16 March 2017

OneSavings Bank plc

Preliminary results for the year ended 31 December 2016

Financial highlights

- Underlying profit before taxation[1] up by 29% to £137.0m (2015: £105.9m)
- Gross originations up by 28% to £2.3bn (2015: £1.8bn)
- Net loans and advances grew by 16% in 2016 to £5.9bn (2015: £5.1bn). Underlying loan book growth of 20%, excluding the impact of the Rochester 1 disposal
- Net interest margin (NIM) increased to 314bps (2015: 309bps)
- Continued focus on cost control and efficiency alongside strong income growth drove a cost:income ratio[3] of 27% (2015: 26%)
- Return on equity (RoE)[4] remained strong at 29% (2015: 32%). Proforma RoE of 32% excluding the impact of the new 8% Bank Corporation Tax Surcharge, despite strengthening our Common Equity Tier 1 (CET1) capital ratio to 13.3% (2015: 11.6%)
- Underlying basic earnings per share[5] grew 20% to 41.7 pence (2015: 34.8 pence)
- Final dividend[6] of 7.6 pence per share giving a full year dividend of 10.5 pence per share, in-line with our target dividend payout ratio
- Exceptional gain on disposal of the Group's economic interest in the Rochester 1 securitisation vehicle of £34.7m and an exceptional loss of £9.8m in respect of accelerated amortisation of fair value adjustments on hedged assets relating to legacy back book long-dated interest rate swap cancellations[2].

Andy Golding, CEO of OneSavings Bank, said:

"I am delighted to report that OneSavings Bank has delivered another year of strong performance in 2016. We have once again met or exceeded all of the financial objectives we set at IPO despite a number of regulatory and tax changes.

This was another period of strong loan book growth through our specialist lending brands, demonstrating the strength of our organic lending franchise with a 28% increase in new originations in 2016, whilst also improving our net interest margin. We continued to demonstrate strong organic capital generation capability through profitability and further increased our capital ratio following the sale of our economic interest in the Rochester Financing No.1 plc securitisation. I am particularly pleased that we delivered another strong return on equity despite the impact of the Bank Corporation Tax Surcharge and higher capital levels.

Following this strong performance in 2016, we entered 2017 with a strong pipeline of new business and are seeing very strong application levels in our core businesses. We expect to deliver net loan book growth in the mid-teens in 2017, whilst keeping NIM and cost to income ratio broadly flat.

OneSavings Bank is well placed to take advantage of opportunities in our core businesses in 2017 and we remain confident in our ability to generate attractive returns for our shareholders".

Key Metrics

	2016	2015
Net interest margin[7] (bps)	314	309
Statutory profit before tax (£m)	163.1	105.3
Total assets (£bn)	6.6	6.0
Statutory basic EPS[8] (pence)	49.4	34.1
Loan to deposit ratio[9] (%)	90	93
3 months + arrears[10] (%)	1.4	2.1
Loan loss ratio[11] (bps)	16	23
Customer net promoter score (%)	59	55

Enquiries:

OneSavings Bank plc

Alastair Pate t: 01634 835728

Brunswick Group

Robin Wrench / Simone Selzer t: 020 7404 5959

Analyst Presentation

A presentation for analysts will be held at 9:30am on Thursday 16 March at The Lincoln Centre, 18 Lincoln's Inn Fields, WC2A 3ED. The UK dial in is +44 (0) 20 3427 1900 and the passcode is 6591962. The presentation will be webcast and available from 9.30am on the OneSavings Bank website at osb.co.uk in the Investor Relations, Report and Accounts section. Registration is open immediately.

About OneSavings Bank plc

OneSavings Bank plc ('OSB') began trading as a bank on 1 February 2011 when the trade and assets of Kent Reliance Building Society 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 selected sub-sectors of the lending market in which it has established expertise, platforms and capabilities, and where opportunities have been identified for both high returns on a risk-adjusted basis and strong growth. These include Buy-to-Let/SME (comprising Buy-to-Let, Commercial, Residential development and Funding lines), Residential Mortgages (comprising First charge, Second charge and Funding lines), and Personal Loans. OSB originates organically through specialist brokers and independent financial advisors.

OSB is predominantly funded by retail savings originated through the established Kent Reliance franchise, which includes a network of branches in the South East of England, as well as online and postal channels. Diversification of funding is currently provided by a securitisation and OSB joined the Funding for Lending Scheme in early 2014 and the Term Funding Scheme in November 2016.

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[1] Before net exceptional gains and losses of £24.9m (see Alternative performance measures and Exceptional items in the Financial review for further details), and after deduction of coupons on equity Perpetual Subordinated Bonds (PSBs) of £1.2m (2015: exceptional IPO expenses of £2.1m and coupons on equity PSBs of £1.5m).

[2] See Exceptional items in the Financial review for further details.

[3] Administrative expenses including depreciation and amortisation as a percentage of total income after deducting coupons on equity PSBs.

[4] Underlying profit after taxation is calculated before net exceptional gains and losses, including the tax effect, of £18.5m (see Alternative performance measures and Exceptional items in the Financial review for further details) and after deducting

coupons on equity PSBs, including the tax effect, of £0.9m (2015: before exceptional IPO expenses, including the tax effect, of £1.6m and after deducting coupons on equity PSBs, including the tax effect, of £1.2m) as a percentage of average shareholders' equity (excluding equity PSBs of £22m).

[5] Underlying profit after taxation divided by the weighted average number of ordinary shares in issue.

[6] Representing 25% of underlying profit after tax. To be paid on 17 May 2017, subject to approval at the Annual General Meeting on 10 May 2017, with a record date of 31 March 2017. For 2015, the dividend of 6.7p per share represented a final two-thirds dividend.

[7] Net interest income, less coupons on PSBs classified as equity, as a percentage of average interest bearing assets including FLS drawings (off balance sheet) and TFS drawings.

[8] Statutory profit after taxation divided by the weighted average number of ordinary shares in issue.

[9] Excluding the impact of the FLS and TFS schemes

[10] Portfolio arrears rate (excluding legacy problem loan book) of accounts for which there are missed or overdue payments by more than three months

[11] Impairment losses expressed as a percentage of average gross loans and advances

Non-IFRS performance measures

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

Important disclaimer

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

Any forward-looking statements made in this document speak only as of the date they are made and it should not be assumed that they have been revised or updated in the light of new information of future events. Except as required by the Prudential Regulation Authority, the Financial Conduct Authority, the London Stock Exchange PLC or applicable law, OSB expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained in this document to reflect any change in OSB's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based. The information, statements and opinions contained in this document and subsequent discussion do not constitute a public offer under any applicable law or an offer to sell any securities or financial instruments or any advice or recommendation with respect to such securities or financial instruments.

Chief Executive’s Statement

Continued strong performance

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

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

Results at a glance

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

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

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

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

Best specialist lender

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

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

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

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

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

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

Award winning savings

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

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

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

Operational excellence and service is core

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

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

Building a business for the future

The Group's strength and expertise in manual underwriting has continued to exercise strong diligence over loan and customer assessment, contributing to the Group's loan loss ratio falling to 16bps in the year to 31 December 2016 (2015: 23bps). We remain particularly pleased with the performance of the front book of mortgages. From more than 29,000 loans totalling £5.9bn of new organic originations since the Bank's creation in February 2011, we only have 91 cases of arrears over three months in duration, with an aggregate balance of £8.6m and an average loan to value ('LTV') of 60%, reflecting the continued strength of the Bank's underwriting and lending criteria.

