OneSavings Bank plc

Interim report for the six months ended 30 June 2017

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OneSavings Bank plc
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OneSavings Bank plc ('OSB'), the specialist lending and retail savings group, announces another strong set of results for the six months ended 30 June 2017.

Financial highlights

- Underlying profit before tax[1] increased 20% to £78.4m (1H 2016: restated[2] £65.3m)
- Loan book growth of 10%, driven by 26% growth in gross organic origination to £1,229m (1H 2016: £973m)
- Continued focus on cost discipline and efficiency alongside strong income growth delivered a cost to income ratio[3] of 28% (1H 2016: restated[2] 26%)
- Net interest margin ('NIM')[4] of 322bps (1H 2016: restated[2] 309bps)
- Loan loss ratio[5] of 4bps (1H 2016: 18bps)
- Fully-loaded Common Equity Tier 1 ('CET1') capital ratio strengthened to 13.7% (FY 2016: 13.3%)
- Total capital ratio strengthened to 17.3% (FY 2016: 15.1%) through issue of £60m Additional Tier 1 Securities ('AT1 securities') in May 2017
- Return on equity[6] of 28% (1H 2016: 29%) despite higher average capital levels
- Interim dividend of 3.5p per share, up 21% (1H 2016: 2.9p)[7]

Commenting on the results, Group CEO Andy Golding, said:

"I am delighted that OneSavings Bank has delivered yet another strong set of results for the first half of 2017. We continued to successfully navigate significant regulatory and tax change impacting the Buy-to-Let market in the first half, delivering 26% growth in total organic origination versus the first half of 2016. We also generated a 20% growth in underlying profit before tax and a best in class return on equity of 28%, whilst maintaining our strong cost discipline and deep understanding of pricing for risk.

We further strengthened our capital base through the issue of £60m of Additional Tier 1 securities in May 2017. I am delighted with the credit performance of the book, with a loan loss ratio of 4bps in the first half, reflecting our robust underwriting standards, lending criteria and sensible loan to values.

Application levels in our core businesses for the third quarter to date remain strong and our focus on professional landlords continues to position us well, with the impact of regulation, including additional requirements for specialist underwriting from 1 October 2017, expected to further shift Buy-to-Let activity towards our target market.

Given the current pipeline we expect to deliver net loan book growth of at least high-teens in 2017, whilst keeping NIM for the full year broadly flat to 2016 and cost to income ratio broadly flat to the first half."

OneSavings Bank plc

Interim report for the six months ended 30 June 2017

Key metrics

	1H 2017	1H 2016
Statutory profit before tax (£m)*	**78.4**	100.0
Total assets (£bn)	**7.2**	6.3
Net loan book (£bn)	**6.5**	5.4
Basic EPS[8] (pence)	**24.1**	30.2
Underlying basic EPS[9] (pence)	**24.1**	19.7
Loan to deposit ratio[10] (%)	**93**	85
3 months+ arrears[11] (%)	**1.4**	2.1
Customer net promoter score (%)	**60**	59

***** Statutory profit before tax of £100.0m in H1 2016 included a £34.7m exceptional gain on the sale of the Bank's economic interest in the Rochester Financing No. 1 plc securitisation vehicle

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Results presentation

OneSavings Bank will be holding an interim results presentation for analysts at 9:30am on Thursday 24 August at The Lincoln Centre, 18 Lincoln's Inn Fields, WC2A 3ED. The UK dial in is 020 3427 1901 and the passcode is 2268494. The presentation will be webcast and available from 9.30am on the OneSavings Bank website at www.osb.co.uk/investor relations/report and accounts. Registration is open immediately.

About OneSavings Bank plc

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

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

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

Notes

[1] Before exceptional items of £nil (1H 2016: £34.7m gain on sale of economic interest in the Rochester Financing No. 1 plc securitisation vehicle)

[2] Prior to 2017, OSB deducted coupons on equity Perpetual Subordinated Bonds ('PSBs') accounted for as dividends from underlying profit before and after tax, net interest margin and cost to income ratio. Following a review of market practice in advance of the Bank's AT1 issue, OSB no longer deducts these coupons from the calculation of these key performance indicators. The comparatives have been restated accordingly (see Financial Review for further details). Interest payments on AT1 securities classified as dividends will be treated in the same way.

[3] Administrative expenses, including depreciation and amortisation as a percentage of total income
[4] Net interest income as a percentage of average interest bearing assets including off balance sheet Funding for Lending Scheme (FLS) drawings, on an annualised basis
[5] Impairment losses expressed as a percentage of average gross loans and advances, annualised
[6] Underlying profit after tax (profit after tax excluding exceptional items after tax of £nil in the first half of 2017 (1H 2016: £25.7m) and after deducting coupons on equity PSBs, including the tax effect of £0.4m (1H 2016: £0.6m) as a percentage of average shareholders' equity (excluding equity PSBs of £22m and AT1 securities of £60m as at 30 June 2017) of £417.0m in first half 2017 and £326.3m in first half 2016, on an annualised basis
[7] The proposed interim dividend of 3.5 pence per share for the first half of 2017 is based on one third of the total 2016 dividend of 10.5 pence per share (1H 2016: 2.9 pence per share, one third of the 2015 dividend of 8.7 pence per share)
[8] Statutory profit after tax attributable to ordinary shareholders (statutory profit after tax less coupons on equity PSBs) divided by the weighted average number of ordinary shares in issue
[9] Underlying profit after tax and after deducting coupons on equity PSBs, including the tax effect of £0.4m (1H 2016: £0.6m) divided by the weighted average number of ordinary shares in issue
[10] Excluding the impact of the Bank of England's Funding for Lending and Term Funding Schemes
[11] Portfolio arrears rate (excluding legacy problem loan book) of accounts for which there are missing or overdue payments by more than three months

Non-IFRS performance measures

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

Important disclaimer

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

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

Key Performance Indicators

£1,229m Gross new organic lending up 26%
(H1 2016: £973m)

322bps[4] Net interest margin up 13bps
(H1 2016: restated[2] 309bps)

£78.4m Profit before tax down 22% (due to £34.7m exceptional gain in 2016)
(H1 2016: £100.0m)

£78.4m[1] Underlying profit before tax up 20%
(H1 2016: restated[2] £65.3m)

24.1p[8] Basic EPS down 20%
(H1 2016: 30.2p)

24.1p[9] Underlying basic EPS up 22%
(H1 2016: 19.7p)

28%[3] Strong cost to income ratio
(H1 2016: restated[2] 26%)

28%[6] Return on equity remains strong
(H1 2016: 29%)

4bps[5] Loan loss ratio improved 14bps
(H1 2016: 18bps)

13.7% Fully-loaded common equity tier 1 ratio strengthened
(H1 2016: 13.3%)

60% Customer NPS up 1ppt
(H1 2016: 59%)

3.5p[7] Interim dividend per share
(H1 2016: 2.9p)

For definitions of key ratios please see footnotes above

Chief Executive's Statement

Strong first half performance

I am pleased to report another strong performance for the first half of 2017, with continued growth in our earnings and net loan book. We continued to successfully navigate significant regulatory and tax change impacting the Buy-to-Let market in the first half, delivering 26% growth in total organic origination versus the first half of 2016, and driving net loan book growth of 10% in the first half to £6.5bn. This was achieved whilst maintaining our strong discipline on understanding and pricing for risk, with net interest margin improving to 322bps, underlying profit before tax up 20% to £78.4m and underlying basic earnings per share up 22% to 24.1 pence.

Balance sheet growth was achieved whilst delivering a best in class return on equity of 28% despite holding higher levels of CET1 capital following the sale of the Rochester Financing No.1 plc securitisation ('Rochester 1 disposal') in May 2016. The Group's capital position was further strengthened in May 2017 by the issuance of £60m of Additional Tier 1 Capital ('AT1 securities'). I was delighted with the positive response to our AT1 issuance, demonstrating the strength of our balance sheet and investment proposition to debt investors. Focused cost efficiency, despite additional investment in the business to meet the growing demands of regulation, continued to drive an excellent cost to income ratio of 28%.

Continued development of our strong lending franchise

We continue to differentiate ourselves from the competition by offering well defined propositions in high margin, underserved markets, where we have the experience and distribution relationships to successfully develop and service those markets.

The net loan book growth in the period was driven by a 26% increase in gross organic origination to £1,229m, including a particularly strong increase in our core Buy-to-Let lending sub-segment, as the market became more focused on our professional landlord audience during the first half of 2017.

During the first quarter of 2017, we experienced a surge in Buy-to-Let application volumes as the impact of regulatory changes introducing more complex underwriting standards took effect. This resulted in temporary pressure on our service levels which resulted in a short-term negative broker Net Promoter Score ('NPS') of -7%. We quickly took appropriate actions to improve turnaround times, and I am pleased that broker NPS is now positive again with an upward trend.

Mortgage application volumes for the third quarter to date remain strong in our core products, and for Buy-to-Let, remortgages continue to represent c.60% of new origination for our Kent Reliance brand. During the first half of 2017, we have continued to invest in our sales capability. I am particularly proud that we have continued to win national and broker firm awards throughout the period, including Best Specialist Lender and Best Business Development Managers Team from The Mortgage Strategy Awards, demonstrating our commitment to brokers.

Growth in the overall Buy-to-Let market has slowed in response to tax and regulatory changes; UK Finance (formerly the Council of Mortgage Lenders) has forecast that gross advances will fall from £40.6bn in 2016 to £35bn during 2017. In the main, this reduction is a result of the reduced attractiveness of the sector to the amateur investor, many of whom have entered the market in recent years. Demand from professional landlords has remained strong and we expect to see the market continue to professionalise in the near term as the tax and regulatory changes continue to take effect.

Our proposition has always been targeted towards the professional landlord, hence these changes have had a positive impact on OSB. Our average market share of new business increased in the first six months of 2017, given our specialism and expertise in lending to limited companies and large portfolio landlords.

Average loan size in our core businesses is c.£250,000, demonstrating that our loan book primarily consists of standard family homes and smaller flats, typically subject to sustained high demand.

Chief Executive's Statement

We saw a reduction in originations in the residential sector in the first half of 2017 to £131.9m (H1 2016: £172.9m). This was primarily caused by second charge lending falling to £24.9m from £42.0m in the first half of 2016, as we allowed our market share to drop where we felt the second charge market was not pricing fully for risk.

OSB offers a 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 in mid-2016, there has been a significant increase in the number of borrowers choosing a new product within three months of their initial product ending, driven 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.

We continue to innovate products in other sub-sectors, including the launch of bridging finance through our InterBay brand in the first half. Our Group wide distribution capability provides us with competitive advantage in launching new products in these specialist markets.

We remain pleased with the performance of our more cyclical businesses. The quality of our Heritable residential development finance business pipeline remains strong, with new applications coming primarily from a mixture of repeat business from the team's extensive existing relationships and referrals. We continue to apply the more stringent loan assessment criteria introduced in 2016, resulting in higher decline rates, but we are seeing strong loan performance, growth and profitability.

Sustainable funding model with award winning savings

We continue to benefit from our stable and award winning retail funding franchise with over 9,000 new savings customers joining the Bank in the first half of 2017, and our retention rates on maturing bonds and ISAs remaining exceptionally strong at 87%. The strength and fairness of our retail savings proposition, together with excellent customer service, a quality brand 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, which is demonstrated by our excellent NPS for customers of 60%.

Whilst remaining committed to our retail savings franchise, we have complemented it by taking advantage of the government funding schemes; Term Funding Scheme ('TFS') and Funding for Lending Scheme ('FLS'). Total funding through these schemes increased by £315m to £941m in the half year to 30 June 2017. Net new retail deposits were up 2% from 31 December 2016 to £6bn.

I am delighted that Kent Reliance has been recognised by Moneyfacts in 2017 as the Best Cash ISA Provider for the fifth year running. The Bank also received the ISA Provider of the Year Award from Consumer Moneyfacts for the second consecutive year. These awards are a testament to our savings proposition and to the outstanding customer service delivered by our staff.

Operational excellence and service are core to our growth

Our low cost to income ratio of 28% reflects our efficient and scalable operating platform, and has been achieved despite additional investment in the business to meet the demands of new regulation. Our overseas operation, OSBIndia, which undertakes a range of primary processing services at a significantly lower cost than an equivalent UK-based operation, is a significant differentiator. OSBIndia service quality remains high, reflected in our improved and outstanding customer NPS of 60%. We continue to focus on driving improved customer experience across our savings and lending franchises.

The Group's IFRS 9 models and first generation internal ratings-based approach ('IRB') models were delivered on schedule in late 2016 and we commenced the parallel run for IFRS 9 at the start of 2017, positioning us very well to implement the requirements for 2018.

Chief Executive's Statement

We continue to develop our business for the future

OSB has a depth of specialist underwriting expertise and continues to exercise strong diligence over loan assessment through an effective lending policy and specialist manual underwriting process. The underlying arrears trend is falling and we remain particularly pleased with the performance of the front book of mortgages, which has negligible 3 month+ arrears, reflecting our robust underwriting standards and lending criteria. This helped drive a low loan loss charge of just 4bps in the first half.

