Notes to the Financial Statements

For the year ended 31 December 2017

1. Accounting policies

The principal accounting policies applied in the preparation of the financial statements for the Group and the Bank are set out below.

a) Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the European Union ('EU') and interpretations issued by the International Financial Reporting Interpretations Committee ('IFRIC').

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

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

b) Going concern

The Board undertakes regular rigorous assessments of whether the 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 requirements as set out by the Prudential Regulatory Authority ('PRA').

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

c) Basis of consolidation

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

In the Bank's financial statements investments in subsidiary undertakings are stated at cost less provision for any impairment.

d) Foreign currency translation

The consolidated financial statements are presented in Pounds Sterling which is the presentation currency of the Group. The financial statements of each of the Bank's subsidiaries are measured using the currency of the primary economic environment in which the subsidiary operates (the 'functional currency'). Foreign currency transactions are translated into the functional currencies using the exchange rates prevailing at the date of the transactions. Monetary items denominated in foreign currencies are retranslated at the rate prevailing at the period end.

Foreign exchange gains and losses resulting from the retranslation and settlement of these items are recognised in profit or loss. Non-monetary items measured at cost in the foreign currency are translated using the spot FX rate at the date of the transaction. Non-monetary items measured at fair value in the foreign currency are translated into the functional currency at the spot FX rate at the date of which the fair value is determined.

The assets and liabilities of foreign operations with functional currencies other than Pounds Sterling are translated into the presentation currency at the exchange rate on the reporting date. The income and expenses of foreign operations are translated at the rates on the dates of transactions. Exchange differences on foreign operations are recognised in other comprehensive income and accumulated in the foreign exchange reserve within equity.

e) Segmental reporting

IFRS 8 requires operating segments to be identified on the basis of internal reports and components of the Group which are regularly reviewed by the chief operating decision maker to allocate resources to segments and to assess their performance. For this purpose, the chief operating decision maker of the Group is the Board of Directors.

The Group lends within the UK and the Channel Islands.

The Group segments its lending by product, focusing on the customer need and reason for a loan. It operates under two segments: Buy-to-Let/SME ('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 and contribution to profit for the year have been reported in the BTL/SME segment with comparatives reclassified accordingly.

1. Accounting policies continued

e) Segmental reporting continued

The comparatives have been reclassified in the following notes:

- note 3 – Interest receivable and similar income
- note 17 – Loans and advances to customers
- note 18 – Provisions for impairment losses on loans and advances
- note 37 – Risk management
- note 41 – Operating segments.

f) Interest income and expense

Interest income and interest expense for all interest-bearing financial instruments measured at amortised cost are recognised in profit or loss using the effective interest rate ('EIR') method. The EIR is the rate which discounts the expected future cash flows, over the expected life of the financial instrument, to the net carrying value of the financial asset or liability.

When calculating the EIR, the Group estimates cash flows considering all contractual terms of the instrument and behavioural aspects (for example, prepayment options) but not considering future credit losses. The calculation of the EIR includes all transaction costs and fees paid or received that are an integral part of the interest rate, together with the discounts or premiums arising on the acquisition of loan portfolios. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial instrument.

The Group monitors the actual cash flows for each acquired book and where they diverge significantly from expectation, the future cash flows are reset (an AG8 adjustment). In assessing whether to adjust future cash flows on an acquired portfolio, the Group considers the cash variance on an absolute and percentage basis. The Group also considers the total variance across all acquired portfolios. Where cash flows for an acquired portfolio are reset, they are discounted at the EIR to derive a new carrying value, with changes taken to profit or loss as interest income. The EIR rate is adjusted for AG7 events where there is a change to the reference interest rate (LIBOR or Base Rate) affecting portfolios with a variable interest rate which will impact future cash flows. The revised EIR is the rate which exactly discounts the revised cash flows to the net carrying value of the loan portfolio.

Interest income on AFS investments is included in interest receivable and similar income. Interest on derivatives is included in interest receivable and similar income or interest expense and similar charges following the underlying instrument it is hedging.

Interest paid on equity Perpetual Subordinated Bonds ('PSBs') and AT1 securities is recognised directly in equity as paid.

g) Fees and commissions

Fees and commissions which are an integral part of the EIR of a financial instrument are recognised as an adjustment to the EIR and recorded in interest income. Other fees and commissions are recognised on the accruals basis as services are provided or on the performance of a significant act, net of VAT and similar taxes.

h) Taxation

Income tax comprises current and deferred tax. It is recognised in profit or loss, other comprehensive income or directly in equity, consistently with the recognition of items it relates to.

Current tax is the expected tax charge or credit on the taxable income or loss in the period and any adjustments in respect of previous years.

Deferred tax is the tax expected to be payable or recoverable in respect of temporary differences between the carrying amounts of assets or liabilities for accounting purposes and carrying amounts for tax purposes.

Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available to utilise the asset. The recognition of deferred tax is mainly dependent on the projections of future taxable profits and future reversals of temporary differences. The current Board's projections of future taxable income assume that the Group will utilise its deferred tax asset within the foreseeable future.

i) Dividends

Dividends are recognised in equity in the period in which they are paid or, if earlier, approved by shareholders.

j) Cash and cash equivalents

Cash and cash equivalents comprise cash, non-restricted balances with central banks and highly liquid financial assets with maturities of less than three months subject to an insignificant risk of changes in their fair value.

k) Intangible assets

Purchased software and costs directly associated with the development of computer software are capitalised as intangible assets where the software is a unique and identifiable asset controlled by the Group and will generate future economic benefits.

Costs to establish technological feasibility or to maintain existing levels of performance are recognised as an expense.

Software is amortised on a straight-line basis in profit or loss over its estimated useful life, which is generally five years. Intangible assets are reviewed for impairment on an annual basis.

Notes to the Financial Statements continued

For the year ended 31 December 2017

1. Accounting policies continued

l) Property, plant and equipment

Property, plant and equipment comprise freehold land and buildings, major alterations to office premises, computer equipment and fixtures measured at cost less accumulated depreciation. These assets are reviewed for impairment annually, and if they are considered to be impaired, are written down immediately to their recoverable amounts.

Gains and losses on disposals, calculated as the difference between the net disposal proceeds with the carrying amount of the asset, are included in profit or loss.

Items of property, plant and equipment are depreciated on a straight-line basis over their estimated useful economic lives as follows:

Buildings	50 years
Leasehold improvements	10 years
Equipment and fixtures	5 years

Land, deemed to be 25% of purchase price of buildings, is not depreciated.

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

m) Financial instruments

i. Recognition

The Group initially recognises loans and advances, deposits, debt securities issued and subordinated liabilities on the date on which they are originated. All other financial instruments are accounted for on the trade date which is when the Group becomes a party to the contractual provisions of the instrument.

The Group initially recognises financial assets and financial liabilities at fair value plus, for instruments not at FVTPL, transaction costs that are directly attributable to its acquisition or issue. Transaction costs relating to the acquisition or issue of a financial instrument at FVTPL are recognised in the profit or loss as incurred.

ii. Classification

The Group classifies its financial instruments in accordance with IAS 39 and IAS 32, with financial assets being classified into the following categories:

- Loans and receivables
- Available-for-sale
- At fair value through profit or loss

The Group classifies non-derivative financial liabilities as measured at amortised cost.

The Group has no financial assets nor liabilities classified as held for trading or held to maturity.

iii. Derecognition

Financial assets are derecognised when the contractual rights to receive cash flows have expired and where substantially all the risks and rewards of ownership have been transferred. Where contractual cash flows are significantly modified (e.g. through the broker-led Choices programme) the original financial asset is derecognised with a new financial asset recognised for the modified cash flows.

Financial liabilities are derecognised only when the obligation is discharged, cancelled or has expired.

iv. Offsetting

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group currently has a legally enforceable right to offset the amounts and it intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously in accordance with the requirements of IAS 32.

The Group's derivatives are covered by industry standard master netting agreements. Master netting agreements create a right of set-off that becomes enforceable only following a specified event of default or in other circumstances not expected to arise in the normal course of business. These arrangements do not qualify for offsetting under IAS 32 and as such the Group reports derivatives on a gross basis.

Collateral in respect of derivatives is subject to the standard industry terms of International Swaps and Derivatives Association ('ISDA') Credit Support Annex. This means that the cash received or given as collateral can be pledged or used during the term of the transaction but must be returned on maturity of the transaction. The terms also give each counterparty the right to terminate the related transactions upon the counterparty's failure to post collateral. Collateral paid or received does not qualify for offsetting under IAS 32, and is recognised in loans and advances to credit institutions and amounts owed to credit institutions respectively.

Income and expenses are presented on a net basis only when permitted under IFRS, or for gains and losses arising from a group of similar transactions.

v. Amortised cost measurement

The amortised cost of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition, plus or minus the cumulative amortisation using the EIR method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

vi. Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date.

When available, the Group measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. The Group measures the fair value of its investment securities and PSBs using quoted market prices.

If there is no quoted price in an active market, then the Group uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique is system generated and calculates fair value based on known cash flow dates and interest rates and expected future interest rates extrapolated from an input zero coupon 24 point yield curve.

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 credit valuation adjustments ('CVA') and debit valuation adjustments ('DVA'). The DVA and CVA take into account the respective credit ratings of the Bank and counterparty and whether the derivative is collateralised or not. In considering which similar instruments to use, management takes into account the sensitivity of the instrument to changes in market rates and the credit quality of the instrument. Interest rate derivatives are valued using discounted cash flow models and observable market data and will be sensitive to benchmark interest rate curves.

vii. Identification and measurement of impairment

The Group regularly assesses its financial assets valued at amortised cost for impairment. During the reporting period, the main category within the scope was loans and advances to customers.

The Group individually assesses for impairment loans over £0.5m which are more than three months in arrears, where LPA receivers are appointed, the property is taken in possession or there are any other events that suggest a high probability of credit loss. Loans are considered at a connection level, i.e. including all loans belonging to and connected to the customer.

The Group estimates cash flows from these loans, including expected interest and principal payments, rental or sale proceeds, selling and other costs. The Group obtains up-to-date independent valuations for properties put up for sale.

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

If the present value of estimated future cash flows discounted at the original EIR is less than the carrying value of the loan, a specific provision is recognised for the difference. Such loans are classified as impaired. If the present value of the estimated future cash flows exceeds the carrying value no specific provision is recognised.

All loans which have not been individually assessed are subsequently assessed for impairment collectively with each loan being assigned a one year probability of default ('PD') and a loss given default ('LGD') generally consistent with the requirements of the internal ratings based ('IRB') approach, leading to the expected loss ('EL'). The provision is the sum of all ELs. The calculation uses indexed valuations from ONS statistics applied at a postcode level. All provisions on loans greater than three months in arrears are treated as a specific provision as they are considered to be impaired. Loans less than three months in arrears are assigned a collective provision.

Different PDs are used for BTL/SME mortgages, Residential mortgages and unsecured loans. Interest-only mortgages, which are predominantly within the BTL/SME segment, are not differentiated further from capital repayment mortgages. As PDs are generated from historic portfolio performance using a mix of interest-only and repayment loans, they capture the impact of interest only mortgages as long as the mix remains similar.

The Group has been contacting owner-occupied residential customers with upcoming interest-only loan maturities and tracking responses and outcomes through specific campaigns since 2014. There is no provision for the non-repayment risk of these loans.

Notes to the Financial Statements continued

For the year ended 31 December 2017

1. Accounting policies continued

vii. Identification and measurement of impairment continued

Second charge mortgages are considered separately to first charge residential mortgages in that separate PDs are calculated and used in loss calculations based on previous experience of losses on second charge loans. The LGD calculation on second charge mortgages considers the fact that the holder of the first charge on collateral has first claim on the proceeds of a sale.

Incurred but not reported losses ('IBNR'), where a loss trigger has occurred but the borrower has not yet missed a payment, are captured through the Group's collective provisioning process. PD rates are calculated for loans that are not in arrears based on historic loss data and a provision value is calculated for these accounts. The calculation of PD rates incorporates assumptions for emergence periods ('EP'), cure rates and forbearance. The Group conducts detailed analysis to calculate the time taken for a customer to fall into arrears post a loss event occurring (i.e. loss of employment). This EP is then considered within a wider observation period utilised to model the time taken post loss event for the customer to reach a default state.

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

The Group classifies a loan as forborne at the point a concession is granted based on the deteriorated financial status of the borrower. Accounts are classified as forborne only for the period of time which the loan is known to be, or may still be, in financial difficulty. When the borrower is no longer experiencing financial difficulties the loan will revert to standard terms. If the forbearance eliminates the arrears, the loan is no longer considered past due.

None of the currently used forbearance measures modify the overall cash flows to an extent that requires derecognition of the existing and recognition of a new loan under IAS 39.

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

viii. Designation at fair value through the profit or loss account

The Group has not irrevocably designated any financial assets or financial liabilities at FVTPL during the current and previous year.

n) Loans and receivables

Loans and receivables are predominantly mortgage loans and advances to customers with fixed or determinable payments that are not quoted in an active market and that the Group does not intend to sell in the near term. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the EIR method, less impairment losses. Where exposures are hedged by derivatives, designated and qualifying as fair value hedges, the fair value adjustment for the hedged risk to the carrying value of the hedged loans and advances is reported in fair value adjustments for hedged assets.

Loans and advances over which the Group transfers its rights to the collateral thereon to the Bank of England under the Funding for Lending ('FLS') and Term Funding Scheme ('TFS') are not derecognised from the statement of financial position, as the Group retains substantially all the risks and rewards of ownership, including all cash flows arising from the loans and advances and exposure to credit risk. The Group accounts for TFS and FLS under IAS 39 Financial Instruments.

o) Investment securities

Investment securities comprise securities held for liquidity purposes (UK treasury bills and supranational bonds in the nature of investment securities). These assets are non-derivatives that are designated as AFS. These are held at fair value with movements being taken to other comprehensive income and accumulate in the AFS reserve within equity, except for impairment losses which are taken to profit or loss. When the instrument is sold, the gain or loss accumulated in equity is reclassified to profit or loss.

The treasury bills that the Group borrows against the transferred assets under the FLS are not recognised in the statement of financial position.

p) Deposits, debt securities issued and subordinated liabilities

Deposits, debt securities issued and subordinated liabilities are the Group's sources of debt funding. They comprise deposits from retail customers and credit institutions, including collateralised loan advances from the Bank of England under the TFS, issued debt securities and subordinated liabilities. Subordinated liabilities include the Sterling PSBs where the terms allow no discretion over the payment of interest. These financial liabilities are initially measured at fair value less direct transaction costs, and subsequently held at amortised cost using the EIR method.

Cash received under the TFS is recorded in deposits from credit institutions. Interest is accrued over the life of the agreements on an EIR basis.

The Group classifies certain financial instruments as equity where they meet the following conditions:

- the financial instrument includes no contractual obligation to deliver cash or another financial asset on potentially unfavourable conditions;

p) Deposits, debt securities issued and subordinated liabilities continued
- the financial instrument is a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
- the financial instrument is a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.

Equity financial instruments comprise own shares, equity PSBs and AT1 securities. Accordingly, the coupon paid on the equity PSBs and AT1 securities, and related tax effects, are recognised directly in retained earnings when paid. See note 35 for additional details.

q) Sale and repurchase agreements
Financial assets sold subject to repurchase agreements ('repo') are retained in the financial statements if they fail derecognition criteria of IAS 39 described in paragraph m(iii) above. The financial assets that are retained in the financial statements are reflected as loans or investment securities and the counterparty liability is included in amounts owed to depositors, credit institutions or other customers. Financial assets purchased under agreements to resell at a pre-determined price where the transaction is financing in nature ('reverse repo') are accounted for as loans and receivables. The difference between the sale and repurchase price is treated as interest and accrued over the lives of agreements using the EIR method.

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

Derivative financial instruments are recognised at their fair value with changes in their fair value taken to profit or loss. Fair values are calculated by discounting cash flows at the prevailing interest rates.

All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative. Derivatives covered by master netting agreements are settled and therefore recognised on a net basis.

In accordance with IAS 39, the Group adopts hedge accounting where the criteria specified in IAS 39 (EU endorsed) are met. A hedged item is defined as a recognised asset or liability which exposes the entity to risk of changes in fair value or future cash flows, and is designated as being hedged. The Group uses fair value hedge accounting for a portfolio hedge of interest rate risk (IAS39 – AG 114). Portfolio hedge accounting allows for hedge effectiveness testing and accounting over an entire portfolio of derivatives.

Where there is an effective hedge relationship for fair value hedges, the Group recognises the change in fair value of each hedged item in profit or loss with the cumulative movement in their value being shown separately in the statement of financial position as 'Fair value adjustments on hedged assets and liabilities'. The fair value changes of both the derivative and the hedge substantially offset each other to reduce profit volatility. To qualify for hedge accounting at inception, the hedge relationship is clearly documented and the derivative must be expected to be highly effective in offsetting the hedged risk. In addition, effectiveness must be tested throughout the life of the hedge relationship.

The Group has derivatives in place against the pipeline, with loans originating in subsequent months. The derivative is included within hedge accounting once loans have originated. Fair value movements prior to loans originating, when the derivative is against the pipeline, are recognised in full in the period in profit or loss. These are subsequently unwound over the remaining life of the derivative on a straight-line basis from the period the derivative is hedge accounted for against originated loans.

The Group discontinues hedge accounting when the derivative ceases through expiry, when the derivative is cancelled or the underlying hedged item matures, is sold or is repaid.

If a derivative is cancelled, it is derecognised from the statement of financial position. If a derivative no longer meets the criteria for hedge accounting or is cancelled whilst still effective, the fair value adjustment relating to the hedged assets or liabilities within the hedge relationship prior to the derivative becoming ineffective or being cancelled remains on the statement of financial position and is amortised over the remaining life of the hedged assets or liabilities. The rate of amortisation over the remaining life is in-line with the income or cost generated from the hedged assets or liabilities.

s) Debit and credit valuation adjustments
The DVA and CVA are included in the fair value of derivative financial instruments. The DVA is based on the expected loss a counterparty faces due to the risk of the Group's default. The CVA reflects the Group's risk of the counterparty's default.

The methodology is based on a standard calculation, taking into account:
- the one year PD, updated on a regular basis;
- the expected exposure at default;
- the expected LGD; and
- the average maturity of the swaps.

Notes to the Financial Statements continued

For the year ended 31 December 2017

1. Accounting policies continued

t) Provisions and contingent liabilities

A provision is recognised when there is a present obligation as a result of a past event, it is probable that the obligation will be settled and the amount can be estimated reliably.

Contingent liabilities are possible obligations arising from past events, whose existence will be confirmed only by uncertain future events, or present obligations arising from past events which are either not probable or the amount of the obligation cannot be reliably measured. Contingent liabilities are not recognised but disclosed unless their probability is remote.

u) Employee benefits – defined contribution scheme

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

v) Share-based payments

In accordance with IFRS 2 Share-based payments, options and awards granted to employees over the Bank's shares under the Group's share-based incentive schemes are measured at fair value at grant and are charged on a straight-line basis to profit or loss (with a corresponding increase in the share-based payment reserve within equity) over the vesting period in which the employees become unconditionally entitled to the awards. The cumulative expense within the share-based payment reserve is reclassified to retained earnings upon vesting.

The amount recognised as an expense is adjusted to reflect the actual number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of awards that do meet the related conditions at the vesting date. The amount recognised as an expense for awards subject to market conditions is based on the proportion that is expected to meet the condition as assessed at the grant date. No adjustment is made for the actual proportion that meets the market condition at vesting. Share-based payments that vest on grant are immediately expensed in full with a corresponding increase in equity.

The grant date fair value of a nil price option over the Bank's shares which vests at grant or which carries the right to dividends or dividend equivalents during the vesting period (IPO share awards) is the share price at the grant date. The grant date fair value of awards of the Bank's shares that do not carry automatic rights to dividends or dividend equivalents (the Deferred Share Bonus Plan ('DSBP')) is based on the Bank's share price at the grant date adjusted for the impact of the expected dividend yield. The fair value at grant date of awards made under the Share Save Schemes is determined using a Black-Scholes Option model.

The grant date fair value of awards that are subject to non-market conditions and which do not carry automatic rights to dividends or dividend equivalents (the earnings per share ('EPS') element of the Performance Share Plan ('PSP')) is based on the share price at the grant date adjusted for the impact of the expected dividend yield. An assessment is made at each reporting date on the proportion of the awards expected to meet the related non-market vesting conditions.

The fair value of an award that is subject to market conditions (the relative share price element of the PSP) is determined at grant date using a Monte Carlo model. No adjustment is made for the actual proportion that meets the market condition at vesting.

