RIS Announcement

Date: 28 March 2012
On behalf of: OneSavings Bank Plc ("the Bank")

OneSavings Bank Plc
Final results for the 11 months period ended 31 December 2011

OneSavings Bank Plc, the mutual Bank, announces its results for the 11 months period to 31 December 2011. The summary of the results for the period is:

- Transfer of all the assets and liabilities of Kent Reliance Building Society to OneSavings Bank Plc, in conjunction with an injection of £50m capital from OSB Holdco Limited, on 1 February 2011
- Total assets £2,356m (prior period £1,967m) *
- Management expense ratio of 0.72% (prior period 0.71%) *
- Post tax loss of £11.1m (prior period post tax loss £38.5m) *
- Loss driven by the back book of savings and mortgages acquired from Kent Reliance Building Society that does not generate sufficient net interest income in the current low interest environment
- Strategy in place to originate and acquire profitable mortgage assets to improve net interest position: mortgage asset purchases made in November 2011 and January 2012
- Further capital injection of £15m by OSB Holdco Limited on 31 August 2011
- Bank's equity as at 31 December 2011 was £89.5m (prior period £35.1m) *

Post period end

- Appointment of Andy Golding as permanent Chief Executive from 3 January
- Appointment of Stephan Wilcke as Chairman from 28 February

* where comparatives appear these relate to the Kent Reliance Building Society prior reporting period ended 31 January 2011 (16 months)

Commenting on the results and outlook, Andy Golding, new CEO of OneSavings Bank Plc, said:

"While the Bank is currently loss-making, the position is much improved over 2010. A lot has been achieved during the year to manage the Group's risk and provide a solid platform for growth. Many financial services organisations are having to simply wait out the economic storm or dramatically constrain new business, whereas OneSavings Bank plc has the capital backing to grow significantly.

"There is a real opportunity to create a connected banking business with mutual roots, all aimed at providing value for money for our members and customers through the Kent Reliance brand plus existing and potential new group companies."

Stephan Wilcke, the recently appointed Chairman of OneSavings, added:

"As indicated at the time of our interim results in August 2011 these losses are in line with expectations. However, the underlying performance of the Bank is significantly improved and a number of the steps taken during the year are only now starting to make an impact. Andy Golding's appointment as permanent CEO has helped to focus our work and identify many opportunities for the future growth and success of OneSavings Bank."

ENDS

Enquiries:

OneSavings Bank Plc	Andy Golding, CEO	01634 888 615
Redleaf Polhill	Emma Kane	020 7566 6720
	Samantha Robbins	osb@redleafpolhill.com
	David Ison	

About OneSavings Bank plc

- Kent Reliance, krbs.com, Reliance Property Loans, Jersey Home Loans and Guernsey Home Loans are all trading names of OneSavings Bank plc. The Bank originates from mutual roots and has operated for over 150 years. Today it operates as a hybrid modern mutual bank, with core values in terms of treating its customers fairly and offering long term sustainable value for money, but with the capital advantages of a bank.

- OneSavings Bank plc is registered at Reliance House, Sun Pier, Chatham, Kent (registered number 7312896) and is authorised and regulated by the Financial Services Authority (registered number 530504).

- OneSavings Bank plc is a member of the Financial Services Compensation Scheme.

- OneSavings Bank plc was formed as Sevco 5067 Limited on 13 July 2010; it changed its name to OneSavings Limited on 3 August 2010 and was converted to OneSavings plc on 8 October 2010 and became OneSavings Bank plc on 1 February 2011 and, following confirmation by the members of Kent Reliance Building Society (KRBS) and the Financial Services Authority (FSA), began trading as a bank on this date when the trade and assets of KRBS were transferred into the business.

Chief Executive summary

I joined OneSavings Bank plc ("The Bank") on 3 January 2012 as permanent Chief Executive, to replace J Wood who had been carrying out the role on an interim basis.

In my report I will comment on the current economic environment and its impact on the Bank's results in 2011 and I will also describe the opportunities for future growth and the strategic journey back to long-term profitability that the Board is committed to delivering.

The Bank's results are driven principally by the back book of savings and mortgages of Kent Reliance which, in a low Bank of England Base Rate environment, do not generate positive net interest income. The Board has consciously continued to offer value for money savings products rather than seek to claw back income through savings rate reductions. This is the key driver of the losses seen in 2011; however, the position is much improved over 2010.