We have continued our focus on disciplined lending in the first half using criteria and pricing to strengthen the credit mix of new business post the Brexit referendum. The weighted average loan to value ('LTV') of the mortgage book remained low at 64% as at 30 June 2017, with an average LTV of 69% on new origination in the first half. We continue to have minimal exposure to high end London property with only 2% of our total loan book secured on properties valued at greater than £2m and with an LTV above 65%. Following regulatory changes to underwriting standards for Buy-to-Let lending at the start of 2017, our average interest coverage ratio ('ICR') increased to 190% (FY 2016: 171%).

We have a cautious approach to assessing customer affordability and welcomed the Buy-to-Let underwriting standards introduced in January which ensure, inter alia, that lenders reflect the changes to personal tax on landlords within their affordability assessments. We have always assessed affordability for borrowers through our specialist underwriting model and we continue to apply stringent stress tests.

Outlook

Trading conditions in our core businesses remain positive, with strong application levels for the third quarter to date. We expect full year net loan book growth driven by organic lending of at least high-teens, NIM broadly flat to 2016 and cost to income ratio for the full year broadly flat to the first half.

We are mindful of the macroeconomic environment, primarily driven by uncertainties surrounding the outcome of Brexit negotiations and the potential impact on the UK economy, including some easing of house price inflation, particularly in London. However, we believe that our specialist underwriting capabilities are even more relevant in times of uncertainty as they give us a greater and deeper understanding of the risks that we can actively manage and price for. We manage the business prudently with careful business planning together with excellent credit risk management, and continue to focus on achieving risk-adjusted high returns in our chosen markets.

The market sub-segments targeted by OSB, principally professional landlords, including limited companies, have remained strong despite the overall slowdown in the Buy-to-Let market so far in 2017. We remain confident in the underlying strength of the Private Rented Sector. We believe that we are well-placed to continue to grow market share as the Buy-to-Let market continues to professionalise and as it reacts to the additional requirements for specialist underwriting from 1 October 2017.

We will continue to concentrate on what we have proven we do best; using our relationships, manual underwriting expertise and secured lending strategy to lend responsibly to customers in underserved markets. We remain well-placed to take advantage of opportunities that arise using these well proven capabilities.

Andy Golding

Chief Executive Officer

OneSavings Bank plc

Interim report for the six months ended 30 June 2017

Interim Management Report

Business highlights

OneSavings Bank delivered strong earnings and balance sheet growth during the first half of 2017. The annualised return on equity was 28% (H1 2016: 29%) despite holding higher levels of CET1 capital following the Rochester 1 disposal in May 2016, and basic earnings per share were 24.1p (H1 2016: 30.2p including the gain on Rochester 1 disposal) with underlying basic earnings per share up 22% to 24.1p (H1 2016: 19.7p). The net loan book grew 10% in the first half to £6,546.6m due to strong new originations, particularly in Buy-to-Let.

Statutory profit before tax of £78.4m was 22% lower than in the first half of 2016 (H1 2016: £100.0m) due to the exceptional gain of £34.7m on Rochester 1 disposal in May 2016. On an underlying basis, excluding this exceptional gain, profit before tax increased by 20% to £78.4m (H1 2016: restated[1] £65.3m). This significant improvement in underlying profitability reflects the strength of our lending and funding franchises and efficient operating model.

Gross new organic lending of £1,229.2m was up 26% compared to £973.1m in the first half of 2016. This was due to strong levels of demand for our core Buy-to-Let products aimed at professional landlords, including limited company Buy-to-Let, as the impact of regulatory changes introducing more complex underwriting standards and changes to personal taxation took effect, driving additional business flow to specialist lenders.

The Bank made no portfolio acquisitions during the first six months of 2017 (H1 2016: portfolios of first and second charge mortgages for £130.7m). However, we will continue to evaluate selective inorganic opportunities that provide long-term value and meet our strategic objectives when they arise.

The Bank remained predominantly retail funded during the first half, but continued to utilise the Bank of England's Funding for Lending ('FLS') scheme and the Term Funding Scheme ('TFS') drawing down additional net funding of £315.0m in the first half. The Bank also continued its planned transition out of FLS into TFS. As at 30 June 2017, TFS drawdowns increased to £551.0m and FLS reduced to £389.6m (31 December 2016: £101.0m and £524.6m, respectively).

On 25 May 2017, OSB issued £60m of 9.125% AT1 securities, the proceeds of which will be used to further optimise the capital stack and to continue to support the general corporate purposes of the Group, including the growth of the Group's business.

[1] Restated to exclude coupons on equity PSBs classified as dividends (see reconciliation in the Financial review below)

Interim Management Report

Financial review

Summarised financial information, including key ratios, is presented in the tables below:

Summary Profit or Loss	First half 2017 £m	First half 2016 £m
Net interest income	**117.1**	99.1
Fair value losses on financial instruments	**(5.6)**	(1.7)
Net fees and commissions	**0.3**	0.5
External servicing fees	**(1.0)**	(1.4)
Administrative expenses[1]	**(30.6)**	(25.4)
Regulatory provisions	**(0.4)**	(0.9)
Impairment losses	**(1.4)**	(4.9)
Exceptional gain on sale	**-**	34.7
Profit before tax	**78.4**	100.0
Profit after tax	**59.0**	74.1
Underlying profit before tax	**78.4**	65.3[2]
Underlying profit after tax	**59.0**	48.4[2]

Key ratios	First half 2017	First half 2016
Net interest margin	**322bps**	309bps[2]
Basic earnings per share, pence	**24.1**	30.2
Underlying basic earnings per share, pence	**24.1**	19.7
Return on equity	**28%**	29%
Management expense ratio[3], annualised	**89bps**	83bps
Cost to income ratio	**28%**	26%[2]
Loan loss ratio	**4bps**	18bps

Extracts from the Statement of Financial Position	30-Jun-17 £m	31-Dec-16 £m
Loans and advances	**6,546.6**	5,939.2
Retail deposits	**6,047.0**	5,952.4
Total assets	**7,213.0**	6,580.9
Key ratios		
Liquidity ratio[4]	**14.9%**	17.9%
Common equity tier 1 ratio	**13.7%**	13.3%
Total capital ratio	**17.3%**	15.1%
Total leverage ratio	**6.5%**	5.5%

[1] Including depreciation and amortisation
[2] Restated to exclude coupons on equity PSBs classified as dividends (see reconciliation below)
[3] Administrative expenses including depreciation and amortisation as a percentage of average total assets
[4] Liquid assets as a percentage of funding liabilities

For definitions of other key ratios please see footnotes above

Interim Management Report

Restated key ratios

The following tables show the impact of removing the deduction of coupons on equity PSBs classified as dividends from the calculation of net interest income in certain key ratios from 2017 in line with market practice.

Change in key ratio calculation

Cost to income ratio	First half 2017 %	First half 2016 %
Previous method	28	27
Add back coupons on equity PSBs	(0)	(1)
Current method	28	26
Net interest margin		
Previous method	3.20	3.07
Add back coupons on equity PSBs	0.02	0.02
Current method	3.22	3.09

Underlying profit before tax	First half 2017 £m	First half 2016 £m
Previous method	77.9	64.6
Add back coupons on equity PSBs	0.5	0.7
Current method	78.4	65.3
Underlying profit after tax		
Previous method	58.6	47.8
Add back coupons on equity PSBs	0.4	0.6
Current method	59.0	48.4

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. 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. Prior to 2017, OSB deducted coupons on equity PSBs accounted for as dividends from underlying profit before and after tax. Following a review of market practice in advance of the Bank’s AT1 issue, OSB will no longer deduct these coupons and underlying profit before and after tax for the first half of 2016 have been restated throughout this document accordingly.

Interim Management Report

Reconciliation of statutory profit to underlying profit

	Profit before tax		Profit after tax	
	First half 2017 £m	Restated First half 2016 £m	First half 2017 £m	Restated First half 2016 £m
Statutory profit	**78.4**	100.0	**59.0**	74.1
Exceptional gain on Rochester 1 disposal	**-**	(34.7)	**-**	(25.7)
Underlying profit	**78.4**	65.3	**59.0**	48.4

Strong profit growth

The Group reported strong profitability in the first half of 2017 with profit before tax of £78.4m (H1 2016: £100.0m, including the exceptional gain of £34.7m on the Rochester 1 disposal). Excluding the exceptional gain on the Rochester 1 disposal in 2016, underlying profit before tax for the first six months of 2017 was up 20% at £78.4m (H1 2016: restated £65.3m) primarily reflecting strong balance sheet growth and net interest income.

Profit after tax for the first half of 2017 was £59.0m (H1 2016: £74.1m, including £25.7m after tax exceptional gain on the Rochester 1 disposal). Underlying profit after tax, excluding the exceptional gain in 2016, increased by 22% to £59.0m (H1 2016: restated £48.4m). The Bank's effective tax rate fell to 24.7% for the first half of 2017 (H1 2016: 25.9%) due to a reduction in the rate of corporation tax from 20% to 19% effective 1 April 2017 and a reduction in the proportion of Group profits subject to the Bank Corporation Tax Surcharge.

Net interest margin (NIM)

The Group reported an increase in net interest income of 18% to £117.1m in the first half of 2017 (H1 2016: £99.1m) and NIM of 322bps (H1 2016: restated 309bps). The higher NIM reflected a reduced cost of retail funds and additional benefit from TFS, more than offsetting the roll-off of higher yielding acquired loan books.

Fair value losses on financial instruments

Fair value losses on financial instruments in the first half of 2017 were £5.6m (2016: £1.7m). The increase was due to accelerated amortisation of fair value adjustments on hedged assets relating to cancelled swaps of £6.2m (2016: £1.6m). The Group started to accelerate the amortisation in-line with the roll-off of the underlying legacy long-dated fixed rate mortgages in the second half of 2016.

Net fees and commissions

Net fees and commissions income of £0.3m in first half of 2017 (H1 2016: £0.5m) comprised fees and commissions receivable of £0.8m (H1 2016: £0.9m) offset by fees and commissions payable of £0.5m (2016: £0.4m). Fees and commissions receivable include arrangement fees on funding lines and master servicing fees. Fees and commissions payable include branch agency fees and commission paid to the Kent Reliance Provident Society for conducting member engagement activities for the Bank.

External servicing fees

External servicing fees decreased to £1.0m in the first half of 2017 (H1 2016: £1.4m) mainly due to the Rochester 1 disposal in May 2016 and the run-off of certain other acquired portfolios.

Efficient and scalable operating platform

Administrative expenses, including depreciation, were up 20% to £30.6m for the first half of 2017 (H1 2016: £25.4m) largely due to increased staff costs in-line with growth in the business and the increased cost of meeting new regulation.

The Group's annualised management expense ratio was up 6bps to 0.89% for the first half of 2017 (H1 2016: 0.83%) and cost to income ratio increased to 28% (H1 2016: restated 26%) reflecting these additional costs. 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 continued to fall to £0.4m for the first half of 2017 (H1 2016: £0.9m) based on lower estimates published in the FSCS outlook for the current period and reduced final costs for the prior year. This includes the full annual charge recognised on 1 April in each year, based on retail savings balances as at the previous 31 December.

Impairment losses

Impairment losses decreased to £1.4m in the first half of 2017 (H1 2016: £4.9m) representing a loan loss ratio of 4bps on average gross loans and advances on an annualised basis (H1 2016: 18bps). In June 2016, the Group applied additional conservatism to collectively assessed impairment assumptions as a prudent measure in response to increased macroeconomic uncertainty post the UK referendum vote to leave the European Union. This increased loan losses across the acquired residential portfolios in the first six months of 2016. In addition, the reduction in impairment losses was driven by lower underlying loan losses on acquired residential portfolios, and the effect of increasing property values reducing potential loss.

The performance of the front book of mortgages remains strong, reflecting the continued strength of the Bank's underwriting and lending criteria. From more than 33,500 loans totalling £7.0bn organically originated since the creation of the Bank in February 2011, only 122 were more than three months in arrears as at 30 June 2017, with a total value of £20.6m and an average LTV of just 61%.

Exceptional items

There were no exceptional items in the first half of 2017. Exceptional income in the first half of 2016 of £34.7m comprised of the gain on disposal of the Bank's entire economic interest in the Rochester 1 securitisation vehicle.

Dividends

The Group's dividend policy is to declare interim dividends based on one third of the prior year's total dividend. To that end, the Board has declared an interim dividend of 3.5 pence per share for first half of 2017, based on the 2016 full year dividend of 10.5 pence per share. The Board continues to target a full year dividend pay-out ratio of at least 25 per cent of underlying profit after tax less coupons on equity PSBs and AT1 securities classified as dividends.

Interim Management Report

Balance sheet growth

Loans and advances grew by 10% in the first half of 2017 to £6,546.6m (31 December 2016: £5,939.2m). This growth was funded by a mixture of retail deposits which increased by 2% to £6,047.0m (31 December 2016: £5,952.4m) and net new drawings under the TFS. The Bank drew down £315.0m of additional net new funding from the Bank of England in the first half of 2017. In addition, OSB continued with its planned transition out of FLS into TFS. The Bank had total borrowings of £389.6m under the FLS and £551.0m under the TFS as at 30 June 2017 (31 December 2016: £524.6m and £101.0m, respectively).