Where the allowable cost of share-based awards for tax purposes is greater than the cost determined in accordance with IFRS 2, the tax effect of the excess is taken to the share-based payment reserve within equity. The tax effect is reclassified to retained earnings upon vesting.

Employer's national insurance is charged to profit or loss at the share price at the reporting date on the same vesting schedule as the underlying awards.

w) Exceptional items

Exceptional items are material income or expense items which are non-recurring in nature. Exceptional items are reported separately in profit or loss to highlight the underlying performance of the Group and make it more relevant for comparison with other periods. There were no exceptional items during 2017.

In 2016, the Group's exceptional items comprised the gain on disposal of the entire economic interest in Rochester Financing No.1 plc ('Rochester 1') securitisation vehicle and a loss in respect of accelerated amortisation of fair value adjustments on hedged assets relating to prior years. Further details can be found in note 10.

x) Securitisation

The Group assesses whether it controls special purpose entities ('SPE') and the requirement to consolidate them under the criteria of IFRS 10. The criteria include the power to direct relevant activities, exposure or rights to variable returns and the ability to use its power to affect the amount of these returns.

The Group had no economic interest in SPEs at the 2017 and 2016 reporting dates.

y) Adoption of new standards

In 2017 the Group adopted amendments to existing standards that were endorsed for adoption by the EU and mandatory for annual reporting periods beginning on or after 1 January 2017.

In adopting the amendments to IAS 7: Statement of cash flows, a reconciliation has been added to the Group's subordinated liabilities (note 32) to enable the reconciliation of amounts included within financing activities in the statement of cash flows.

There was no impact on these financial statements or accounting policies applied in their preparation upon adopting the amendments to IAS 12 Income taxes in relation to the recognition of deferred tax assets for unrealised losses.

Included below are standards and amendments which are being considered for future reporting periods which have not been applied in preparing these financial statements.

- IFRS 9 Financial Instruments, effective from 1 January 2018

i. Background

In July 2014 the International Accounting Standards Board ('IASB') issued the finalised version of IFRS 9 Financial Instruments: Recognition and Measurement, replacing the earlier accounting standard for financial instruments IAS 39, responding to concerns raised during the financial crisis about the timeliness of impairment recognition.

The new standard has three key areas of change relating to:

- Classification and measurement
- Hedge accounting
- Impairment

The recognition and measurement of impairment is intended to be more forward looking than under IAS 39 and therefore the resulting impairment charge may be more volatile. The day one adoption will drive a higher Group provision requirement which is detailed in section (f) below.

ii. Classification and measurement

IFRS 9 requires classification of financial assets into one of three measurement categories, based on the Group's business model and the contractual cash flow characteristics of the financial instruments including:

- Fair value through other comprehensive income ('FVOCI')
- Fair value through profit and loss, or
- Amortised cost.

The Group completed its assessment of solely payment of principal and interest ('SPPI') compliance that reviews the cash flow characteristics of financial assets to establish which business model they should be held under.

Following the SPPI compliance review, the Group completed its classification and measurement review of financial assets and liabilities with no material impact to the current classification of financial asset and liabilities. Current loans to customers that are classified as loans and receivables and measured at amortised cost under IAS 39 will continue to be measured at amortised cost under IFRS 9. Securities held for liquidity purposes that are classified as AFS and designated as FVOCI under IAS 39 will continue to be measured as FVOCI under IFRS 9.

Under IFRS 9, the provision of forbearance measures is considered a modification event. Forbearance measures reflect a change in credit risk on existing contracts where the contractual cash flows are not wholly different. Forbearance measures therefore do not give rise to a derecognition event.

The IASB issued a modification to IFRS 9 in October 2017 dealing with negative compensation for prepayments that will not affect the Group.

iii. Hedge accounting

The IASB is currently finalising its project to address macro hedge accounting strategies. Until this is finalised IFRS 9 allows firms to continue to apply IAS 39 fair value hedge accounting.

The Group has elected to continue with the IAS 39 hedge accounting rules. The Group will implement the revised hedge accounting disclosure requirements by the related amendments to IFRS 7 financial instruments disclosure requirements from 2018.

iv. Impairment (Expected credit loss, 'ECL')

IFRS 9 replaces the IAS 39 'incurred loss' impairment recognition framework with a three stage ECL approach. The IFRS 9 approach results in an earlier recognition of potential future losses.

Notes to the Financial Statements continued

For the year ended 31 December 2017

1. Accounting policies continued

y) Adoption of new standards continued

The three impairment stages are as follows:

- Stage 1 – entities are required to recognise a 12 month ECL allowance on initial recognition.
- Stage 2 – a lifetime loss allowance is held for assets where a significant increase in credit risk has been identified since initial recognition. The assessment of whether credit risk has increased significantly since initial recognition is performed for each reporting period for the life of the loan.
- Stage 3 – requires objective evidence that an asset is credit impaired at which point a lifetime ECL allowance is required.

Key accounting judgements and estimates

The IFRS 9 accounting standard requires significant levels of judgement and estimates to be made by the Group, upon adoption which are discussed below:

Measurement of ECL

The assessment of credit risk and the estimation of ECL must be unbiased and probability weighted. ECL is measured on either a 12 month or lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or where an account meets the Group's definition of default.

The expected credit loss calculation is a product of an individual loans PD, EAD and LGD discounted at the effective interest rate.

For stage 2 and 3, the Group applies lifetime PDs but uses 12 month PDs for stage 1. The ECL drivers of PD, EAD and LGD are modelled at an account level. The assessment of whether a significant increase in credit risk has occurred is based on the lifetime PD estimate.

Key inputs into ECL calculations

The Group has developed a suite of bespoke PD, LGD and EAD models using segmentation based on the underlying characteristics of the Group's loan portfolios.

PD models – The Group developed a number of PD models to assess the likelihood of default event occurring within the next 12 months, utilising internal and external credit bureau information. Consequently the Group also computes a lifetime PD estimate for each loan exposure once recognised, underpinned by the 12 month PD estimate.

LGD model – The Group has developed a single LGD model, which includes a number of judgement and estimate inputs including propensity to go to possession given default ('PPD'), forced sale discount ('FSD'), time to sale ('TTS') and sale cost estimates.

EAD model – The Group has developed a single EAD model to cover all applicable exposures.

Significant increase in credit risk ('SICR') (movement to stage 2)

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

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

The Group's risk function constantly monitors the ongoing appropriateness of the transfer criteria, where any proposed amendments will be reviewed and approved by the Group's management committees and the Board Risk and Audit Committees at least semi-annually or more frequently if required.

The IFRS 9 standard includes a rebuttable presumption that if an account is 30 days past due it has experienced a significant increase in credit risk. The Group considers 30 days past due to be an appropriate back stop measure and therefore has not rebutted this presumption.

A borrower will move back into stage 1, where the SICR definition is no longer satisfied.

Definition of default (movement to stage 3)

The Group has identified a number of quantitative and qualitative criteria to determine whether an account meets the definition of default and therefore moves to stage 3.

The criteria currently includes:

- The rebuttable assumption that 90 days past due is an indicator of default. The Group has not rebutted this assumption and therefore deems 90 days past due as an indicator of default. This also ensures alignment between the Group's Internal Ratings Based Models and the Basel/Regulatory definition of default.
- The Group has also deemed it appropriate to classify accounts that have moved into forbearance or repossession as meeting the definition of default.

A borrower will move out of stage 3 when their credit risk improves such that they roll back to zero days past due and remain there for 12 consecutive months. The borrower will move to stage 1 or stage 2 dependent on whether the SICR applies.

Forward looking macroeconomic scenarios
The IFRS 9 standard requires firms to consider the risk of default and impairment loss taking into account expectations of economic changes that are reasonable.

The Group has developed a bespoke macroeconomic model to determine the most significant factors which may influence the likelihood of an exposure defaulting in the future. At present the most significant macroeconomic factors relate to (1) HPI (2) unemployment and (3) the Bank of England base rate.

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

The Group currently does not have an in-house economics function and therefore sources economic forecasts from an appropriately qualified third party. The Group will consider a minimum of three probability weighted scenarios, including base, upside and downside scenarios. However, the Group will constantly monitor the ongoing appropriateness of its approach referencing industry best practise.

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

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

Purchase or originated credit impaired ('POCI')
Under IFRS 9, acquired loans that meet a firms definition of default (90 days past due or forbearance) at acquisition are treated as a POCI asset. These assets will attract a lifetime ECL allowance over the full term of the loan, even when the loan asset does not meet the definition of default post acquisition.

v. Implementation and programme governance

The Group delivered the requirements of IFRS 9 from 1 January 2018 after completing the successful parallel testing phase of its IFRS 9 programme throughout the full year to 31 December 2017. The IFRS 9 programme included senior representatives from the finance and risk functions, overseen by an IFRS 9 Executive Steering Committee which oversaw the Group's implementation of the requirements ensuring compliance to the standard.

The Group's Model Review Committee continues to oversee the ongoing performance of the underlying IFRS 9 suite of models. During the period, a number of independent model validation reports were received from external third parties, covering the full spectrum of PD, lifetime PD, LGD, EAD and macroeconomic models.

Existing committee structures will be utilised to oversee IFRS 9 impairment performance on an ongoing basis, including the Group's Credit Committee which receives monthly impairment performance reports from the risk function and the Group's Assets and Liabilities Committee ('ALCO') which oversees and approves the use of macroeconomic scenarios.

The Board Risk and Audit Committees received regular updates from the risk function and IFRS 9 programmes, ensuring Board level oversight, review and challenge and ultimate approval of all key judgements and estimates which underpin IFRS 9 impairment calculations. Going forward the Risk and Audit Committees will continue to oversee the ongoing implementation of IFRS 9.

The Group's external auditors have undertaken audit procedures covering classification and measurement and expected credit loss calculations.

vi. Impact of transition to IFRS 9

Adoption of IFRS 9 will result in c. £4m (c.+19%) increase in total Group impairment provision balances, reflecting the strength of security underpinning the loan book, the ongoing strong credit profile performance (driven by conservative LTV and low arrears levels) and the incurred loss protection held against acquired portfolio assets.

Incurred loss protection is the simulated loss estimate of the portfolio at the point of acquisition and is offset against modelled future cash flows to derive the EIR for the book. The incurred loss protection is therefore recognised over the life of the book through interest income. Incurred loss remaining is the protection at acquisition reduced by the cumulative losses observed since acquisition.

The only transitional accounting adjustments required by the Group on the adoption of IFRS 9 will be in the area of impairment. The initial impact of IFRS 9 will be shown in the opening reserves.

Notes to the Financial Statements continued

For the year ended 31 December 2017

1. Accounting policies continued

y) Adoption of new standards continued

vi. Impact of transition to IFRS 9 continued

In terms of capital, the Group has advised the PRA that it is adopting the transitional rules and will disclose its capital on a transitional and end state in its annual accounts and Pillar 3 report from 2018 onwards. The end state capital impact of adopting IFRS 9 based on the 2017 year end position would be a 0.09% decrease in fully loaded Common Equity Tier 1 ('CET 1') capital. The transitional period is from 2018 to 2022.

The Group continues to track the predictability of the models and make changes where this falls below an acceptable threshold, whilst assessing the ongoing appropriateness of all key judgement and estimate areas ahead of the full reporting of IFRS 9 impacts later in 2018.

The Group's strategy is to continue to be a specialist lender of secured loan products at sensible loan to value and development values. As such, collateral valuations are a key driver of movements in the Group's impairment allowance requirements, where a 10% reduction in house prices would result in an approximate £9m (36%) increase in expected impairment provision balances which are not individually assessed.

The Group remains cautious around the uncertainty that remains with respect to the volatility which the IFRS 9 approach may bring in response to changes in economic expectations and the speed of recognition of loss in a downturn scenario.

The transition to the IFRS 9 approach has resulted in the development and implementation of new processes and controls across both the risk and finance functions. The Group is well prepared for the wider changes required for other key risk management processes, including the development of detailed management reporting (including Pillar 3 reporting and FINREP), development of enhanced stress testing capabilities to support the setting of credit and solvency risk appetite and the Group's ICAAP.

Capital planning and performance

The impact of IFRS 9 has been included within the Group's capital and annual business planning processes. No changes were made to the Group's strategic plan and the Group does not expect a change to the go forward business model.

- IFRS 15 Revenue from Contracts with Customers, effective from 1 January 2018, replaces IAS 11 Construction contracts, IAS 18 Revenue and several related interpretations. IFRS 15 introduces a single framework for revenue recognition based on a five-step model to determine when to recognise revenue and at what amount. The five steps of the model are: identify the contract; identify performance obligations; determine the transaction price; allocate the transaction price; and recognise revenue. Depending on whether certain criteria are met, revenue is recognised either over time, in a manner that depicts the entity's performance, or at a point in time, when control of the goods or services is transferred to the customer. The new standard is not expected to have a significant impact on the financial statements.
- IFRS 16 Leases, effective from 1 January 2019, replaces IAS 17 Leases, IFRIC 4 Determining Whether an Arrangement Contains a Lease and two related SIC interpretations. The new standard requires lessees to recognise right-of-use assets and lease liabilities for most leases over 12 months long. Lessor accounting has largely remained unchanged. Adoption of IFRS 16 in respect of rented properties is not expected to have a material effect on the financial statements.

2. Judgements in applying accounting policies and critical accounting estimates

In preparing these financial statements, the Group has made judgements, estimates and assumptions which affect the reported amounts within the current and next financial year. Actual results may differ from these estimates.

Estimates and judgements are regularly reviewed based on past experience, expectations of future events and other factors. The key areas where estimates and judgements are made are as follows:

i. Loan book impairments: This section provides details of the critical elements of judgement which underpin loan impairment calculations. Less significant judgements are not disclosed.

Individual impairment

Assessments for individually significant loans involve significant judgement to be made by management in relation to estimating future cash flows, including the cost of obtaining and selling collateral, the likely sale proceeds and any rental income prior to sale. The most significant area of judgement is the likely sale proceeds. The individually assessed provisioning process is therefore underpinned by updated external valuations being obtained once a case is adopted by the collections team. All assets which do not have an individually assessed provision are assessed on a collective basis.

Collective impairment

Collective provision assessments are also subject to estimation uncertainty, underpinned by a number of judgements and estimates being made by management which are utilised within impairment calculations. Key areas of judgement utilised within collective provisioning calculations include PD, the LGD and the EP. Provisions on loans three months plus in arrears are treated as specific provisions. Provisions on loans less than three months in arrears are treated as collective provisions.

Probability of default

To compute PD rates the Group analyses how accounts transition from up-to-date and varying arrears severity positions to the default state which is reached once an account is greater than six months in arrears. Embedded within the PD calculation is a computed cure rate, which allows the Group to model the probability of an account curing from each state. A 10% relative worsening of the PD rate would increase total provisions by £0.4m as at 31 December 2017 (2016: £0.3m). The increase year on year is primarily driven by the increasing asset base.

Loss given default
The LGD model simulates the likely loss once a default event has occurred. The key components of the LGD calculation relate to the valuation of the underlying collateral, forced sale discount rates post repossession and the costs to sell (variable and fixed). Therefore the LGD is sensitive to the application of the HPI. As at 31 December 2017, a 10% fall in house prices would result in an incremental £5.0m (2016: £4.7m) of provision being required. The increase year on year is primarily driven by the increasing asset base.

Emergence period
The current collective provision methodology does not utilise an explicit EP within IBNR calculations, however the observation period which is utilised within PD calculations includes an implied EP. During 2016, the Group conducted a detailed analysis to understand the time it takes for a loss event (e.g. becoming unemployed) to be identified (i.e. missed payment) using external and internal data sources. The outcome of this review resulted in the observation period used within PD calculations elongating due to a lengthening of the implied EP.

ii. Loan book acquisition accounting and income recognition: Acquired loan books are initially recognised at fair value. Significant judgement is exercised in calculating their EIR using cash flow models which include assumptions on the likely macroeconomic environment, including HPI, unemployment levels and interest rates, as well as loan level and portfolio attributes and history used to derive prepayment rates, the probability and timing of defaults and the amount of incurred losses.

The EIR on loan books purchased at significant discounts or premiums is particularly sensitive to the prepayment ('CPR') and default ('CDR') rates derived, as the purchase discount or premium is recognised over the expected life of the loan book through the EIR. New defaults are modelled at zero loss (as losses will be recognised in profit or loss as impairment losses) and therefore have the same impact on the EIR as prepayments.

Different assumptions to derive the CPR and CDR in the cash flow models at acquisition will impact EIR rates. A 10% increase/decrease in the EIR% for each of the Bank's acquired mortgage books would increase/decrease interest income by c. £3.5m in 2017 (2016: c. £4.8m).

Incurred losses at acquisition are calculated using the Group's collective provision model (see (i) Loan book impairments above for further details).

The EIR calculated at acquisition is not changed for subsequent variances in actual to expected cash flows. The Group monitors the actual cash flows for each acquired book and where they diverge significantly from expectation, the future cash flows are reset (an 'AG8' adjustment). In assessing whether to adjust future cash flows on an acquired portfolio, the Group considers the cash variance on an absolute and percentage basis. The Group also considers the total variance across all acquired portfolios and the economic outlook. Where cash flows for an acquired portfolio are reset, they are discounted at the EIR to derive a new carrying value, with changes taken to profit or loss as interest income. The Group recognised a loss of £0.3m in 2017 as a result of resetting cash flows on acquired mortgage books (2016: gain of £1.4m).

iii. Effective interest rate: A number of assumptions are made when calculating the EIR for newly originated loan assets. These include their expected lives, likely redemption profiles and the anticipated level of any early redemption charges.

Certain mortgage products offered by the Group include significant directly attributable net fee income, in particular Buy-to-Let, and/or revert to the standard variable rate ('SVR') after an initial discounted or fixed period. Judgement is used in assessing the expected rate of prepayment during the discounted or fixed period of these mortgages and the expected life of those that prepay. The Group uses historical experience in its assessment. Judgement is also used in assessing whether and for how long mortgages that reach the end of the product term stay on SVR. The most significant area of judgement is the period spent on SVR.

A 10% increase/decrease in the rate of prepayments during the product term for 2017 new originations would increase/decrease interest income for 2017 by c. £0.1m (2016: c. £0.1m). A three month shorter/longer life for those prepaying mortgages would increase/decrease interest income in 2017 by c. £0.4/£0.3m (2016: c. £0.4/£0.3m).

The Group prudently assumes no period on SVR before the borrower refinances on to a new product or redeems as it waits for a stable trend to emerge following the automation of the broker-led Choice programme in late 2016. Since then, there has been a significant and consistent decrease in the number of borrowers remaining on SVR for more than three months, to around 20%.

The impact of a three month longer expected life on 2017 new origination, that is expected to reach the end of the discounted or fixed period, would be to recognise an additional £1.9m (2016: £0.8m) of interest income, as the impact of spreading fee income over a longer period is more than offset by the impact of a higher revert rate for the additional period.

Notes to the Financial Statements continued

For the year ended 31 December 2017

3. Interest receivable and similar income

	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
At amortised cost:		
On BTL/SME mortgages	**247.3**	208.8
On Residential mortgages	**91.8**	107.1
On investment securities	**0.1**	1.2
On other liquid assets	**2.0**	1.6
At fair value through profit or loss:		
Net expense on derivative financial instruments	**(8.5)**	(9.2)
	332.7	309.5

Included within interest receivable is £1.3m (2016: £1.3m) in respect of interest accrued on accounts with an individually assessed specific provision.

4. Interest payable and similar charges

	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
On retail deposits	**86.1**	101.8
On Perpetual Subordinated Bonds	**0.9**	0.9
On subordinated liabilities	**0.9**	1.2
On wholesale borrowings	**3.1**	3.2
Net income on derivative financial instruments	**(3.7)**	(4.2)
	87.3	102.9

5. Fair value gains and losses on financial instruments

	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
Fair value changes in hedged assets	**(8.7)**	3.2
Hedging of assets	**10.0**	(3.0)
Fair value changes in hedged liabilities	**2.9**	(0.5)
Hedging of liabilities	**(3.1)**	0.3
Ineffective portion of hedges[1]	**1.1**	–
Amortisation of fair value adjustments on hedged assets	**(7.3)**	(4.9)
Net gain on unmatched swaps	**–**	0.1
Debit and credit valuation adjustment	**(0.1)**	(0.1)
	(6.3)	(4.9)

1. Ineffective portion of hedges was less than £0.1m for 2016.

Amortisation of fair value adjustments on hedged assets relates to hedged assets and liabilities where the hedges were terminated before maturity and were effective at the point of termination.