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

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

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

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

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

Strengthening the senior management team

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

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

Market outlook

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

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

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

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

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

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

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

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

Looking forward in 2017

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

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

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

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

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

1 See reconciliation of statutory profit to underlying profit in Alternative performance measures in Financial review.
2 Excluding the impact of drawdowns under the FLS and TFS.

Operating and financial review

Group overview

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

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

Business highlights

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

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

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

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

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

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

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

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

The Bank's secured funding line business in both its Buy-to-Let/SME and Residential segments remains important, although additional controls and more prudent criteria were put in place after the result of the EU referendum in light of potential market uncertainties.

Notwithstanding these additional controls, gross advances to other lenders, including bridge and asset finance businesses, were up 19% to £156.2m in 2016 (2015: £131.4m) with total loans outstanding as at 31 December 2016 of £122.3m (2015: £125.8m). Four new funding lines were added in the year.

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

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

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

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

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

1 See reconciliation of statutory profit to underlying profit in Alternative performance measures in the Financial review.

Financial objectives

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

Financial objectives 2014-2016[1]

		2016 Result
Funding/liquidity strength	Maintain loan to deposit ratio of <100%[2]	90%
Cost discipline	Cost:income ratio of <35%	27%
Capital strength	CRD IV CET1 ratio >10%	13.3%
Shareholder returns	RoE of >25%	29%
Dividend policy	Pay-out ratio of ≥25%[3]	25%

1 Objectives relate to the financial planning cycle that lasted until the end of 2016. This does not represent any forecast, target or expectation as to future results or performance and there can be no assurance that the objective will be met.
2 Excluding the impact of any drawdown under the FLS and TFS schemes.
3 Pay-out ratio of at least 25 per cent of underlying profit after taxation.

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

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

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

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

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

Segmental review

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

31 December 2016, £m	BTL/SME	Residential	Personal loans	Total
Gross loans to customers	4,094.9	1,859.9	9.4	5,964.2
Provision for impairment losses	(16.9)	(7.8)	(0.3)	(25.0)
Net loans to customers	4,078.0	1,852.1	9.1	5,939.2
Risk weighted assets	1,936.6	798.7	7.7	2,743.0
Net interest income	132.0	71.4	3.2	206.6
Other income/expense	0.3	(4.7)	(0.8)	(5.2)
Total income	132.3	66.7	2.4	201.4
Impairment losses	(2.1)	(7.2)	0.3	(9.0)
Contribution to profit	130.2	59.5	2.7	192.4

31 December 2015, £m	BTL/SME	Residential	Personal loans	Central[1]	Total
Gross loans to customers	3,105.5	2,007.1	49.5	-	5,162.1
Provision for impairment losses	(17.7)	(2.2)	(7.4)	-	(27.3)
Net loans to customers	3,087.8	2,004.9	42.1	-	5,134.8
Risk weighted assets	1,435.1	858.6	45.8	-	2,339.5
Net interest income	95.2	69.0	5.6	-	169.8
Other income/expense	(0.6)	(5.9)	(1.4)	0.6	(7.3)
Total income	94.6	63.1	4.2	0.6	162.5
Impairment losses	(5.3)	(2.4)	(2.9)	-	(10.6)
Contribution to profit	89.3	60.7	1.3	0.6	151.9

[1] Central function includes gains on the sale of treasury assets

Buy-to-Let/SME

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

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

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

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

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

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

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

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

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

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

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

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

1 Council of Mortgage Lenders, New and outstanding buy-to-let new mortgages, UK, MM17, 7 Feb 2017

Residential mortgages

Residential sub-segment: gross loans

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

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

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

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

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

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

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

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

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

Residential mortgages made a contribution to Group profit of £59.5m in 2016, down 2% (2015: £60.7m), reflecting the positive impact of new lending and portfolio purchases, and the falling cost of funds, more than offset by the impact of the sale of higher yielding mortgages in the Rochester 1 securitisation vehicle and higher impairment losses of £7.2m (2015: £2.4m). The impairment losses were recognised on acquired mortgage portfolios in run-off, due to incremental prudence added to the collectively assessed provision calculations following the EU referendum result. Total arrears balances fell in 2016, reducing the underlying impairment provisions.

Personal loans

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

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

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

Financial review

Summary Profit or Loss	Group 31/12/2016 £m	Group 31/12/2015 £m
Net interest income	**206.6**	169.8
Net losses on financial instruments	**(4.3)**	(2.6)
Net fees and commissions	**1.7**	0.0
External servicing fees	**(2.6)**	(4.7)
Administrative expenses[1]	**(53.7)**	(41.1)
FSCS and other provisions	**(0.5)**	(3.4)
Impairment losses	**(9.0)**	(10.6)
Exceptional items	**24.9**	(2.1)
Profit before taxation	**163.1**	105.3
Profit after taxation	**120.9**	84.1
Underlying profit before taxation [2]	**137.0**	105.9
Underlying profit after taxation[2]	**101.5**	84.5

Key ratios		
Net interest margin	**314bps**	309bps
Cost:income ratio	**27%**	26%
Management expense ratio[3]	**86bps**	75bps
Loan loss ratio	**0.16%**	0.23%
Basic EPS, pence per share	**49.4**	34.1
Underlying basic EPS, pence per share[2]	**41.7**	34.8
Return on equity	**29%**	32%
Dividend per share, pence per share	**10.5p**	8.7p

Extracts from the Statement of Financial Position

	£m	£m
Loans and advances	**5,939.2**	5,134.8
Retail deposits	**5,952.4**	5,363.8
Total assets	**6,580.9**	5,970.4

Key ratios		
Liquidity ratio[4]	**17.9%**	16.4%
Common equity tier 1 ratio[5]	**13.3%**	11.6%
Total capital ratio	**15.1%**	14.1%
Leverage ratio	**5.5%**	4.5%

1 Including depreciation and amortisation.
2 See Alternative performance measures below for further details.
3 Administrative expenses including depreciation and amortisation as a percentage of average total assets.
4 Liquid assets as a percentage of funding liabilities.
5 Fully-loaded under Basel III /CRD IV.

Strong profit growth

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

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

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

Alternative performance measures

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

Reconciliation of statutory profit to underlying profit

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

[1]IPO related costs are £0.4m in 2016, however due to materiality level, this expense is now shown within staff costs.

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

Underlying basic EPS of 41.7 pence per share is calculated by dividing underlying profit after taxation of £101.5m by the weighted average number of ordinary shares in issue during the year of 243.1m.

Net interest margin

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

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

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

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

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

Losses on financial instruments

The net loss on financial instruments in 2016 of £4.3m (2015: net loss £2.6m) includes £4.9m amortisation of fair value adjustments on hedged assets relating to cancelled swaps (2015: £3.2m) and £0.6m gain on disposal of the non-performing personal loans with a gross value of £10.6m (2015: a net gain of £0.6m from the sale of the Bank's RMBS portfolio). The increase in the amortisation of fair value adjustments includes the impact of accelerating the amortisation in-line with the run-off of the underlying legacy long-term fixed rate mortgages due to faster than expected prepayments.