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. OSB ended the first six months of 2017 with a liquidity ratio of 14.9% (31 December 2016: 17.9%) following a recalibration of the Group's liquidity runway. The Bank's liquidity coverage ratio of 189% as at 30 June 2017, including off-balance sheet FLS drawdowns, is significantly in excess of the regulatory minimum of 90%.

The Bank's retail savings franchise continues to provide the business with long-term sustainable funding for balance sheet growth as evidenced in the first half of 2017 by the continued strong retention rate for maturing deposits of 87% and an exceptional level of customer satisfaction with a Net Promoter Score of 60%.

Capital

The Bank's capital position continued to strengthen in the first half through organic capital generation, with a fully-loaded CET1 ratio of 13.7% as at 30 June 2017 (31 December 2016: 13.3%).

In the first half of 2017, the Bank further strengthened its capital position by issuing £60m of AT1 securities which drove an increase of 2.2 percentage points in the total capital ratio to 17.3% (31 December 2016: 15.1%) and an increase of a percentage point in the leverage ratio to 6.5% (31 December 2016: 5.5%).

The Bank had a Pillar 2a requirement of 1.2% of risk weighted assets as at 30 June 2017 and 31 December 2016.

Interim Management Report

Segmental review

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

First half 2017, £m	**Total**	**BTL/SME[1]**	**Residential mortgages**
Net interest income	**117.1**	**83.4**	**33.7**
Other expense	**(6.3)**	**(1.4)**	**(4.9)**
Total income	**110.8**	**82.0**	**28.8**
Impairment (losses)/credit	**(1.4)**	**(1.5)**	**0.1**
Contribution to profit	**109.4**	**80.5**	**28.9**
First half 2016, £m			
Net interest income	99.1	62.8	36.3
Other expense	(2.6)	(0.7)	(1.9)
Total income	96.5	62.1	34.4
Impairment losses	(4.9)	(0.7)	(4.2)
Contribution to profit	91.6	61.4	30.2

As at 30 June 2017, £m	**Total**	**BTL/SME[1]**	**Residential mortgages**
Gross loans to customers	**6,569.2**	**4,801.5**	**1,767.7**
Provision for impairment losses	**(22.6)**	**(15.6)**	**(7.0)**
Net loans to customers	**6,546.6**	**4,785.9**	**1,760.7**
Risk weighted assets	**2,990.9**	**2,242.0**	**748.9**
As at 31 December 2016, £m			
Gross loans to customers	5,964.2	4,104.3	1,859.9
Provision for impairment losses	(25.0)	(17.2)	(7.8)
Net loans to customers	5,939.2	4,087.1	1,852.1
Risk weighted assets	2,743.0	1,944.3	798.7

[1] The personal loan portfolio has largely completed its run-off and is therefore no longer considered as a separate segment by the Group. The remaining net loan book of £2.3m (31 December 2016: £9.1m) and negative contribution to profit for the period of £0.7m (H1 2016: contribution to profit of £1.5m) have been reported in the Buy-to-Let/SME segment with comparatives restated accordingly.

Interim Management Report

Buy-to-Let/SME

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

	30-Jun-17 £m	31-Dec-16 £m
Buy-to-Let	**4,266.8**	3,613.3
Commercial	**302.9**	268.3
Residential development	**151.3**	141.6
Funding lines	**77.9**	71.7
Personal loans[1]	**2.6**	9.4
Total	**4,801.5**	4,104.3

[1] See footnote above

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

According to UK Finance (formerly the Council for Mortgage Lenders), gross Buy-to-Let advances stood at £17.3bn in the first six months of 2017, down 24% on the same period in 2016, albeit that period was inflated by a spike in purchases arising from the implementation of the 3% Stamp Duty Land Tax surcharge on second properties from 1 April 2016. UK Finance currently forecast gross Buy-to-Let advances to reach £35bn in 2017, compared to £40.6bn in 2016. The regulatory and taxation changes that largely drove this decrease have led to heightened demand from professional landlords, including limited companies, for OSB's specialist capabilities and expertise leading to growth in our market share of new lending in the first six months of 2017.

Against this backdrop, OSB has delivered strong growth, evidenced by significantly higher originations in the Buy-to-Let/SME segment, up 37% at £1,097.3m for the first half of 2017, compared to £800.2m in the first half of 2016.

The Buy-to-Let sub-segment loan portfolio grew by £653.4m in the first half of 2017 to a gross value of £4,266.8m (31 December 2016: £3,613.3m) as we benefited from the strong levels of organic origination. Following the regulatory changes to underwriting standards for Buy-to-Let lending at the start of 2017, our average interest coverage ratio increased to 190% (FY 2016: 171%).

Our exposure to commercial real estate is limited, at a gross value of £302.9m as at 30 June 2017 (31 December 2016: £268.3m) and the portfolio has a low weighted average LTV of 61% and average loan size of £295,000.

In 2014, the Bank launched Heritable Development Finance, to provide prudent development finance to smaller residential developers, with a preference for forging relationships with those active outside of the prime central London market. The business continues to grow in spite of new entrants to the market, as customers seek an experienced and knowledgeable lender. However, following the UK vote to leave the EU, the number of potential development schemes which can withstand our stringent stress testing has reduced. The residential development funding gross loan book at the end of the first half of 2017 was £151.3m, with a further £76.5m committed (31 December 2016: £141.6m and £70.0m respectively).

In addition, the Bank continued to provide secured funding lines to non-bank lenders which operate in certain high-yielding, specialist sub-segments, such as bridging finance and asset finance. Total credit approved limits as at 30 June 2017 were £313.0m with total loans outstanding of £77.9m (31 December 2016: £244.0m and £71.7m respectively). During the period, three new funding lines were approved and are in the documentation process. The pipeline remains robust, however following the UK's vote to leave the EU, a more cautious risk approach has been adopted.

Interim Management Report

OSB's combined Buy-to-Let/SME loan portfolio[1] grew 17% during the first half of 2017, ending the period with a net carrying value of £4,785.9m (31 December 2016: restated £4,087.1m[1]). The average loan to value ('LTV') remained low at 69% (31 December 2016: 69%) with 1% of loans by value with an LTV exceeding 90% (31 December 2016: 0.4%). The average LTV of new Buy-to-Let/SME origination in the first half of 2017 was 70% (H1 2016: 74%).

The Buy-to-Let/SME segment made a contribution to Group profit[1] of £80.5m in the first half of 2017, up 31% compared to £61.4m in the first half of 2016, primarily reflecting the positive impact of new lending and the falling cost of funds.

[1] Includes the remaining personal loan portfolio.

Residential mortgages

Residential sub-segments: gross loans

	30-Jun-17 £m	31-Dec-16 £m
First charge	**1,297.1**	1,322.1
Second charge	**455.3**	487.2
Funding lines	**15.3**	50.6
Total	**1,767.7**	1,859.9

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

During the first half of 2017, the Group organically originated residential lending of £131.9m (H1 2016: £172.9m). This included first charge residential lending in the UK, predominantly in London and the South-East, through the Kent Reliance brand as well as second charge lending through the Prestige Finance brand. The Bank made no portfolio acquisitions in the first half of 2017 (H1 2016: portfolios of first and second charge residential mortgages for £130.7m).

Our first charge residential book had a gross value of £1,297.1m as at 30 June 2017 (31 December 2016: £1,322.1m) with new organic lending in the first half of 2017 offset by redemptions on the back book and acquired mortgage portfolios in run-off.

The second charge residential loan book reduced by 7% as at 30 June 2017 with a gross value of £455.3m (31 December 2016: £487.2m) with organic origination more than offset by redemptions on the organic book and acquired books in run-off. We continue to maintain appropriate pricing for risk in the second charge residential market which has seen downward pricing pressure as a result of new entrants and an increase in competition.

OSB continued to provide secured funding lines to non-bank lenders which operate in certain high-yielding, specialist sub-segments, such as residential bridge finance. The Bank has adopted a more cautious approach in our more cyclical businesses following the EU referendum. Total credit approved limits as at 30 June 2017 were £35.1m with total loans outstanding of £15.3m (31 December 2016: £86.2m and £50.6m respectively). During the period, one facility of £34.4m matured.

OSB's total residential loan portfolio had a net carrying value of £1,760.7m as at 30 June 2017 (31 December 2016: £1,852.1m). The average LTV remained low at 58% (31 December 2016: 58%) with only 2% of loans by value with LTV's exceeding 90% (31 December 2016: 3%). The average LTV of new residential origination in the first half of 2017 was 66% (H1 2016: 65%).

Interim Management Report

Residential mortgages made a contribution to Group profit of £28.9m in the first half of 2017, down 4% compared to £30.2m in the first half 2016, following the disposal of higher yielding mortgages in Rochester 1 in May 2016 and accelerated amortisation of hedged assets relating to cancelled swaps in the first half of 2017, partially offset by the impact of lower loan losses. The Bank increased prudency in collective provision assumptions in the first half of 2016, following the UK vote to leave the EU, which particularly impacted acquired second charge mortgages.

Interim Management Report

Risk Management Report

Progress made during the six months to 30 June 2017

During the half year to 30 June 2017 the Group made strong progress against its strategic risk management objectives for the year.

Key highlights included the delivery of enhanced risk appetite statements for 2017, further embedding the risk appetite framework whilst enhancing governance arrangements in relation to the oversight, review and challenge of proposed limits and thresholds, coupled with improvements in stress testing and scenario analysis across all risk types.

The IFRS 9 programme continued to progress to plan, with the Group running parallel impairment calculations throughout the period. An independent model validation review was conducted via an independent third party, reviewing the underlying models, implementation standards and governance arrangements in place which confirmed that the Group is well-positioned to meet the requirements for adoption at January 2018. The Group has prioritised integration of the IFRS 9 capability into other core risk processes including risk appetite, future loss forecasting, stress testing and the Internal Capital Adequacy Assessment Process ('ICAAP') as a key priority for the second half of 2017.

Progression to an Internal Ratings Based ('IRB') approach for calculating credit risk capital requirements remains a key strategic initiative, building on the development of the Group's first generation IRB models and rating engine which completed during December 2016; the Group ran IRB capital calculations in parallel throughout the period to 30 June 2017. Good progress has also been made in relation to building out a robust road map to the Group's IRB waiver application, via the completion of an internal self-assessment against the Capital Requirements Regulation articles and wider application requirements.

A strategic data management programme has been mobilised to oversee tactical and strategic enhancements being made to the Group's data management and governance capabilities. External third party data was acquired to underpin enhanced analytics across the credit and operational risk types, also allowing the Group to benchmark stress testing activity.

Enhanced stress testing and scenario analysis capabilities were developed and implemented during the period, to support the Group's delivery of key regulatory submissions including the ICAAP and the Internal Liquidity Assessment Process ('ILAAP').

The Group continued to make significant investment in people across the Risk and Compliance function ensuring there is sufficient capacity to deliver the strategic risk enhancements planned for the second half of the year and beyond.

Principal risks and uncertainties

The Board is responsible for determining the nature and extent of the principal risks it is willing to take in order to achieve its strategic objectives.

There has not been a material change in the Group's business strategy, risk management framework or risk appetite during the six months to 30 June 2017. In the opinion of the Directors, the key principal risks have not changed materially from the overview provided in the 2016 Annual Report and Accounts.

The table below details, at a high level, the principal risks which the Board believes are the most material with respect to potential adverse movements impacting the business model, future financial performance, solvency and liquidity. A more detailed review of the Group's principal risks and uncertainties is detailed within the Chief Risk Officer's Report in the 2016 Annual Report and Accounts on pages 42 to 45, which can be accessed via our website at www.osb.co.uk.