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

6. Gain on sales of financial instruments

The Bank routinely buys and sells liquidity assets in order to confirm the ease with which cash can be realised and the robustness of the valuations assigned to such assets. During the year, transactions in liquid assets resulted in a gain of less than £0.1m (2016: less than £0.1m).

During 2016, the Group sold £10.9m of non-performing loans from its personal loan portfolio. These loans had a carrying value of £1.3m after provisions of £5.6m and prior year write-offs of £4.0m. The loans were sold for cash proceeds of £1.9m, creating a £0.6m gain on sale.

7. Administrative expenses

	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
Staff costs	**35.9**	29.5
Facilities costs	**2.4**	2.4
Marketing costs	**2.7**	2.2
Support costs	**8.4**	6.2
Professional fees	**5.0**	5.6
Other costs[1]	**7.2**	5.2
	61.6	51.1

1. Other costs mainly consist of irrecoverable VAT expense.

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

	Group Year ended 31-Dec-17 £'000	Group Year ended 31-Dec-16 £'000
Audit of the Bank and Group accounts	**638**	414
Audit of the Group's subsidiary undertakings pursuant to legislation	**178**	121
Audit related assurance services	**96**	96
Tax compliance and advice	**–**	70
Regulatory advice and support	**8**	36
All other non-audit services	**47**	48
	967	785

Included within the audit of the Bank and Group accounts is £165k (2016: £nil) relating to the audit of IFRS 9. Other non-audit services in 2017 include support for the AT1 securities issuance and treasury hedge accounting.

Staff numbers and costs
Staff costs comprise the following categories:

	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
Salaries, incentive pay and other benefits	**28.9**	24.4
Share-based payments	**2.4**	1.5
Social security costs	**3.3**	2.5
Other pension costs	**1.3**	1.1
	35.9	29.5

The average number of people employed by the Group (including Executive Directors) during the year was 813 (2016: 674), analysed below:

	Group 2017	Group 2016
Operations	**442**	315
Support functions	**371**	359
	813	674

Notes to the Financial Statements continued

For the year ended 31 December 2017

8. Directors' emoluments and transactions

	Bank Year ended 31-Dec-17 £'000	Bank Year ended 31-Dec-16 £'000
Directors' emoluments[1]	**1,912**	1,869
Payments in respect of personal pension plans	**104**	97
Gains made on the exercise of share options[2]	**17**	–
	2,033	1,966

1. Director's emoluments comprise salary costs, NED fees and other short-term incentive benefits as disclosed in the Annual Report on Remuneration.
2. Gains made on the exercise of share options relate to the Sharesave Scheme, further discussed in note 9.

In addition to the total Directors' emoluments above, the Executive Directors were granted a deferred bonus of £346k (2016: £335k) in the form of shares deferred for three years under the DSBP. The DSBP does not have any further performance conditions attached, however it is subject to clawback and is forfeited if the Executive Director leaves prior to vesting unless a good leaver reason applies such as redundancy, retirement or ill health.

The Executive Directors received a further share award under the PSP with a grant date face value of £895k (2016: £700k) using a share price of £4.08 (2016: £2.53) (the average mid-market quotation for the preceding five days before grant). These shares vest in three years subject to performance conditions discussed in note 9 and the Annual Report on Remuneration.

There was no compensation for loss of office during either 2017 or 2016.

There were no outstanding loans granted in the ordinary course of business to Directors and their connected persons as at 31 December 2017 and 2016.

The Annual Report on Remuneration and note 9 Share-based payments provide further details on Directors' emoluments.

9. Share-based payments

The Group operates the following share-based schemes:

IPO Share Awards

Certain Directors, senior managers and other employees of the Bank received one-off share awards in the form of nil price options over shares in the Bank on its admission to the London Stock Exchange in June 2014. A proportion of these awards vested on admission with the remainder vesting over either a 12, 24 or 48 month period. The cost of IPO Share Awards based on their fair value at grant date of 170 pence per share (the IPO offer price) is recognised over the respective vesting period (adjusted for expected attrition) with awards that vested on admission being immediately expensed in full. The expense is reported within administrative expenses in profit or loss and is offset fully by an additional capital contribution as the awards were granted by OSB Holdco Limited, the Bank's major shareholder at the time of the IPO.

Sharesave Scheme

The Save As You Earn ('SAYE') or Sharesave Scheme is an all-employee share option scheme which is open to all UK-based employees. The Sharesave Scheme allows employees to purchase options by saving a fixed amount of between £5 and £500 per month over a period of either three or five years at the end of which the options, subject to leaver provisions, are usually exercisable. The Sharesave Scheme has been in operation since 2014 and is granted annually, with the exercise price set at a 20% discount of the share price on the date of grant.

Deferred Share Bonus Plan

The DSBP applies to Executive Directors and certain senior managers and requires 50% of their performance bonuses to be deferred in shares for three or five years. There are no further performance conditions attached, but the share awards are subject to clawback provisions. The DSBP is a share-based award and as such is expensed over its vesting period. The first DSBP relating to 2014 bonuses was granted in March 2015.

Performance Share Plan

Executive Directors and certain senior managers are also eligible for a PSP based on performance conditions linked to EPS and total shareholder return ('TSR') over a three year vesting period. The first award was issued in March 2015.

The performance conditions applying to PSP awards are based on a combination of EPS and TSR equally weighted and assessed independently. For the EPS element, growth targets are linked to the Company's three year growth plan, measuring growth from the base figure for the prior year. For the TSR element, OSB share's relative performance is measured against the FTSE All Share index, excluding investment trusts.

The share-based expense for the year includes a charge in respect of the remaining IPO awards with future vesting provisions, Sharesave scheme, the DSBP and PSP. All charges are included in employee expenses within note 7 Administrative expenses.

The share-based payment expense during the year comprised of the following:

	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
IPO share award expensed in the year	**0.3**	0.4
Sharesave Scheme	**0.2**	0.1
Deferred Share Bonus Plan	**0.9**	0.5
Performance Share Plan	**1.0**	0.5
	2.4	1.5

Movements in the number of share awards and their weighted average exercise prices are presented below:

	IPO share awards	Sharesave Scheme		Deferred Share Bonus Plan	Performance Share Plan
	Number	Number	Weighted average exercise price, £	Number	Number
At 1 January 2017	**652,198**	**818,253**	**1.78**	**758,381**	**1,080,991**
Granted	**–**	**336,288**	**3.15**	**433,534**	**510,094**
Exercised	**–**	**(382,597)**	**1.35**	**–**	**–**
Forfeited	**–**	**(39,603)**	**2.43**	**(5,153)**	**(2,055)**
At 31 December 2017	**652,198**	**732,341**	**2.60**	**1,186,762**	**1,589,030**
Exercisable at					
At 31 December 2017	**–**	**–**	**–**	**–**	**–**

	IPO share awards	Sharesave Scheme		Deferred Share Bonus Plan	Performance Share Plan
	Number	Number	Weighted average exercise price, £	Number	Number
At 1 January 2016	1,237,844	761,927	1.66	301,575	579,157
Granted	–	149,675	2.40	456,806	519,757
Exercised	(465,855)	(2,126)	1.34	–	–
Forfeited	(119,791)	(91,223)	1.83	–	(17,923)
At 31 December 2016	652,198	818,253	1.78	758,381	1,080,991
Exercisable at					
At 31 December 2016	–	–	–	–	–

For the share-based awards granted during the year, the weighted average grant date fair value was 383 pence (2016: 251 pence).

There were no IPO share awards exercised during 2017. The weighted average market price at exercise for IPO share awards exercised during 2016 was 307 pence.

Notes to the Financial Statements continued

For the year ended 31 December 2017

9. Share-based payments continued

The range of exercise prices and weighted average remaining contractual life of outstanding awards are as follows:

	2017		2016	
Exercise price	Number	Weighted average remaining contractual life (years)	Number	Weighted average remaining contractual life (years)
IPO share awards				
Nil	**652,198**	**0.4**	652,198	1.4
Sharesave Scheme				
134-315 pence	**732,341**	**2.1**	818,253	1.6
Deferred Share Bonus Plan				
Nil	**1,186,762**	**1.4**	758,381	1.8
Performance Share Plan				
Nil	**1,589,030**	**1.2**	1,080,991	1.7
	4,160,331	**1.3**	3,309,823	1.6

The valuation of share awards is based on the following assumptions:

IPO Share Awards

The grant date fair value of the IPO share awards was the issue price of 170 pence as they are in the form of nil price options which carry rights to dividends during the vesting period. The charge in respect of awards with future vesting provisions assumed a weighted average attrition of nil (2016: nil) per annum. This is lower than the overall expected staff attrition rate as nil attrition was assumed for certain senior managers who received larger awards.

Sharesave Scheme

The grant date fair values of awards under the Sharesave Scheme were determined using a Black-Scholes model. This determined the fair value of options over 1 ordinary share in the 2017 three and five year Sharesave Scheme as 75 pence and 71 pence respectively (2016: 18 pence and 20 pence), using the following input assumptions in the valuation models:

	2017	2016	2015	2014
Contractual life, years	**3/5 years**	3/5 years	3/5 years	3/5 years
Share price at issue, £	**3.93**	3.00	2.84	1.68
Exercise price, £	**3.15**	2.40	2.27	1.34
Expected volatility[1]	**17.9%**	18.7%	20.0%	20.0%
Attrition rate	**11.8%**	12.0%	9.6%	10.5%
Dividend yield	**4.1%**	4.6%	3.6%	3.0%

1. The volatility was based on a benchmark of the FTSE 350 diversified financials as insufficient history was available for the Bank's shares.

Deferred Share Bonus Plan

The grant date fair value of awards under the DSBP of 361 (2016: 271) pence per share for three year and 337 pence per share for five year plans are based on the mid-market share price at the grant date of 404 (2016: 309) pence per share, adjusted for the impact of dividends, as the awards do not carry automatic rights to dividends. A dividend yield of 4.1% (2016: 4.6%) was used based on available analyst consensus. The expense for 2017 assumes an attrition rate of 11.8% (2016: 12.0%).

Performance Share Plan

The grant date fair value of awards under the PSP of 361 (2016: 271) pence per share is based on the mid-market share price at the grant date of 404 (2016: 309) pence per share, adjusted for the impact of dividends, as the awards do not carry automatic rights to dividends. A dividend yield of 4.1% (2016: 4.6%) was assumed based on available analyst consensus. The expense for 2017 assumes an attrition rate of 11.8% (2016: 12.0%).

A vesting rate is incorporated into the EPS element of the PSP, based on the expectation that the required target growth will be achieved over the vesting period. A vesting rate is also calculated for the TSR element of the PSP, based on a Monte Carlo model using historical share price performance data for the target benchmark FTSE All Share Index excluding investment trusts and the FTSE 350 Diversified Financials as a proxy for the Company's shares as insufficient history was available.

10. Exceptional items

The Group had no exceptional items during 2017.

Exceptional items to December 2016 consist of the gain on disposal of the Group's entire economic interest in Rochester 1 securitisation vehicle and an exceptional loss of £9.8m in respect of accelerated amortisation of fair value adjustments on hedged assets relating to legacy back-book long-dated interest rate swap cancellations.

The Rochester 1 sale resulted in derecognition of securitised mortgage assets from the Group's balance sheet and the deconsolidation of Rochester 1. This removed a total of £239.8m of securitised mortgage assets and cash reserves in the vehicle and £171.6m of debt securities in issue from the Group's balance sheet.

The Group uses interest rate swaps to hedge fixed rate mortgages and adopts fair value hedge accounting where the criteria specified in IAS39 (EU endorsed) are met. Under hedge accounting, the change in the fair value of hedged mortgages for interest rate risk is recognised in profit or loss, as an offset to fair value movements on the swaps, with the cumulative movement reflected as fair value adjustments on hedged assets in the statement of financial position. A number of long-dated legacy swaps were cancelled in 2012 and 2013 whilst still effective. Following the cancellations, the fair value adjustment on the legacy hedged long-term fixed rate mortgages (c. 25 years at origination) remained in the statement of financial position to be amortised over their remaining lives. Both the cancelled swaps and hedged mortgages were inherited from the Kent Reliance Building Society.

During 2016, the Group reviewed the roll-off of the legacy long-dated fixed rate mortgages. Following this review, the Group accelerated the amortisation of the associated fair value adjustments in line with the mortgage asset run-off, due to faster than expected prepayments since cancellation. The exceptional loss represents the impact of accelerating the amortisation in prior years from 2012 to 2015, which was not material in any individual year. It has been presented as an exceptional item and excluded from 2016 underlying profit before tax to provide an appropriate measure of the underlying performance of the Group in 2016.

Exceptional items are summarised in the table below:

	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
Gain on disposal of Rochester 1	**–**	34.7
Amortisation of fair value adjustments for hedged assets	**–**	(9.8)
	–	24.9

11. Taxation

	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
Corporation tax	**(41.5)**	(42.3)
Deferred taxation	**0.7**	0.1
Total taxation	**(40.8)**	(42.2)

Notes to the Financial Statements continued

For the year ended 31 December 2017

11. Taxation continued

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

	Year ended 31-Dec-17 £m	Year ended 31-Dec-16 £m
Profit before taxation	**167.7**	163.1
Profit multiplied by the weighted average rate of corporation taxation in the UK during 2017 of 19.25% (2016: 20.00%)	**(32.3)**	(32.6)
Bank surcharge	**(8.3)**	(8.6)
Taxation effects of:		
Expenses not deductible for taxation purposes	**(0.2)**	(0.4)
Adjustments in respect of earlier years	**(0.4)**	(0.5)
Tax adjustments in respect of share-based payments	**0.3**	0.1
Impact of tax losses carried forward	**0.2**	0.1
Timing differences on capital items	**(0.1)**	(0.2)
Other	**–**	(0.1)
Total taxation charge	**(40.8)**	(42.2)

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

12. Earnings per share

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

For the purpose of calculating EPS, profit attributable to ordinary shareholders is arrived at by adjusting profit for the year for the after-tax amounts of the coupon on PSBs and AT1 securities classified as equity. The tax on coupons is based on the rate of taxation applicable to the Bank, including the bank surcharge:

	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
Profit for the year	**126.9**	120.9
Adjustments:		
Coupon on PSBs and AT1 securities classified as equity	**(3.7)**	(1.2)
Tax on coupons	**1.0**	0.3
Profit attributable to ordinary shareholders	**124.2**	120.0
Exceptional items:		
Gain on disposal of Rochester 1	**–**	(34.7)
Amortisation of fair value adjustments for hedged assets	**–**	9.8
Tax on above	**–**	6.4
Underlying profit attributable to ordinary shareholders	**124.2**	101.5

	Group Year ended 31-Dec-17	Group Year ended 31-Dec-16
Weighted average number of shares, millions		
Basic	**243.2**	243.1
Diluted	**245.1**	244.6
Earnings per share, pence per share		
Basic	**51.1**	49.4
Diluted	**50.7**	49.0
Underlying earnings per share, pence per share		
Basic	**51.1**	41.7
Diluted	**50.7**	41.5

13. Dividends

During the year, the Bank paid the following dividends:

	Bank Year ended 31-Dec-17		Bank Year ended 31-Dec-16	
	£m	**Pence per share**	£m	Pence per share
Final dividend for the prior year	**18.5**	**7.6**	16.3	6.7
Interim dividend for the current year	**8.5**	**3.5**	7.0	2.9
	27.0		23.3	

A summary of the Bank's distributable reserves from which dividends can be paid are shown below:

	Bank	
	As at 31-Dec-17 £m	As at 31-Dec-16 £m
Net assets	**475.8**	350.2
Less:		
– Share capital	**(2.4)**	(2.4)
– Share premium	**(158.4)**	(157.9)
– Other non-distributable reserves[1]	**(93.1)**	(29.8)
Distributable reserves	**221.9**	160.1

1. Other non-distributable reserves include the capital contribution, equity bonds, foreign exchange reserve, AFS reserve and share-based payment reserve.

The Directors propose a final dividend of 9.3 pence per share (2016: 7.6 pence) payable on 16 May 2018 with an ex-dividend date of 22 March 2018 and a record date of 23 March 2018. This dividend is not reflected in these financial statements as it is subject to approval by shareholders at the AGM on 10 May 2018. Together with the interim dividend of 3.5 pence (2016: 2.9 pence), it makes a total dividend for 2017 of 12.8 pence (2016: 10.5 pence) per share.

14. Cash and cash equivalents

		RESTATED		RESTATED
	Group As at 31-Dec-17 £m	Group As at 31-Dec-16 £m	**Bank As at 31-Dec-17 £m**	Bank As at 31-Dec-16 £m
Cash in hand	**0.5**	0.4	**0.5**	0.4
Unencumbered loans and advances to credit institutions	**1,165.4**	402.3	**1,157.5**	398.0
Investment securities with maturity less than 3 months	**–**	82.6	**–**	82.6
	1,165.9	485.3	**1,158.0**	481.0

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 (being the cash ratio deposit and swap margin paid) within cash and cash equivalents.

Unencumbered loans and advances to credit institutions excludes £10.0m (2016: 9.1m) held in the cash ratio deposit with the Bank of England and excludes £11.8m (2016: £6.4m) of encumbered assets in the form of cash margin collateral paid in relation to the Group's derivatives.

Notes to the Financial Statements continued

For the year ended 31 December 2017

15. Loans and advances to credit institutions

Loans and advances to credit institutions have remaining maturities as follows:

	Group As at 31-Dec-17 £m	Group As at 31-Dec-16 £m	**Bank As at 31-Dec-17 £m**	Bank As at 31-Dec-16 £m
Repayable on demand	**1,161.4**	402.3	**1,157.5**	398.0
Less than three months	**15.8**	6.4	**11.8**	6.4
More than five years	**10.0**	9.1	**10.0**	9.1
	1,187.2	417.8	**1,179.3**	413.5

Included within repayable on demand is £1,136.9m (2016: £391.9m) in the Bank of England reserve account.

Included within less than three months is £11.8m (2016: £6.4m) of loans and advances with other credit institutions in the form of margin cash collateral paid in relation to the Group's derivatives which is considered to be encumbered.

Included within more than five years is £10.0m (2016: £9.1m) held in the cash ratio deposit with the Bank of England which is considered to be encumbered.

16. Investment securities

	Group and Bank As at 31-Dec-17 £m	Group and Bank As at 31-Dec-16 £m
Government investment securities	**19.1**	141.7
	19.1	141.7
Investment securities have remaining maturities as follows:		
Less than three months	**–**	82.6
Three months to one year	**–**	40.0
One to five years	**19.1**	19.1
	19.1	141.7

At 31 December 2017, the Group held £nil (2016: £524.6m) of treasury bills received from the Bank of England under the FLS. These securities are accounted for off balance sheet but included in liquid assets for regulatory purposes. In exchange, the Group pledges with the Bank of England either loans to customers or other investment securities. These assets cannot be sold or pledged further under normal circumstances.

At the reporting date, the Group had no treasury assets (2016: £nil) pledged with the Bank of England in exchange for the treasury bills. The value of pledged loans to customers is disclosed in note 17.

The Group had no assets sold under repos at the 2017 and 2016 reporting dates.

The Directors consider that the primary purpose of holding investment securities is prudential. These securities are held as liquid assets with the intention of use on a continuing basis in the Group's activities and are classified as AFS.

Movements during the year of investment securities are analysed as follows:

	Group and Bank 2017 £m	Group and Bank 2016 £m
At 1 January	**141.7**	393.4
Additions	**–**	460.4
Disposals and maturities	**(122.7)**	(712.2)
Changes in fair value	**0.1**	0.1
At 31 December	**19.1**	141.7

17. Loans and advances to customers

	Group As at 31-Dec-17 £m	Group As at 31-Dec-16 £m	**Bank As at 31-Dec-17 £m**	Bank As at 31-Dec-16 £m
BTL/SME mortgages	**5,654.1**	4,104.3	**4,588.7**	3,299.5
Residential mortgages	**1,673.5**	1,859.9	**1,477.8**	1,613.1
	7,327.6	5,964.2	**6,066.5**	4,912.6
Less: provision for impairment losses on loans and advances (see note 18)	**(21.6)**	(25.0)	**(15.5)**	(19.1)
	7,306.0	5,939.2	**6,051.0**	4,893.5

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

	Group As at 31-Dec-17 £m	Group As at 31-Dec-16 £m	**Bank As at 31-Dec-17 £m**	Bank As at 31-Dec-16 £m
Less than three months	**139.4**	150.8	**119.0**	135.9
Three months to one year	**224.9**	162.9	**158.8**	123.3
One to five years	**308.6**	279.5	**151.0**	170.2
More than five years	**6,654.7**	5,371.0	**5,637.7**	4,483.2
	7,327.6	5,964.2	**6,066.5**	4,912.6
Less: provision for impairment losses on loans and advances (see note 18)	**(21.6)**	(25.0)	**(15.5)**	(19.1)
	7,306.0	5,939.2	**6,051.0**	4,893.5

The above analysis is based on contractual maturity and may not reflect actual experience of repayments, since many mortgage loans are repaid early.

