floating rate notes	5,011	-	-	-	5,011
Treasury bills	261,464	-	-	-	261,464
RMBS	16,117	-	5,825	-	21,942
Gilts	106,396	-	-	-	106,396
Total	390,792	15,004	273,716	22,527	702,039
Percentages	55.7%	2.1%	39.0%	3.2%	100.0%

Ratings	Bank 31 December 2012				
	AAA	AA	A	Less than A rating	Total
	£'000	£'000	£'000	£'000	£'000
Certificates of deposit	-	15,004	-	-	15,004
Call accounts	1,804	-	200,682	524	203,010
Time deposits	-	-	65,020	22,003	87,023
Floating rate notes	5,011	-	-	-	5,011
Treasury bills	261,464	-	-	-	261,464
RMBS	16,117	-	5,825	-	21,942
Gilts	106,396	-	-	-	106,396
Total	390,792	15,004	271,527	22,527	699,850
Percentages	55.9%	2.1%	38.8%	3.2%	100.0%

Industry sector/asset class	Group 31 December 2013		Bank 31 December 2013	
	£'000	%	£'000	%
Banks	630,146	100.0%	608,693	100.0%
Total	630,146	100.0%	608,693	100.0%

Industry sector/asset class	Group 31 December 2012		Bank 31 December 2012	
	£'000	%	£'000	%
Financial institutions				
Banks	**640,024**	**91.2%**	**637,835**	**91.1%**
Building societies	**62,015**	**8.8%**	**62,015**	**8.9%**
Total	**702,039**	**100.0%**	**699,850**	**100.0%**

Geographical exposure	Group 31 December 2013		Bank 31 December 2013	
	£'000	%	£'000	%
United Kingdom	**497,411**	**78.9%**	**507,044**	**83.3%**
Rest of Europe	**101,649**	**16.1%**	**101,649**	**16.7%**
Australia	**28,886**	**4.6%**	**-**	**0.0%**
India	**2,200**	**0.4%**	**-**	**0.0%**
Total	**630,146**	**100.0%**	**608,693**	**100.0%**

Geographical exposure	Group 31 December 2012		Bank 31 December 2012	
	£'000	%	£'000	%
United Kingdom	**628,054**	**89.6%**	**628,091**	**89.8%**
Rest of Europe	**56,754**	**8.1%**	**56,754**	**8.1%**
Australia	**15,005**	**2.1%**	**15,005**	**2.1%**
India	**2,226**	**0.2%**	**-**	**0.0%**
Total	**702,039**	**100.0%**	**699,850**	**100.0%**

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, through wholesale funding facilities and through control of the growth of the business.

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 19 to 25.

The following table provides an analysis of the Group's gross contractual cash flows payable under financial liabilities:

Group **As at 31 December 2013**	**Up to 3 months** **£'000**	**3 - 12 months** **£'000**	**1 - 5 years** **£'000**	**More than 5 years** **£'000**	**Total** **£'000**
Amounts owed to retail depositors	**1,403,941**	**836,320**	**1,037,535**	**-**	**3,277,796**
Amounts owed to credit institutions and other customers	**1,991**	**1,004**	**518**	**-**	**3,513**
Debt securities in issue	**-**	**-**	**273,759**	**-**	**273,759**
Derivative financial instruments	**(796)**	**138**	**15,227**	**7,996**	**22,565**
Other liabilities	**12,826**	**-**	**-**	**-**	**12,826**
Subordinated liabilities	**65**	**909**	**11,323**	**19,299**	**31,596**
Perpetual subordinated bonds	**595**	**1,184**	**4,736**	**15,000**	**21,515**
Total liabilities	**1,418,622**	**839,555**	**1,343,098**	**42,295**	**3,643,570**

* Debt securities in issue do not include future interest due as this cannot be determined as principal repayments depend on, amongst other factors, the schedule of principal receipts on the securitised mortgages. See note 22 for more details.