Net fees and commission

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

External servicing fees

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

Efficient and scalable operating platform

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

9 and internal ratings-based approach to risk weights ('IRB').

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

Regulatory provisions

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

Impairment losses

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

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

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

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

Exceptional items

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

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

During 2016, the Group reviewed the roll-off of the legacy long-dated fixed rate mortgages. Following this review, the Group accelerated the amortisation of the associated fair value adjustments on hedged assets in-line with the mortgage asset run-off, due to faster than expected prepayments since cancellation.

The exceptional loss represents the impact of accelerating the amortisation in prior years from 2012 to 2015, which was not material in any individual year. It has been presented as an exceptional item and excluded from 2016 underlying profit before tax to provide an appropriate measure of the underlying performance of the Group in 2016. The exceptional loss would have reduced fair value adjustments on hedged assets by £9.8m, retained earnings by £7.6m (including the tax effect) and the CET1 ratio by 0.3% points as at 31 December 2015.

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

Dividend

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

Balance sheet growth

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

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

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

Liquidity

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

Capital

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

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

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

Summary cash flow statement

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

Cash flow statement

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

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

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

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

Statement of Profit or Loss

For the year ended 31 December 2016

	Group 2016 £m	Group 2015 £m
Interest receivable and similar income	**309.5**	268.2
Interest payable and similar charges	**(102.9)**	(98.4)
Net interest income	**206.6**	169.8
Fair value losses on financial instruments	**(4.9)**	(3.2)
Gains on sales of financial instruments	**0.6**	0.6
Fees and commissions receivable	**2.5**	1.1
Fees and commissions payable	**(0.8)**	(1.1)
External servicing fees	**(2.6)**	(4.7)
Total income	**201.4**	162.5
Administrative expenses	**(51.1)**	(39.4)
Depreciation and amortisation	**(2.6)**	(1.7)
Impairment losses	**(9.0)**	(10.6)
FSCS and other provisions	**(0.5)**	(3.4)
Exceptional gain on sale	**34.7**	-
Exceptional amortisation of fair value adjustments on hedged assets	**(9.8)**	-
Exceptional IPO expenses	**-**	(2.1)
Profit before taxation	**163.1**	105.3
Taxation	**(42.2)**	(21.2)
Profit for the year	**120.9**	84.1
Dividend, pence per share	**10.5**	8.7
Earnings per share, pence per share		
Basic	**49.4**	34.1
Diluted	**49.0**	34.0

The above results are derived wholly from continuing operations.

Statement of Other Comprehensive Income

For the year ended 31 December 2016

	Group 2016 £m	Group 2015 £m
Profit for the year	**120.9**	84.1
Items which may be reclassified to profit or loss:		
Fair value changes on available-for-sale securities		
Arising in the year	**0.1**	(0.5)
Transferred to profit or loss	**-**	(0.6)
Revaluation of foreign operations	**0.9**	(0.5)
Tax on items in other comprehensive income	**-**	0.2
Other comprehensive income for the year	**1.0**	(1.4)
Total comprehensive income for the year	**121.9**	82.7

Statement of Financial Position

As at 31 December 2016

	Group 2016 £m	Group 2015 £m
Assets		
Cash in hand	**0.4**	0.4
Loans and advances to credit institutions	**417.8**	354.7
Investment securities	**141.7**	393.4
Loans and advances to customers	**5,939.2**	5,134.8
Derivative assets	**1.8**	1.0
Fair value hedges – assets	**46.9**	58.2
Deferred taxation asset	**3.4**	3.4
Intangible assets	**4.7**	3.1
Property, plant and equipment	**13.1**	9.6
Other assets	**11.9**	11.8
Total assets	**6,580.9**	5,970.4

Liabilities		
Amounts owed to retail depositors	**5,952.4**	5,363.8
Amounts owed to credit institutions	**101.7**	1.5
Amounts owed to other customers	**4.0**	5.9
Debt securities in issue	**-**	188.4
Derivative liabilities	**24.4**	19.8
Fair value hedges – liabilities	**1.9**	1.4
Current taxation liability	**21.1**	9.2
Other liabilities	**18.6**	18.9
FSCS and other provisions	**1.5**	2.3
Subordinated liabilities	**21.6**	24.6
Perpetual subordinated bonds	**15.3**	15.3
	6,162.5	5,651.1
Equity		
Share capital	**2.4**	2.4
Share premium	**157.9**	157.9
Retained earnings	**240.7**	144.0
Other reserves	**17.4**	15.0
	418.4	319.3
Total equity and liabilities	**6,580.9**	5,970.4

Statement of Changes in Equity

For the year ended 31 December 2016

Group	Share capital	Share premium	Capital contribution	Transfer reserve	Foreign exchange reserve	Available -for-sale reserve	Share-based payment reserve	Retained earnings	Equity bonds[1]	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Balance at 1 January 2016	**2.4**	**157.9**	**5.8**	**(12.8)**	**(0.8)**	**(0.1)**	**0.9**	**144.0**	**22.0**	**319.3**
Profit for the year	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**120.9**	**-**	**120.9**
Coupon paid on equity bonds[2]	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(0.9)**	**-**	**(0.9)**
Dividends paid	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(23.3)**	**-**	**(23.3)**
Other comprehensive income	**-**	**-**	**-**	**-**	**0.9**	**0.1**	**-**	**-**	**-**	**1.0**
Share based payments[3]	**-**	**-**	**0.4**	**-**	**-**	**-**	**1.0**	**-**	**-**	**1.4**
Balance at 31 December 2016	**2.4**	**157.9**	**6.2**	**(12.8)**	**0.1**	**-**	**1.9**	**240.7**	**22.0**	**418.4**

Group	Share capital	Share premium	Capital contribution	Transfer reserve	Foreign exchange reserve	Available -for-sale reserve	Share-based payment reserve	Retained earnings	Equity bonds[1]	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Balance at 1 January 2015	2.4	157.9	4.5	(12.8)	(0.3)	0.8	0.1	75.0	22.0	249.6
Profit for the year	-	-	-	-	-	-	-	84.1	-	84.1
Coupon paid on equity bonds[2]	-	-	-	-	-	-	-	(1.2)	-	(1.2)
Dividends paid	-	-	-	-	-	-	-	(14.3)	-	(14.3)
Other comprehensive income	-	-	-	-	(0.5)	(0.9)	-	-	-	(1.4)
Share based payments[3]	-	-	`1.3	-	-	-	0.8	0.4	-	2.5
Balance at 31 December 2015	2.4	157.9	5.8	(12.8)	(0.8)	(0.1)	0.9	144.0	22.0	319.3

1 Equity bonds comprise £22m of Perpetual Subordinated Bonds.
2 Coupon paid on equity bonds is shown net of tax.
3 The tax effect in excess of the related cumulative remuneration expense is recognised directly in equity within the share-based payment reserve and reclassified to retained earnings upon vesting.