The Group purchased no mortgage books from other financial institutions during 2017. During 2016, the Group purchased mortgage books with a gross value of £205.2m for a total of £180.7m.

At 31 December 2017, mortgages with a carrying value of £2,303.2m (2016: £1,413.9m) were pledged with the Bank of England under their asset purchase facilities, FLS and TFS. The Group considers these loans to be encumbered.

Included within loans and advances to customers are mortgages totalling £28.9m (2016: £32.0m) retained by the Group, who act as master servicer for securitisation vehicles, to comply with the EU risk retention requirements. The Group considers these loans to be encumbered.

Notes to the Financial Statements continued
For the year ended 31 December 2017

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

2017

Specific	BTL/SME £m	Residential mortgages £m	Total £m
Group			
At 1 January 2017	16.8	6.6	23.4
Write-offs in year	(4.8)	(3.0)	(7.8)
Charge for the year net of recoveries	0.7	3.3	4.0
At 31 December 2017	12.7	6.9	19.6
Bank			
At 1 January 2017	12.9	4.8	17.7
Write-offs in year	(4.9)	(0.8)	(5.7)
Charge for the year net of recoveries	1.1	0.7	1.8
At 31 December 2017	9.1	4.7	13.8
Collective			
Group			
At 1 January 2017	0.4	1.2	1.6
Write-offs in year	–	–	–
Charge for the year net of recoveries	0.1	0.3	0.4
At 31 December 2017	0.5	1.5	2.0
Bank			
At 1 January 2017	0.2	1.2	1.4
Charge for the year net of recoveries	0.1	0.2	0.3
At 31 December 2017	0.3	1.4	1.7
Total			
Group			
At 1 January 2017	17.2	7.8	25.0
Write-offs in year	(4.8)	(3.0)	(7.8)
Charge for the year net of recoveries	0.8	3.6	4.4
At 31 December 2017	13.2	8.4	21.6
Bank			
At 1 January 2017	13.1	6.0	19.1
Write-offs in year	(4.9)	(0.8)	(5.7)
Charge for the year net of recoveries	1.2	0.9	2.1
At 31 December 2017	9.4	6.1	15.5

2016 (Restated)

Specific	BTL/SME £m	Residential mortgages £m	Total £m
Group			
At 1 January 2016	17.3	0.9	18.2
Write-offs in year	(2.9)	(1.6)	(4.5)
Transfer between reserves[1]	0.4	4.8	5.2
Charge for the year net of recoveries	2.0	2.5	4.5
At 31 December 2016	16.8	6.6	23.4
Bank			
At 1 January 2016	14.5	–	14.5
Write-offs in year	(3.0)	(1.4)	(4.4)
Transfer between reserves[1]	0.4	4.7	5.1
Charge for the year net of recoveries	1.0	1.5	2.5
At 31 December 2016	12.9	4.8	17.7

Collective	BTL/SME £m	Residential mortgages £m	Total £m
Group			
At 1 January 2016	7.8	1.3	9.1
Write-offs in year	(1.2)	–	(1.2)
Disposals[2]	(5.6)	–	(5.6)
Transfer between reserves[1]	(0.4)	(4.8)	(5.2)
(Credit)/charge for the year net of recoveries	(0.2)	4.7	4.5
At 31 December 2016	0.4	1.2	1.6
Bank			
At 1 January 2016	7.7	1.1	8.8
Write-offs in year	(1.1)	–	(1.1)
Disposals[2]	(5.6)	–	(5.6)
Transfer between reserves[1]	(0.4)	(4.7)	(5.1)
(Credit)/charge for the year net of recoveries	(0.4)	4.8	4.4
At 31 December 2016	0.2	1.2	1.4

Total	BTL/SME £m	Residential mortgages £m	Total £m
Group			
At 1 January 2016	25.1	2.2	27.3
Write-offs in year	(4.1)	(1.6)	(5.7)
Disposals[2]	(5.6)	–	(5.6)
Charge for the year net of recoveries	1.8	7.2	9.0
At 31 December 2016	17.2	7.8	25.0
Bank			
At 1 January 2016	22.2	1.1	23.3
Write-offs in year	(4.1)	(1.4)	(5.5)
Disposals[2]	(5.6)	–	(5.6)
Charge for the year net of recoveries	0.6	6.3	6.9
At 31 December 2016	13.1	6.0	19.1

1. In 2016, there was an update to the categorisation where all loans greater than three months in arrears are treated as specific provisions, in addition to loans that are individually assessed. This resulted in an increase in specific provisions of £5.2m for the Group and £5.1m for the Bank during 2016, with a corresponding decrease in collective provisions.
2. During 2016, the Group sold a portion of non-performing loans from its personal loan portfolio. See note 6 for further details.

Notes to the Financial Statements continued

For the year ended 31 December 2017

19. Impairment losses

	Group Year ended 31-Dec-17 £m	Group Year ended 31-Dec-16 £m
Write-offs in the year	**7.8**	5.7
Disposals	**–**	5.6
Decrease in provision	**(3.4)**	(2.3)
	4.4	9.0

20. Derivatives

The table below reconciles the gross amount of derivative contracts to the carrying balance shown in the statement of financial position:

Group and Bank	Gross amount of recognised financial assets/ (liabilities) £m	Net amounts of financial assets/ (liabilities) presented in the statement of financial position £m	Contracts subject to master netting agreements not offset in the statement of financial position £m	Cash collateral paid/(received) not offset in the statement of financial position £m	Net amount £m
As at 31 December 2017					
Derivative assets	**6.1**	**6.1**	**(5.9)**	**(0.3)**	**(0.1)**
Derivatives liabilities	**(21.8)**	**(21.8)**	**5.9**	**11.8**	**(4.1)**
As at 31 December 2016					
Derivatives assets	1.8	1.8	(1.5)	(0.6)	(0.3)
Derivative liabilities	(24.4)	(24.4)	1.5	6.4	(16.5)

The effects of over collateralisation have not been taken into account in the above table.

Included within derivative liabilities is £4.6m (2016: £16.0m) of derivative contracts not covered by master netting agreements and therefore no cash collateral has been paid.

The Group recognises cash collateral received within amounts owed to credit institutions and cash collateral paid within loans and advances to credit institutions.

21. Fair value adjustments on hedged items

	Group and Bank As at 31-Dec-17 £m	Group and Bank As at 31-Dec-16 £m
Hedged assets		
Current hedge relationships	**15.9**	23.6
Cancelled hedge relationships	**16.0**	23.3
	31.9	46.9
Hedged liabilities		
Current hedge relationships	**–**	(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.

The movement in cancelled hedge relationships is as follows:

	Group and Bank 2017 £m	Group and Bank 2016 £m
Balance at 1 January	**23.3**	37.8
New cancellations	**–**	0.2
Amortisation (see note 5)	**(7.3)**	(4.9)
Exceptional loss (see note 10)	**–**	(9.8)
Balance at 31 December	**16.0**	23.3

22. Investments in subsidiaries, intercompany loans and transactions with related parties

The balances between the Bank and its subsidiaries at the reporting date are summarised in the table below:

2017

	Shares in subsidiary undertakings £m	Intercompany loans receivable £m	Intercompany loans payable £m	Total £m
At 1 January	**1.8**	**982.2**	**(1.9)**	**982.1**
Additions	**–**	**298.4**	**(29.4)**	**269.0**
Repayments	**–**	**(88.1)**	**0.1**	**(88.0)**
At 31 December	**1.8**	**1,192.5**	**(31.2)**	**1,163.1**

2016

	Shares in subsidiary undertakings £m	Intercompany loans receivable £m	Intercompany loans payable £m	Deemed loan liability £m	Total £m
At 1 January	1.8	942.7	(4.9)	(169.5)	770.1
Additions	–	126.0	(0.6)	–	125.4
Repayments	–	(86.5)	3.6	–	(82.9)
Disposals	–	–	–	169.5	169.5
At 31 December	1.8	982.2	(1.9)	–	982.1

Notes to the Financial Statements continued

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22. Investments in subsidiaries, intercompany loans and transactions with related parties continued

A list of the Bank's direct and indirect subsidiaries are below. Subsidiaries have a registered office of Reliance House, Sun Pier, Chatham, Kent, ME4 4ET ('Reliance House') unless otherwise stated.

2017

Direct investments	Class of shares	Activity	Registered office	Ownership	Charged by/(to) the Bank during the year £m	Balance due to/(by) the Bank £m
Easioption Limited	Ordinary	Holding company	Reliance House	**100%**	**–**	**0.5**
Guernsey Home Loans Limited	Ordinary	Mortgage provider	Reliance House	**100%**	**(0.3)**	**17.5**
Guernsey Home Loans Limited (Guernsey)	Ordinary	Mortgage provider	1st Floor, Tudor House, Le Bordage, St Peter Port, Guernsey, GY1 1DB	**100%**	**(1.0)**	**46.6**
Heritable Development Finance Limited[1]	Ordinary	Mortgage originator and servicer	Reliance House	**85%**	**1.9**	**(0.9)**
Interbay Group Holdings Limited	Ordinary	Holding company	Reliance House	**100%**	**–**	**–**
Jersey Home Loans Limited	Ordinary	Mortgage provider	Reliance House	**100%**	**(0.1)**	**3.2**
Jersey Home Loans Limited (Jersey)	Ordinary	Mortgage provider	26 New Street, St Helier, Jersey, JE2 3RA	**100%**	**(4.3)**	**201.4**
OSB India Private Limited[2]	Ordinary	Back office processing	Salarpuria Magnificia, 10th floor, 78 Old Madras Road, Bangalore, 560016, Karnataka, India	**100%**	**5.4**	**5.9**
Prestige Finance Limited	Ordinary	Mortgage originator and servicer	Reliance House	**100%**	**3.2**	**(1.3)**
Reliance Property Loans Limited	Ordinary	Mortgage provider	Reliance House	**100%**	**(0.1)**	**4.1**
Rochester Mortgages Limited	Ordinary	Mortgage provider	Reliance House	**100%**	**–**	**–**
Indirect investments						
Inter Bay Financial I Limited	Ordinary	Holding company	Reliance House	**100%**	**(0.3)**	**19.8**
Inter Bay Financial II Limited	Ordinary	Holding company	Reliance House	**100%**	**(0.2)**	**17.7**
Interbay Funding, Ltd	Ordinary	Mortgage servicer	Reliance House	**100%**	**–**	**(28.9)**
Interbay ML, Ltd	Ordinary	Mortgage provider	Reliance House	**100%**	**(10.2)**	**875.6**
Interbay Holdings Ltd	Ordinary	Holding company	Reliance House	**100%**	**–**	**–**
5D Finance Limited	Ordinary	Mortgage servicer	Reliance House	**100%**	**–**	**0.2**
5D Lending Ltd	Ordinary	Mortgage provider	Reliance House	**100%**	**–**	**(0.1)**
					(6.0)	**1,161.3**

1. Heritable Development Finance Limited is a business development partnership with Heritable Capital Limited. The entity is majority owned and controlled by the Bank. It has minimal retained earnings and immaterial non-controlling interest which is not presented separately in the Group reserves.
2. OSB India Private Limited is owned 70.28% by the Bank and 29.72% by Easioption Limited.

2016

Direct investments	Class of shares	Activity	Registered office	Ownership	Charged by/(to) the Bank during the year £m	Balance due to/(by) the Bank £m
Easioption Limited	Ordinary	Holding company	Reliance House	100%	–	0.5
Guernsey Home Loans Limited	Ordinary	Mortgage provider	Reliance House	100%	(0.5)	21.3
Guernsey Home Loans Limited (Guernsey)	Ordinary	Mortgage provider	1st Floor, Tudor House, Le Bordage, St Peter Port, Guernsey, GY1 1DB	100%	(1.5)	64.1
Heritable Development Finance Limited	Ordinary	Mortgage originator and servicer	Reliance House	85%	2.1	(1.0)
Interbay Group Holdings Limited	Ordinary	Holding company	Reliance House	100%	–	–
Jersey Home Loans Limited	Ordinary	Mortgage provider	Reliance House	100%	(0.1)	4.5
Jersey Home Loans Limited (Jersey)	Ordinary	Mortgage provider	26 New Street, St Helier, Jersey, JE2 3RA	100%	(6.1)	262.2
OSB India Private Limited	Ordinary	Back office processing	Salarpuria Magnificia, 10th floor, 78 Old Madras Road, Bangalore, 560016, Karnataka, India	100%	3.7	0.5
Prestige Finance Limited	Ordinary	Mortgage originator and servicer	Reliance House	100%	3.0	(0.9)
Reliance Property Loans Limited	Ordinary	Mortgage provider	Reliance House	100%	(0.1)	4.4
Rochester Mortgages Limited	Ordinary	Mortgage provider	Reliance House	100%	–	–
Indirect investments						
Cavenham Financial Services Limited[1]	Ordinary	Dormant entity	Reliance House	100%	0.1	–
Inter Bay Financial I Limited	Ordinary	Holding company	Reliance House	100%	(0.4)	19.6
Inter Bay Financial II Limited	Ordinary	Holding company	Reliance House	100%	(0.4)	17.5
Interbay Funding, Ltd	Ordinary	Mortgage servicer	Reliance House	100%	(0.1)	4.4
Interbay ML, Ltd	Ordinary	Mortgage provider	Reliance House	100%	(12.0)	583.1
Interbay Holdings Ltd	Ordinary	Holding company	Reliance House	100%	–	–
5D Finance Limited	Ordinary	Mortgage servicer	Reliance House	100%	–	0.2
5D Lending Ltd	Ordinary	Mortgage provider	Reliance House	100%	–	(0.1)
					(12.3)	980.3

1. Cavenham Financial Services Limited was struck off on 17 January 2017.

All of the above investments are reviewed annually for impairment. All of the subsidiaries are either actively trading or are fully funded by the Bank. Based on management's assessment of the future cash flows of each entity, no impairment has been recognised.

In addition to the above subsidiaries, the Bank has transactions with Kent Reliance Provident Society ('KRPS'), one of its founding shareholders. KRPS runs member engagement forums for the Bank. In exchange, the Bank provides KRPS with various services, including IT, finance and other support functions. During the year, the Bank covered operating expenses of KRPS amounting to £0.3m (2016: £0.3m).

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

Transactions with key management personnel

The Board considers the key management personnel to comprise Executive and Non-Executive Directors. Directors' remuneration is disclosed in note 8 and the Annual Report on Remuneration.

No loans were issued to related parties during 2017 (2016: £nil).

Key management personnel and connected persons held deposits with the Group of £1.5m (2016: £1.4m).

Notes to the Financial Statements continued

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23. Intangible assets

	Group 2017 £m	Group 2016 £m	Bank 2017 £m	Bank 2016 £m
Cost				
At 1 January	**8.5**	5.6	**6.8**	4.3
Additions	**4.2**	2.9	**3.9**	2.5
Disposals and write-offs	**(0.3)**	–	**(0.3)**	–
At 31 December	**12.4**	8.5	**10.4**	6.8
Amortisation				
At 1 January	**3.8**	2.5	**2.7**	1.6
Charged in year	**1.8**	1.3	**1.6**	1.1
Disposals and write-offs	**–**	–	**–**	–
At 31 December	**5.6**	3.8	**4.3**	2.7
Net book value				
At 31 December	**6.8**	4.7	**6.1**	4.1

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

24. Property, plant and equipment

Group 2017	**Freehold land and buildings £m**	**Leasehold improvements £m**	**Equipment and fixtures £m**	**Total £m**
Cost				
At 1 January	**8.7**	**0.5**	**7.5**	**16.7**
Additions	**7.5**	**0.1**	**2.5**	**10.1**
Disposals and write-offs	**–**	**–**	**(0.1)**	**(0.1)**
At 31 December	**16.2**	**0.6**	**9.9**	**26.7**
Depreciation				
At 1 January	**0.4**	**0.1**	**3.1**	**3.6**
Charged in year	**0.2**	**0.1**	**1.4**	**1.7**
Disposals and write-offs	**–**	**–**	**(0.1)**	**(0.1)**
At 31 December	**0.6**	**0.2**	**4.4**	**5.2**
Net book value				
At 31 December	**15.6**	**0.4**	**5.5**	**21.5**

Group 2016	Freehold land and buildings £m	Leasehold improvements £m	Equipment and fixtures £m	Total £m
Cost				
At 1 January	5.9	0.4	5.8	12.1
Additions	2.8	0.1	1.9	4.8
Disposals and write-offs	–	–	(0.3)	(0.3)
Translation difference	–	–	0.1	0.1
At 31 December	8.7	0.5	7.5	16.7
Depreciation				
At 1 January	0.3	–	2.2	2.5
Charged in year	0.1	0.1	1.1	1.3
Disposals and write-offs	–	–	(0.3)	(0.3)
Translation difference	–	–	0.1	0.1
At 31 December	0.4	0.1	3.1	3.6
Net book value				
At 31 December	8.3	0.4	4.4	13.1

Bank 2017	**Freehold land and buildings £m**	**Leasehold improvements £m**	**Equipment and fixtures £m**	**Total £m**
Cost				
At 1 January	**6.4**	**0.5**	**5.7**	**12.6**
Additions	**5.1**	**0.1**	**1.7**	**6.9**
At 31 December	**11.5**	**0.6**	**7.4**	**19.5**
Depreciation				
At 1 January	**0.4**	**0.1**	**2.2**	**2.7**
Charged in year	**0.2**	**0.1**	**1.1**	**1.4**
At 31 December	**0.6**	**0.2**	**3.3**	**4.1**
Net book value				
At 31 December	**10.9**	**0.4**	**4.1**	**15.4**

Bank 2016	Freehold land and buildings £m	Leasehold improvements £m	Equipment and fixtures £m	Total £m
Cost				
At 1 January	3.6	0.4	4.6	8.6
Additions	2.8	0.1	1.1	4.0
At 31 December	6.4	0.5	5.7	12.6
Depreciation				
At 1 January	0.3	–	1.3	1.6
Charged in year	0.1	0.1	0.9	1.1
At 31 December	0.4	0.1	2.2	2.7
Net book value				
At 31 December	6.0	0.4	3.5	9.9

25. Deferred taxation asset

	Group 2017 £m	Group 2016 £m	**Bank 2017 £m**	Bank 2016 £m
At 1 January	**3.4**	3.4	**0.8**	0.7
Profit or loss credit	**0.7**	0.1	**0.7**	0.1
Tax taken directly to equity	**1.0**	(0.1)	**1.0**	–
At 31 December	**5.1**	3.4	**2.5**	0.8
Analysed as:				
Losses carried forward	**2.5**	2.3	**–**	–
Accelerated depreciation	**0.1**	0.1	**–**	–
Share-based payments	**2.5**	1.0	**2.5**	0.8
	5.1	3.4	**2.5**	0.8

The deferred tax has been calculated using the relevant rates for the expected periods of utilisation.

As at 31 December 2017, the Group had £3.7m (2016: £5.1m) of losses for which a deferred tax asset has not been recognised.

A reduction in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and a further reduction to 18% (effective from 1 April 2020) were substantively enacted on 26 October 2015. An additional reduction to 17% (effective 1 April 2020) was substantively enacted on 6 September 2016.

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26. Other assets

	Group As at 31-Dec-17 £m	Group As at 31-Dec-16 £m	**Bank As at 31-Dec-17 £m**	Bank As at 31-Dec-16 £m
Prepayments	**1.9**	1.4	**1.7**	1.3
Other assets[1]	**3.0**	10.5	**3.0**	2.5
	4.9	11.9	**4.7**	3.8

1. During the year, the Group reclassified deferred broker fees paid in the Interbay group of subsidiaries from other assets to loans and advances to customers. The amount of deferred broker fees as at 31 December 2016 was £7.3m.