Bank **As at 31 December 2013**	**Up to 3 months** **£'000**	**3 - 12 months** **£'000**	**1 - 5 years** **£'000**	**More than 5 years** **£'000**	**Total** **£'000**
Amounts owed to retail depositors	**1,403,941**	**836,320**	**1,037,535**	**-**	**3,277,796**
Amounts owed to credit institutions and other customers	**1,991**	**1,004**	**518**	**-**	**3,513**
Derivative financial instruments	**(796)**	**138**	**15,227**	**7,996**	**22,565**
Other liabilities	**10,486**	**-**	**-**	**-**	**10,486**
Subordinated liabilities	**65**	**909**	**11,323**	**19,299**	**31,596**
Perpetual subordinated bonds	**595**	**1,184**	**4,736**	**15,000**	**21,515**
Total liabilities	**1,416,282**	**839,555**	**1,069,339**	**42,295**	**3,367,471**

Group and Bank As at 31 December 2012	**Up to 3 months**	**3 - 12 months**	**1 - 5 years**	**More than 5 years**	**Total**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Amounts owed to retail depositors	**1,162,361**	**262,777**	**752,557**	**600,432**	**2,778,127**
Amounts owed to credit institutions and other customers	**10,185**	**14,005**	**537**	**-**	**24,727**
Derivative financial instruments	**(541)**	**1,219**	**20,555**	**43,398**	**64,631**
Other liabilities	**10,241**	**-**	**-**	**-**	**10,241**
Subordinated liabilities	**65**	**1,075**	**10,999**	**19,299**	**31,438**
Perpetual Subordinated Bonds	**595**	**1,181**	**1,184**	**15,000**	**17,960**
Total liabilities	**1,182,906**	**280,257**	**785,832**	**678,129**	**2,927,124**

It has been assumed that Perpetual Subordinated Bonds will not mature at the first call date.

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. The Group measures Interest rate risk using multiple interest rate curve shift scenarios designed to emulate a full range of market movements. Exposure is mitigated on a continuous basis through the use of derivatives within limits set by the ALCO and the Board. After taking into account the derivatives entered into by the Group, the interest rate sensitivity at period end 31 December 2013 following a parallel increase of 2% in interest rates was £1.5m (31 December 2012: £0.6m).

There is no material difference between the interest rate risk profile for the Group and that for the Bank.

Fair value adjustments for hedged risk

This represents the fair value adjustments to the carrying value of mortgage assets, amounts owed to credit institutions and other customers, subordinated debt, and subscribed capital 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 as at the period end. The Group does not undertake transactions for trading or speculative purposes. Market values have been used to determine fair values but where these are not available the financial instruments have been valued by discounting cash flows at prevailing interest rates.

	Group 31 December 2013				
	Positive book value £'000	Positive fair value £'000	Negative book value £'000	Negative fair value £'000	Principal/ Notional £'000
Cash and balances with the Bank of England	267	267	-	-	267
Loans and advances to credit institutions	269,101	269,101	-	-	269,003
Investment securities	361,045	357,905	-	-	359,547
Loans and advances to customers	3,041,248	3,439,255	-	-	3,231,050
Amounts owed to retail depositors	-	-	(3,251,576)	(3,296,988)	(3,213,635)
Amounts owed to credit institutions	-	-	(1,438)	(1,438)	(274,002)
Amounts owed to other customers	-	-	(2,351)	(2,369)	(2,324)
Debt securities in issue	-	-	(273,759)	(273,759)	(273,000)
Subordinated liabilities	-	-	(27,579)	(28,918)	(27,353)
Perpetual subordinated bonds	-	-	(15,263)	(15,710)	(15,000)
Derivatives	757	757	(22,566)	(22,566)	1,597,250
Total	3,672,418	4,067,285	(3,594,532)	(3,641,748)	

	Bank 31 December 2013				
	Positive book value £'000	Positive fair value £'000	Negative book value £'000	Negative fair value £'000	Principal/ Notional £'000
Cash and balances with the Bank of England	267	267	-	-	267
Loans and advances to credit institutions	247,648	247,648	-	-	247,550
Investment securities	361,045	357,905	-	-	359,547
Loans and advances to customers	2,322,268	2,626,182	-	-	2,506,331
Investments in group undertakings	713,105	713,105	-	-	713,105
Amounts owed to retail depositors	-	-	(3,251,576)	(3,296,988)	(3,213,635)
Amounts owed to credit institutions	-	-	(1,438)	(1,438)	(1,417)
Amounts owed to other customers	-	-	(2,351)	(2,369)	(2,324)
Subordinated liabilities	-	-	(27,579)	(28,918)	(27,353)
Perpetual subordinated bonds	-	-	(15,263)	(15,710)	(15,000)
Derivatives	757	757	(22,566)	(22,566)	1,597,250
Total	3,645,090	3,945,864	(3,320,773)	(3,367,989)	