Statement of Cash Flows

For the year ended 31 December 2016

	Group Year ended 31-Dec-16 £m	Group Year ended 31-Dec-15 £m
Cash flows from operating activities		
Profit before tax	**163.1**	105.3
Adjustments for non-cash items:		
Depreciation and amortisation	**2.6**	1.7
Interest on subordinated liabilities	**1.2**	1.3
Interest on Perpetual Subordinated Bonds	**0.9**	1.0
Impairment charge on loans	**9.0**	10.6
Gain on sale of financial instruments	**(0.6)**	(0.6)
FSCS and other provisions	**0.5**	3.4
Fair value losses on financial instruments	**4.9**	3.2
Share based payments	**1.5**	1.8
Exceptional items	**(24.9)**	-
Changes in operating assets and liabilities		
Increase in loans to customers	**(1,031.3)**	(1,226.0)
Increase in retail deposits	**588.6**	1,032.2
Decrease in other assets	**-**	0.5
Decrease in derivatives and hedged items	**0.9**	-
(Decrease)/increase in other liabilities	**(1.4)**	5.3
Exchange differences on working capital	**0.9**	(0.5)
Cash used in operating activities	**(284.1)**	(60.8)
Interest paid on bonds and subordinated debt	**(2.1)**	(2.2)
Sales of financial instruments	**1.9**	-
FSCS and other provisions paid	**(1.3)**	(2.7)
Tax paid	**(29.6)**	(13.6)
Net cash used in operating activities	**(315.2)**	(79.3)
Cash flows from investing activities		
Maturity and sales of investment securities	**712.2**	213.8
Purchases of investment securities	**(460.4)**	(449.1)
Proceeds from disposal of a subsidiary[1]	**80.2**	-
Purchases of equipment and intangible assets	**(7.7)**	(9.1)
Cash generated from/(used in) investing activities	**324.3**	(244.4)
Cash flows from financing activities		
Increase/(decrease) in amounts owed to credit institutions	**98.3**	(20.0)

Coupon paid on equity bonds	**(1.2)**	(1.5)
Dividends paid	**(23.3)**	(14.3)
Repayment of debt	**(19.8)**	(53.0)
Net cash generated from/(used) in financing activities	**54.0**	(88.8)
Net increase/(decrease) in cash and cash equivalents	**63.1**	(412.5)
Cash and cash equivalents at the beginning of the period		
Cash in hand	**0.4**	0.3
Loans and advances to credit institutions repayable on demand	**354.7**	767.3
	355.1	767.6
Cash and cash equivalents at the end of the period		
Cash in hand	**0.4**	0.4
Loans and advances to credit institutions repayable on demand	**417.8**	354.7
	418.2	355.1
Movement in cash and cash equivalents	**63.1**	(412.5)

1 Proceeds from a disposal of a subsidiary relate to the Group's disposal of the entire economic interest in Rochester Financing No.1 plc securitisation vehicle.

Extract from notes to the financial statements

1. Interest receivable and similar income

	Group 31-Dec-16 £m	Group 31-Dec-15 £m
On BTL/SME mortgages	**205.0**	149.7
On residential mortgages	**107.1**	115.9
On personal loans	**3.8**	7.5
On investment securities	**1.2**	1.6
On other liquid assets	**1.6**	2.8
Net expense on derivative financial instruments	**(9.2)**	(9.3)
	309.5	268.2

Included within interest receivable is £1.3m (2015: £2.4m) in respect of interest accrued on accounts with an individually assessed specific provision.

2. Interest payable and similar charges

	Group 31-Dec-16 £m	Group 31-Dec-15 £m
On retail deposits	**101.8**	94.8
On Perpetual Subordinated Bonds	**0.9**	1.0
On subordinated liabilities	**1.2**	1.3
On wholesale borrowings	**3.2**	5.7
Net income on derivative financial instruments	**(4.2)**	(4.4)
	102.9	98.4

3. Fair value adjustments on hedged items

	Group 31-Dec-16 £m	Group 31-Dec-15 £m
Hedged assets		
Current hedge relationships	**23.6**	20.4
Cancelled hedge relationships	**23.3**	37.8
	46.9	58.2
Hedged liabilities		
Current hedge relationships	**(1.9)**	(1.4)

The fair value adjustments for hedged assets in respect of cancelled hedge relationships represent fair value adjustments for interest rate risk on legacy long-term fixed rate mortgages (c. 25 years at origination) where the interest rate swap hedges were terminated before maturity and were effective at the point of termination.

The movement in cancelled hedge relationships is as follows:

	Group 2016 £m	Group 2015 £m
Balance at 1 January	**37.8**	41.0
New cancellations	**0.2**	-
Amortisation	**(4.9)**	(3.2)
Exceptional loss	**(9.8)**	-
Balance at 31 December	**23.3**	37.8

General note to the financial information

The financial information set out in the announcement does not constitute the Company's statutory accounts for the years ended 31 December 2015 or 31 December 2016, but is derived from those statutory accounts, which have been reported on by the Company's auditors. Statutory accounts for the years ended 31 December 2015 have been delivered to the Registrar of Companies and those for the year ended 31 December 2016 will be delivered to the Registrar following the Company's Annual General Meeting.

Sections of this preliminary announcement, including but not limited to the Chief Executive's Report and Operating and Financial Report, may contain forward-looking statements with respect to certain of the plans and current goals and expectations relating to the future financial condition, business performance and results of the Group. These have been made by the Directors in good faith using information available up to the date on which they approved this report. By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of the Group and depend upon circumstances that may or may not occur in the future. There are a number of factors that could cause actual future financial conditions, business performance, results or developments to differ materially from the plans, goals and expectations expressed or implied by these forward-looking statements and forecasts. Nothing in this document should be construed as a forecast.

A copy of the Annual Report and Accounts for the year ended 31 December 2016 will be posted to shareholders in due course. Copies of this announcement can be obtained from the Group Company Secretary, OneSavings Bank PLC at Reliance House, Sun Pier, Chatham, Kent ME4 4ET.

Risk statements

Strategic Risk Management Framework

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

Risk Principles and Culture

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

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

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

Risk Strategy & Appetite

Risk Strategy

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

This risk strategy is based on three key components:

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

Risk Appetite

At OSB, we have established a clear linkage between our strategy and risk appetite, ensuring that the setting and monitoring of risk appetite is embedded within the business (with respect to processes e.g. business planning processes, new product development / approval). Our risk appetite is informed by our strategic choices and our business strategy, which in turn is developed within the confines of our articulated risk appetite. Our risk appetite is calibrated to a plausible but extreme macroeconomic scenario severity (1 in 20), which seeks to ensure that our strategy and business model remains resilient under a range of macroeconomic environments.

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

Risk Appetite Statements

Overarching Risk Appetite Statement

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

Strategic and Business Risk Appetite Statement

The Group's strategic and business risk appetite states that the Group does not intend to undertake any long to medium-term strategic actions that would put at risk its vision of being a leading specialist lender, backed by a strong and dependable saving franchise. The Group adopts a long-term sustainable business model which, while focused on niche sub-sectors, is capable of adapting to growth objectives and external developments.

Reputational Risk Appetite Statement

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

Credit Risk Appetite Statement

The Group seeks to maintain a high quality lending portfolio that generates adequate returns, in benign and stressed periods. The portfolio is actively managed to operate within set criteria and limits based on profit volatility, focusing on key sectors, recoverable values, and affordability and exposure levels. The Group aims to continue to generate sufficient income and control credit losses to a level such that it remains profitable even when subjected to a credit portfolio stress of a 1 in 20 intensity stress scenario.