Interim Management Report

Principal risks	Key mitigating actions
Strategic and business risk	• Regular monitoring of the Group's strategic and business performance against market commitments, and the balanced business scorecard and risk appetite by the Board and the Executive Committee. • The Group also extensively uses stress testing to flex core business planning assumptions to assess potential performance under stressed operating conditions.
Reputational risk	• Established processes are in place to proactively identify and manage potential sources of reputational risk.
Credit risk	Individual borrower defaults • All loans are extended via thorough bespoke and expert underwriting to ensure the ability and propensity of borrowers to repay is appropriate, whilst sufficient security is in place in case an account defaults. • Should there be problems with a loan, the collections and recoveries team works with customers unable to meet their loan servicing 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 focused on security levels, and is scrutinised by the Group's independent Real Estate team as well as by external valuers. Development finance lending is extended only after a deep investigation of a borrower's track record and the specific project details and requires approval by a dedicated Development Finance Transactional Credit Committee. Macroeconomic downturn • The Group works within clearly defined portfolio limits approved by the Risk Committee and the Board covering loan to value, affordability, sector and geographic concentration. These are reviewed at least annually. In addition, stress testing is performed 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 Group only transacts with high quality wholesale counterparties. Derivative exposures include collateral agreements to mitigate credit exposures.
Market risk	Interest rate risk • The Group's Treasury department actively hedges to match the timing of cash flows from assets and liabilities. Basis risk • 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	• The Group's funding strategy is focused on a highly stable retail deposit franchise. The large numbers of depositors provide diversification, with a high proportion of balances covered by the Financial Services Compensation Scheme 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 liquidity insurance facilities can be accessed in the unlikely event that it should become necessary.
Solvency risk	• The Group actively monitors its capital requirements and resources against financial forecasts and plans and undertakes stress testing analysis to subject its solvency ratios to extreme but plausible scenarios. The Group also holds prudent levels of capital buffers based on CRD IV requirements and expected balance sheet growth. The

	Group engages actively with regulators, industry bodies and advisers to keep abreast of potential changes providing feedback through the consultation process and actively manages its capital strategy and plan.
Operational risk	Network /system intrusion • A series of tools has been designed and deployed to identify and prevent network/system intrusions. The effectiveness of implemented controls is overseen by a dedicated IT Security Governance Committee, with specialist IT security staff employed by the Group. Data risk • The Group continues to invest in its data management architecture, systems governance and controls. People risk • The Group has a series of initiatives that are intended to respond to people 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 • The Group carries out scenario based Business Continuity Planning (‘BCP’), has crisis management procedures and recovery and contingency plans. The BCP is periodically tested to ensure the Group can execute derived plans if required.
Conduct risk	Product suitability • 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. • In 2016, the Group established an effective mortgage product transfer scheme Choices. Data protection • In addition to a series of network/system controls, the Group performs extensive root cause analysis of any data leaks in order to ensure that the appropriate mitigating actions are taken.
Compliance and regulatory risk	• The Group has adopted the European Mortgage Credit Directive and Senior Managers and Certification Regime in an effective and timely manner. • The adoption of the Prudential Regulation Authority (‘PRA’) underwriting standards for Buy-to-Let contracts and the lending policy requirements around affordability mean that the Group should be well-placed to respond to any macro prudential regulation of the Buy-to-Let sector. • Another consultation of note relates to the recently published consultation paper by the PRA relating to proposed refinements to the 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.

Emerging risks

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

Emerging risks	Key mitigating actions
Political and macroeconomic uncertainty As a result of the UK government triggering Article 50 and subsequent general election result during the period to 30 June 2017, there is an increased likelihood of a period of macroeconomic uncertainty. The Group's lending activity is solely focused within the United Kingdom and as such will be impacted by any risks emerging from changes in the macroeconomic environment.	• The Group has implemented robust monitoring processes and via various stress testing activity (i.e. ad hoc, risk appetite and ICAAP) understands how the Group performs over a variety of macroeconomic stress scenarios and has subsequently developed a suite of early warning indicators which are closely monitored to identify changes in the macro environment.
Regulatory capital requirements The Basel Committee on Banking Supervision is consulting on changes to the Standardised Approach for assessing capital requirements for institutions. The most material proposal relates to a potential increase in the risk weightings applicable to Buy-to-Let lending assets. The Group also notes the separate consultation paper proposing revisions to the IRB approach for assessing capital, which may limit the impact of institutions transitioning to an IRB approach in due course.	• The Group continues to closely monitor and assess any potential changes to prudential capital requirements and will continue to liaise with the appropriate regulators as required. • The Group continues to make good progress with respect to transitioning to an IRB approach for assessing capital requirements.
Cyber security risks This risk relates to the Group being unable to maintain pace with the increasing threat of cybercrime.	• The Bank continues to enhance its suite of preventative and detective controls to ensure that the control framework is consistent throughout the Group. • Documented response plans are established and testing performed to ensure that any breach is managed effectively. • Dedicated resources are in place and have been further increased in order to manage and coordinate cyber risk related threats.
General data usage From 25 May 2018 the Group will have to comply with proposed changes to General Data Protection Regulation ('GDPR'). This will result in increased regulatory requirements with respect to processing personal customer, employee and other data in the course of day-to-day business activities.	• The Group has mobilised a project (with dedicated resources) to implement GDPR as required.

Credit risk portfolio performance

The Group's credit profile continues to exhibit strong performance across all risk indicators and has operated within the Board approved risk appetite within the period.

During the six months to 30 June 2017, the Group's portfolio composition mix continued to evolve favourably with pre-2011 lending continuing to run down as expected. Legacy problem loans reduced from £13.8m to £11.9m within the period. Post-2011 lending, incorporating enhanced lending criteria, continued to make up an increasing proportion of the Group's total loans and advances to customers.

This portfolio mix shift coupled with the continuing benign economic conditions supported the portfolio arrears rate[1] remaining stable at 1.4% as at June 2017 (31 December 2016: 1.4%).

There was however an observed increase in the reported balances of accounts not impaired past due less than 1 month as at 30 June 2017 (see note 16 Risk management and financial instruments, table Analysis of mortgage portfolio by arrears and collateral held). The increase was driven by accounts that completed in June 2017 entering technical arrears with first contractual payments scheduled to be received during July 2017. There was 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.

Other key risk measures also performed strongly within the period including:

Measure	First half 2017	First half 2016	Variance	Commentary
New origination average LTV for BTL/SME lending	70%	74%	-4%	• New lending average LTV reduced
Weighted average Interest Coverage Ratio for new BTL/SME lending	190%	161%	+29%	• Increase in average BTL/SME ICR
New origination average LTV for Residential lending	66%	65%	+1.0%	• New lending average LTV remained stable
Percentage of new Residential lending with a loan to income (LTI) > 4.5	3.7%	1.5%	+2.2%	• A marginal increase in cases with an LTI > 4.5, however the Group has not written any loans with a debt to income ratio above 85% within the period.

[1] excluding legacy problem loans

- Exposure to semi-commercial/commercial lending remains low at £303m with a weighted average LTV of 61%;
- Exposure to residential development finance remains low at £151m with a further £77m committed and a weighted average LTV of 44%; and
- The Group has limited exposure to high LTV loans on properties worth more than £2m. In total, only 2% of its total loan book is secured on properties valued at greater than £2m with a LTV greater than 65%.

The continuing portfolio mix shift and continuing strong arrears performance of originations post 2011, coupled with the relatively benign economic environment led to strong impairment performance within the period. The Group's loan loss ratio improved by 14bps to 4bps from H1 2016 to H1 2017, noting that in June 2016 the Group applied additional conservatism to collectively assessed impairment calculations as a prudent measure due to the increasing likelihood of macroeconomic uncertainty after the UK referendum vote to leave the European Union.

Interim Management Report

The Group continues to closely monitor impairment coverage levels:

Impairment coverage review

	30-Jun-17	31-Dec-16
Gross loans and advances to customers £m	**6,569.2**	5,964.2
Provisions for impairment losses £m	**22.6**	25.0
Incurred loss remaining[1] £m	**8.2**	8.4
Coverage ratio versus loans and advances[2] %	**0.47**	0.56
Coverage ratio versus impaired balances[3] %	**39.2**	41.5

[1] Incurred loss is the expected loss of the portfolio at the point of acquisition and is offset against the modelled future cash flows to derive the effective interest rate for the book. The incurred loss protection is therefore recognised over the life of the book against the unwind of any purchase discount or premium through interest income. Incurred loss remaining is this protection reduced by the cumulative losses observed since acquisition.
[2] Coverage ratio versus loans and advances is the total collective and specific provisions plus incurred losses remaining versus gross loans and advances.
[3] Coverage ratio versus impaired balances is the total collective and specific provisions plus incurred loss remaining versus impaired balances. Impaired balances are defined as loans where a specific provision has been raised. Personal loans are not included in the impaired balances.

The coverage ratio with respect to loans and advances to customers reduced to 0.47% from 0.56% at 31 December 2016 driven by a reduction in collectively assessed provision balances, strong arrears performance coupled with increasing property values reducing the overall exposure to losses post enforcement of security. Within the period a large individually impaired property was also sold contributing to the reduction in total Group provision balances. Coverage versus impaired balances remained strong at 39.2% as at 30 June 2017, although reduced versus 31 December 2016, again predominantly driven by lower total provision balances.

Whilst the Bank only lends to borrowers it considers are able to pay the sums due under the terms of a mortgage, inevitably some borrowers will fall into arrears. The overriding principle when dealing with a borrower in arrears is that the Bank follows prescribed policies and procedures that allow for a flexible and individual approach, tailored to the circumstances of the particular borrower.

Interim Management Report

During the six months period to 30 June 2017, the Group continued to experience a low level of new cases requiring forbearance arrangements. There were 96 new cases of forbearance with balances totalling £10.6m, which on a run rate basis is broadly comparable with the first half of 2016.

Forbearance measures undertaken

	H1 2017 number of accounts	June 2017 month end balances	H1 2016 number of accounts	June 2016 month end balances
Forbearance type:		**£m**		**£m**
Interest only switch	**24**	**1.4**	21	3.1
Interest rate reduction	**-**	**-**	3	2.2
Term extension	**21**	**3.8**	16	4.6
Payment holiday	**34**	**3.9**	8	0.2
Payment concession (reduced monthly payments)	**17**	**1.5**	35	3.3
Capitalisation	**-**	**-**	-	-
Total	**96**	**10.6**	83	13.4

	H1 2017 number of accounts	June 2017 month end balances	H1 2016 number of accounts	June 2016 month end balances
Loan type		**£m**		**£m**
First charge owner occupier	**40**	**3.3**	57	7.6
Second charge owner occupier	**41**	**4.6**	17	0.6
Buy-to-Let	**15**	**2.7**	9	5.2
Commercial	**-**	**-**	-	-
Total	**96**	**10.6**	83	13.4

Liquidity and funding risk management overview

OneSavings Bank's lending strategy is supported by a strong retail savings franchise, which provides the Bank with a sustainable funding platform to support long-term balance sheet growth. This strength is reflected in high retention levels on maturing fixed term products of 87% in the first half of 2017 and strong customer satisfaction scores. In addition, only 7% of the Bank's retail deposits as at 30 June 2017 were above the FSCS protection level of £85k. Diversification of funding is also provided by active participation in the FLS and the TFS.

The Group continues to operate a conservative approach to managing liquidity with a liquidity ratio of 14.9% as at 30 June 2017 (31 December 2016: 17.9%). The liquidity coverage ratio at 30 June 2017 was 189%, significantly above the regulatory minimum of 90%.

Market risk

The Group has a small amount of foreign exchange exposure, due to the Rupee denominated running costs of its OSBIndia office. Rupee denominated running costs during the period to 30 June 2017 were £2.4m (H1 2016: £1.6m).

Solvency risk management overview

The Group continued to maintain an appropriate level and quality of capital to support its growth objectives and to meet its prudential requirements. The Group strengthened its capital position in the first half of 2017 with a CET1 ratio of 13.7% as at 30 June 2017 (31 December 2016: 13.3%), which remains comfortably in excess of the regulatory requirements. During the period to 30 June 2017, the Group issued £60m of AT1 securities that qualify as additional Tier 1 capital under CRD IV.

OSB's capital buffers are subject to active monitoring by the Board and senior management in the context of the Bank's strategic objectives, performance commitments, economic and market conditions, regulatory changes and other risks to which the Bank is exposed.

The Group continues to closely monitor the ongoing consultation paper issued by the Basel Committee on Banking Supervision ('BCBS') during December 2015 regarding revisions to the Standardised Approach for assessing the capital adequacy of financial services institutions. A key proposed amendment is a potential increase in the risk weights applicable to Buy-to-Let exposures. The BCBS approved another consultation paper during March 2016 which detailed proposed revisions to the IRB, which may, if implemented, apply floors which would cap the comparative capital consumption advantage versus the Standardised Approach.

The PRA also published two further consultation papers, with the first aiming to reduce distortions in the market for certain asset classes, by allowing Standardised Approach financial institutions who can demonstrate a potential over provision to offset against capital requirements in other areas, aiming to create a more level playing field versus institutions that adhere to an IRB approach. The second consultation paper is intended to make the IRB application process more accessible for smaller UK financial services institutions. The Group welcomes these proposals as it progresses towards transitioning to an IRB approach to capital measurement.

Statement of Directors' Responsibilities

We confirm that to the best of our knowledge:

• the condensed set of financial statements has been prepared in accordance with IAS 34, Interim Financial Reporting, as adopted by the EU;

• the interim management report includes a fair review of the information required by:

(a) DTR 4.2.7R of the Disclosure Guidance and Transparency Rules, being an indication of important events that have occurred during the first six months of the financial year and their impact on the condensed set of financial statements; and a description of the principal risks and uncertainties for the remaining six months of the year; and

(b) DTR 4.2.8R of the Disclosure Guidance and Transparency Rules, being related party transactions that have taken place in the first six months of the current financial year and that have materially affected the financial position or performance of the entity during that period; and any changes in the related party transactions described in the last annual report that could do so.

The Board of Directors, as listed below, represents those individuals responsible for this interim management report:

Graham Allatt

Eric Anstee

Andrew Doman

Rod Duke

Andy Golding

Tim Hanford

Margaret Hassall

Mary McNamara

April Talintyre

By order of the Board

Date: 23 August 2017

Independent Review Report to OneSavings Bank plc

Conclusion

We have been engaged by the company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2017 which comprises the Consolidated Statement of Profit or Loss, the Consolidated Statement of Other Comprehensive Income, the Consolidated Statement of Financial Position, the Consolidated Statement of Changes in Equity and the Consolidated Statement of Cash Flows and the related explanatory notes.