27. Amounts owed to retail depositors

	Group and Bank As at 31-Dec-17 £m	Group and Bank As at 31-Dec-16 £m
Amounts owed to retail depositors	**6,650.3**	5,952.4

Repayable in the ordinary course of business as follows:

	Group and Bank As at 31-Dec-17 £m	Group and Bank As at 31-Dec-16 £m
On demand	**2,051.8**	1,932.5
Less than three months	**862.0**	702.4
Three months to one year	**2,590.7**	1,977.2
One to five years	**1,145.8**	1,340.3
	6,650.3	5,952.4

28. Amounts owed to credit institutions

Repayable in the ordinary course of business as follows:

	Group and Bank As at 31-Dec-17 £m	Group and Bank As at 31-Dec-16 £m
Less than three months	**0.3**	0.7
Three months to one year	**–**	–
One to five years	**1,250.0**	101.0
	1,250.3	101.7

As at 31 December 2017, amounts owed to credit institutions included £1,250.0m (2016: £101.0m) owed to the Bank of England under the TFS. In exchange, the Group pledges with the Bank of England either loans and advances to customers or other investment securities. The value of pledged loans and advances to customers is disclosed in note 17.

29. Amounts owed to other customers

Repayable in the ordinary course of business as follows:

	Group and Bank As at 31-Dec-17 £m	Group and Bank As at 31-Dec-16 £m
Less than three months	**0.5**	4.0
Three months to one year	**25.2**	–
	25.7	4.0

30. Other liabilities

	Group As at 31-Dec-17 £m	Group As at 31-Dec-16 £m	**Bank As at 31-Dec-17 £m**	Bank As at 31-Dec-16 £m
Falling due within one year:				
Accruals and deferred income	**11.8**	7.6	**9.8**	6.0
Other creditors[1]	**4.5**	11.0	**3.6**	1.4
	16.3	18.6	**13.4**	7.4

1. During the year, the Group reclassified accrued arrangement fees received on the completion of new loans in the Interbay group of subsidiaries from other liabilities to loans and advances to customers. The amount of accrued arrangement fees as at 31 December 2016 was £8.7m.

31. FSCS and other regulatory provisions

The Financial Services Compensation Scheme ('FSCS') provides protection of deposits for the customers of authorised financial services firms, should a firm collapse. FSCS protects retail deposits of up to £85,000 (2016: £75,000) for single account holders and £170,000 (2016: £150,000) for joint holders.

The compensation paid out to consumers is initially funded through loans from the Bank of England and HM Treasury. In order to repay the loans and cover its costs, the FSCS charges levies on firms regulated by the PRA and the Financial Conduct Authority ('FCA'). The Group is among those firms and pays the FSCS a levy based on its share of total UK deposits. In accordance with IFRIC 21 interpretation of IAS 37, the FSCS liability for 2017 will be recognised in 2018. The FSCS balance at the reporting date relates to the levy from previous years.

The Group has reviewed its current exposure to Plevin Payment Protection Insurance claims and other FCA conduct rules exposures and has recognised a provision of £0.9m (2016: £0.1m) to cover potential future claims.

An analysis of the Group and Bank's FSCS and other provisions are presented below:

Group and Bank	**FSCS 2017 £m**	**Other provisions 2017 £m**	**Total 2017 £m**	FSCS 2016 £m	Other provisions 2016 £m	Total 2016 £m
As at 1 January	**1.4**	**0.1**	**1.5**	2.2	0.1	2.3
Paid during the year	**(1.0)**	**–**	**(1.0)**	(1.3)	–	(1.3)
Charge	**0.1**	**0.8**	**0.9**	0.5	–	0.5
At 31 December	**0.5**	**0.9**	**1.4**	1.4	0.1	1.5

32. Subordinated liabilities

	Group and Bank 2017 £m	Group and Bank 2016 £m
At 1 January	**21.6**	24.6
Repayment of debt at maturity	**(10.7)**	(3.0)
As at 31 December	**10.9**	21.6

The Group's outstanding subordinated liabilities are summarised below:

	Group and Bank As at 31-Dec-17 £m	Group and Bank As at 31-Dec-16 £m
Linked to LIBOR:		
Floating rate subordinated liabilities 2017 (LIBOR + 1.5%)	**–**	5.7
Floating rate subordinated loans 2022 (LIBOR + 5%)	**0.3**	0.3
Floating rate subordinated loans 2022 (LIBOR + 2%)	**0.4**	0.4
Linked to the average standard mortgage rate of the five largest building societies:		
Floating rate subordinated liabilities 2017 (+5.963%)	**–**	5.0
Fixed rate:		
Subordinated liabilities 2019 (7.45%)[1]	**5.1**	5.1
Subordinated liabilities 2024 (6.45%)[2]	**5.1**	5.1
	10.9	21.6

1. On 27 September 2016, the Group decided not to call the £5.0m first tranche of the subordinated debt with original maturity of 27 September 2024. As the debt was not called, the coupon rate reset to 7.45% until maturity.
2. The Group has the option to call the £5.0m second tranche of the subordinated debt on 27 September 2019.

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32. Subordinated liabilities continued

Subordinated liabilities are repayable at the dates stated or earlier at the option of the Group with the prior consent of the PRA. All subordinated liabilities are denominated in sterling and are unlisted.

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

33. Perpetual Subordinated Bonds

	Group and Bank As at 31-Dec-17 £m	Group and Bank As at 31-Dec-16 £m
Sterling Perpetual Subordinated Bonds	**15.3**	15.3

The bonds are listed on the London Stock Exchange. They were issued with no discretion over the payment of interest and may not be settled in the Group's own equity. They are therefore classified as financial liabilities. The coupon rate is 5.9884%.

34. Share capital

	Number of shares	Nominal value (£m)	Premium (£m)
At 1 January 2017	**243,082,091**	**2.4**	**157.9**
Shares issued under OSB employee share plan	**382,597**	**–**	**0.5**
At 31 December 2017	**243,464,688**	**2.4**	**158.4**
At 1 January 2016	243,079,965	2.4	157.9
Shares issued under OSB employee share plan	2,126	–	–
At 31 December 2016	243,082,091	2.4	157.9

35. Other reserves

Transfer reserve

The transfer reserve of £12.8m (Bank: £15.2m) represents the difference between the value of net assets transferred to the Group from Kent Reliance Building Society in 2011 and the value of shares issued to the A ordinary shareholders.

AFS reserve

The AFS reserve of £0.1m (2016: £nil) represents the cumulative net change in the fair value of investment securities measured at FVOCI.

Perpetual Subordinated Bonds

In addition to the PSBs in note 33, the Bank has issued £22.0m of PSBs which are classified as equity in accordance with the conditions contained in note 1(p). The classification of these PSBs means that any coupon payments on them are treated within retained earnings rather than through profit or loss. The coupon rate was 6.591% until the reset date on 7 March 2016, after which it was reset to 4.5991% until the next reset date on 7 March 2021.

AT1 securities

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.

Transaction costs directly related to the AT1 securities issuance have been recognised directly in equity within retained earnings net of tax.

36. Financial commitments and guarantees

a) As at 31 December 2017, the Group's contracted or anticipated capital expenditure commitments not provided for amounted to £0.3m (2016: £1.1m). 2017 consists of branch refurbishment costs. 2016 consisted of branch refurbishment costs and UK head office improvements.

b) The Group's minimum lease commitments under operating leases are summarised in the table below:

	Group As at 31-Dec-17 £m	Group As at 31-Dec-16 £m	**Bank As at 31-Dec-17 £m**	Bank As at 31-Dec-16 £m
Land and buildings: due within:				
One year	**0.5**	0.4	**0.3**	0.4
Two to five years	**1.0**	0.9	**0.8**	0.8
	1.5	1.3	**1.1**	1.2

c) Undrawn mortgage loan facilities:

	Group As at 31-Dec-17 £m	Group As at 31-Dec-16 £m	**Bank As at 31-Dec-17 £m**	Bank As at 31-Dec-16 £m
BTL/SME mortgages	**485.9**	188.5	**390.5**	120.3
Residential mortgages	**44.3**	176.9	**44.3**	176.9
	530.2	365.4	**434.8**	297.2

Undrawn loan facilities are approved loan applications which have not yet been exercised. They are payable on demand and are usually drawn down or expire within three months.

d) The Group did not have any issued financial guarantees as at 31 December 2017 (2016: £nil).

37. Risk management

Overview

Financial instruments form the vast majority of the Group's and Bank's assets and liabilities. The Group manages risk on a consolidated basis, and risk disclosures are provided on this basis.

Types of financial instrument

Financial instruments are a broad definition which includes financial assets, financial liabilities and equity instruments. The main financial assets of the Group are loans to customers and liquid assets, which, in turn, consist of cash in the Bank of England call account, call accounts with other credit institutions and UK and EU sovereign debt. These are funded by a combination of financial liabilities and equity instruments. Financial liability funding comes predominantly from retail deposits and drawdowns under the Bank of England TFS, supported by debt securities, subordinated debt, wholesale and other funding. Equity instruments include own shares, perpetual bonds and AT1 securities meeting the equity classification criteria. The Group's main activity is mortgage lending; it raises funds or invests in particular types of financial assets primarily in order to satisfy banking industry regulations and manage the risks arising from its operations. The Group does not trade in financial instruments for speculative purposes.

The Group uses derivative instruments to manage its financial risks. Derivative financial instruments ('derivatives') are financial instruments whose value changes in response to changes in underlying variables such as interest rates. Typically, the contract value of derivatives is much smaller than that of the instruments they relate to, which makes them a convenient tool for benefiting from value changes without the need to buy or sell the whole underlying product. The most common derivatives comprise futures, forwards and swaps. Among these, the Group only uses swaps.

Derivatives are used by the Group solely to reduce ('hedge') the risk of loss arising from changes in market factors. Derivatives are not used for speculative purposes.

Types of derivatives and uses

The derivative instruments used by the Group in managing its risk exposures are interest rate swaps. Interest rate swaps convert fixed interest rates to floating or vice versa. As with other derivatives, the underlying product is not sold and payments are based on notional principal amounts.

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37. Risk management continued

Unhedged fixed rate liabilities create the risk of paying above-the-market rate if interest rates subsequently decrease. Unhedged fixed rate mortgages and liquid assets bear the opposite risk of earning below-the-market income when rates go up. While fixed rate assets and liabilities naturally hedge each other to a certain extent, this hedge is usually never balanced.

The Group uses swaps to convert its instruments, such as mortgages, deposits and liquid assets, from fixed or base rate-linked rates to LIBOR-linked variable rates. This ensures a guaranteed margin between the interest income and interest expense, regardless of changes in the Risk review.

Types of risk

The principal financial risks to which the Group is exposed are credit, liquidity and market risks, the latter comprising of interest and exchange rate risk. In addition to financial risks, the Group is exposed to various other risks, most notably operational, conduct and regulatory, covered in the Risk review.

The financial risks are analysed below. Additional information is contained within the Principal risks and uncertainties on pages 39 to 44.

Credit risk

Credit risk is the risk that unexpected losses may arise as a result of the Group's borrowers or market counterparties failing to meet their obligations to repay.

The Group has adopted the Standardised Approach for assessment of credit risk capital requirements. This approach considers risk weightings as defined under Basel II and Basel III principles.

The classes of financial instruments to which the Group is most exposed are loans and advances to customers, loans and advances to credit institutions, cash in the Bank of England call account, call and current accounts with other credit institutions and investment securities. The maximum credit risk exposure equals the total carrying amount of the above categories plus off balance sheet undrawn mortgage facilities.

Credit risk – loans and advances to customers

Credit risk associated with mortgage lending is largely driven by the housing market and level of unemployment. A recession and/or high interest rates could cause pressure within the market, resulting in rising levels of arrears and repossessions.

All loan applications are assessed with reference to the Group's lending policy. Changes to the policy are approved by the Board, with mandates set for the approval of loan applications.

The Credit Committee and the Assets and Liabilities Committee ('ALCO') regularly monitor lending activity, taking appropriate actions to reprice products and adjust lending criteria in order to control risk and manage exposure. Where necessary and appropriate, changes to the lending policy are recommended to the Risk Committee and the Board.

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

	Group As at 31-Dec-17		Group As at 31-Dec-16	
	£m	%	£m	%
BTL/SME mortgages	5,654.1	77	4,104.3	69
Residential mortgages	1,673.5	23	1,859.9	31
Total loans before provisions	**7,327.6**	**100**	5,964.2	100

	Bank As at 31-Dec-17		Bank As at 31-Dec-16	
	£m	%	£m	%
BTL/SME mortgages	4,588.7	76	3,299.5	67
Residential mortgages	1,477.8	24	1,613.1	33
Total loans before provisions	**6,066.5**	**100**	4,912.6	100

Property values are updated to reflect changes in the HPI. A breakdown of loans and advances to customers by indexed loan-to-value ('LTV') is as follows:

LTV analysis by band for all loans:

Group	As at 31-Dec-17			
	BTL/SME £m	Residential £m	Total £m	%
Band				
0%–50%	**747.6**	**808.3**	**1,555.9**	**21**
50%–60%	**960.5**	**260.6**	**1,221.1**	**16**
60%–70%	**1,606.8**	**228.3**	**1,835.1**	**25**
70%–80%	**1,939.4**	**184.5**	**2,123.9**	**29**
80%–90%	**359.1**	**138.2**	**497.3**	**7**
90%–100%	**15.1**	**31.6**	**46.7**	**1**
>100%	**24.5**	**22.0**	**46.5**	**1**
Total mortgages before provisions	**5,653.0**	**1,673.5**	**7,326.5**	**100**
Personal loans	**1.1**	**–**	**1.1**	**–**
Total loans before provisions	**5,654.1**	**1,673.5**	**7,327.6**	**100**

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

Bank	As at 31-Dec-17			
	BTL/SME £m	Residential £m	Total £m	%
Band				
0%–50%	**587.1**	**738.2**	**1,325.3**	**22**
50%–60%	**745.4**	**225.8**	**971.2**	**16**
60%–70%	**1,259.2**	**188.0**	**1,447.2**	**24**
70%–80%	**1,631.2**	**161.7**	**1,792.9**	**29**
80%–90%	**333.1**	**121.5**	**454.6**	**7**
90%–100%	**10.4**	**26.3**	**36.7**	**1**
>100%	**21.2**	**16.3**	**37.5**	**1**
Total mortgages before provisions	**4,587.6**	**1,477.8**	**6,065.4**	**100**
Personal loans	**1.1**	**–**	**1.1**	**–**
Total loans before provisions	**4,588.7**	**1,477.8**	**6,066.5**	**100**

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For the year ended 31 December 2017

37. Risk management continued

Bank	As at 31-Dec-16 BTL/SME £m	Residential £m	Total £m	%
Band				
0%–50%	613.0	714.8	1,327.8	27
50%–60%	663.7	251.1	914.8	19
60%–70%	940.0	249.7	1,189.7	24
70%–80%	892.5	206.8	1,099.3	22
80%–90%	157.8	129.5	287.3	6
90%–100%	1.1	38.4	39.5	1
>100%	22.0	22.8	44.8	1
Total mortgages before provisions	3,290.1	1,613.1	4,903.2	100
Personal loans	9.4	–	9.4	–
Total loans before provisions	3,299.5	1,613.1	4,912.6	100

LTV analysis by band for BTL/SME:

Group	As at 31-Dec-17				
	Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Band					
0%–50%	567.0	66.8	88.3	25.5	747.6
50%–60%	841.2	62.3	42.8	14.2	960.5
60%–70%	1,437.7	120.6	8.9	39.6	1,606.8
70%–80%	1,811.5	112.8	3.9	11.2	1,939.4
80%–90%	343.1	2.5	–	13.5	359.1
90%–100%	14.2	0.4	–	0.5	15.1
>100%	19.1	5.4	–	–	24.5
Total mortgages before provisions	5,033.8	370.8	143.9	104.5	5,653.0
Personal loans					1.1
Total loans before provisions					5,654.1

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

Bank	As at 31-Dec-17				
	Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Band					
0%–50%	**466.8**	**6.5**	**88.3**	**25.5**	**587.1**
50%–60%	**686.3**	**2.1**	**42.8**	**14.2**	**745.4**
60%–70%	**1,204.4**	**6.3**	**8.9**	**39.6**	**1,259.2**
70%–80%	**1,607.9**	**8.2**	**3.9**	**11.2**	**1,631.2**
80%–90%	**319.5**	**0.1**	**–**	**13.5**	**333.1**
90%–100%	**9.9**	**–**	**–**	**0.5**	**10.4**
>100%	**17.0**	**4.2**	**–**	**–**	**21.2**
Total mortgages before provisions	**4,311.8**	**27.4**	**143.9**	**104.5**	**4,587.6**
Personal loans					**1.1**
Total loans before provisions					**4,588.7**

Bank	As at 31-Dec-16				
	Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Band					
0%–50%	458.6	17.8	104.7	31.9	613.0
50%–60%	613.2	8.4	23.5	18.6	663.7
60%–70%	905.1	0.3	13.4	21.2	940.0
70%–80%	891.2	1.3	–	–	892.5
80%–90%	157.8	–	–	–	157.8
90%–100%	1.1	–	–	–	1.1
>100%	17.7	4.3	–	–	22.0
Total mortgages before provisions	3,044.7	32.1	141.6	71.7	3,290.1
Personal loans					9.4
Total loans before provisions					3,299.5

LTV analysis by band for Residential mortgages:

Group	As at 31-Dec-17			
	First charge £m	Second charge £m	Funding lines £m	Total £m
Band				
0%–50%	**647.1**	**150.2**	**11.0**	**808.3**
50%–60%	**163.3**	**94.2**	**3.1**	**260.6**
60%–70%	**147.9**	**78.4**	**2.0**	**228.3**
70%–80%	**136.1**	**47.2**	**1.2**	**184.5**
80%–90%	**116.4**	**21.6**	**0.2**	**138.2**
90%–100%	**22.2**	**9.3**	**0.1**	**31.6**
>100%	**7.6**	**14.4**	**-**	**22.0**
Total mortgages before provisions	**1,240.6**	**415.3**	**17.6**	**1,673.5**

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

Notes to the Financial Statements continued

For the year ended 31 December 2017

37. Risk management continued

Bank	As at 31-Dec-17			
	First charge £m	Second charge £m	Funding lines £m	Total £m
Band				
0%–50%	**577.0**	**150.2**	**11.0**	**738.2**
50%–60%	**128.5**	**94.2**	**3.1**	**225.8**
60%–70%	**107.6**	**78.4**	**2.0**	**188.0**
70%–80%	**113.3**	**47.2**	**1.2**	**161.7**
80%–90%	**99.7**	**21.6**	**0.2**	**121.5**
90%–100%	**16.9**	**9.3**	**0.1**	**26.3**
>100%	**1.9**	**14.4**	**–**	**16.3**
Total mortgages before provisions	**1,044.9**	**415.3**	**17.6**	**1,477.8**

Bank	As at 31-Dec-16			
	First charge £m	Second charge £m	Funding lines £m	Total £m
Band				
0%–50%	532.7	154.5	27.6	714.8
50%–60%	138.8	103.1	9.2	251.1
60%–70%	140.3	102.3	7.1	249.7
70%–80%	138.0	64.0	4.8	206.8
80%–90%	100.9	27.2	1.4	129.5
90%–100%	22.3	16.0	0.1	38.4
>100%	2.3	20.1	0.4	22.8
Total mortgages before provisions	1,075.3	487.2	50.6	1,613.1

Analysis of mortgage portfolio by arrears and collateral held

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

In 2016, there was an update to the categorisation where collectively assessed provisions on loans greater than three months in arrears are now treated as specific provisions, in addition to those that are individually assessed, as disclosed in note 18.