Market Risk Appetite Statement

The Group actively manages market risk arising from structural interest rate positions. The Group does not seek to take a significant interest rate position or a directional view on rates and it limits its mismatched and basis risk exposures.

Liquidity and Funding Risk Appetite Statement

The Group actively manages stable and efficient access to funding and liquidity to support its ongoing operations. It also maintains an appropriate level and quality of liquid asset buffer so as to withstand market and idiosyncratic liquidity-related stresses.

Solvency Risk Appetite Statement

The Group seeks to ensure that it is able to meet its Board level capital buffer requirements under a 1 in 20 stress severity scenario. The Group's solvency risk appetite is constrained within the leverage ratio related requirements. We manage our capital resources in a manner which avoids excessive leverage and allows us flexibility in raising capital.

Operational Risk Appetite Statement

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

Conduct Risk Appetite Statement

The Bank considers its culture and behaviours in ensuring the fair treatment of customers and in maintaining the integrity of the markets in which it operates a fundamental part of its strategy and a key driver to sustainable profitability and growth. OSB does not tolerate any systemic failure to deliver fair customer outcomes. On an isolated basis incidents can result in detriment owing to human and / or operational failures. Where such incidents occur they are thoroughly investigated, and the appropriate remedial actions are taken to address any customer detriment and to prevent recurrence.

Compliance and Regulatory Risk Appetite Statement

The Group will not tolerate systemic failures to comply with the relevant laws, regulations and codes of conduct applicable to its business activities. The Group's compliance culture and supporting procedures ensure adherence to all relevant regulation and it actively monitors and assesses changing and emerging regulatory standards. The Group applies its own intellectual capital and seeks external advice where appropriate to ensure that it is compliant with the intent and spirit of regulation without causing unforeseen detriment to its customers.

Risk Governance and Organisational Structure

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

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

2016 highlights

IFRS 9

The Board has identified transition towards IRB based capital treatment as an important strategic objective and the Group has made significant progress in the development of its IFRS 9 and Internal Ratings Based ('IRB') frameworks. The Group's IFRS 9 programme progressed to plan, moving into the parallel run phase for 2017. We are well placed to implement IFRS 9 in 2018.

Credit Risk

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

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

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

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

Since its inception, the Group has experienced material loan growth with Group loans and advances totalling £5.9bn as at December 2016. Importantly, there has been a portfolio composition change over the period, with post 2011 lending (incorporating enhanced lending criteria) now making up a greater proportion of the total Group loan balances. Since 2011, the

Group has originated 29,000 loans with only 91 cases with aggregate balances totalling £8.6m greater than three months in arrears, with an average 60% LTV, reflecting the continued strength of the Group's underwriting and lending criteria. During 2016, the Group continued to prudently underwrite new loans, carefully assessing customer affordability as demonstrated by the number of newly originated residential mortgage loans with a loan to income of greater than 4.5 falling to 2.6% from 3.3% during 2015. Buy-to-Let interest coverage ratios ('ICR') for new loans increased to 171% up from 159% during 2015, further demonstrating the prudent underwriting conducted during 2016. Buy-to-Let LTVs for new lending remained stable at 72%, whilst residential mortgage new lending LTVs increased marginally to 66% from 64% during 2016. The acquired portfolios, funding lines and development finance portfolios continued to perform in-line with expectations, whilst the Group also sold £10.9m (gross value) of non-performing personal loan accounts during the year. Pre 2011 lending balances continued to run down during the year, and historic problem loans reduced from £17.8m to £13.8m as at December 2016.

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

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

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

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

The Group continues to observe low levels of accounts in forbearance with total forbearance balances reducing materially within the year.

Segment and sub-segment credit risk analysis

Loan to value analysis by band for all loans:

	As at 31-Dec-16			
	BTL/SME	**Residential**	**Total**	
Band	**£m**	**£m**	**£m**	**%**
0 - 50%	**755.9**	**761.7**	**1,517.6**	**25**
50% - 60%	**859.6**	**278.7**	**1,138.3**	**19**
60% - 70%	**1,202.4**	**282.7**	**1,485.1**	**25**
70% - 80%	**1,041.2**	**257.1**	**1,298.3**	**22**
80% - 90%	**194.8**	**196.9**	**391.7**	**7**
90% - 100%	**5.0**	**48.0**	**53.0**	**1**
>100%	**36.0**	**34.8**	**70.8**	**1**
Total mortgages before provisions	**4,094.9**	**1,859.9**	**5,954.8**	**100**
Personal loans			**9.4**	
Total loans before provisions			**5,964.2**	

	As at 31-Dec-15			
	BTL/SME[1]	**Residential**	**Total**	
Band	**£m**	**£m**	**£m**	**%**
0 - 50%	452.2	771.3	1,223.5	24
50% - 60%	618.3	331.7	950.0	19
60% - 70%	960.6	364.1	1,324.7	26
70% - 80%	780.0	303.3	1,083.3	21
80% - 90%	259.0	172.0	431.0	8
90% - 100%	10.0	43.2	53.2	1
>100%	25.4	21.5	46.9	1
Total mortgages before provisions	3,105.5	2,007.1	5,112.6	100
Personal loans			49.5	
Total loans before provisions			5,162.1	

1 During 2016 the Group received enriched data for BTL/SME items and has subsequently reclassified the 2015 comparatives for funding line items. In 2015 the Group made an assumption that all funding line items have LTVs in the 60%-70% band.

Loan to value analysis by band for BTL/SME:

	As at 31-Dec-16				
	Buy-to-Let	Commercial	Residential development	Funding lines	Total
Band	£m	£m	£m	£m	£m
0 - 50%	**534.1**	**85.2**	**104.7**	**31.9**	**755.9**
50% - 60%	**750.4**	**67.1**	**23.5**	**18.6**	**859.6**
60% - 70%	**1,096.8**	**71.0**	**13.4**	**21.2**	**1,202.4**
70% - 80%	**1,006.2**	**35.0**	**-**	**-**	**1,041.2**
80% - 90%	**193.0**	**1.8**	**-**	**-**	**194.8**
90% - 100%	**5.0**	**-**	**-**	**-**	**5.0**
>100%	**27.8**	**8.2**	**-**	**-**	**36.0**
Total mortgages before provisions	**3,613.3**	**268.3**	**141.6**	**71.7**	**4,094.9**

	As at 31-Dec-15				
	Buy-to-Let	Commercial	Residential development	Funding lines	Total
Band	£m	£m	£m	£m	£m
0 - 50%	376.2	58.7	17.3	-	452.2
50% - 60%	517.6	50.5	50.2	-	618.3
60% - 70%	793.2	75.6	22.0	69.8	960.6
70% - 80%	736.8	37.7	5.5	-	780.0
80% - 90%	255.3	3.7	-	-	259.0
90% - 100%	8.6	1.4	-	-	10.0
>100%	22.8	2.6	-	-	25.4
Total mortgages before provisions	2,710.5	230.2	95.0	69.8	3,105.5

Loan to value analysis by band for Residential:

Band	First charge £m	Second charge £m	Funding line £m	Total £m
	As at 31-Dec-16			
0 - 50%	**579.6**	**154.5**	**27.6**	**761.7**
50% - 60%	**166.4**	**103.1**	**9.2**	**278.7**
60% - 70%	**173.3**	**102.3**	**7.1**	**282.7**
70% - 80%	**188.3**	**64.0**	**4.8**	**257.1**
80% - 90%	**168.3**	**27.2**	**1.4**	**196.9**
90% - 100%	**31.9**	**16.0**	**0.1**	**48.0**
>100%	**14.3**	**20.1**	**0.4**	**34.8**
Total mortgages before provisions	**1,322.1**	**487.2**	**50.6**	**1,859.9**

Band	First charge £m	Second charge £m	Funding line £m	Total £m
	As at 31-Dec-15			
0 - 50%	616.4	152.7	2.2	771.3
50% - 60%	217.8	111.8	2.1	331.7
60% - 70%	205.3	116.6	42.2	364.1
70% - 80%	210.8	85.5	7.0	303.3
80% - 90%	137.8	31.7	2.5	172.0
90% - 100%	31.9	11.3	-	43.2
>100%	13.2	8.2	0.1	21.5
Total mortgages before provisions	1,433.2	517.8	56.1	2,007.1

Geographical analysis by region

Region	As at 31-Dec-2016		As at 31-Dec-2015	
	£m	**%**	**£m**	**%**
East Anglia	**182.2**	**3**	146.9	3
East Midlands	**204.5**	**3**	173.6	3
Greater London	**2,543.1**	**43**	2,116.4	42
Guernsey	**93.4**	**2**	110.5	2
Jersey	**282.0**	**5**	340.2	7
North East	**90.3**	**2**	74.0	1
North West	**273.2**	**5**	247.9	5
Northern Ireland	**16.8**	**-**	15.7	-
Scotland	**56.1**	**1**	64.7	1
South East	**1,278.5**	**21**	1,020.6	21
South West	**380.6**	**6**	324.2	6
Wales	**114.7**	**2**	105.6	2
West Midlands	**308.6**	**5**	257.0	5
Yorks & Humberside	**130.8**	**2**	115.3	2
Total mortgages before provisions	**5,954.8**	**100**	5,112.6	100
Personal loans	**9.4**		49.5	
Total loans before provisions	**5,964.2**		5,162.1	

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.

In 2016 there was an update to the provision categorisation where collectively assessed provisions on loans greater than 3 months in arrears are now treated as specific, in addition to those that are individually assessed. The 2015 comparatives have not been restated.

Loan balance	Group As at 31-Dec-2016 £m	Restated[1] Group As at 31-Dec-2015 £m
Not impaired:		
Not past due	**5,478.4**	4,678.1
Past due < 1 month	**183.5**	210.5
Past due 1 to 3 months	**168.2**	90.5
Past due 3 to 6 months	**24.4**	37.8
Past due 6 to 12 months	**12.8**	26.3
Past due over 12 months	**6.2**	22.6
Possessions[2]	**0.8**	1.3
	5,874.3	5,067.1
Impaired[3]:		
Not past due	**3.2**	13.5
Past due < 1 month	**1.0**	0.1
Past due 1 to 3 months	**1.2**	0.3
Past due 3 to 6 months	**14.8**	2.7
Past due 6 to 12 months	**16.3**	5.3
Past due over 12 months	**31.8**	12.5
Possessions	**12.2**	11.1
	80.5	45.5
Total mortgages before provisions	**5,954.8**	5,112.6
Personal loans	**9.4**	49.5
Total loans before provisions	**5,964.2**	5,162.1

1 During 2016, the Group received revised data for impairments and has subsequently restated the 2015 comparatives. The 2015 comparatives have not been restated for the change in provision categorisation.
2 Mortgages with properties in possession are not considered impaired if the fair value of collateral exceeds the value of debt.
3 Impaired is defined as loans with a specific provision against them.

Analysis of mortgage portfolio by arrears for BTL/SME

	As at 31-Dec-16				
	Buy-to-Let	Commercial	Residential development	Funding lines	Total
	£m	£m	£m	£m	£m
Not impaired:					
Not past due	**3,468.7**	**252.9**	**141.6**	**71.7**	**3,934.9**
Past due < 1 month	**62.5**	**3.3**	**-**	**-**	**65.8**
Past due 1 to 3 months	**56.5**	**1.1**	**-**	**-**	**57.6**
Past due 3 to 6 months	**2.0**	**0.3**	**-**	**-**	**2.3**
Past due 6 to 12 months	**0.4**	**0.7**	**-**	**-**	**1.1**
Past due over 12 months	**-**	**0.3**	**-**	**-**	**0.3**
	3,590.1	**258.6**	**141.6**	**71.7**	**4,062.0**
Impaired					
Not past due	**2.5**	**0.1**	**-**	**-**	**2.6**
Past due < 1 month	**-**	**0.4**	**-**	**-**	**0.4**
Past due 1 to 3 months	**-**	**0.3**	**-**	**-**	**0.3**
Past due 3 to 6 months	**1.1**	**0.2**	**-**	**-**	**1.3**
Past due 6 to 12 months	**2.3**	**0.1**	**-**	**-**	**2.4**
Past due over 12 months	**9.0**	**6.0**	**-**	**-**	**15.0**
Possessions	**8.3**	**2.6**	**-**	**-**	**10.9**
	23.2	**9.7**	**-**	**-**	**32.9**
Total mortgages before provisions	**3,613.3**	**268.3**	**141.6**	**71.7**	**4,094.9**

As at 31-Dec-15

	Buy-to-Let	Commercial	Residential development	Funding lines	Total
	£m	**£m**	**£m**	**£m**	**£m**
Not impaired:					
Not past due	2,593.0	214.7	95.0	69.8	2,972.5
Past due < 1 month	72.2	3.6	-	-	75.8
Past due 1 to 3 months	13.4	0.7	-	-	14.1
Past due 3 to 6 months	0.4	0.9	-	-	1.3
Past due 6 to 12 months	1.7	1.4	-	-	3.1
Past due over 12 months	0.7	0.4	-	-	1.1
	2,681.4	221.7	95.0	69.8	3,067.9
Impaired:					
Not past due	8.9	4.4	-	-	13.3
Past due < 1 month	-	0.1	-	-	0.1
Past due 1 to 3 months	-	0.1	-	-	0.1
Past due 3 to 6 months	0.4	0.5	-	-	0.9
Past due 6 to 12 months	3.4	-	-	-	3.4
Past due over 12 months	8.7	0.7	-	-	9.4
Possessions	7.7	2.7	-	-	10.4
	29.1	8.5	-	-	37.6
Total mortgages before provisions	2,710.5	230.2	95.0	69.8	3,105.5