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2017 is not prepared, in all material respects, in accordance with IAS 34 Interim Financial Reporting as adopted by the EU and the Disclosure Guidance and Transparency Rules ('the DTR') of the UK's Financial Conduct Authority ('the UK FCA').

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity issued by the Auditing Practices Board for use in the UK. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. We read the other information contained in the half-yearly financial report and consider whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the DTR of the UK FCA.

As disclosed in note 1, the annual financial statements of the Group are prepared in accordance with International Financial Reporting Standards as adopted by the EU. The directors are responsible for preparing the condensed set of financial statements included in the half-yearly financial report in accordance with IAS 34 as adopted by the EU.

Our responsibility

Our responsibility is to express to the company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

The purpose of our review work and to whom we owe our responsibilities

This report is made solely to the company in accordance with the terms of our engagement to assist the company in meeting the requirements of the DTR of the UK FCA. Our review has been undertaken so that we might state to the company those matters we are required to state to it in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company for our review work, for this report, or for the conclusions we have reached.

Pamela McIntyre (Senior Statutory Auditor)
for and on behalf of KPMG LLP
Chartered Accountants
15 Canada Square
London, E14 5GL

23 August 2017

Condensed Consolidated Statement of Profit or Loss

	Note	Six months ended 30-Jun-17 (Unaudited) £m	Six months ended 30-Jun-16 (Unaudited) £m
Interest receivable and similar income	2	**158.5**	153.4
Interest payable and similar charges	3	**(41.4)**	(54.3)
Net interest income		**117.1**	99.1
Fair value losses on financial instruments	4	**(5.6)**	(1.7)
Fees and commissions receivable		**0.8**	0.9
Fees and commissions payable		**(0.5)**	(0.4)
External servicing fees		**(1.0)**	(1.4)
Total income		**110.8**	96.5
Administrative expenses	5	**(29.0)**	(24.2)
Depreciation and amortisation		**(1.6)**	(1.2)
Impairment losses	13	**(1.4)**	(4.9)
FSCS and other provisions		**(0.4)**	(0.9)
Exceptional gain on sale	6	**-**	34.7
Profit before taxation		**78.4**	100.0
Taxation	7	**(19.4)**	(25.9)
Profit for the period		**59.0**	74.1
Dividend, pence per share	8	**3.5**	2.9
Earnings per share, pence per share			
Basic	9	**24.1**	30.2
Diluted	9	**23.9**	30.1

The accompanying notes form an integral part of these condensed financial statements.

OneSavings Bank plc

Interim report for the six months ended 30 June 2017

Condensed Consolidated Statement of Other Comprehensive Income

	Six months ended 30-Jun-17 (Unaudited) £m	Six months ended 30-Jun-16 (Unaudited) £m
Profit for the period	**59.0**	**74.1**
Other comprehensive income for the period		
Items which may be reclassified to profit or loss:		
Fair value changes on available-for-sale securities		
Arising in the period	**0.1**	(0.8)
Transferred to profit or loss	**-**	0.7
Revaluation of foreign operations	**(0.1)**	0.4
Tax on items in other comprehensive income	**-**	0.1
	-	0.4
Total comprehensive income for the period	**59.0**	74.5

The accompanying notes form an integral part of these condensed financial statements.

OneSavings Bank plc

Interim report for the six months ended 30 June 2017

Condensed Consolidated Statement of Financial Position

	Note	As at 30-Jun-17 (Unaudited) £m	As at 31-Dec-16 (Audited) £m
Assets			
Cash in hand		**0.4**	0.4
Loans and advances to credit institutions		**579.3**	417.8
Investment securities		**19.1**	141.7
Loans and advances to customers	11	**6,546.6**	5,939.2
Derivative assets		**0.7**	1.8
Fair value adjustments on hedged assets	14	**34.8**	46.9
Deferred taxation asset		**4.2**	3.4
Intangible assets		**5.7**	4.7
Property, plant and equipment		**19.7**	13.1
Other assets		**2.5**	11.9
Total assets		**7,213.0**	6,580.9
Liabilities			
Amounts owed to retail depositors		**6,047.0**	5,952.4
Amounts owed to credit institutions		**552.0**	101.7
Amounts owed to other customers		**17.6**	4.0
Derivative liabilities		**17.9**	24.4
Fair value adjustments on hedged liabilities	14	**0.7**	1.9
Current taxation liability		**18.2**	21.1
Other liabilities		**12.2**	18.6
FSCS and other provisions		**1.9**	1.5
Subordinated liabilities		**10.7**	21.6
Perpetual subordinated bonds		**15.3**	15.3
		6,693.5	6,162.5
Equity			
Share capital		**2.4**	2.4
Share premium		**157.9**	157.9
Retained earnings		**280.2**	240.7
Other reserves	15	**79.0**	17.4
		519.5	418.4
Total equity and liabilities		**7,213.0**	6,580.9

The accompanying notes form an integral part of these condensed financial statements.

OneSavings Bank plc

Interim report for the six months ended 30 June 2017

Condensed Consolidated Statement of Changes in Equity

	Share capital £m	Share premium £m	Capital contribution £m	Transfer reserve £m	Foreign exchange reserve £m	Available-for-sale reserve £m	Share-based payment reserve £m	Retained earnings £m	Equity bonds[1] £m	Total £m
Balance at 1 January 2017	**2.4**	**157.9**	**6.2**	**(12.8)**	**0.1**	**-**	**1.9**	**240.7**	**22.0**	**418.4**
Profit for the period	-	-	-	-	-	-	-	59.0	-	59.0
Coupon paid on equity bonds[2]	-	-	-	-	-	-	-	(0.4)	-	(0.4)
Dividends paid								(18.5)		(18.5)
Other comprehensive income	-	-	-	-	(0.1)	0.1	-	-	-	-
Share-based payments	-	-	0.1	-	-	-	1.5	-	-	1.6
Additional Tier 1 securities issuance[3]	-	-	-	-	-	-	-	(0.6)	60.0	59.4
Balance at 30 June 2017 (Unaudited)	**2.4**	**157.9**	**6.3**	**(12.8)**	**-**	**0.1**	**3.4**	**280.2**	**82.0**	**519.5**

[1] Equity bonds comprise £22m of Perpetual Subordinated Bonds and £60m of fixed rate resetting perpetual subordinated contingent convertible securities.
[2] Coupon paid on Perpetual Subordinated Bonds is shown net of tax.
[3] Additional Tier 1 securities issuance costs of £0.6m are shown net of tax.

The accompanying notes form an integral part of these condensed financial statements.

Condensed Consolidated Statement of Changes in Equity

	Share capital £m	Share premium £m	Capital contribution £m	Transfer reserve £m	Foreign exchange reserve £m	Available -for-sale reserve £m	Share-based payment reserve £m	Retained earnings £m	Equity bonds[1] £m	Total £m
Balance at 1 January 2016	2.4	157.9	5.8	(12.8)	(0.8)	(0.1)	0.9	144.0	22.0	319.3
Profit for the period	-	-	-	-	-	-	-	74.1	-	74.1
Coupon paid on equity bonds[2]	-	-	-	-	-	-	-	(0.6)	-	(0.6)
Dividends paid	-	-	-	-	-	-	-	(16.3)	-	(16.3)
Other comprehensive income	-	-	-	-	0.4	-	-	-	-	0.4
Share-based payments	-	-	0.3	-	-	-	-	-	-	0.3
Balance at 30 June 2016 (unaudited)	2.4	157.9	6.1	(12.8)	(0.4)	(0.1)	0.9	201.2	22.0	377.2

[1] Equity bonds comprise £22m of Perpetual Subordinated Bonds.
[2] Coupon paid on Perpetual Subordinated Bonds is shown net of tax.

The accompanying notes form an integral part of these condensed financial statements.

Notes to the Condensed Consolidated Financial Statements

	Note	Six months ended 30-Jun-17 (Unaudited) £m	Restated Six months ended 30-Jun-16 (Unaudited) £m
Cash flows from operating activities			
Profit before tax		**78.4**	100.0
Adjustments for non-cash items:			
Depreciation and amortisation		**1.6**	1.2
Interest on subordinated liabilities		**0.3**	0.6
Interest on Perpetual Subordinated Bonds		**0.4**	0.4
Impairment charge on loans		**1.4**	4.9
FSCS and other provisions		**0.4**	0.9
Fair value losses on financial instruments		**5.6**	1.7
Share-based payments		**0.9**	0.4
Exceptional items		**-**	(34.7)
Changes in operating assets and liabilities			
Increase in loans and advances to credit institutions		**(7.9)**	(3.8)
Increase in loans to customers		**(608.8)**	(500.2)
Increase in retail deposits		**94.6**	447.3
Decrease/(increase) in other assets		**3.8**	(1.2)
Decrease in derivatives and hedged items		**5.5**	0.7
Increase/(decrease) in bank and other deposits		**13.9**	(5.2)
(Decrease)/increase in other liabilities		**(7.1)**	9.7
Exchange differences on working capital		**(0.1)**	0.4
Cash (used in)/generated from operating activities		**(417.1)**	23.1
Interest paid on bonds and subordinated debt		**(0.7)**	(0.5)
Tax paid		**(21.5)**	(15.3)
Net cash (used in)/generated from operating activities		**(439.3)**	7.3

Notes to the Condensed Consolidated Financial Statements

	Note	Six months ended 30-Jun-17 (Unaudited) £m	Restated Six months ended 30-Jun-16 (Unaudited) £m
Cash flows from investing activities			
Maturity and sales of investment securities		**40.0**	361.3
Purchases of investment securities		**-**	(243.2)
Purchases of equipment and intangible assets		**(9.2)**	(5.3)
Proceeds from disposal of a subsidiary[1]		**-**	80.2
Cash generated from investing activities		**30.8**	193.0
Cash flows from financing activities			
Increase in amounts owed to credit institutions		**450.0**	-
Coupon paid on equity bonds		**(0.5)**	(0.7)
Dividends paid		**(18.5)**	(16.3)
Additional Tier 1 securities issuance net of costs		**59.2**	-
Repayment of debt[2]		**(10.7)**	(16.7)
Cash generated from/(used in) financing activities		**479.5**	(33.7)
Net increase in cash and cash equivalents		**71.0**	166.6
Cash and cash equivalents at the beginning of the period	10	**485.3**	370.5
Cash and cash equivalents at the end of the period	10	**556.3**	537.1
Movement in cash and cash equivalents		**71.0**	166.6

[1] Proceeds from a disposal of a subsidiary relate to the Group's disposal of its entire economic interest in Rochester Financing No. 1 plc during 2016.
[2] Repayment of debt comprises the 2017 LIBOR linked floating rate subordinated liabilities of £5.7m and the 2017 average standard mortgage rate linked floating subordinated liabilities of £5.0m.

The 2016 comparatives have been restated to include investment securities with maturity less than three months and to exclude encumbered loans and advances to credit institutions within cash and cash equivalents.

The accompanying notes form an integral part of these condensed financial statements.

Notes to the Condensed Consolidated Financial Statements

1. Accounting policies

The principal accounting policies applied in the preparation of the accounts for the Group are set out below.

a) Basis of preparation

These Interim Group Financial Statements have been prepared in accordance with the Disclosure Guidance and Transparency Rules ('DTR') of the FCA and in accordance with International Accounting Standard 34 Interim Financial Reporting as adopted by the EU.

The accounting policies, presentation and methods of computation are consistent with those applied by the Group in its latest audited financial statements, which were prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted by the EU and interpretations issued by the International Financial Reporting Interpretations Committee. They do not include all the information required for a complete set of IFRS financial statements. However, selected explanatory notes are included to explain events and transactions that are significant to an understanding of the changes in the Group's financial position and performance since the last Interim Report as at 30 June 2016 and last Annual Report and Accounts for the year ended 31 December 2016.

The comparative figures for the year ended 31 December 2016 are not the Group's statutory accounts for that financial year. The statutory accounts for the year ended 31 December 2016 have been delivered to the Registrar of Companies in England and Wales in accordance with section 447 of the Companies Act 2006. The Auditor has reported on those accounts. Its report was unqualified, did not include a reference to any matters to which the Auditor drew attention by way of emphasis without qualifying their report, and did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

These interim financial statements were authorised for issue by the Company's Board of Directors on 23 August 2017.

b) Accounting standards

The accounting policies used are consistent with those set out on pages 104 to 113 of the 2016 Annual Report and Accounts.

Additional Tier 1 Securities
The new Additional Tier 1 Securities ('AT1 securities') have been recognised as equity as OSB has full discretion over the payment of interest. Accordingly, the interest paid on the AT1 securities and the related tax effect will be recognised directly within retained earnings when paid. Costs directly associated with the AT1 securities issuance and the related tax effect have been taken directly to retained earnings.

c) Going concern

The Board undertakes regular rigorous assessments of whether the Group is a going concern in the light of current economic conditions and all available information about future risks and uncertainties.