A lot has been done during 2011 to manage the Bank's risks, including significant de-risking of the volatility to further negative interest and market rate movements on the balance sheet and the creation of a strategy to acquire profitable mortgage assets which will over time improve the net interest position, as well as a further capital injection from JC Flowers of £15 million. Additionally, the cost base has been managed to benchmark well against comparable peers, with a management expenses ratio of 0.72%.

The Directors' report focuses in more detail on the individual components of the accounts.

Whilst currently loss making, there is a real opportunity to create a connected banking business with mutual roots, all aimed at providing value for money for our members and customers through the Kent Reliance brand plus existing and potential new Group companies.

While many financial services organisations have to simply wait out the economic storm or dramatically constrain new business, OneSavings Bank plc has the capital backing from its shareholders to grow significantly. In November 2011 and January 2012 two significant mortgage asset purchases were made and there are plans to do more during 2012 and beyond. The Board will also seek to acquire profitable businesses, where commonality of culture aligns with the addition of returns on capital to the Bank at an appropriately mitigated level of risk.

We will work hard on the provision of customer services through the Kent Reliance brand. We have already re-branded our outlets back to Kent Reliance away from krbs, as well as making improvements to a number of premises and we are seeking planning permission (which at the time of writing is pending) to open a new branch in Canterbury town centre. We will strengthen our IT systems during 2012 with a view to delivering much improved online capability for both new and existing customers.

The brand of Kent Reliance is strong and well regarded and it is my intention to build on this in actions as well as words. I have already instructed our product teams to move away from "new customer only" offers and introductory bonuses where product rates fall after an initial period and instead focus on long-term value for money products. I am keen to introduce member loyalty products, periodically offering existing savers and borrowers something better than that which is available externally.

We will also increase our mortgage lending through Kent Reliance. As a regional mutual I believe part of our role is to do our bit to support the housing market. We have received excellent feedback so far on our affordable housing products and mortgages aimed at helping self employed borrowers as well as various other niche markets. We will seek to build and grow this commitment throughout 2012.

We will continue to benefit from access to efficient and cost effective core processing through our Indian subsidiaries, however this will not be at the expense of continuously improving our customer service and satisfaction.

Finally, I am currently working on strengthening my senior management team and looking to move away from interims to permanent senior staff who are all committed to a simple three part strategic journey:

Growth - through profitable acquisition and organic mortgage lending.
Strength – through a strong risk management culture and framework.
Proposition – the development of our service, product and channel offerings to new and existing customers and members.

A Golding
Chief Executive

Directors' report

The Directors present their report and the financial statements for the period ended 31 December 2011.

This is the first reporting period for OneSavings Bank plc ("The Bank"). The Bank was formed as Sevco 5067 Limited on 13 July 2010 domiciled and incorporated in United Kingdom. Sevco 5067 Limited changed its name to OneSavings Limited on 3 August 2011, was converted to OneSavings plc on 8 October 2010, and became OneSavings Bank plc on 1 February 2011.

Principal activities

The Bank's principal purpose is to provide mortgage finance to its borrowers and to provide long-term good value savings products to our investors.

The Bank has a number of subsidiaries including Jersey Home Loans Limited and Guernsey Home Loans Limited in the Channel Islands (which provide mortgages in Jersey and Guernsey respectively), and Easioption BPO Services Pvt Limited and Easiprocess Pvt Limited in India (which provide back office processing services to the Bank). Together with the Bank, and the Bank's other subsidiaries, these form the OneSavings Bank Group ("The Group").

Business review and future developments

The Bank was established to take on the assets and liabilities of Kent Reliance Building Society ('KRBS'), and is jointly owned by Kent Reliance Provident Society ('KRPS') and OneSavings Bank Holdco Limited ('OSB Holdco'), a wholly-owned subsidiary of funds advised by J.C Flowers & Co LLC ('JCF').

KRPS is a new industrial and provident society that was established to take on the membership of KRBS upon the transfer of the assets and liabilities to the Bank. An industrial and provident society is a form of mutual organisation that exists to benefits its members.

On 1 February 2011 all the assets and liabilities, including Members' Investment Accounts and Mortgage Accounts, of KRBS were transferred to OneSavings Bank plc. Following this transfer, and receipt of permission from the Financial Services Authority ('FSA') to use the sensitive business name "Bank", OneSavings plc changed its name to OneSavings Bank plc with effect from 1 February 2011.

In return for the £50m of new capital injected, 17,426 B ordinary shares and 32,574 convertible preference shares in the Bank were received by OSB Holdco. KRPS received 26,000 A ordinary shares in return for the trade and net assets its members transferred from KRBS.