	Group 31 December 2012				
	Positive book value £'000	Positive fair value £'000	Negative book value £'000	Negative fair value £'000	Principal/ Notional £'000
Cash and balances with the Bank of England	282	282	-	-	282
Loans and advances to credit institutions	291,700	291,700	-	-	293,847
Investment securities	410,339	388,398	-	-	390,696
Loans and advances to customers	2,196,050	2,504,861	-	-	2,314,589
Amounts owed to retail depositors	-	-	(2,744,646)	(2,801,332)	(2,778,537)
Amounts owed to credit institutions	-	-	(3,190)	(3,190)	(3,180)
Amounts owed to other customers	-	-	(21,763)	(24,783)	(21,651)
Subordinated liabilities	-	-	(27,576)	(29,599)	(27,353)
Perpetual Subordinated Bonds	-	-	(15,189)	(16,799)	(15,000)
Derivatives	-	-	(63,949)	(63,948)	1,553,700
Total	2,898,371	3,185,241	(2,876,313)	(2,939,651)	

	Bank 31 December 2012				
	Positive book value £'000	Positive fair value £'000	Negative book value £'000	Negative fair value £'000	Principal/ Notional £'000
Cash and balances with the Bank of England	282	282	-	-	282
Loans and advances to credit institutions	289,511	289,511	-	-	291,621
Investment securities	410,339	388,398	-	-	390,696
Loans and advances to customers	1,496,853	1,680,805	-	-	1,496,853
Investments in group undertakings	703,683	703,683	-	-	703,683
Amounts owed to retail depositors	-	-	(2,744,646)	(2,801,332)	(2,778,537)
Amounts owed to credit institutions	-	-	(3,190)	(3,190)	(3,180)
Amounts owed to other customers	-	-	(21,763)	(24,783)	(21,651)
Subordinated liabilities	-	-	(27,576)	(29,599)	(27,353)
Perpetual Subordinated Bonds	-	-	(15,189)	(16,799)	(15,000)
Derivatives	-	-	(63,949)	(63,948)	1,553,700
Total	2,900,668	3,062,679	(2,876,313)	(2,939,651)	

The table below indicates the source of inputs used to derive the carrying value of the Group's assets and liabilities that are held at fair value:

Group and Bank	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
31 December 2013				
Financial assets				
Available for sale				
Government investment securities	339,171	-	-	339,171
Transferable investment securities - unlisted	-	432	-	432
Transferable investment securities - listed	-	-	-	-
Derivative financial instruments				
Interest rate swaps	-	757	-	757
	339,171	1,189	-	340,360
Financial liabilities				
Derivative financial instruments				
Interest rate swaps	-	(22,566)	-	(22,566)
	-	(22,566)	-	(22,566)

Group and Bank	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
31 December 2012				
Financial assets				
Available for sale				
Government investment securities	367,870	-	-	367,870
Transferable investment securities - unlisted	-	20,528	-	20,528
Transferable investment securities - listed	-	21,941	-	21,941
Derivative financial instruments				
Interest rate swaps	-	-	-	-
	367,870	42,469	-	410,339
Financial liabilities				
Derivative financial instruments				
Interest rate swaps	-	(63,949)	-	(63,949)
	-	(63,949)	-	(63,949)

Fair values are determined using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

Level 1

These are valuation techniques that are based entirely on quoted market prices in an actively traded market and are the most reliable.

Level 2

These are valuation techniques for which all significant inputs are taken from 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.

Where discounting techniques are used in respect of derivatives, management have chosen to use LIBOR rather than the Overnight Index Swap ('OIS') rate. This will be reviewed when derivative clearing is introduced. The fair value of the Group's derivative financial instruments includes a Debt Valuation Adjustment (DVA) as disclosed in note 4.

In considering which similar instruments to use, management take 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.

Level 3

These are valuation techniques for which any one or more significant input is not based on observable market data. None of the Group's financial assets or liabilities are valued using this technique.