Analysis of mortgage portfolio by arrears for Residential

	As at 31-Dec-16			
	First charge £m	Second charge £m	Funding lines £m	Total £m
Not impaired:				
Not past due	**1,100.6**	**392.3**	**50.6**	**1,543.5**
Past due < 1 month	**99.8**	**17.9**	**-**	**117.7**
Past due 1 to 3 months	**80.2**	**30.4**	**-**	**110.6**
Past due 3 to 6 months	**12.8**	**9.3**	**-**	**22.1**
Past due 6 to 12 months	**5.0**	**6.7**	**-**	**11.7**
Past due over 12 months	**2.8**	**3.1**	**-**	**5.9**
Possessions	**0.8**	**-**	**-**	**0.8**
	1,302.0	**459.7**	**50.6**	**1,812.3**
Impaired:				
Not past due	**0.6**	**-**	**-**	**0.6**
Past due < 1 month	**0.6**	**-**	**-**	**0.6**
Past due 1 to 3 months	**0.9**	**-**	**-**	**0.9**
Past due 3 to 6 months	**6.0**	**7.5**	**-**	**13.5**
Past due 6 to 12 months	**5.8**	**8.1**	**-**	**13.9**
Past due over 12 months	**4.9**	**11.9**	**-**	**16.8**
Possessions	**1.3**	**-**	**-**	**1.3**
	20.1	**27.5**	**-**	**47.6**
Total mortgages before provisions	**1,322.1**	**487.2**	**50.6**	**1,859.9**

As at 31-Dec-15

	First charge £m	Second charge £m	Funding line £m	Total £m
Not impaired:				
Not past due	1,255.1	394.4	56.1	1,705.6
Past due < 1 month	90.7	44.0	-	134.7
Past due 1 to 3 months	43.6	32.8	-	76.4
Past due 3 to 6 months	18.9	17.6	-	36.5
Past due 6 to 12 months	10.2	13.0	-	23.2
Past due over 12 months	5.5	16.0	-	21.5
Possessions	1.3	-	-	1.3
	1,425.3	517.8	56.1	1,999.2
Impaired:				
Not past due	0.2	-	-	0.2
Past due < 1 month	-	-	-	-
Past due 1 to 3 months	0.2	-	-	0.2
Past due 3 to 6 months	1.8	-	-	1.8
Past due 6 to 12 months	1.9	-	-	1.9
Past due over 12 months	3.1	-	-	3.1
Possessions	0.7	-	-	0.7
	7.9	-	-	7.9
Total mortgages before provisions	1,433.2	517.8	56.1	2,007.1

Forbearance measures undertaken during 2016

Forbearance type	2016 number of accounts	2016 year-end balances £m	2015 number of accounts	2015 year- end balances £m
Interest only switch	**60**	**6.3**	106	10.7
Interest rate reduction	**3**	**2.2**	-	-
Term extension	**31**	**5.9**	59	3.5
Payment holiday	**37**	**3.6**	21	6.5
Voluntary assisted sale	**-**	**-**	11	7.7
Payment concession (reduced monthly payments)	**58**	**6.4**	70	5.7
Capitalisation	**3**	**0.1**	4	0.2
Full or partial debt forgiveness	**-**	**-**	-	-
Total	**192**	**24.5**	271	34.3

Loan type	2016 number of accounts	2016 year-end balance £m	2015 number of accounts	2015 year-end balance £m
First charge owner occupier	**117**	**12.3**	200	21.0
Second charge owner occupier	**60**	**6.2**	38	1.3
Buy-to-Let	**14**	**5.5**	27	11.5
Commercial	**1**	**0.5**	6	0.5
Total	**192**	**24.5**	271	34.3

Solvency Risk

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

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

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

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

Liquidity and Funding

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

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

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

Market Risk

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

Interest Rate Risk

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

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

Basis Risk

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

As with structural interest rate risk, capital allocation has been set in proportion to common equity tier 1 capital, with exposure assessed and monitored monthly across a range of 'business as usual' and stressed scenarios.

Operational Risk

OSB continues to assume a proactive approach to the management of operational risks. The Operational Risk Management Framework has been designed to ensure a robust approach to the identification, measurement and mitigation of operational risks, utilising a combination of both qualitative and quantitative techniques in order to promote an environment of progressive operational risk management. The Group's operational processes, systems and controls are designed to minimise disruption to customers, damage to the Bank's reputation and any detrimental impact on financial performance. The Bank actively promotes the continual evolution of its operating environment through the identification, evaluation and mitigation of risks, whilst recognising that the complete elimination of operational risk is not possible.

A strong culture of transparency and escalation has been cultivated throughout the organisation, with the operational Risk function having a Group-wide remit, ensuring a risk management model that is well embedded and consistently applied. In addition, a community of Risk Champions representing each business line and functional area has been identified. Operational Risk Champions ensure that the operational risk identification and assessment processes are established across the Group in a consistent manner. Risk Champions are provided with appropriate support and training by the Group Operational Risk function.

Regulatory and Compliance Risk

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

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

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

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

Conduct Risk

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

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

OSB views effective conduct risk management as a core feature of its risk culture and values. A clear tone from the top with respect to conduct ensures awareness of behaviours which demonstrate commitment to good customer outcomes and market integrity.

Strategic and Business Risk

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

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

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

Principal risks and uncertainties

Strategic and business risk

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

Arising from

Performance against strategic and business targets does not meet stakeholder expectations. This has the potential to damage the Group’s franchise value and reputation.

Mitigation and control

Regular monitoring by the Board and the Executive Committee of monitoring of strategic and business performance against market commitments, the balanced business scorecard and risk appetite. Use of stress testing to flex core business planning assumptions to assess potential performance under stressed operating conditions.

Reputational risk

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

Arising from

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

Mitigation and control

Culture and commitment to treating customers fairly and being open and transparent in communication with key stakeholders. Established processes to proactively identify and manage potential sources of reputational risk.

Credit risk

Credit risk is defined as the potential for loss due to the failure of a counterparty to meet its contractual obligation to repay a debt in accordance with the agreed terms.

Individual borrower defaults

Borrowers may encounter idiosyncratic problems in repaying their loans, for example loss of a job or execution problems with a development project. While most of the Bank’s lending is secured, some borrowers fail to maintain the value of the security.

Mitigation and controls

All loans are extended only after thorough bespoke and expert underwriting to ensure ability and propensity of borrowers to repay and sufficient security in case of default.

Should there be problems with a loan, the collections and recoveries team works with customers unable to meet their loan service obligations to reach a satisfactory conclusion while adhering to the principle of treating customers fairly.

Our strategic focus on lending to professional landlords means that properties are likely to be well managed, with income from a diversified portfolio mitigating the impact of rental voids or maintenance costs. Lending to owner-occupiers is subject to a detailed affordability assessment, including the borrower's ability to continue payments if interest rates increase. Lending on commercial property is more based on security, and is scrutinised by the Group's independent Real Estate team as well as by external valuers. Development lending is extended only after a deep investigation of the borrower's track record and the specific project and requires approval by a dedicated Development Finance Transactional Credit Committee.

Macroeconomic downturn

A broad deterioration in the economy would adversely impact both the ability of borrowers to repay loans and the value of the Group's security. Credit losses would impact across the lending portfolio, so even if individual impacts were to be small, the aggregate impact on the Group could be significant.

Mitigation and controls

The Group works within portfolio limits on LTV, affordability, name, sector and geographic concentration that are approved by the Risk Committee and the Board. These are reviewed at least annually. In addition, stress testing is performed as part of the ICAAP to ensure the Group maintains sufficient capital to absorb losses in an economic downturn and will continue to meet its regulatory requirements.

Wholesale credit risk

The Bank has wholesale exposures both through call accounts used for transactional and liquidity purposes and through derivative exposures used for hedging.