Projections for the Group have been prepared, covering its future performance, capital and liquidity for a period in excess of 12 months from the date of approval of these financial statements including stress scenarios. These projections show that the Group has sufficient capital and liquidity to continue to meet its regulatory capital requirements as set out by the PRA.

1. Accounting policies (continued)

The Board has therefore concluded that the Group has sufficient resources to continue in operational existence for a period in excess of 12 months and as a result it is appropriate to prepare these Interim Group Financial Statements on a going concern basis.

d) Segmental reporting

The Group segments its lending by product, focusing on the customer need and reason for a loan. From 1 January 2017, the Group operates under two segments: BTL/SME and Residential mortgages.

The personal loan portfolio has largely completed its run-off and is therefore no longer considered as a separate segment by the Group. The remaining net loan book of £2.3m (31 December 2016: £9.1m) and negative contribution to profit for the period of £0.7m (first half of 2016: contribution to profit of £1.5m) have been reported in the BTL/SME segment with comparatives restated accordingly.

The comparatives have been restated in note 2 – Interest receivable and similar income, note 11 – Loans and advances to customers, note 12 – Provisions for impairment losses on loans and advances, note 16 – Risk management and financial instruments and note 18 – Operating segments.

e) Judgements and estimates

The preparation of the Interim Report requires management to make estimates and assumptions that affect the reported income and expense, assets and liabilities and disclosure of contingencies at the date of the Interim Report. Although these estimates and assumptions are based on management's best judgement at that date, actual results may differ from these estimates. There have been no significant changes in the basis upon which estimates have been determined compared to that applied at 31 December 2016, as described on pages 110 to 112 of the 2016 Annual Report and Accounts. Estimates and assumptions are reviewed on an ongoing basis. Revisions to estimates are recognised in the period in which the estimate is revised and in any future periods affected.

f) IFRS 9 programme

The Group has made good progress in its IFRS 9 programme, described on pages 112 and 113 of the 2016 Annual Report and Accounts and has been parallel running since the start of 2017. Business as usual ('BAU') processes are being implemented with a complete end-to-end control framework substantially completed in the second quarter of this year that will be finalised in the third quarter.

The Group has satisfactorily completed its classification and measurement review of financial assets and liabilities with no material impacts expected to its classification of financial assets and liabilities. The Group has also satisfactorily completed its assessments of solely payment of principal & interest compliance that reviews the cash flow characteristics of financial assets to ensure they can continue to be classified within an amortised cost model under IFRS 9. These are still subject to external audit.

The IFRS 9 models have been developed, subject to audit, with their performance being monitored as part of the parallel run process since January this year. Whilst the macroeconomic variables the Group will use in its modelling and the scenarios have been finalised, the Group has engaged an external provider of industry standard macroeconomic information to further enhance the quality of macroeconomic data and scenarios that will be used in existing models over the next quarter. The IFRS 9 models have been developed to a high standard in conjunction with the Group's first generation IRB models. Both IFRS 9 and IRB models have satisfactorily undergone an external independent review process that was finalised in the second quarter of 2017.

Notes to the Condensed Consolidated Financial Statements (continued)

1. Accounting policies (continued)

The adoption of IFRS 9 is likely to increase the Group's loan loss provision balance and expense, although the financial impact will be spread over the year of adoption and restated opening reserves. Aside from a minor personal loans portfolio that accounts for less than 0.1% of the Group's total assets, the Group only provides secured loans. The IFRS 9 regulatory capital impact cannot be fully assessed until a final determination is made on the transitional arrangements from IAS 39 to IFRS 9. However based on information available to date, we do not expect there will be a material impact.

IFRS 9 is expected to have a significant impact on operations, particularly in the risk and finance functions of the Group. The appropriate governance framework is near completion in terms of the necessary oversight for reviewing expected credit losses and models, with the establishment of a BAU model review committee to assess ongoing model monitoring, model developments, and assessment of judgements made. Ongoing model monitoring, recalibrations and parallel running is being undertaken by the current BAU teams who will also be part of the BAU teams once IFRS 9 is live. External consultants have been engaged to develop additional IFRS 9 and IRB loss forecasting and stress testing models that will be required for the Group's ICAAP in 2018. The external consultants will also provide a layer of external review over model enhancements and recalibrations performed in-house in the third quarter this year.

Hedge accounting will become more closely aligned with risk management practices under IFRS 9. The Group has elected to continue with IAS 39 hedging that is an option under IFRS 9 until a separate IASB project to address macro hedge accounting strategies is finalised and can be assessed. Whilst at this stage the Group expects to continue with IAS 39 hedge accounting, it will implement the revised hedge accounting disclosures required by the related amendments to IFRS 7 Financial Instruments: Disclosures.

The Group continues to make solid progress in its IFRS 9 implementation programme and is well-placed to implement the requirements for 2018.

2. Interest receivable and similar income

	Six months ended 30-Jun-17 (Unaudited) £m	Restated Six months ended 30-Jun-16 (Unaudited) £m
At amortised cost:		
On BTL/SME mortgages	**116.4**	97.2
On Residential mortgages	**45.7**	59.4
On investment securities	**-**	0.6
On other liquid assets	**0.6**	1.0
At fair value through profit or loss:		
Net expense on derivative financial instruments	**(4.2)**	(4.8)
	158.5	153.4

Notes to the Condensed Consolidated Financial Statements (continued)

3. Interest payable and similar charges

	Six months ended 30-Jun-17 (Unaudited) £m	Six months ended 30-Jun-16 (Unaudited) £m
On retail deposits	**41.4**	53.1
On Perpetual Subordinated Bonds	**0.4**	0.4
On subordinated liabilities	**0.3**	0.6
On wholesale borrowings	**1.1**	2.3
Net income on derivative financial instruments	**(1.8)**	(2.1)
	41.4	54.3

4. Fair value losses on financial instruments

	Six months ended 30-Jun-17 (Unaudited) £m	Six months ended 30-Jun-16 (Unaudited) £m
Fair value changes in hedged assets	**(5.9)**	10.7
Hedging of assets	**6.5**	(10.6)
Fair value changes in hedged liabilities	**1.2**	(3.7)
Hedging of liabilities	**(1.1)**	3.6
Ineffective portion of hedges	**0.7**	-
Amortisation of fair value adjustments on hedged assets	**(6.2)**	(1.6)
Net gains on unmatched swaps	**-**	0.1
Debit and credit valuation adjustment	**(0.1)**	(0.2)
	(5.6)	(1.7)

Amortisation of fair value adjustments on hedged assets relates to hedged assets and liabilities where the hedges were terminated before maturity and were effective at the point of termination. The Group commenced accelerating the amortisation in line with the roll-off of the underlying legacy long-dated fixed rate mortgages in the second half of 2016.

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

5. Administrative expenses

	Six months ended 30-Jun-17 (Unaudited) £m	Six months ended 30-Jun-16 (Unaudited) £m
Staff costs[1]	**17.2**	13.0
Facilities costs	**1.2**	1.2
Marketing costs	**1.2**	1.4
Support costs	**3.1**	3.3
Professional fees	**2.5**	3.1
Other costs[2]	**3.8**	2.2
	29.0	24.2

[1] Staff costs include £0.1m (2016: £0.1m) relating to the IPO share awards and £0.9m (2016: £0.3m) of share-based executive management compensation.
[2] Other costs mainly consist of irrecoverable VAT expense.

The average number of persons employed by the Group (including executive Directors) during the period was 775 (first half of 2016: 618).

6. Exceptional items

There were no exceptional items in the six month period to 30 June 2017.

Exceptional items in the six month period to 30 June 2016 consisted of the gain on disposal of the Group's entire economic interest in Rochester 1. The sale resulted in derecognition of securitised mortgage assets from the Group's balance sheet and the deconsolidation of Rochester 1. This removed a total of £239.8m of securitised mortgage assets and cash reserves in the vehicle and £171.6m of debt securities in issue from the Group's balance sheet.

Exceptional items are summarised in the table below:

	Six months ended 30-Jun-17 (Unaudited) £m	Six months ended 30-Jun-16 (Unaudited) £m
Gain on Rochester 1 disposal	**-**	34.7
	-	34.7

Notes to the Condensed Consolidated Financial Statements (continued)

7. Taxation

	Six months ended 30-Jun-17 (Unaudited) £m	Six months ended 30-Jun-16 (Unaudited) £m
Corporation tax	**(19.4)**	(25.9)
Total current taxation	**(19.4)**	(25.9)
Deferred taxation	**-**	-
Total taxation	**(19.4)**	(25.9)

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

	Six months ended 30-Jun-17 (Unaudited) £m	Six months ended 30-Jun-16 (Unaudited) £m
Profit before taxation	**78.4**	100.0
Profit multiplied by the weighted average rate of corporation tax in the UK during 2017 of 19.25% (2016: 20.00%)	**(15.1)**	(20.0)
Bank surcharge[1]	**(3.8)**	(5.9)
Taxation effects of:		
Adjustments in respect of earlier years	**(0.5)**	-
Tax adjustments in respect of share-based payments	**0.2**	-
Impact of tax losses carried forward	**0.1**	-
Timing differences on capital items	**(0.4)**	
Other	**0.1**	-
Total taxation charge	**(19.4)**	(25.9)

[1] Introduced from 1 January 2016 and charged at 8% on all taxable profits above £25.0m in the parent company which is a retail deposit taker.

A reduction in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) was substantively enacted on 26 October 2015. A further reduction to 18% (effective from 1 April 2020) was substantively enacted on 26 October 2015, and an additional reduction to 17% (effective 1 April 2020) was substantively enacted on 6 September 2016. This will reduce the Group’s future tax charge accordingly.

8. Dividends

During the period, the Group paid the following dividends:

	Six months ended 30-Jun-17 (Unaudited)		Six months ended 30-Jun-16 (Unaudited)	
	£m	**Pence per share**	**£m**	**Pence per share**
Final dividend for the prior year	**18.5**	**7.6**	16.3	6.7
	18.5		16.3	

The Directors propose an interim dividend for the first half of 2017 of 3.5 pence per share, based on one third of the total 2016 dividend of 10.5 pence per share, payable on 3 November 2017 with an ex-dividend date of 12 October 2017 and a record date of 13 October 2017. This dividend is not reflected in these financial statements as it was declared after the reporting date.

9. Earnings per share

Earnings per share ('EPS') are based on the profit for the period and the number of ordinary shares in issue. Basic EPS are calculated by dividing profit attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the period. Diluted earnings per share take into account share options, awards and preference shares which can be converted to ordinary shares.

For the purpose of calculating earnings per share, profit attributable to ordinary shareholders is arrived at by adjusting profit for the period for the after-tax amount of the coupon on Perpetual Subordinated Bonds classified as equity:

	Six months ended 30-Jun-17 (Unaudited) £m	Six months ended 30-Jun-16 (Unaudited) £m
Profit for the period	**59.0**	74.1
Adjustments:		
Coupon on Perpetual Subordinated Bonds classified as equity	**(0.5)**	(0.7)
Tax on coupon	**0.1**	0.1
Profit attributable to ordinary shareholders	**58.6**	73.5

Notes to the Condensed Consolidated Financial Statements (continued)

9. Earnings per share (continued)

Earnings per share are summarised in the table below:

	Six months ended 30-Jun-17 (Unaudited)	Six months ended 30-Jun-16 (Unaudited)
Weighted average number of shares, millions		
Basic	**243.1**	243.1
Diluted	**245.1**	243.9
Earnings per share, pence per share		
Basic	**24.1**	30.2
Diluted	**23.9**	30.1

10. Cash and cash equivalents

	As at 30-Jun-17 (Unaudited) £m	As at 31-Dec-16 (Audited) £m	As at 30-Jun-16 (Unaudited) £m	As at 31- Dec-15 (Audited) £m
Cash in hand	**0.4**	0.4	0.4	0.4
Unencumbered loans and advances to credit institutions	**555.9**	402.3	435.8	345.1
Investment securities with maturity less than 3 months	**-**	82.6	100.9	25.0
	556.3	485.3	537.1	370.5

Unencumbered loans and advances to credit institutions includes £514.4m (30 June 2016: £417.7m) placed with the Bank of England and excludes £23.4m (30 June 2016: £13.4m) of encumbered assets.