Below is a summary of capped collateral:

	Group As at 31-Dec-17		Group As at 31-Dec-16	
	Loan balance £m	Capped collateral £m	Loan balance £m	Capped collateral £m
Not past due and not impaired	**6,792.9**	**6,784.8**	5,478.4	5,464.5
Past due but not impaired	**452.2**	**452.1**	395.9	395.8
Impaired	**81.4**	**76.6**	80.5	69.1
Total mortgages before provisions	**7,326.5**	**7,313.5**	5,954.8	5,929.4
Personal loans	**1.1**		9.4	
Total loans before provisions	**7,327.6**		5,964.2	

	Bank As at 31-Dec-17		Bank As at 31-Dec-16	
	Loan balance £m	Capped collateral £m	Loan balance £m	Capped collateral £m
Not past due and not impaired	**5,613.8**	**5,606.5**	4,494.3	4,481.3
Past due but not impaired	**394.4**	**394.2**	349.1	349.0
Impaired	**57.2**	**52.9**	59.8	50.9
Total mortgages before provisions	**6,065.4**	**6,053.6**	4,903.2	4,881.2
Personal loans	**1.1**		9.4	
Total loans before provisions	**6,066.5**		4,912.6	

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

	Group As at 31-Dec-17		Group As at 31-Dec-16	
	Loan balance £m	Capped collateral £m	Loan balance £m	Capped collateral £m
Not impaired:				
Not past due	**6,792.9**	**6,784.8**	5,478.4	5,464.5
Past due < 1 month	**307.1**	**307.1**	183.5	183.5
Past due 1 to 3 months	**102.0**	**101.9**	168.2	168.2
Past due 3 to 6 months	**20.9**	**20.9**	24.4	24.3
Past due 6 to 12 months	**14.1**	**14.1**	12.8	12.8
Past due over 12 months	**7.6**	**7.6**	6.2	6.2
Possessions[1]	**0.5**	**0.5**	0.8	0.8
	7,245.1	**7,236.9**	5,874.3	5,860.3
Impaired[2]:				
Not past due	**12.3**	**7.7**	3.2	0.4
Past due < 1 month	**0.8**	**0.8**	1.0	1.0
Past due 1 to 3 months	**2.2**	**2.1**	1.2	1.2
Past due 3 to 6 months	**23.7**	**23.7**	14.8	14.8
Past due 6 to 12 months	**16.3**	**16.3**	16.3	16.2
Past due over 12 months	**14.5**	**14.4**	31.8	24.9
Possessions	**11.6**	**11.6**	12.2	10.6
	81.4	**76.6**	80.5	69.1
Total mortgages before provisions	**7,326.5**	**7,313.5**	5,954.8	5,929.4
Personal loans	**1.1**		9.4	
Total loans before provisions	**7,327.6**		5,964.2	
Contractual maturity:				
Past due but not impaired				
Less than three months	**9.3**		5.0	
Three months to one year	**7.2**		4.3	
One to five years	**27.7**		22.4	
More than five years	**408.0**		364.2	
	452.2		395.9	
Impaired				
Less than three months	**11.2**		17.0	
Three months to one year	**0.9**		1.2	
One to five years	**5.9**		2.5	
More than five years	**63.4**		59.8	
	81.4		80.5	

1. Mortgages with properties in possession are not considered impaired if the fair value of collateral exceeds the value of debt.
2. Impaired is defined as loans with a specific provision against them.

Notes to the Financial Statements continued

For the year ended 31 December 2017

37. Risk management continued

	Bank As at 31-Dec-17		Bank As at 31-Dec-16	
	Loan balance £m	Capped collateral £m	Loan balance £m	Capped collateral £m
Not impaired:				
Not past due	5,613.8	5,606.5	4,494.3	4,481.3
Past due < 1 month	267.7	267.6	162.2	162.2
Past due 1 to 3 months	87.2	87.1	146.8	146.7
Past due 3 to 6 months	19.8	19.8	21.5	21.5
Past due 6 to 12 months	12.9	12.9	12.1	12.1
Past due over 12 months	6.3	6.3	5.7	5.7
Possessions[1]	0.5	0.5	0.8	0.8
	6,008.2	6,000.7	4,843.4	4,830.3
Impaired[2]:				
Not past due	7.0	2.7	2.7	0.4
Past due < 1 month	0.5	0.5	0.5	0.5
Past due 1 to 3 months	–	–	–	–
Past due 3 to 6 months	20.8	20.8	12.5	12.5
Past due 6 to 12 months	12.4	12.4	12.9	12.9
Past due over 12 months	12.1	12.1	26.7	20.1
Possessions	4.4	4.4	4.5	4.5
	57.2	52.9	59.8	50.9
Total mortgages before provisions	6,065.4	6,053.6	4,903.2	4,881.2
Personal loans	1.1		9.4	
Total loans before provisions	6,066.5		4,912.6	
Contractual maturity:				
Past due but not impaired				
Less than three months	7.6		3.0	
Three months to one year	1.4		2.9	
One to five years	21.1		15.8	
More than five years	364.3		327.4	
	394.4		349.1	
Impaired				
Less than three months	7.1		16.0	
Three months to one year	0.3		1.2	
One to five years	5.4		2.5	
More than five years	44.4		40.1	
	57.2		59.8	

1. Mortgages with properties in possession are not considered impaired if the fair value of collateral exceeds the value of debt.
2. Impaired is defined as loans with a specific provision against them.

Analysis of mortgage portfolio by arrears for BTL/SME

Group	As at 31-Dec-17				
	Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Not impaired:					
Not past due	4,810.7	360.8	143.9	104.5	5,419.9
Past due < 1 month	160.4	2.8	–	–	163.2
Past due 1 to 3 months	31.9	0.6	–	–	32.5
Past due 3 to 6 months	2.7	–	–	–	2.7
Past due 6 to 12 months	0.7	–	–	–	0.7
Past due over 12 months	0.3	0.8	–	–	1.1
Possessions	–	–	–	–	–
	5,006.7	365.0	143.9	104.5	5,620.1
Impaired:					
Not past due	4.6	4.5	–	–	9.1
Past due < 1 month	–	0.1	–	–	0.1
Past due 1 to 3 months	–	–	–	–	–
Past due 3 to 6 months	9.1	–	–	–	9.1
Past due 6 to 12 months	4.0	0.4	–	–	4.4
Past due over 12 months	1.6	0.1	–	–	1.7
Possessions	7.8	0.7	–	–	8.5
	27.1	5.8	–	–	32.9
Total mortgages before provisions	5,033.8	370.8	143.9	104.5	5,653.0
Personal loans					1.1
Total loans before provisions					5,654.1
Contractual maturity:					
Past due but not impaired					
Less than three months	5.8	–	–	–	5.8
Three months to one year	5.6	–	–	–	5.6
One to five years	5.1	0.8	–	–	5.9
More than five years	179.5	3.4	–	–	182.9
	196.0	4.2	–	–	200.2
Impaired					
Less than three months	6.9	–	–	–	6.9
Three months to one year	0.6	–	–	–	0.6
One to five years	1.1	0.1	–	–	1.2
More than five years	18.5	5.7	–	–	24.2
	27.1	5.8	–	–	32.9

Notes to the Financial Statements continued

For the year ended 31 December 2017

37. Risk management continued

	As at 31-Dec-16				
Group	Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Not impaired:					
Not past due	3,468.7	252.9	141.6	71.7	3,934.9
Past due < 1 month	62.5	3.3	–	–	65.8
Past due 1 to 3 months	56.5	1.1	–	–	57.6
Past due 3 to 6 months	2.0	0.3	–	–	2.3
Past due 6 to 12 months	0.4	0.7	–	–	1.1
Past due over 12 months	–	0.3	–	–	0.3
Possessions	–	–	–	–	–
	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
Contractual maturity:					
Past due but not impaired					
Less than three months	0.1	–	–	–	0.1
Three months to one year	0.4	–	–	–	0.4
One to five years	4.1	–	–	–	4.1
More than five years	116.8	5.7	–	–	122.5
	121.4	5.7	–	–	127.1
Impaired					
Less than three months	15.4	–	–	–	15.4
Three months to one year	–	–	–	–	–
One to five years	–	–	–	–	–
More than five years	7.8	9.7	–	–	17.5
	23.2	9.7	–	–	32.9

Bank	Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
	As at 31-Dec-17				
Not impaired:					
Not past due	4,119.2	22.7	143.9	104.5	4,390.3
Past due < 1 month	145.7	0.5	–	–	146.2
Past due 1 to 3 months	25.5	–	–	–	25.5
Past due 3 to 6 months	2.3	–	–	–	2.3
Past due 6 to 12 months	0.6	–	–	–	0.6
Past due over 12 months	0.3	–	–	–	0.3
Possessions	–	–	–	–	–
	4,293.6	23.2	143.9	104.5	4,565.2
Impaired:					
Not past due	2.4	4.2	–	–	6.6
Past due < 1 month	–	–	–	–	–
Past due 1 to 3 months	–	–	–	–	–
Past due 3 to 6 months	7.6	–	–	–	7.6
Past due 6 to 12 months	3.0	–	–	–	3.0
Past due over 12 months	0.9	–	–	–	0.9
Possessions	4.3	–	–	–	4.3
	18.2	4.2	–	–	22.4
Total mortgages before provisions	4,311.8	27.4	143.9	104.5	4,587.6
Personal loans					1.1
Total loans before provisions					4,588.7
Contractual maturity:					
Past due but not impaired					
Less than three months	4.4	–	–	–	4.4
Three months to one year	–	–	–	–	–
One to five years	2.7	–	–	–	2.7
More than five years	167.3	0.5	–	–	167.8
	174.4	0.5	–	–	174.9
Impaired					
Less than three months	6.6	–	–	–	6.6
Three months to one year	–	–	–	–	–
One to five years	0.8	–	–	–	0.8
More than five years	10.8	4.2	–	–	15.0
	18.2	4.2	–	–	22.4

Notes to the Financial Statements continued

For the year ended 31 December 2017

37. Risk management continued

Bank	As at 31-Dec-16 Buy-to-Let £m	Commercial £m	Residential development £m	Funding lines £m	Total £m
Not impaired:					
Not past due	2,922.4	25.1	141.6	71.7	3,160.8
Past due < 1 month	53.6	1.4	–	–	55.0
Past due 1 to 3 months	50.2	0.3	–	–	50.5
Past due 3 to 6 months	0.6	–	–	–	0.6
Past due 6 to 12 months	0.4	–	–	–	0.4
Past due over 12 months	–	0.3	–	–	0.3
Possessions	–	–	–	–	–
	3,027.2	27.1	141.6	71.7	3,267.6
Impaired:					
Not past due	2.6	0.1	–	–	2.7
Past due < 1 month	–	–	–	–	–
Past due 1 to 3 months	–	–	–	–	–
Past due 3 to 6 months	0.8	–	–	–	0.8
Past due 6 to 12 months	1.2	–	–	–	1.2
Past due over 12 months	8.5	4.9	–	–	13.4
Possessions	4.4	–	–	–	4.4
	17.5	5.0	–	–	22.5
Total mortgages before provisions	3,044.7	32.1	141.6	71.7	3,290.1
Personal loans					9.4
Total loans before provisions					3,299.5
Contractual maturity:					
Past due but not impaired					
Less than three months	0.1	–	–	–	0.1
Three months to one year	–	–	–	–	–
One to five years	0.8	0.1	–	–	0.9
More than five years	103.9	1.9	–	–	105.8
	104.8	2.0	–	–	106.8
Impaired					
Less than three months	15.4	–	–	–	15.4
Three months to one year	–	–	–	–	–
One to five years	–	–	–	–	–
More than five years	2.1	5.0	–	–	7.1
	17.5	5.0	–	–	22.5

Analysis of mortgage portfolio by arrears for Residential mortgages

Group	As at 31-Dec-17			
	First charge £m	Second charge £m	Funding lines £m	Total £m
Not impaired:				
Not past due	1,023.6	331.8	17.6	1,373.0
Past due < 1 month	123.1	20.8	–	143.9
Past due 1 to 3 months	46.4	23.1	–	69.5
Past due 3 to 6 months	10.5	7.7	–	18.2
Past due 6 to 12 months	8.1	5.3	–	13.4
Past due over 12 months	3.2	3.3	–	6.5
Possessions	0.5	–	–	0.5
	1,215.4	392.0	17.6	1,625.0
Impaired:				
Not past due	2.9	0.3	–	3.2
Past due < 1 month	0.7	–	–	0.7
Past due 1 to 3 months	2.2	–	–	2.2
Past due 3 to 6 months	7.5	7.1	–	14.6
Past due 6 to 12 months	6.6	5.3	–	11.9
Past due over 12 months	2.2	10.6	–	12.8
Possessions	3.1	–	–	3.1
	25.2	23.3	–	48.5
Total mortgages before provisions	1,240.6	415.3	17.6	1,673.5
Contractual maturity:				
Past due but not impaired				
Less than three months	3.3	0.2	–	3.5
Three months to one year	1.0	0.6	–	1.6
One to five years	11.5	10.3	–	21.8
More than five years	176.0	49.1	–	225.1
	191.8	60.2	–	252.0
Impaired				
Less than three months	4.2	0.1	–	4.3
Three months to one year	–	0.3	–	0.3
One to five years	0.8	3.9	–	4.7
More than five years	20.2	19.0	–	39.2
	25.2	23.3	–	48.5

Notes to the Financial Statements continued

For the year ended 31 December 2017

37. Risk management continued

Group	As at 31-Dec-16			
	First charge £m	Second charge £m	Funding lines £m	Total £m
Not impaired:				
Not past due	1,100.6	392.3	50.6	1,543.5
Past due < 1 month	99.8	17.9	–	117.7
Past due 1 to 3 months	80.2	30.4	–	110.6
Past due 3 to 6 months	12.8	9.3	–	22.1
Past due 6 to 12 months	5.0	6.7	–	11.7
Past due over 12 months	2.8	3.1	–	5.9
Possessions	0.8	–	–	0.8
	1,302.0	459.7	50.6	1,812.3
Impaired:				
Not past due	0.6	–	–	0.6
Past due < 1 month	0.6	–	–	0.6
Past due 1 to 3 months	0.9	–	–	0.9
Past due 3 to 6 months	6.0	7.5	–	13.5
Past due 6 to 12 months	5.8	8.1	–	13.9
Past due over 12 months	4.9	11.9	–	16.8
Possessions	1.3	–	–	1.3
	20.1	27.5	–	47.6
Total mortgages before provisions	1,322.1	487.2	50.6	1,859.9
Contractual maturity:				
Past due but not impaired				
Less than three months	4.3	0.6	–	4.9
Three months to one year	2.8	1.1	–	3.9
One to five years	9.1	9.2	–	18.3
More than five years	185.2	56.5	–	241.7
	201.4	67.4	–	268.8
Impaired				
Less than three months	1.3	0.3	–	1.6
Three months to one year	0.2	1.0	–	1.2
One to five years	–	2.5	–	2.5
More than five years	18.6	23.7	–	42.3
	20.1	27.5	–	47.6

Bank	As at 31-Dec-17			
	First charge £m	Second charge £m	Funding lines £m	Total £m
Not impaired:				
Not past due	874.1	331.8	17.6	1,223.5
Past due < 1 month	100.7	20.8	–	121.5
Past due 1 to 3 months	38.6	23.1	–	61.7
Past due 3 to 6 months	9.8	7.7	–	17.5
Past due 6 to 12 months	7.0	5.3	–	12.3
Past due over 12 months	2.7	3.3	–	6.0
Possessions	0.5	–	–	0.5
	1,033.4	392.0	17.6	1,443.0
Impaired:				
Not past due	0.1	0.3	–	0.4
Past due < 1 month	0.5	–	–	0.5
Past due 1 to 3 months	–	–	–	–
Past due 3 to 6 months	6.1	7.1	–	13.2
Past due 6 to 12 months	4.1	5.3	–	9.4
Past due over 12 months	0.6	10.6	–	11.2
Possessions	0.1	–	–	0.1
	11.5	23.3	–	34.8
Total mortgages before provisions	1,044.9	415.3	17.6	1,477.8
Contractual maturity:				
Past due but not impaired				
Less than three months	3.0	0.2	–	3.2
Three months to one year	0.8	0.6	–	1.4
One to five years	8.1	10.3	–	18.4
More than five years	147.4	49.1	–	196.5
	159.3	60.2	–	219.5
Impaired				
Less than three months	0.4	0.1	–	0.5
Three months to one year	–	0.3	–	0.3
One to five years	0.7	3.9	–	4.6
More than five years	10.4	19.0	–	29.4
	11.5	23.3	–	34.8

Notes to the Financial Statements continued

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37. Risk management continued

Bank	As at 31-Dec-16			
	First charge £m	Second charge £m	Funding lines £m	Total £m
Not impaired:				
Not past due	890.6	392.3	50.6	1,333.5
Past due < 1 month	89.3	17.9	–	107.2
Past due 1 to 3 months	65.9	30.4	–	96.3
Past due 3 to 6 months	11.6	9.3	–	20.9
Past due 6 to 12 months	5.0	6.7	–	11.7
Past due over 12 months	2.3	3.1	–	5.4
Possessions	0.8	–	–	0.8
	1,065.5	459.7	50.6	1,575.8
Impaired:				
Not past due	–	–	–	–
Past due < 1 month	0.5	–	–	0.5
Past due 1 to 3 months	–	–	–	–
Past due 3 to 6 months	4.2	7.5	–	11.7
Past due 6 to 12 months	3.6	8.1	–	11.7
Past due over 12 months	1.4	11.9	–	13.3
Possessions	0.1	–	–	0.1
	9.8	27.5	–	37.3
Total mortgages before provisions	1,075.3	487.2	50.6	1,613.1
Contractual maturity:				
Past due but not impaired				
Less than three months	2.3	0.6	–	2.9
Three months to one year	1.8	1.1	–	2.9
One to five years	5.7	9.2	–	14.9
More than five years	165.1	56.5	–	221.6
	174.9	67.4	–	242.3
Impaired				
Less than three months	0.3	0.3	–	0.6
Three months to one year	0.2	1.0	–	1.2
One to five years	–	2.5	–	2.5
More than five years	9.3	23.7	–	33.0
	9.8	27.5	–	37.3

Geographical analysis by region
An analysis of loans by region is provided below:

Region	Group As at 31-Dec-17 £m	Group As at 31-Dec-17 %	Group As at 31-Dec-16 £m	Group As at 31-Dec-16 %
East Anglia	**236.4**	**3**	182.2	3
East Midlands	**249.6**	**4**	204.5	3
Greater London	**3,173.0**	**43**	2,543.1	43
Guernsey	**73.8**	**1**	93.4	2
Jersey	**225.1**	**3**	282.0	5
North East	**103.0**	**1**	90.3	2
North West	**347.9**	**5**	273.2	5
Northern Ireland	**16.9**	**–**	16.8	–
Scotland	**51.1**	**1**	56.1	1
South East	**1,591.7**	**22**	1,278.5	21
South West	**522.3**	**7**	380.6	6
Wales	**142.9**	**2**	114.7	2
West Midlands	**425.4**	**6**	308.6	5
Yorks and Humberside	**167.4**	**2**	130.8	2
Total mortgages before provisions	**7,326.5**	**100**	5,954.8	100
Personal loans	**1.1**		9.4	
Total loans before provisions	**7,327.6**		5,964.2	

Region	Bank As at 31-Dec-17 £m	Bank As at 31-Dec-17 %	Bank As at 31-Dec-16 £m	Bank As at 31-Dec-16 %
East Anglia	**212.4**	**4**	159.7	3
East Midlands	**203.8**	**3**	164.8	3
Greater London	**2,726.9**	**45**	2,234.3	46
North East	**86.3**	**1**	74.6	2
North West	**277.0**	**5**	228.4	5
Northern Ireland	**16.5**	**–**	16.4	–
Scotland	**50.3**	**1**	55.3	1
South East	**1,426.6**	**24**	1,161.7	24
South West	**439.1**	**7**	335.4	7
Wales	**126.1**	**2**	102.2	2
West Midlands	**374.6**	**6**	272.7	5
Yorks and Humberside	**125.8**	**2**	97.7	2
Total mortgages before provisions	**6,065.4**	**100**	4,903.2	100
Personal loans	**1.1**		9.4	
Total loans before provisions	**6,066.5**		4,912.6	

Credit risk – Loans and advances to credit institutions and investment securities
The Group holds treasury instruments in order to meet liquidity requirements and for general business purposes. The credit risk arising from these investments is closely monitored and managed by the Group's treasury department. In managing these assets, Group treasury operates within guidelines laid down in the treasury policy approved by the Board and performance is monitored and reported to ALCO monthly, including through the use of an internally developed rating model based on counterparty credit default swap spreads.

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

During the year, the average balance of cash in hand, loans and advances to credit institutions and investment securities on a monthly basis was £710.7m (2016: £678.8m).

Notes to the Financial Statements continued

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37. Risk management continued

The following table presents the credit quality of the Group's assets exposed to credit risk. The Group mainly uses external credit ratings provided by Fitch, Moody's or Standard & Poor's.