Mitigation and controls

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

Market risk

This is defined as potential loss due to changes in market prices or values.

Interest rate risk

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

Mitigation and controls

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

Basis risk

A divergence in market rates could lead to a loss in value, as assets and liabilities are linked to different rates.

Mitigation and controls

The Group strategically focuses on products linked to administered rates to keep control of yield. Where there is a mismatch of market rates in the portfolio (e.g. base rate vs. LIBOR), the Treasury department hedges the exposure.

Liquidity and funding risk

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

Retail funding stress

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

Mitigation and controls

The Group's funding strategy is focused on a highly stable retail deposit franchise. The large number of depositors provides diversification, with a high proportion of balances covered by the FSCS and so at no material risk of a retail run.

In addition, the Group performs in-depth liquidity stress testing and maintains a liquid asset portfolio sufficient to meet obligations under stress.

Finally, the Group has prepositioned mortgage collateral with the Bank of England, so that its liquidity insurance facilities can be accessed in the unlikely event that should become necessary.

Solvency risk

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

Arising from

Key risks to solvency arise from balance sheet growth and unexpected losses which can result in the Bank's capital requirements increasing or capital resources being depleted such that it no longer meets the solvency ratios as mandated by the PRA and Board risk appetite.

The regulatory capital regime is subject to change and could lead to increases in the level and quality of capital that the Group needs to hold to meet regulatory requirements.

Mitigation and controls

Currently the Bank operates from a strong capital position and a consistent record of strong profitability.

The Bank actively monitors its capital requirements and resources against financial forecasts and plans and undertakes stress testing analysis to subject its solvency ratios to extreme but plausible scenarios.

The Bank also holds prudent levels of capital buffers based on CRD IV requirements and expected balance sheet growth.

The Group engages actively with regulators, industry bodies, and advisers to keep abreast of potential changes and provide feedback through the consultation process and actively manages its capital strategy and plan.

Operational risk

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

Network/system intrusion

If hackers were to penetrate the Group's IT system, consequences could range from the diversion of funds to the theft of customer data.

Mitigation and controls

A series of tools designed to identify and prevent network / system intrusions are deployed across the Group.

The effectiveness of the controls is overseen by a dedicated IT Security Governance Committee, with specialist IT Security staff employed by the Bank.

Data risk

The use of inaccurate, incomplete or outdated data may result in a range of risks impacting risk management and reporting services.

Mitigation and controls

The Bank continues to invest in and enhance its data management architecture, systems, governance and controls.

People risk

The risk that the Bank will be unable to meet its future resource requirements through a combination of higher than expected staff attrition and / or the inability to identify and hire candidates with the necessary skills.

Mitigation and controls

The Bank has a series of initiatives that are intended to respond to this risk. This includes the introduction of a range of development programmes intended to improve retention and increase the population of in-house developed talent.

Operational Resilience

Banks should have business resiliency, continuity monitoring and plans in place to ensure an ability to operate on an ongoing basis and limit losses in the event of severe business disruption.

Mitigation and controls

The Bank carries out scenario based Business Continuity Planning (BCP), has crisis management procedures and recovery and contingency plans. The BCP is periodically tested to ensure operability.

Conduct risk

This is defined as the risk that the Group's behaviours or actions result in customer detriment or negative impact on the integrity of the markets in which it operates.

Product suitability

Whilst the Group originates relatively simple products, there remains a risk that (primarily legacy) products may be deemed to be unfit for their original purpose in-line with the current regulatory definitions.

Mitigation and controls

The Group has a strategic commitment to provide simple, customer-focused products. In addition, a Product Governance framework is established to oversee both the origination of new products and to revisit the ongoing suitability of the existing product suite.

The combination of a dedicated Product Governance team and an independent Conduct Risk team serves to effectively manage this risk. During the year, the Group established an effective product transfer programme.

Data protection

The risk that customer data is accessed inappropriately, either as a consequence of network / system intrusion or through operational errors in the management of the data.

Mitigation and controls

In addition to a series of network / system controls (documented within as part of the operational risks), the Bank performs extensive root cause analysis of any data leaks in order to ensure that the appropriate mitigating actions are taken.

Compliance and Regulatory risk

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

Arising from

Key compliance based regulatory changes that the Bank is subject to include European Mortgage Credit Directive (EMCD), Senior Managers Regime (SMR) and potential macro prudential controls of the Buy-to-Let sector.

Further proposals currently under discussion, including the Basel Committee consultation on standardised risk weights, could lead to significant increases in the Group's capital requirements.

Mitigation and controls

The Bank has adopted the EMCD and SMR in an effective and timely manner.

The adoption of SS13/16 and the lending policy requirements around affordability mean that the Bank should be well placed to respond to any macro prudential regulation of the Buy-to-Let sector.

The Basel proposals will be subject to extensive consultation and the eventual outcome could be materially different to those initially proposed. The adoption of the eventual changes may take a number of years to implement. The Group intends to migrate to IRB.

Another consultation of note relates to the recently published CP/13 issued by the PRA, which details proposed refinements to the PRA's Pillar 2A capital framework. The Group is currently assessing the potential impact this consultation may have on the Group's capital strategy and plan going forward.

Conduct regulation

Regulatory changes focused on the conduct of business could force changes in the way the Group carries out business and impose substantial compliance costs. For example, the Financial Policy Committee's increased focus on Buy-to-Let lending or tax changes such as the Bank Corporation Tax Surcharge must be considered.

Mitigants

The Group has a programme of regulatory horizon scanning linking into a formal regulatory change management programme. In addition, the focus on simple products and customer oriented culture means that current practice may not have to change significantly to meet new conduct regulations.

Viability Statement

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

The three-year time period was selected for the following reasons:

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

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

The Group manages and monitors its risk profile through its strategic risk management framework, in particular through its risk appetite statement and risk limits. Potential changes in its risk profile are assessed across the business planning horizon by subjecting the operating and financial plan to severe but plausible macroeconomic and idiosyncratic scenarios.

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

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

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

Directors’ responsibility statement

The responsibility statement below has been prepared in connection with the full Annual Report of the Company for the year ended 31 December 2016. Certain parts of these accounts are not presented within this announcement.

The Directors are responsible for preparing the Annual Report and the Group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors are required to prepare the Group financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and applicable law and have elected to prepare the parent company financial statements on the same basis.

Under company law the Directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent company and of the profit or loss of the Company for that period.

In preparing each of the Group and parent company financial statements, the Directors are required to:

- Select suitable accounting policies and then apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State whether they have been prepared in accordance with 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 parent company’s transactions and disclose with reasonable accuracy at any time the financial position of the parent company, and enable them to ensure that the financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report, Directors’ Report, Directors’ Remuneration Report and Corporate Governance Statement that complies with that law and those regulations. The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company’s website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

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

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole; and

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

We consider the Annual Report and accounts, taken as a whole, are fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

Each of the persons who is a Director at the date of the approval of this report conform that:

- so far as the Director is aware, there is no relevant audit information of which the Company's auditor is unaware;
- the Director has taken all the steps that he/she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Approved by the Board and signed on its behalf by:

Jason Elphick
Group General Counsel and Company Secretary
16 March 2016