Notes to the Condensed Consolidated Financial Statements (continued)

11. Loans and advances to customers

	As at 30-Jun-17 (Unaudited) £m	Restated As at 31-Dec-16 (Audited) £m
BTL/SME mortgages	**4,801.5**	4,104.3
Residential mortgages	**1,767.7**	1,859.9
	6,569.2	5,964.2
Less: Provisions for impairment losses on loans and advances (see note 12)	**(22.6)**	(25.0)
	6,546.6	5,939.2

12. Provisions for impairment losses on loans and advances

2017 Specific	**BTL/SME £m**	**Residential mortgages £m**	**Total £m**
At 1 January 2017	**16.8**	**6.6**	**23.4**
Write-offs in period	**(3.1)**	**(0.7)**	**(3.8)**
Charge/(credit) for the period net of recoveries	**1.7**	**(0.1)**	**1.6**
At 30 June 2017 (Unaudited)	**15.4**	**5.8**	**21.2**

Collective	**BTL/SME £m**	**Residential mortgages £m**	**Total £m**
At 1 January 2017	**0.4**	**1.2**	**1.6**
Write-offs in period	**-**	**-**	**-**
Charge/(credit) for the period net of recoveries	**(0.2)**	**-**	**(0.2)**
At 30 June 2017 (Unaudited)	**0.2**	**1.2**	**1.4**

Total	**BTL/SME £m**	**Residential mortgages £m**	**Total £m**
At 1 January 2017	**17.2**	**7.8**	**25.0**
Write-offs in period	**(3.1)**	**(0.7)**	**(3.8)**
Charge/(credit) for the period net of recoveries	**1.5**	**(0.1)**	**1.4**
At 30 June 2017 (Unaudited)	**15.6**	**7.0**	**22.6**

Notes to the Condensed Consolidated Financial Statements (continued)

12. Provisions for impairment losses on loans and advances (continued)

2016 (Restated)

Specific	**BTL/SME £m**	**Residential mortgages £m**	**Total £m**
At 1 January 2016	17.3	0.9	18.2
Write-offs in period	(2.9)	(1.6)	(4.5)
Transfer between reserves	0.4	4.8	5.2
Charge for the period net of recoveries	2.0	2.5	4.5
At 31 December 2016 (Audited)	16.8	6.6	23.4

Collective	**BTL/SME £m**	**Residential mortgages £m**	**Total £m**
At 1 January 2016	7.8	1.3	9.1
Write-offs in period	(1.2)	-	(1.2)
Disposals	(5.6)	-	(5.6)
Transfer between reserves	(0.4)	(4.8)	(5.2)
Charge/(credit) for the period net of recoveries	(0.2)	4.7	4.5
At 31 December 2016 (Audited)	0.4	1.2	1.6

Total	**BTL/SME £m**	**Residential mortgages £m**	**Total £m**
At 1 January 2016	25.1	2.2	27.3
Write-offs in period	(4.1)	(1.6)	(5.7)
Disposals	(5.6)	-	(5.6)
Charge/(credit) for the period net of recoveries	1.8	7.2	9.0
At 31 December 2016 (Audited)	17.2	7.8	25.0

13. Impairment losses

	Six months ended 30-Jun-17 (Unaudited) £m	**Six months ended 30-Jun-16 (Unaudited) £m**
Write-offs in the period	**3.8**	1.5
(Decrease)/increase in provision	**(2.4)**	3.4
	1.4	4.9

14. Fair value hedges

	As at 30-Jun-17 (Unaudited) £m	As at 31-Dec-16 (Audited) £m
Hedged assets		
Current hedge relationships	**17.7**	23.6
Cancelled hedge relationships	**17.1**	23.3
	34.8	46.9
Hedged liabilities		
Current hedge relationships	**(0.7)**	(1.9)

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

15. Other reserves

On 25 May 2017 OSB issued £60m of Fixed Rate Resetting Perpetual Subordinated Contingent Convertible Securities (‘AT1 securities’) that qualify as Additional Tier 1 capital under CRD IV. The securities will be subject to full conversion into ordinary shares of OSB in the event that its CET1 capital ratio falls below 7%. The AT1 securities will pay interest at a rate of 9.125% per annum until the first reset date of 25 May 2022, with the reset interest rate equal to 835.9 basis points over the five-year semi-annual mid-swap rate for such a period. Interest is paid semi-annually on 25 May and 25 November. OSB may at any time cancel any interest payment at its full discretion and must cancel interest payments in certain circumstances specified in the terms and conditions of the AT1 securities. The AT1 securities are perpetual with no fixed redemption date. OSB may, in its discretion and subject to satisfying certain conditions, redeem all (but not some) of the AT1 securities at the principal amount outstanding plus any accrued but unpaid interest from the first reset date and on any interest payment date thereafter.

Notes to the Condensed Consolidated Financial Statements (continued)

16. Risk management and financial instruments

The tables below are a summary of the Group's risk management and financial instruments disclosures, of which a complete disclosure for the year ended 31 December 2016 is included in the Group's 2016 Annual Report and Accounts. The tables do not represent all risks the Group is exposed to and should be read in conjunction with the Risk Management Report above.

Credit risk

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

	As at 30-Jun-17		Restated As at 31-Dec-16	
	£m	%	£m	%
BTL/SME mortgages	**4,801.5**	**73**	4,104.3	69
Residential mortgages	**1,767.7**	**27**	1,859.9	31
Total loans before provisions	**6,569.2**	**100**	5,964.2	100

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

LTV analysis by band for all loans:

	As at 30-Jun-17			
	BTL/SME	Residential	Total	
	£m	£m	£m	%
Band:				
0% - 50%	**738.2**	**871.3**	**1,609.5**	**24**
50% - 60%	**962.5**	**294.5**	**1,257.0**	**19**
60% - 70%	**1,488.0**	**260.5**	**1,748.5**	**27**
70% - 80%	**1,357.7**	**188.5**	**1,546.2**	**24**
80% - 90%	**203.4**	**118.4**	**321.8**	**5**
90% - 100%	**9.5**	**21.8**	**31.3**	**-**
>100%	**39.6**	**12.7**	**52.3**	**1**
Total mortgages before provisions	**4,798.9**	**1,767.7**	**6,566.6**	**100**
Personal loans	**2.6**	**-**	**2.6**	**-**
Total loans before provisions	**4,801.5**	**1,767.7**	**6,569.2**	**100**

Notes to the Condensed Consolidated Financial Statements (continued)

16. Risk management and financial instruments (continued)

	As at 31-Dec-16			
	BTL/SME	Residential	Total	
	£m	£m	£m	%
Band:				
0% - 50%	755.9	761.7	1,517.6	25
50% - 60%	859.6	278.7	1,138.3	19
60% - 70%	1,202.4	282.7	1,485.1	25
70% - 80%	1,041.2	257.1	1,298.3	22
80% - 90%	194.8	196.9	391.7	7
90% - 100%	5.0	48.0	53.0	1
>100%	36.0	34.8	70.8	1
Total mortgages before provisions	4,094.9	1,859.9	5,954.8	100
Personal loans	9.4	-	9.4	-
Total loans before provisions	4,104.3	1,859.9	5,964.2	100

LTV analysis by band for BTL/SME:

	As at 30-Jun-17				
	Buy-to-Let	Commercial	Residential development	Funding lines	Total
	£m	£m	£m	£m	£m
Band:					
0% - 50%	**603.5**	**47.1**	**83.5**	**4.1**	**738.2**
50% - 60%	**856.4**	**67.3**	**34.1**	**4.7**	**962.5**
60% - 70%	**1,309.2**	**95.7**	**29.8**	**53.3**	**1,488.0**
70% - 80%	**1,269.6**	**68.4**	**3.9**	**15.8**	**1,357.7**
80% - 90%	**201.2**	**2.2**	**-**	**-**	**203.4**
90% - 100%	**6.8**	**2.7**	**-**	**-**	**9.5**
>100%	**20.1**	**19.5**	**-**	**-**	**39.6**
Total mortgages before provisions	**4,266.8**	**302.9**	**151.3**	**77.9**	**4,798.9**
Personal loans					**2.6**
Total loans before provisions					**4,801.5**

Notes to the Condensed Consolidated Financial Statements (continued)

16. Risk management and financial instruments (continued)

	As at 31-Dec-16				
	Buy-to-Let	Commercial	Residential development	Funding lines	Total
	£m	£m	£m	£m	£m
Band:					
0% - 50%	534.1	85.2	104.7	31.9	755.9
50% - 60%	750.4	67.1	23.5	18.6	859.6
60% - 70%	1,096.8	71.0	13.4	21.2	1,202.4
70% - 80%	1,006.2	35.0	-	-	1,041.2
80% - 90%	193.0	1.8	-	-	194.8
90% - 100%	5.0	-	-	-	5.0
>100%	27.8	8.2	-	-	36.0
Total mortgages before provisions	3,613.3	268.3	141.6	71.7	4,094.9
Personal loans					9.4
Total loans before provisions					4,104.3

LTV analysis by band for Residential:

	As at 30-Jun-17			
	First charge	Second charge	Funding lines	Total
	£m	£m	£m	£m
Band:				
0% - 50%	**680.1**	**180.4**	**10.8**	**871.3**
50% - 60%	**189.6**	**104.0**	**0.9**	**294.5**
60% - 70%	**169.4**	**89.0**	**2.1**	**260.5**
70% - 80%	**132.9**	**54.3**	**1.3**	**188.5**
80% - 90%	**101.2**	**17.2**	**-**	**118.4**
90% - 100%	**16.2**	**5.4**	**0.2**	**21.8**
>100%	**7.7**	**5.0**	**-**	**12.7**
Total mortgages before provisions	**1,297.1**	**455.3**	**15.3**	**1,767.7**

16. Risk management and financial instruments (continued)

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

16. Risk management and financial instruments (continued)

Analysis of mortgage portfolio by arrears and collateral held

The tables below provide further information on collateral in the mortgage portfolio by payment due status. Capped collateral only recognises collateral to the value of each individual mortgage and does not recognise over-collateralisation.

Below is a summary of capped collateral:

	As at 30-Jun-17		As at 31-Dec-16	
	Loan balance £m	Capped collateral £m	Loan balance £m	Capped collateral £m
Not past due and not impaired	**6,070.4**	**6,058.7**	5,478.4	5,464.5
Past due but not impaired	**417.8**	**417.1**	395.9	395.8
Impaired	**78.4**	**69.9**	80.5	69.1
Total mortgages before provisions	**6,566.6**	**6,545.7**	5,954.8	5,929.4
Personal loans	**2.6**		9.4	
Total loans before provisions	**6,569.2**		5,964.2	

A breakdown of the table above by payment due status is as follows:

	As at 30-Jun-17		As at 31-Dec-16	
	Loan balance £m	Capped collateral £m	Loan balance £m	Capped collateral £m
Not impaired:				
Not past due	**6,070.4**	**6,058.7**	5,478.4	5,464.5
Past due < 1 month	**271.3**	**271.2**	183.5	183.5
Past due 1 to 3 months	**87.2**	**87.2**	168.2	168.2
Past due 3 to 6 months	**35.5**	**35.5**	24.4	24.3
Past due 6 to 12 months	**15.8**	**15.2**	12.8	12.8
Past due over 12 months	**7.2**	**7.2**	6.2	6.2
Possessions	**0.8**	**0.8**	0.8	0.8
	6,488.2	**6,475.8**	5,874.3	5,860.3
Impaired:				
Not past due	**11.2**	**6.6**	3.2	0.4
Past due < 1 month	**3.6**	**3.4**	1.0	1.0
Past due 1 to 3 months	**0.2**	**0.2**	1.2	1.2
Past due 3 to 6 months	**15.8**	**15.8**	14.8	14.8
Past due 6 to 12 months	**12.4**	**12.2**	16.3	16.2
Past due over 12 months	**24.8**	**22.2**	31.8	24.9
Possessions	**10.4**	**9.5**	12.2	10.6
	78.4	**69.9**	80.5	69.1
Total mortgages before provisions	**6,566.6**	**6,545.7**	5,954.8	5,929.4
Personal loans	**2.6**		9.4	
Total loans before provisions	**6,569.2**		5,964.2	

Notes to the Condensed Consolidated Financial Statements (continued)

16. Risk management and financial instruments (continued)

Analysis of mortgage portfolio by arrears for BTL/SME

	As at 30-Jun-17				
	Buy-to-Let	**Commercial**	**Residential development**	**Funding lines**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**
Not impaired:					
Not past due	**4,068.9**	**291.0**	**151.3**	**77.9**	**4,589.1**
Past due < 1 month	**136.8**	**2.2**	**-**	**-**	**139.0**
Past due 1 to 3 months	**20.7**	**0.9**	**-**	**-**	**21.6**
Past due 3 to 6 months	**14.3**	**-**	**-**	**-**	**14.3**
Past due 6 to 12 months	**1.2**	**0.7**	**-**	**-**	**1.9**
Past due over 12 months	**-**	**0.4**	**-**	**-**	**0.4**
	4,241.9	**295.2**	**151.3**	**77.9**	**4,766.3**
Impaired:					
Not past due	**1.4**	**4.5**	**-**	**-**	**5.9**
Past due < 1 month	**2.7**	**0.1**	**-**	**-**	**2.8**
Past due 1 to 3 months	**-**	**0.1**	**-**	**-**	**0.1**
Past due 3 to 6 months	**3.4**	**1.0**	**-**	**-**	**4.4**
Past due 6 to 12 months	**0.7**	**0.1**	**-**	**-**	**0.8**
Past due over 12 months	**8.5**	**1.2**	**-**	**-**	**9.7**
Possessions	**8.2**	**0.7**	**-**	**-**	**8.9**
	24.9	**7.7**	**-**	**-**	**32.6**
Total mortgages before provisions	**4,266.8**	**302.9**	**151.3**	**77.9**	**4,798.9**
Personal loans					**2.6**
Total loans before provisions					**4,801.5**

Notes to the Condensed Consolidated Financial Statements (continued)