Valuation techniques include net present value and discounted cashflow models, comparison to similar instruments for which market observable prices exist, Black-Scholes and other valuation models. Assumptions and market observable inputs used in valuation techniques include risk-free and benchmark interest rates, foreign currency exchange rates, equity index prices and expected price volatilities. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date that would have been determined by market participants acting at arm's length.

Observable prices are those that have been seen either from counterparties or from market pricing sources including Bloomberg. The use of these depends upon the liquidity of the relevant market.

30. 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 £645k (2012: £499k).

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

2013 the liability to remaining members is £1.6k (31 December 2012: £1.6k) matched by Scheme assets.

31. 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 Prudential Regulation Authority (PRA), the Bank's primary prudential supervisor, to provide a sufficient capital base to cover business risks and support future business development.

The Bank has implemented Basel II requirements in measuring credit risks under the standardised approach and operational risk under the basic indicator approach. Under Pillar I of Basel II, the Bank calculates its minimum capital requirements based on 8% of risk weighted assets. The Prudential Regulation Authority then applies a multiplier to this amount to cover risks under Pillar II of Basel II and generate 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 ultimate responsibility for capital adequacy rests with the Board of Directors. The Bank's ALCO, which consists of the Chief Executive Officer, Finance Director 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.

	2013 £'000	2012 £'000
Tier 1 Capital		
Permanent share capital	198	197
Transfer reserve	(12,818)	(12,818)
Retained earnings / (losses)	24,031	(545)
Share premium account / Capital contribution	121,157	106,421
Deductions from tier 1 capital	(1,117)	(910)
Non-cumulative preference shares	1,067	804
Total tier 1 capital after deductions	132,518	93,149
Tier 2 Capital		
Perpetual subordinated bonds	36,852	37,189
Available for sale reserve	(156)	1,285
Collective provisions	3,072	1,284
Subordinated liabilities	26,650	26,873
Bonds	703	703
Deductions from tier 2 capital	(7,078)	(4,147)
Total tier 2 capital after deductions	60,043	63,187
Excess of Tier 2 over Tier 1	-	-
Total regulatory capital	192,561	156,336

The Bank has solo consolidation waivers for most of its subsidiaries. The impact of this has been included in the above table.

32. Operating segments

The Group has historically assessed the performance of the Group as a whole. During the year the Group segmented its lending by product, focusing on the customer need and reason for a loan. It now operates under three segments:

1. ***Residential Mortgages***; lending to customers who live in their own homes, secured either via first or second charges against the residential home,

2. ***Buy-to-Let/SME***; secured lending on property for investment and commercial purposes, 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:

Group 2013	Residential mortgages £'000	BTL/SME £'000	Personal loans £'000	Central £'000	Total £'000
Balances at the reporting date					
Gross loans and advances to customers	1,764,639	1,098,834	205,308	-	3,068,781
Provision for impairment losses on loans and advances	(3,075)	(22,360)	(2,098)	-	(27,533)
Loans and advances to customers	1,761,564	1,076,474	203,210	-	3,041,248
Capital expenditure	1,081	452	72	-	1,605
Risk weighted assets	722,760	513,202	162,578	-	1,398,540
Profit or loss for the year					
Net interest income	42,334	17,199	11,233	-	70,766
Other income / (expense)	(3,999)	(531)	(805)	-	(5,335)
Total income	38,335	16,668	10,428	-	65,431
Impairment losses	(543)	(4,688)	(2,098)	-	(7,329)
Contribution to profit	37,792	11,980	8,330	-	58,102
Operating expenses					(24,557)
Regulatory provisions					(2,128)
Negative goodwill					-
Profit before taxation					31,417
Taxation					(4,646)
Profit for the year					26,771

Group 2012	Residential mortgages £'000	BTL/SME £'000	Personal loans £'000	Central £'000	Total £'000
Balances at the reporting date					
Gross loans and advances to customers	1,614,462	612,560	-	-	2,227,022
Provision for impairment losses on loans and advances	(2,535)	(28,437)	-	-	(30,972)
Loans and advances to customers	1,611,927	584,123	-	-	2,196,050
Capital expenditure	2,408	840	-	-	3,248
Risk weighted assets	715,110	337,656	-	-	1,052,766
Profit or loss for the year					
Net interest income	12,960	3,201	-	-	16,161
Other income / (expense)	(2,714)	(347)	-	2,893	(168)
Total income	10,246	2,854	-	2,893	15,993
Impairment losses	(1,610)	(3,691)	-	-	(5,301)
Contribution to profit	8,636	(837)	-	2,893	10,692
Operating expenses					(19,296)
Regulatory provisions					(930)
Negative goodwill					17,603
Profit before taxation					8,069
Taxation					996
Profit for the year					9,065