	Group					
As at 31-Dec-17	**AAA £m**	**AA £m**	**A+ £m**	**A £m**	**Less than A rating £m**	**Total £m**
Bank of England[1]	**–**	**1,146.9**	**–**	**–**	**–**	**1,146.9**
Call accounts	**–**	**0.2**	**–**	**11.0**	**29.1**	**40.3**
Floating rate notes	**19.1**	**–**	**–**	**–**	**–**	**19.1**
Total	**19.1**	**1,147.1**	**–**	**11.0**	**29.1**	**1,206.3**
As at 31-Dec-16						
Bank of England[1]	–	401.0	–	–	–	401.0
Call accounts	–	1.5	0.5	4.4	10.4	16.8
Floating rate notes	29.1	–	–	–	–	29.1
Treasury bills	–	112.6	–	–	–	112.6
Total	29.1	515.1	0.5	4.4	10.4	559.5

	Bank					
As at 31-Dec-17	**AAA £m**	**AA £m**	**A+ £m**	**A £m**	**Less than A rating £m**	**Total £m**
Bank of England[1]	**–**	**1,146.9**	**–**	**–**	**–**	**1,146.9**
Call accounts	**–**	**0.2**	**–**	**11.0**	**21.2**	**32.4**
Floating rate notes	**19.1**	**–**	**–**	**–**	**–**	**19.1**
Total	**19.1**	**1,147.1**	**–**	**11.0**	**21.2**	**1,198.4**
As at 31-Dec-16						
Bank of England[1]	–	401.0	–	–	–	401.0
Call accounts	–	1.5	0.5	4.4	6.1	12.5
Floating rate notes	29.1	–	–	–	–	29.1
Treasury bills	–	112.6	–	–	–	112.6
Total	29.1	515.1	0.5	4.4	6.1	555.2

The below tables show the industry sector and asset class of the Group's loans and advances to credit institutions and investment securities:

	Group As at 31-Dec-17		Group As at 31-Dec-16	
	£m	**%**	£m	%
Bank of England[1]	**1,146.9**	**95**	401.0	72
Other banks	**40.3**	**3**	16.8	3
Central government	**–**	**–**	112.6	20
Supranationals	**19.1**	**2**	29.1	5
Total	**1,206.3**	**100**	559.5	100

	Bank As at 31-Dec-17		Bank As at 31-Dec-16	
	£m	**%**	£m	%
Bank of England[1]	**1,146.9**	**96**	401.0	73
Other banks	**32.4**	**3**	12.5	2
Central government	**–**	**–**	112.6	20
Supranationals	**19.1**	**1**	29.1	5
Total	**1,198.4**	**100**	555.2	100

1. Balances with the Bank of England include £10.0m (2016: £9.1m) held in the cash ratio deposit.

The below tables show the geographical exposure of the Group's loans and advances to credit institutions and investment securities:

	Group As at 31-Dec-17		Group As at 31-Dec-16	
	£m	**%**	£m	%
United Kingdom	**1,181.0**	**98**	525.6	94
Rest of Europe	**19.1**	**2**	29.1	5
Canada	**0.2**	**–**	1.5	–
India	**6.0**	**–**	3.3	1
Total	**1,206.3**	**100**	559.5	100

	Bank As at 31-Dec-17		Bank As at 31-Dec-16	
	£m	**%**	£m	%
United Kingdom	**1,179.1**	**98**	524.6	95
Rest of Europe	**19.1**	**2**	29.1	5
Canada	**0.2**	**–**	1.5	–
Total	**1,198.4**	**100**	555.2	100

The Group monitors exposure concentrations against a variety of criteria, including asset class, sector and geography. To avoid refinancing risks associated with any one counterparty, sector or geographical region, the Board has set appropriate limits. These are contained in the treasury policy.

Liquidity risk
Liquidity risk is the risk of having insufficient liquid assets to fulfil obligations as they become due or the cost of raising liquid funds becoming too expensive.

The Group's approach to managing liquidity risk is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding in order to retain full public confidence in the solvency of the Group and to enable the Group to meet its financial obligations. This is achieved through maintaining a prudent level of liquid assets and control of the growth of the business. The Group has established a call account with the Bank of England and has access to its contingent liquidity facilities.

Liquidity management is the responsibility of the ALCO, with day-to-day management delegated to treasury as detailed in the treasury policy. The ALCO is responsible for setting limits over the level and maturity profile of wholesale funding and for monitoring the composition of the Group financial position. For each material class of financial liability, a contractual maturity analysis is provided in notes 27 to 33.

The Group also monitors a range of numeric triggers, defined in the contingency funding plan and recovery and resolution plan, which are designed to capture liquidity stresses in advance in order to allow sufficient time for management action to take effect. These are monitored daily by the risk team, with breaches immediately reported to the CRO, CEO, CFO and Head of Treasury.

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37. Risk management continued

Liquidity risk – contractual cash flows

The following tables provide an analysis of the Group's gross contractual cash flows, derived using interest rates and contractual maturities at the reporting date and excluding impacts of early payments or non-payments:

Group As at 31-Dec-17	Carrying amount £m	Gross inflow/ outflow £m	Up to 3 months £m	3–12 months £m	1–5 years £m	More than 5 years £m
Financial liability by type						
Amounts owed to retail depositors	6,650.3	6,877.4	2,927.1	2,723.0	1,227.3	–
Amounts owed to credit institutions and other customers	1,276.0	1,296.5	1.9	29.5	1,265.1	–
Derivative liabilities	21.8	21.7	1.2	4.8	8.2	7.5
Subordinated liabilities	10.9	13.9	0.2	0.5	7.5	5.7
Perpetual Subordinated Bonds	15.3	19.4	0.4	0.4	3.6	15.0
Total liabilities	7,974.3	8,228.9	2,930.8	2,758.2	2,511.7	28.2
Off balance sheet loan commitments	530.2	530.2	530.2	–	–	–
Financial asset by type						
Cash in hand	0.5	0.5	0.5	–	–	–
Loans and advances to credit institutions	1,187.2	1,187.2	1,177.2	–	–	10.0
Investment securities	19.1	19.1	–	0.1	19.0	–
Loans and advances to customers	7,306.0	14,732.0	257.6	545.9	2,130.4	11,798.1
Derivative assets	6.1	6.1	–	(0.1)	6.2	–
Total assets	8,518.9	15,944.9	1,435.3	545.9	2,155.6	11,808.1

Group As at 31-Dec-16	Carrying amount £m	Gross inflow/ outflow £m	Up to 3 months £m	3–12 months £m	1–5 years £m	More than 5 years £m
Financial liability by type						
Amounts owed to retail depositors	5,952.4	6,093.7	2,648.9	2,026.0	1,418.8	–
Amounts owed to credit institutions and other customers	105.7	106.6	4.6	0.2	101.8	–
Derivative liabilities	24.4	25.6	1.3	4.9	9.9	9.5
Subordinated liabilities	21.6	25.6	3.0	8.6	7.2	6.8
Perpetual Subordinated Bonds	15.3	19.4	0.4	0.4	3.6	15.0
Total liabilities	6,119.4	6,270.9	2,658.2	2,040.1	1,541.3	31.3
Off balance sheet loan commitments	365.4	365.4	365.4	–	–	–
Financial asset by type						
Cash in hand	0.4	0.4	0.4	–	–	–
Loans and advances to credit institutions	417.8	417.8	408.7	–	–	9.1
Investment securities	141.7	142.0	82.7	40.1	19.2	–
Loans and advances to customers	5,939.2	11,173.8	127.4	602.0	1,686.1	8,758.3
Derivative assets	1.8	2.0	0.6	1.0	0.4	–
Total assets	6,500.9	11,736.0	619.8	643.1	1,705.7	8,767.4

Bank As at 31-Dec-17	Carrying amount £m	Gross inflow/ outflow £m	Up to 3 months £m	3–12 months £m	1–5 years £m	More than 5 years £m
Financial liability by type						
Amounts owed to retail depositors	**6,650.3**	**6,877.4**	**2,927.1**	**2,723.0**	**1,227.3**	**–**
Amounts owed to credit institutions and other customers	**1,276.0**	**1,296.5**	**1.9**	**29.5**	**1,265.1**	**–**
Derivative liabilities	**21.8**	**21.7**	**1.2**	**4.8**	**8.2**	**7.5**
Subordinated liabilities	**10.9**	**13.9**	**0.2**	**0.5**	**7.5**	**5.7**
Perpetual Subordinated Bonds	**15.3**	**19.4**	**0.4**	**0.4**	**3.6**	**15.0**
Total liabilities	**7,974.3**	**8,228.9**	**2,930.8**	**2,758.2**	**2,511.7**	**28.2**
Off balance sheet loan commitments	**434.8**	**434.8**	**434.8**	**–**	**–**	**–**
Financial asset by type						
Cash in hand	**0.5**	**0.5**	**0.5**	**–**	**–**	**–**
Loans and advances to credit institutions	**1,179.3**	**1,179.3**	**1,169.3**	**–**	**–**	**10.0**
Investment securities	**19.1**	**19.1**	**–**	**0.1**	**19.0**	**–**
Loans and advances to customers	**6,051.0**	**12,668.8**	**203.1**	**411.8**	**1,649.1**	**10,404.8**
Derivative assets	**6.1**	**6.1**	**–**	**(0.1)**	**6.2**	**–**
Total assets	**7,256.0**	**13,873.8**	**1,372.9**	**411.8**	**1,674.3**	**10,414.8**

Bank As at 31-Dec-16	Carrying amount £m	Gross inflow/ outflow £m	Up to 3 months £m	3–12 months £m	1–5 years £m	More than 5 years £m
Financial liability by type						
Amounts owed to retail depositors	5,952.4	6,093.7	2,648.9	2,026.0	1,418.8	–
Amounts owed to credit institutions and other customers	105.7	106.6	4.6	0.2	101.8	–
Derivative liabilities	24.4	25.6	1.3	4.9	9.9	9.5
Subordinated liabilities	21.6	25.6	3.0	8.6	7.2	6.8
Perpetual Subordinated Bonds	15.3	19.4	0.4	0.4	3.6	15.0
Total liabilities	6,119.4	6,270.9	2,658.2	2,040.1	1,541.3	31.3
Off balance sheet loan commitments	297.2	297.2	297.2	–	–	–
Financial asset by type						
Cash in hand	0.4	0.4	0.4	–	–	–
Loans and advances to credit institutions	413.5	413.5	404.4	–	–	9.1
Investment securities	141.7	142.0	82.7	40.1	19.2	–
Loans and advances to customers	4,893.5	9,439.1	93.1	505.7	1,295.9	7,544.4
Derivative assets	1.8	2.0	0.6	1.0	0.4	–
Total assets	5,450.9	9,997.0	581.2	546.8	1,315.5	7,553.5

The actual repayment profile of retail deposits may differ from the analysis above due to the option of early withdrawal with a penalty.

The actual repayment profile of loans and advances to customers may differ from the analysis above since many mortgage loans are repaid early.

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37. Risk management continued

Liquidity risk – asset encumbrance

Asset encumbrance levels are monitored monthly at ALCO. The following tables provide an analysis of the Group's encumbered and unencumbered assets:

	Group As at 31-Dec-17				
	Encumbered		Unencumbered		
	Pledged as collateral £m	Other[1] £m	Available as collateral £m	Other[2] £m	Total £m
Cash in hand	–	–	0.5	–	0.5
Loans and advances to credit institutions	11.8	10.0	1,136.9	28.5	1,187.2
Investment securities	–	–	19.1	–	19.1
Loans and advances to customers	2,303.2	28.9	–	4,973.9	7,306.0
Derivative assets	–	–	–	6.1	6.1
Non-financial assets	–	–	–	70.2	70.2
	2,315.0	38.9	1,156.5	5,078.7	8,589.1

	Group As at 31-Dec-16				
	Encumbered		Unencumbered		
	Pledged as collateral £m	Other[1] £m	Available as collateral £m	Other[2] £m	Total £m
Cash in hand	–	–	0.4	–	0.4
Loans and advances to credit institutions	6.4	9.1	391.9	10.4	417.8
Investment securities	–	–	141.7	–	141.7
Loans and advances to customers	1,413.9	32.0	–	4,493.3	5,939.2
Derivative assets	–	–	–	1.8	1.8
Non-financial assets	–	–	–	80.0	80.0
	1,420.3	41.1	534.0	4,585.5	6,580.9

	Bank As at 31-Dec-17				
	Encumbered		Unencumbered		
	Pledged as collateral £m	Other[1] £m	Available as collateral £m	Other[2] £m	Total £m
Cash in hand	–	–	0.5	–	0.5
Loans and advances to credit institutions	11.8	10.0	1,136.9	20.6	1,179.3
Investment securities	–	–	19.1	–	19.1
Loans and advances to customers	2,303.2	28.9	–	3,718.9	6,051.0
Derivative assets	–	–	–	6.1	6.1
Non-financial assets	–	–	–	1,254.9	1,254.9
	2,315.0	38.9	1,156.5	5,000.5	8,510.9

	Bank As at 31-Dec-16				
	Encumbered		Unencumbered		
	Pledged as collateral £m	Other[1] £m	Available as collateral £m	Other[2] £m	Total £m
Cash in hand	–	–	0.4	–	0.4
Loans and advances to credit institutions	6.4	9.1	391.8	6.2	413.5
Investment securities	–	–	141.7	–	141.7
Loans and advances to customers	1,413.9	32.0	–	3,447.6	4,893.5
Derivative assets	–	–	–	1.8	1.8
Non-financial assets	–	–	–	1,049.5	1,049.5
	1,420.3	41.1	533.9	4,505.1	6,500.4

1. Represents assets that are not pledged but that the Group believes it is restricted from using to secure funding for legal or other reasons.
2. Represents assets that are not restricted for use as collateral, but the Group treats as available as collateral once they are readily available to secure funding in the normal course of business.

Liquidity risk – liquidity reserves
The following tables analyse the Group's liquidity reserves:

	Group As at 31-Dec-17		Group As at 31-Dec-16	
	Carrying amount £m	Fair value £m	Carrying amount £m	Fair value £m
Unencumbered balances with central banks	1,136.9	1,136.9	391.9	391.9
Unencumbered cash and balances with other banks	28.5	28.5	10.4	10.4
Other cash and cash equivalents	0.5	0.5	0.4	0.4
Unencumbered investment securities	19.1	19.1	141.7	141.7
Off balance sheet securities under FLS	–	–	524.6	524.6
	1,185.0	1,185.0	1,069.0	1,069.0

	Bank As at 31-Dec-17		Bank As at 31-Dec-16	
	Carrying amount £m	Fair value £m	Carrying amount £m	Fair value £m
Unencumbered balances with central banks	1,136.9	1,136.9	391.8	391.8
Unencumbered cash and balances with other banks	20.6	20.6	6.2	6.2
Other cash and cash equivalents	0.4	0.4	0.4	0.4
Unencumbered investment securities	19.1	19.1	141.7	141.7
Off balance sheet securities under FLS	–	–	524.6	524.6
	1,177.0	1,177.0	1,064.7	1,064.7

Market risk
Market risk is the risk of an adverse change in the Group's income or the Group's net worth arising from movement in interest rates, exchange rates or other market prices. Market risk exists, to some extent, in all the Group's businesses. The Group recognises that the effective management of market risk is essential to the maintenance of stable earnings and preservation of shareholder value.

Interest rate risk
The primary market risk faced by the Group is interest rate risk. Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. It is most prevalent in mortgage lending where fixed rate mortgages are not funded by fixed rate deposits of the same duration, or where the fixed rate risk is not hedged by a fully matching interest rate derivative.

The Group is exposed to movements in interest rates reflecting the mismatch between the dates on which interest receivable on assets and interest payable on liabilities are next reset to market rates or, if earlier, the dates on which the instruments mature. Exposure is mitigated on a continuous basis through the use of derivatives and reserve allocations within limits set by the ALCO and the Board (1.5% of CET1 as at 31 December 2017).

The Group measures interest rate risk using 14 different interest rate curve shift scenarios designed to emulate a full range of market movements. These 14 scenarios are defined by ALCO and are based on three 'shapes' of curve movement (shift, twist and flex) with movements in rates scaled to approximate the potential move over one year at 99.9% two-tailed confidence interval with interest rates floored to zero. In addition, the regulatory scenario of an un-floored parallel shift of 200bps in both directions is applied. After taking into account the derivatives entered into by the Group, the maximum loss under these scenarios as at 31 December 2017 would have been £3.2m (2016: £1.9m) and the maximum gain £1.2m (2016: £2.1m). Against a parallel interest rate increase of 2%, the impact would have been a £2.8m loss (2016: £3.9m gain) in profit or loss.

The interest rate sensitivity is impacted by behavioural assumptions used by the Group, the most significant of which are prepayments and reserve allocations. Expected prepayments are modelled based on historical analysis and current market rates. The reserve allocation strategy is approved by Risk Committee and set to reflect the current balance sheet and future plans.

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

Foreign exchange rate risk
The Group has limited exposure to foreign exchange risk in respect of its Indian operations. A 5% movement in exchange rates would result in £0.1m (2016: £0.1m) effect in profit or loss and £0.3m (2016: £0.2m) in equity.

The Bank is not exposed to foreign exchange risk since all its assets and liabilities are denominated in Pounds Sterling.

Structured entities
The Group had no structured entities as at 31 December 2017 and as at 31 December 2016.

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38. Financial instruments and fair values

i. Financial assets and financial liabilities

The following tables summarise the classification and carrying value of the Group's financial assets and financial liabilities:

	Note	Group As at 31-Dec-17				
		Fair value through profit or loss £m	Available-for-sale £m	Loans and receivables £m	Amortised cost £m	Total carrying amount £m
Assets						
Cash in hand		–	–	0.5	–	0.5
Loans and advances to credit institutions	15	–	–	1,187.2	–	1,187.2
Investment securities	16	–	19.1	–	–	19.1
Loans and advances to customers	17	–	–	7,306.0	–	7,306.0
Derivative assets	20	6.1	–	–	–	6.1
		6.1	19.1	8,493.7	–	8,518.9
Liabilities						
Amounts owed to retail depositors	27	–	–	–	6,650.3	6,650.3
Amounts owed to credit institutions	28	–	–	–	1,250.3	1,250.3
Amounts owed to other customers	29	–	–	–	25.7	25.7
Derivative liabilities	20	21.8	–	–	–	21.8
Subordinated liabilities	32	–	–	–	10.9	10.9
Perpetual Subordinated Bonds	33	–	–	–	15.3	15.3
		21.8	–	–	7,952.5	7,974.3

	Note	Group As at 31-Dec-16				
		Fair value through profit or loss £m	Available-for-sale £m	Loans and receivables £m	Amortised cost £m	Total carrying amount £m
Assets						
Cash in hand		–	–	0.4	–	0.4
Loans and advances to credit institutions	15	–	–	417.8	–	417.8
Investment securities	16	–	141.7	–	–	141.7
Loans and advances to customers	17	–	–	5,939.2	–	5,939.2
Derivative assets	20	1.8	–	–	–	1.8
		1.8	141.7	6,357.4	–	6,500.9
Liabilities						
Amounts owed to retail depositors	27	–	–	–	5,952.4	5,952.4
Amounts owed to credit institutions	28	–	–	–	101.7	101.7
Amounts owed to other customers	29	–	–	–	4.0	4.0
Derivative liabilities	20	24.4	–	–	–	24.4
Subordinated liabilities	32	–	–	–	21.6	21.6
Perpetual Subordinated Bonds	33	–	–	–	15.3	15.3
		24.4	–	–	6,095.0	6,119.4

	Note	Bank As at 31-Dec-17				
		Fair value through profit or loss £m	Available-for-sale £m	Loans and receivables £m	Amortised cost £m	Total carrying amount £m
Assets						
Cash in hand		–	–	0.5	–	0.5
Loans and advances to credit institutions	15	–	–	1,179.3	–	1,179.3
Investment securities	16	–	19.1	–	–	19.1
Loans and advances to customers	17	–	–	6,051.0	–	6,051.0
Derivative assets	20	6.1	–	–	–	6.1
		6.1	19.1	7,230.8	–	7,256.0
Liabilities						
Amounts owed to retail depositors	27	–	–	–	6,650.3	6,650.3
Amounts owed to credit institutions	28	–	–	–	1,250.3	1,250.3
Amounts owed to other customers	29	–	–	–	25.7	25.7
Derivative liabilities	20	21.8	–	–	–	21.8
Subordinated liabilities	32	–	–	–	10.9	10.9
Perpetual Subordinated Bonds	33	–	–	–	15.3	15.3
		21.8	–	–	7,952.5	7,974.3

	Note	Bank As at 31-Dec-16				
		Fair value through profit or loss £m	Available-for-sale £m	Loans and receivables £m	Amortised cost £m	Total carrying amount £m
Assets						
Cash in hand		–	–	0.4	–	0.4
Loans and advances to credit institutions	15	–	–	413.5	–	413.5
Investment securities	16	–	141.7	–	–	141.7
Loans and advances to customers	17	–	–	4,893.5	–	4,893.5
Derivative assets	20	1.8	–	–	–	1.8
		1.8	141.7	5,307.4	–	5,450.9
Liabilities						
Amounts owed to retail depositors	27	–	–	–	5,952.4	5,952.4
Amounts owed to credit institutions	28	–	–	–	101.7	101.7
Amounts owed to other customers	29	–	–	–	4.0	4.0
Derivative liabilities	20	24.4	–	–	–	24.4
Subordinated liabilities	32	–	–	–	21.6	21.6
Perpetual Subordinated Bonds	33	–	–	–	15.3	15.3
		24.4	–	–	6,095.0	6,119.4

The Group has no financial assets nor financial liabilities classified as held for trading or held to maturity.