16. Risk management and financial instruments (continued)

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
Personal loans					9.4
Total loans before provisions					4,104.3

Notes to the Condensed Consolidated Financial Statements (continued)

16. Risk management and financial instruments (continued)

Analysis of mortgage portfolio by arrears for Residential

	As at 30-Jun-17			
	First charge	Second charge	Funding lines	Total
	£m	£m	£m	£m
Not impaired:				
Not past due	1,102.2	363.8	15.3	1,481.3
Past due < 1 month	105.4	26.9	-	132.3
Past due 1 to 3 months	44.4	21.2	-	65.6
Past due 3 to 6 months	11.7	9.5	-	21.2
Past due 6 to 12 months	6.8	7.1	-	13.9
Past due over 12 months	2.9	3.9	-	6.8
Possessions	0.8	-	-	0.8
	1,274.2	432.4	15.3	1,721.9
Impaired:				
Not past due	5.3	-	-	5.3
Past due < 1 month	0.8	-	-	0.8
Past due 1 to 3 months	-	0.1	-	0.1
Past due 3 to 6 months	5.4	6.0	-	11.4
Past due 6 to 12 months	5.1	6.5	-	11.6
Past due over 12 months	4.8	10.3	-	15.1
Possessions	1.5	-	-	1.5
	22.9	22.9	-	45.8
Total mortgages before provisions	1,297.1	455.3	15.3	1,767.7

Notes to the Condensed Consolidated Financial Statements (continued)

16. Risk management and financial instruments (continued)

	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

Notes to the Condensed Consolidated Financial Statements (continued)

16. Risk management and financial instruments (continued)

Geographical analysis by region

An analysis of loans by region is provided below:

Region	As at 30-Jun-2017 £m	%	As at 31-Dec-2016 £m	%
East Anglia	**215.1**	**3**	182.2	3
East Midlands	**224.0**	**3**	204.5	3
Greater London	**2,808.2**	**43**	2,543.1	43
Guernsey	**80.8**	**1**	93.4	2
Jersey	**258.6**	**4**	282.0	5
North East	**94.7**	**1**	90.3	2
North West	**305.0**	**5**	273.2	5
Northern Ireland	**17.5**	**-**	16.8	-
Scotland	**53.7**	**1**	56.1	1
South East	**1,403.9**	**22**	1,278.5	21
South West	**467.5**	**7**	380.6	6
Wales	**128.1**	**2**	114.7	2
West Midlands	**359.9**	**6**	308.6	5
Yorks & Humberside	**149.6**	**2**	130.8	2
Total mortgages before provisions	**6,566.6**	**100**	5,954.8	100
Personal loans	**2.6**		9.4	
Total loans before provisions	**6,569.2**		5,964.2	

16. Risk management and financial instruments (continued)

Fair values of financial assets and financial liabilities

The following tables show a comparison of book and fair values of the Group's financial assets and liabilities at the reporting date:

As at 30 June 2017 (Unaudited)	Carrying amount £m	Principal amount £m	Fair value Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial instruments measured at fair value						
Financial assets						
Investment securities	**19.1**	**19.0**	**19.1**	**-**	**-**	**19.1**
Derivative assets	**0.7**	**2,222.1**	**-**	**0.7**	**-**	**0.7**
	19.8	**2,241.1**	**19.1**	**0.7**	**-**	**19.8**
Financial liabilities						
Derivative liabilities	**(17.9)**	**(889.4)**	**-**	**(17.9)**	**-**	**(17.9)**
Financial instruments not measured at fair value						
Financial assets						
Cash in hand	**0.4**	**0.4**	**-**	**0.4**	**-**	**0.4**
Loans and advances to credit institutions	**579.3**	**579.3**	**-**	**579.3**	**-**	**579.3**
Loans and advances to customers	**6,546.6**	**6,675.3**	**-**	**-**	**6,888.9**	**6,888.9**
	7,126.3	**7,255.0**	**-**	**579.7**	**6,888.9**	**7,468.6**
Financial liabilities						
Amounts owed to retail depositors	**(6,047.0)**	**(6,028.0)**	**-**	**(6,079.1)**	**-**	**(6,079.1)**
Amounts owed to credit institutions	**(552.0)**	**(552.0)**	**-**	**(552.3)**	**-**	**(552.3)**
Amounts owed to other customers	**(17.6)**	**(17.5)**	**-**	**(17.6)**	**-**	**(17.6)**
Subordinated liabilities	**(10.7)**	**(10.7)**	**-**	**(10.9)**	**-**	**(10.9)**
Perpetual subordinated bonds	**(15.3)**	**(15.0)**	**-**	**(15.1)**	**-**	**(15.1)**
	(6,642.6)	**(6,623.2)**	**-**	**(6,675.0)**	**-**	**(6,675.0)**

16. Risk management and financial instruments (continued)

As at 31 December 2016 (Audited)	Carrying amount £m	Principal amount £m	Fair value Level 1 £m	Fair value Level 2 £m	Fair value Level 3 £m	Fair value Total £m
Financial instruments measured at fair value						
Financial assets						
Investment securities	141.7	141.6	141.7	-	-	141.7
Derivative assets	1.8	2,267.1	-	1.8	-	1.8
	143.5	2,408.7	141.7	1.8	-	143.5
Financial liabilities						
Derivative liabilities	(24.4)	(612.4)	-	(24.4)	-	(24.4)
Financial instruments not measured at fair value						
Financial assets						
Cash in hand	0.4	0.4	-	0.4	-	0.4
Loans and advances to credit institutions	417.8	417.8	-	417.8	-	417.8
Loans and advances to customers	5,939.2	6,069.4	-	-	6,259.1	6,259.1
	6,357.4	6,487.6	-	418.2	6,259.1	6,677.3
Financial liabilities						
Amounts owed to retail depositors	(5,952.4)	(5,906.5)	-	(5,992.4)	-	(5,992.4)
Amounts owed to credit institutions	(101.7)	(101.6)	-	(101.7)	-	(101.7)
Amounts owed to other customers	(4.0)	(4.0)	-	(4.0)	-	(4.0)
Subordinated liabilities	(21.6)	(20.7)	-	(24.0)	-	(24.0)
Perpetual subordinated bonds	(15.3)	(15.0)	-	(17.2)	-	(17.2)
	(6,095.0)	(6,047.8)	-	(6,139.3)	-	(6,139.3)

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

Level 1

These are valuation techniques that are based entirely on quoted market prices (unadjusted) in an actively traded market for identical assets and liabilities that the Group has the ability to access. Valuation adjustments and block discounts are not applied to Level 1 instruments. Since valuations are based on readily available observable market prices, this makes them most reliable, reduces the need for management judgement and estimation and also reduces the uncertainty associated with determining fair values.

16. Risk management and financial instruments (continued)

Level 2

These are valuation techniques based on one or more quoted prices in markets that are not active or for which all significant inputs are taken from directly or indirectly observable market data. These include valuation models used to calculate the present value of expected future cash flows and may be employed either when no active market exists or when there are quoted prices available for similar instruments in active markets.

The Group uses LIBOR curves to value its derivatives; however, using overnight index swap (‘OIS’) curves would not materially change their value. The fair value of the Group’s derivative financial instruments incorporates CVA and DVA. The DVA and CVA take into account the respective credit ratings of the Group and counterparty and whether the derivative is collateralised or not. In considering which similar instruments to use, management takes into account the sensitivity of the instrument to changes in market rates and the credit quality of the instrument. Basis risk derivatives are valued using discounted cash flow models and observable market data and will be sensitive to benchmark interest rate curves.

The fair value of loans and advances to credit institutions, which is predominantly placements with the Bank of England, is estimated to be their carrying value.

The fair value of amounts owed to retail depositors, credit institutions and other customers, together with the Group’s subordinated liabilities and perpetual subordinated bonds is estimated using discounted cash flow techniques, applying the rates that are offered for deposits of similar maturities and terms. The fair value of deposits payable on demand is the amount payable at the reporting date.

Level 3

These are valuation techniques for which any one or more significant input is not based on observable market data and the unobservable inputs have a significant effect on the instrument’s fair value. Valuation models that employ significant unobservable inputs require a higher degree of management judgement and estimation in determining the fair value. Management judgement and estimation are usually required for the selection of the appropriate valuation model to be used, determination of expected future cash flows on the financial instruments being valued, determination of the probability of counterparty default and prepayments, determination of expected volatilities and correlations and selection of appropriate discount rates.

Valuation techniques for level 3 instruments may include net present value models, comparison to similar instruments with observable prices, Black-Scholes and other methods.

As disclosed in the tables above, financial instruments with fair value measured at level 3 comprise loans and advances to customers which are measured at amortised cost in the statement of financial position.

Loans to customers belong to this level because their valuation uses unobservable inputs on collectability rates and redemption profiles. Their fair value is calculated using modelled receipts of interest and principal which are discounted at market rates.

Notes to the Condensed Consolidated Financial Statements (continued)

17. Capital management

The Group's individual regulated entities and the Group as a whole complied with all of the capital requirements which they were subject to for the periods presented.

The regulatory capital of the Group is presented below:

	As at 30-Jun-17 (Unaudited) £m	As at 31-Dec-16 (Audited) £m
Common equity tier 1 capital		
Called up share capital	**2.4**	2.4
Share premium, capital contribution and share-based payment reserve	**167.6**	166.0
Retained earnings[1]	**261.4**	217.0
Transfer reserve	**(12.8)**	(12.8)
Other reserves	**0.1**	-
Deductions from common equity tier 1 capital		
Intangible assets	**(5.6)**	(4.7)
Deferred tax asset	**(2.4)**	(2.3)
Common equity tier 1 capital	**410.7**	365.6
Additional tier 1 capital		
AT1 securities	**60.0**	-
Total Tier 1 capital	**470.7**	365.6
Tier 2 capital		
Subordinated debt and PSBs	**47.7**	48.5
Collective provisions	**1.4**	1.6
Deductions from tier 2 capital	**(2.5)**	(2.0)
Total Tier 2 capital	**46.6**	48.1
Total regulatory capital	**517.3**	413.7
Risk weighted assets (unaudited)	**2,990.9**	2,743.0

[1] Within retained earnings, foreseeable dividends in the period are deducted in-line with the Group's dividend policy.

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

Notes to the Condensed Consolidated Financial Statements (continued)

18. Operating segments

From 1 January 2017, the Group distinguishes two segments within its operations: BTL/SME mortgages and Residential mortgages, see note 1 d) for additional details.

The results of operations and the financial position of the above segments are summarised below:

	BTL/SME	Residential mortgages	Total
Balances as at 30-Jun-17 (Unaudited)	**£m**	**£m**	**£m**
Gross loans and advances to customers	**4,801.5**	**1,767.7**	**6,569.2**
Provision for impairment losses on loans and advances	**(15.6)**	**(7.0)**	**(22.6)**
Loans and advances to customers	**4,785.9**	**1,760.7**	**6,546.6**
Capital expenditure	**6.7**	**2.5**	**9.2**

Profit for six months ended 30-Jun-17 (Unaudited)	**BTL/SME £m**	**Residential mortgages £m**	**Total £m**
Net interest income	**83.4**	**33.7**	**117.1**
Other expense	**(1.4)**	**(4.9)**	**(6.3)**
Total income	**82.0**	**28.8**	**110.8**
Impairment (losses)/gains	**(1.5)**	**0.1**	**(1.4)**
Contribution to profit	**80.5**	**28.9**	**109.4**
Operating expenses			**(30.6)**
FSCS and other provisions			**(0.4)**
Profit before taxation			**78.4**
Taxation			**(19.4)**
Profit for the period			**59.0**

18. Operating segments (continued)

Balances as at 31-Dec-16 (Audited)	BTL/SME	Restated Residential mortgages	Total
	£m	£m	£m
Gross loans and advances to customers	4,104.3	1,859.9	5,964.2
Provision for impairment losses on loans and advances	(17.2)	(7.8)	(25.0)
Loans and advances to customers	4,087.1	1,852.1	5,939.2
Capital expenditure	5.3	2.4	7.7
Profit for the six months ended 30-Jun-16 (Unaudited)			
Net interest income	62.8	36.3	99.1
Other expense	(0.7)	(1.9)	(2.6)
Total income	62.1	34.4	96.5
Impairment losses	(0.7)	(4.2)	(4.9)
Contribution to profit	61.4	30.2	91.6
Operating expenses			(25.4)
FSCS and other provisions			(0.9)
Exceptional items			34.7
Profit before taxation			100.0
Taxation			(25.9)
Profit for the period			74.1

19. Related parties

The Group had no related party transactions during the period to 30 June 2017 that would materially affect the position or performance of the Group. Details of transactions for the year ended 31 December 2016 can be found in the 2016 Annual Report and Accounts.

Transactions with Key Management Personnel

During the period, the Group issued executive management awards under the Deferred Share Bonus Plan and Performance Share Plan as described in note 8 in the 2016 Annual Report and Accounts. The impact of these awards in the six months ended 30 June 2017 is reported within staff costs.

20. Events after the reporting date

There have been no material events after the reporting date.

OneSavings Bank plc

Interim report for the six months ended 30 June 2017

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