33. Changes in accounting policies and adoption of new standards

During the year the Bank changed its accounting policy for FSCS levies based on IFRIC 21's interpretation of IAS 37. This has caused the trigger date for the FSCS levy to change from 31 December each year to the following 1 April. IFRIC 21 requires the total liability to be recognised at the trigger date, therefore the change has resulted in a restatement of the comparatives for 2012.

A summary of impact of IFRIC 21 restatement on equity is presented below:

	2012 £'000
Previously reported equity as at 31 December 2012	113,927
Adjustment to FSCS levy due to a change in accounting policy	1,999
Adjusted equity as at 31 December 2012	115,926

In 2013, the FSCS levies charge is £2.1m. The charge would have been £2.4m had the accounting policy not been changed.

See note 27 for further details.

The following new standards and amendments became effective from 1 January 2013:

- Amendments to IAS 1, Presentation of items of Other Comprehensive Income. This amendment requires entities to group items presented in the Statement of Other Comprehensive Income on the basis of whether they are potentially reclassifiable to profit or loss in subsequent periods. The amendment has had no material effect on the financial statements of the Group.
- December 2011 amendments to IFRS 7, Financial Instruments – Disclosures require new disclosures for all recognised financial instruments offset in the statement of financial position. The impact of the amendments to IFRS 7 has not been material to the Group.
- IFRS 13, Fair Value Measurement. This new standard defines fair value and sets out in a single framework comprehensive guidance for measuring fair value. It also requires increased disclosure about fair value measurements. The standard does not change the requirements with regards to which financial and non-financial assets and liabilities will be measured at fair value. The standard has had no material impact on the financial statements of the Group.

The standards below have been endorsed by the EU with a mandatory effective date of 1 January 2014 and therefore have not been applied in preparing these financial statements:

- IFRS 10, Consolidated Financial Statements. This new standard partly replaces IAS 27, Separate Financial Statements and SIC 12, Consolidation - Special Purpose Entities. The new standard defines the principle of control and establishes control as the basis for determining which entities are consolidated in the consolidated financial statements. The IFRSs also set out the accounting requirements for the preparation of consolidated financial statements. With the exception of additional disclosure requirements, the new standard is not expected to have a significant impact for the Group.
- IFRS 11, Joint Arrangements. This new standard replaces IAS 31, Interests in Joint Ventures and SIC 13, Jointly Controlled Entities - Non-Monetary Contributions by Venturers. The new standard removes the choice to apply the proportionate consolidation method, requiring all joint arrangements to be accounted for under the equity method. The new standard will have no impact on the financial statements of the Group.
- IFRS 12, Disclosure of Interests in Other Entities. This standard applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. This standard will have an impact on the disclosure requirements of the Group, but these are not expected to be extensive.
- Amendments to IAS 27, Separate Financial Statements and IAS 28, Investments in Associates and Joint Ventures triggered by publication of IFRS 10-12 are not expected to have a material effect on the financial statements.

The new standards and amendments below have not been yet endorsed by the EU and therefore have not been applied in preparing these financial statements:

- IFRS 9, Financial Instruments is a new standard which may have a significant impact on classification, recognition and measurement of financial instruments of the Group. It has been under development for several years and is still undergoing changes. The Group is monitoring development of IFRS 9 and considering the associated impact on the Group’s financial statements.

34. Events after the reporting date.

In January 2014 the Group joined the Funding-For-Lending scheme and received £98m of treasury bills from the Bank of England.

OneSavings Bank plc
Company Information
For the year ended 31 December 2013

Board of Directors as at the date of signing

S Wilcke - Chairman

Executive Directors

A Golding – Chief Executive

A Talintyre – Finance Director

Non-Executive Directors

R Duke

T Hanford

M McCaig

Sir C McCarthy

D Mills

Dr D Morgan

Secretary

Z Bucknell

Registered office

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Registered number

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