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38. Financial instruments and fair values continued
ii. Fair values
The following tables summarise the carrying value and estimated fair value of financial instruments not measured at fair value in the statement of financial position:

	Group As at 31-Dec-17		Group As at 31-Dec-16	
	Carrying value £m	Estimated fair value £m	Carrying value £m	Estimated fair value £m
Assets				
Cash in hand	**0.5**	**0.5**	0.4	0.4
Loans and advances to credit institutions	**1,187.2**	**1,187.2**	417.8	417.8
Loans and advances to customers	**7,306.0**	**7,715.4**	5,939.2	6,259.1
	8,493.7	**8,903.1**	6,357.4	6,677.3
Liabilities				
Amounts owed to retail depositors	**6,650.3**	**6,684.0**	5,952.4	5,992.4
Amounts owed to credit institutions	**1,250.3**	**1,250.3**	101.7	101.7
Amounts owed to other customers	**25.7**	**25.7**	4.0	4.0
Subordinated liabilities	**10.9**	**11.1**	21.6	24.0
Perpetual Subordinated Bonds	**15.3**	**15.3**	15.3	14.4
	7,952.5	**7,986.4**	6,095.0	6,136.5

	Bank As at 31-Dec-17		Bank As at 31-Dec-16	
	Carrying value £m	Estimated fair value £m	Carrying value £m	Estimated fair value £m
Assets				
Cash in hand	**0.5**	**0.5**	0.4	0.4
Loans and advances to credit institutions	**1,179.3**	**1,179.3**	413.5	413.5
Loans and advances to customers	**6,051.0**	**6,408.4**	4,893.5	5,167.7
	7,230.8	**7,588.2**	5,307.4	5,581.6
Liabilities				
Amounts owed to retail depositors	**6,650.3**	**6,684.0**	5,952.4	5,992.4
Amounts owed to credit institutions	**1,250.3**	**1,250.3**	101.7	101.7
Amounts owed to other customers	**25.7**	**25.7**	4.0	4.0
Subordinated liabilities	**10.9**	**11.1**	21.6	24.0
Perpetual Subordinated Bonds	**15.3**	**15.3**	15.3	14.4
	7,952.5	**7,986.4**	6,095.0	6,136.5

The fair values in this table are estimated using the valuation techniques below. The estimated fair value is stated as at 31 December and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of each financial instrument.

Cash in hand
This represents physical cash across the Group's branch network where fair value is considered to be equal to carrying value.

Loans and advances to credit institutions
This mainly represents the Group's working capital current accounts and call accounts with central governments and other banks with an original maturity of less than three months. Fair value is not considered to be materially different to carrying value.

Loans and advances to customers
This mainly represents secured mortgage lending to customers. The fair value of fixed rate and tracker mortgages have been estimated by using system generated calculations based on known cash flow dates and interest rates and expected future interest rates extrapolated from an input zero coupon 24 point yield curve. The interest rate on variable rate mortgages is considered to be equal to current market product rates and as such fair value is estimated to be equal to carrying value.

Amounts owed to retail depositors
The fair value of fixed rate retail deposits has been estimated using system generated calculations based on known cash flow dates and interest rates and expected future interest rates extrapolated from a input zero coupon 24 point yield curve. Retail deposits at variable rates and deposits payable on demand are considered to be at current market rates and as such fair value is estimated to be equal to carrying value.

Amounts owed to credit institutions
This mainly represents amounts drawn down under the Bank of England TFS. Fair value is considered to be equal to carrying value.

Amounts owed to other customers
This represents fixed rate saving products to corporations and local authorities with original maturities greater than three months. The fair value is estimated using system generated calculations based on known cash flow dates and interest rates and expected future interest rates extrapolated from an input zero coupon 24 point yield curve.

Subordinated liabilities and Perpetual Subordinated Bonds
The fair value of subordinated liabilities is estimated using system generated calculations based on known cash flow dates and interest rates and expected future interest rates extrapolated from an input zero coupon 24 point yield curve. The PSBs are listed on the London Stock Exchange with fair value being the quoted market price at the reporting date.

iii. Fair value classification
The following tables provide an analysis of financial assets and financial liabilities measured at fair value on the statement of financial position grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

Group and Bank As at 31-Dec-17	**Carrying amount £m**	**Principal amount £m**	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Financial assets						
Investment securities	**19.1**	**19.0**	**19.1**	**–**	**–**	**19.1**
Derivative assets	**6.1**	**1,636.1**	**–**	**6.1**	**–**	**6.1**
	25.2	**1,655.1**	**19.1**	**6.1**	**–**	**25.2**
Financial liabilities						
Derivative liabilities	**21.8**	**(2,493.9)**	**–**	**21.8**	**–**	**21.8**

Group and Bank As at 31-Dec-16	Carrying amount £m	Principal amount £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
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

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

Level 2: Fair values that are 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.

Level 3: Fair values 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 instruments 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 the selection of appropriate discount rates.

Investment securities
The fair values of UK treasury bills and supranational bonds are based on quoted bid prices in active markets.

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38. Financial instruments and fair values continued

Derivatives

The Group uses LIBOR curves to value its derivatives; however, using OIS curves would not materially change their value.
The fair value of the Group's derivative financial instruments incorporates CVA and DVA. The DVA and CVA take into account the respective credit ratings of the Bank and counterparty and whether the derivative is collateralised or not. In considering which similar instruments to use, management takes into account the sensitivity of the instrument to changes in market rates and the credit quality of the instrument.

The following table provides an analysis of financial assets and financial liabilities not measured at fair value on the statement of financial position grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

Group As at 31-Dec-17	Carrying amount £m	Principal amount £m	Estimated fair value Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets						
Cash in hand	**0.5**	**0.5**	**–**	**0.5**	**–**	**0.5**
Loans and advances to credit institutions	**1,187.2**	**1,187.2**	**–**	**1,187.2**	**–**	**1,187.2**
Loans and advances to customers	**7,306.0**	**7,441.9**	**–**	**2,788.8**	**4,926.6**	**7,715.4**
	8,493.7	**8,629.6**	**–**	**3,976.5**	**4,926.6**	**8,903.1**
Financial liabilities						
Amounts owed to retail depositors	**6,650.3**	**6,610.1**	**–**	**2,474.4**	**4,209.6**	**6,684.0**
Amounts owed to credit institutions	**1,250.3**	**1,250.3**	**–**	**1,250.3**	**–**	**1,250.3**
Amounts owed to other customers	**25.7**	**25.5**	**–**	**–**	**25.7**	**25.7**
Subordinated liabilities	**10.9**	**10.7**	**–**	**11.1**	**–**	**11.1**
Perpetual Subordinated Bonds	**15.3**	**15.0**	**15.3**	**–**	**–**	**15.3**
	7,952.5	**7,911.6**	**15.3**	**3,735.8**	**4,235.3**	**7,986.4**

Group As at 31-Dec-16	Carrying amount £m	Principal amount £m	Estimated fair value (Restated) Level 1 £m	Level 2 £m	Level 3 £m	Total £m
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[1]	5,939.2	6,069.4	–	2,508.4	3,750.7	6,259.1
	6,357.4	6,487.6	–	2,926.6	3,750.7	6,677.3
Financial liabilities						
Amounts owed to retail depositors[1]	5,952.4	5,906.5	–	2,275.9	3,716.5	5,992.4
Amounts owed to credit institutions	101.7	101.6	–	101.7	–	101.7
Amounts owed to other customers[1]	4.0	4.0	–	–	4.0	4.0
Subordinated liabilities	21.6	20.7	–	24.0	–	24.0
Perpetual Subordinated Bonds[2]	15.3	15.0	14.4	–	–	14.4
	6,095.0	6,047.8	14.4	2,401.6	3,720.5	6,136.5

1. The fair values for prior year comparatives have been reclassified to disclose the different valuation techniques used when assessing fair value is equal to carrying value (Level 2) and where system generated calculations are used to estimate fair value (Level 3).
2. The fair value for prior year comparatives for PSBs has been restated to use quoted market prices.

Bank As at 31-Dec-17	Carrying amount £m	Principal amount £m	Estimated fair value			
			Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets						
Cash in hand	0.5	0.5	–	0.5	–	0.5
Loans and advances to credit institutions	1,179.3	1,179.3	–	1,179.3	–	1,179.3
Loans and advances to customers	6,051.0	6,177.1	–	2,653.3	3,755.1	6,408.4
	7,230.8	7,356.9	–	3,833.1	3,755.1	7,588.2
Financial liabilities						
Amounts owed to retail depositors	6,650.3	6,610.1	–	2,474.4	4,209.6	6,684.0
Amounts owed to credit institutions	1,250.3	1,250.3	–	1,250.3	–	1,250.3
Amounts owed to other customers	25.7	25.5	–	–	25.7	25.7
Subordinated liabilities	10.9	10.7	–	11.1	–	11.1
Perpetual Subordinated Bonds	15.3	15.0	15.3	–	–	15.3
	7,952.5	7,911.6	15.3	3,735.8	4,235.3	7,986.4

Bank As at 31-Dec-16	Carrying amount £m	Principal amount £m	Estimated fair value (Restated)			
			Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets						
Cash in hand	0.4	0.4	–	0.4	–	0.4
Loans and advances to credit institutions	413.5	413.5	–	413.5	–	413.5
Loans and advances to customers[1]	4,893.5	5,015.0	–	2,370.8	2,796.9	5,167.7
	5,307.4	5,428.9	–	2,784.7	2,796.9	5,581.6
Financial liabilities						
Amounts owed to retail depositors[1]	5,952.4	5,906.5	–	2,275.9	3,716.5	5,992.4
Amounts owed to credit institutions	101.7	101.6	–	101.7	–	101.7
Amounts owed to other customers[1]	4.0	4.0	–	–	4.0	4.0
Subordinated liabilities	21.6	20.7	–	24.0	–	24.0
Perpetual Subordinated Bonds[2]	15.3	15.0	14.4	–	–	14.4
	6,095.0	6,047.8	14.4	2,401.6	3,720.5	6,136.5

1. The fair values for prior year comparatives have been reclassified to disclose the different valuation techniques used when assessing fair value is equal to carrying value (Level 2) and where system generated calculations are used to estimate fair value (Level 3).
2. The fair value for prior year comparatives for PSBs has been restated to use quoted market prices.

39. Pension scheme

Defined contribution scheme

The amount charged to profit or loss in respect of contributions to the Group's defined contribution and stakeholder pension arrangements is the contribution payable in the period. The total pension cost in the year amounted to £1.3m (2016: £1.1m).

Defined benefit scheme

Kent Reliance Building Society (the 'Society') operated a defined benefit pension scheme (the 'Scheme') funded by the payment of contributions to a separately administered fund for nine retired members. The Society's Board decided to close the Scheme with effect from 31 December 2001 and introduced a new defined contribution scheme to cover service for Scheme members from 1 January 2002.

The Scheme Trustees, having taken actuarial advice, decided to wind up the Scheme rather than continue to operate it on a 'paid up' basis. The winding up is largely complete. As at 31 December 2017, the liability to remaining members is £2k (31 December 2016: £2k) matched by Scheme assets.

40. Capital management

The Group's prime objectives in relation to the management of capital are to provide a sufficient capital base to cover business risks and support future business development. The Group is compliant with the requirements set out by the PRA, the Group's primary prudential supervisor.

Capital management is based on the three 'pillars' of Basel II. Under Pillar 1, the Group calculates its minimum capital requirements based on 8% of risk weighted assets. The PRA then applies a multiplier to this amount to cover risks under Pillar 2 of Basel II and generates an individual capital guidance ('ICG'). The Group manages and reports its capital on a solo consolidated basis and hence the Bank's capital position is not disclosed separately.

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40. Capital management continued

To comply with Pillar 2, the Group completes an annual self-assessment of risks known as the internal capital adequacy assessment process ('ICAAP') reviewed by the PRA. Pillar 3 requires firms to publish a set of disclosures which allow market participants to assess information on that firm's capital, risk exposures and risk assessment process. The Group's Pillar 3 disclosures can be found on the Group's website.

Basel III came into force through the Capital Requirements Directive and Regulation ('CRD IV'). Basel III complements and enhances Basel I and II with additional safety measures. Basel III changed definitions of regulatory capital, introduced new capital buffers and liquidity ratios, and modified the way regulatory capital is calculated.

The ultimate responsibility for capital adequacy rests with the Board of Directors. The Group's ALCO, which consists of the CEO, CFO and other senior executives, is responsible for the management of the capital process, including approving policy, overseeing internal controls and setting internal limits over capital ratios.

The Group actively manages its capital position and reports this on a regular basis to senior management via the ALCO and other governance committees. Capital requirements are included within budgets, forecasts and strategic plans with initiatives being executed against this plan.

The Group's regulatory capital consists of the sum of the following elements:

- Tier 1 capital comprises of CET1 capital and Additional Tier 1 ('AT1') capital, calculated on a solo consolidation basis. The CET1 capital is made up of share capital, share premium, retained earnings (net of foreseeable dividends), capital contribution reserve, share-based payment reserve, transfer reserve, foreign exchange reserve and AFS reserve. The AT1 capital is made up of issued AT1 securities. Deductions from Tier 1 capital are intangible assets and deferred tax assets subject to future profitability.
- Tier 2 capital comprises of PSBs, dated subordinated debt and general credit risk adjustments. The dated subordinated debt is reduced for amortisation when within five years of maturity or under the Capital Requirements Regulation ('CRR') grandfathering rules.

The Group's Pillar 1 capital information is presented below:

	As at 31-Dec-17 £m	As at 31-Dec-16 £m
Common equity tier 1 capital		
Called up share capital	**2.4**	2.4
Share premium, capital contribution and share-based payment reserve	**169.8**	166.0
Retained earnings	**337.5**	240.7
Transfer reserve	**(12.8)**	(12.8)
Other reserves	**(0.1)**	0.1
Total equity excluding equity bonds	**496.8**	396.4
Foreseeable dividends	**(22.6)**	(18.5)
Solo consolidation adjustments[1]	**(4.8)**	(5.3)
Deductions from common equity tier 1 capital		
Intangible assets	**(6.8)**	(4.7)
Deferred tax asset	**(2.5)**	(2.3)
Common equity tier 1 capital	**460.1**	365.6
Additional tier 1 capital		
AT1 securities	**60.0**	–
Total tier 1 capital	**520.1**	365.6
Tier 2 capital		
Subordinated debt and PSBs	**47.7**	48.5
Collective provisions	**2.0**	1.6
Deductions from tier 2 capital	**(2.5)**	(2.0)
Total tier 2 capital	**47.2**	48.1
Total regulatory capital	**567.3**	413.7
Risk weighted assets (unaudited)	**3,348.5**	2,743.0

1. The Bank has solo consolidation waivers for most of its subsidiaries. The equity for unconsolidated entities has been removed from CET1.

41. Operating segments

From 1 January 2017, the Group distinguishes two segments within its operations (see note 1e for additional information):

1. BTL/SME; secured lending on property for investment and commercial purposes, and
2. Residential mortgages; lending to customers who live in their own homes, secured either via first or second charges against the residential home.

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

Year ended 31-Dec-17	BTL/SME £m	Residential mortgages £m	Total £m
Balances at the reporting date			
Gross loans and advances to customers	5,654.1	1,673.5	7,327.6
Provision for impairment losses on loans and advances	(13.2)	(8.4)	(21.6)
Loans and advances to customers	5,640.9	1,665.1	7,306.0
Capital expenditure	11.0	3.3	14.3
Profit or loss for the period			
Net interest income	177.1	68.3	245.4
Other expense	(1.5)	(5.8)	(7.3)
Total income	175.6	62.5	238.1
Impairment losses	(0.8)	(3.6)	(4.4)
Contribution to profit	174.8	58.9	233.7
Operating expenses			(65.1)
FSCS and other provisions			(0.9)
Profit before taxation			167.7
Taxation			(40.8)
Profit for the year			126.9

Year ended 31-Dec-16	BTL/SME £m	Residential mortgages £m	Total £m
Balances at the reporting date			
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 or loss for the period			
Net interest income	135.2	71.4	206.6
Other expense	(0.5)	(4.7)	(5.2)
Total income	134.7	66.7	201.4
Impairment losses	(1.8)	(7.2)	(9.0)
Contribution to profit	132.9	59.5	192.4
Operating expenses			(53.7)
FSCS and other provisions			(0.5)
Exceptional items			24.9
Profit before taxation			163.1
Taxation			(42.2)
Profit for the year			120.9

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42. Country by country reporting

Country by Country Reporting ('CBCR') was introduced through Article 89 of CRD IV, aimed at the banking and capital markets industry.

From 1 January 2015, all institutions within the scope of CRD IV should publish annually, on a consolidated basis, by country where they have an establishment:

a) their name, nature of activities and geographic location;
b) number of employees;
c) their turnover;
d) pre-tax profit or loss;
e) corporation tax paid; and
f) any public subsidies received.

The ongoing reporting deadline is 31 December each year, starting from 31 December 2015, and disclosures should relate to the most recently ended accounting period.

The name, nature of activities and geographic location of the Group's companies are presented below:

Jurisdiction	Country	Name	Activities
UK[1]	England	OneSavings Bank plc	Commercial banking
		Easioption Limited	
		Guernsey Home Loans Limited	
		Heritable Development Finance Limited	
		Interbay Group Holdings Limited	
		Jersey Home Loans Limited	
		Prestige Finance Limited	
		Reliance Property Loans Limited	
		Rochester Mortgages Limited	
		5D Finance Limited	
		5D Lending Ltd	
		Interbay Funding, Ltd	
		Inter Bay Financial I Limited	
		Inter Bay Financial II Limited	
		Interbay Holdings Ltd	
		Interbay ML, Ltd	
	Guernsey	Guernsey Home Loans Limited	
	Jersey	Jersey Home Loans Limited	
India	India	OSB India Private Limited	Back office processing

1. Guernsey Home Loans Ltd (Guernsey) and Jersey Home Loans Ltd (Jersey) are incorporated in Guernsey and Jersey respectively but are considered to be located in the UK as they are managed and controlled in the UK and have no permanent establishment in Guernsey or Jersey.

Other disclosures required by the CBCR directive are provided below:

2017	**UK**	**India**	**Consolidation**[2]	**Total**
Average number of employees	**483**	**330**	**–**	**813**
Turnover[1], £m	**238.0**	**5.4**	**(5.3)**	**238.1**
Profit/(loss) before tax, £m	**167.5**	**1.0**	**(0.8)**	**167.7**
Corporation tax paid, £m	**41.8**	**0.3**	**–**	**42.1**

2016	UK	India	Consolidation[2]	Total
Average number of employees	431	243	–	674
Turnover[1], £m	201.2	3.9	(3.7)	201.4
Profit/(loss) before tax, £m	162.9	1.0	(0.8)	163.1
Corporation tax paid, £m	29.4	0.2	–	29.6

1. Turnover represents total income before impairment losses, regulatory provisions and operating costs, but after net interest, net commissions and fees, gains and losses on financial instruments and external servicing fees.
2. Relates to a management fee from Indian subsidiaries to OneSavings Bank plc for providing back office processing.

The tables below reconcile tax charged and tax paid during the year.

2017	UK £m	India £m	Total £m
Tax charge	**40.5**	**0.3**	**40.8**
Effects of:			
Other timing differences	**0.8**	**–**	**0.8**
Tax outside of profit or loss	**(1.2)**	**–**	**(1.2)**
Prior year tax paid during the year	**22.3**	**–**	**22.3**
Current year tax to be paid after the reporting date	**(20.6)**	**–**	**(20.6)**
Tax paid	**41.8**	**0.3**	**42.1**

2016	UK £m	India £m	Total £m
Tax charge	41.9	0.3	42.2
Effects of:			
Other timing differences	0.2	–	0.2
Tax outside of profit or loss	(0.3)	–	(0.3)
Prior year tax paid during the year	9.2	–	9.2
Current year tax to be paid after the reporting date	(21.6)	(0.1)	(21.7)
Tax paid	29.4	0.2	29.6

43. Events after the reporting date

There are no material events after the reporting date.

44. Controlling party

As at 31 December 2017, there was no controlling party of OSB. During 2017, OSB Holdco Limited reduced its interest in the Company and as at the balance sheet date no longer held a controlling interest. The Company maintained the Relationship Agreement with OSB Holdco Limited during 2017, as set out on page 69. OSB Holdco Limited is a company controlled by funds advised by J.C. Flowers & Co. LLC.