OSB Holdco injected a further £15m of capital on 31 August 2011 and received 2,541 B ordinary shares and 282,240 convertible preference shares in the Bank.

As at 31 December 2011, OSB Holdco holds 43.47% of the ordinary share capital of the Bank and KRPS holds 26,000 A ordinary shares representing 56.53% of the ordinary share capital of the Bank.

The effect of the above is that OSB Holdco is a co-owner of the Bank and KRPS has a majority of the ordinary shares and, therefore, voting control of the Bank.

This report covers the period from inception on 13 July 2010 until 31 December 2011, although OneSavings Bank plc only started trading as a bank from 1 February 2011 at the point the trade and assets of KRBS were transferred into the business.

During the period, the Group operated at a loss as a result of sustained pressure on net interest income affected by the low prevailing interest rate environment, intense competition for retail funds and significant costs incurred to up-skill the business and enhance the existing control framework.

Some of the items such as negative interest margin, increased expenditure, impairment provisions impacting on the OneSavings Bank plc statutory loss in the period do not necessarily reflect the long-term underlying performance of the Group and the financial position should improve over time as a result of new lending at more attractive margins, further profitable mortgage book acquisitions and the redemption and reversion of negative and low margin back book mortgage accounts.

Financial Results

The Group loss before taxation for the period to 31 December 2011 was £13.2m. The loss after taxation for the period was £11.1m. The Group's equity as at 31 December 2011 was £89.4m.

Key Performance Indicators

The Key Performance Indicators (KPIs) used by management in determining the Group's performance are shown in the following table:

	Group 31-Dec-11
Net interest income	£(1.4m)
Management expense ratio	0.72%
Total assets	£2,356m
Loans and advances	£1,640m
Retail deposits	£2,082m
Regulatory capital	£130m

Net interest income

Net interest was an overall expense of £1.4m for the period to 31 December 2011. The net interest margin was adversely affected by the low prevailing interest rate environment; with the Bank of England base rate remaining throughout the period at its lowest ever level of 0.5% and LIBOR also remaining low. The Group inherited a position from the transfer of business of KRBS, where a significant proportion of its long-term fixed rate mortgages had been hedged to LIBOR and thus is earning low rates of interest on these assets.

Furthermore, competition for retail funds has been intense, meaning retail deposit rates are currently at record levels compared to Bank of England base rate and this imposes a significant strain on the Bank's net interest margin.

Management expense ratio

The Group's annualised management expense ratio, excluding depreciation, was 0.72%. Significant costs were incurred in the period to improve skill sets in the business, enhance its control framework and investigate potential acquisition opportunities.

Total assets

Total assets were £2,356m at 31 December 2011. These assets are predominantly those which were purchased from KRBS, as well as organic mortgage growth during 2011. The 2011 period-end numbers also include a mortgage book acquisition which took place on 1 November 2011 (gross value of mortgage assets acquired £195m).

Loans and advances

The mortgage book at the period end amounted to £1,640m. The acquisition of the new mortgage book on 1 November 2011 increased the carrying value of the mortgage book by £139m.

Retail deposits

Retail deposits at the period end amounted to £2,082m. This compares favourably to the £1,705m acquired upon acquisition from KRBS, reflecting the focus of the business in driving asset growth through competitive retail funding.

Liquidity

The liquidity ratio at 31 December 2011 was 28.35%. The Group operates under the FSA's Individual Liquidity Adequacy Assessment (ILAA) regime and liquidity has been maintained in excess of the FSA minimum requirement.

Capital

The Group's capital adequacy and capital resources were managed and monitored in accordance with the regulatory capital requirements of the FSA, the UK regulator. Refer to Note 31 on Capital Management for details.

Financial risk management objectives and policies

Over the period to 31 December 2011 the Group offered mortgage and savings accounts together with wholesale money market investment and borrowing. There are formal structures in place to monitor, report upon, and manage the risks associated with these activities. The financial instruments used by the Group to manage the structure of the balance sheet and to mitigate risks are disclosed in Note 28 to the financial statements.

Creditor payment policy

The Group's policy concerning the payment of its trade creditors is to pay within the agreed terms of credit, usually 30 days from invoice, once the supplier has discharged its contractual obligations. These terms of payment were settled with suppliers when agreeing the terms of each transaction.

Charitable donations

Charitable donations made during the period amounted to £5,000. The Group has made donations to various Kent Charities. No political donations were made during the period. In addition to this the Bank paid £32k directly to a charity: Multiple Sclerosis Resource Centre Limited, on behalf of S Wilcke.

Directors

The full list of Directors serving on the Board during the period to 31 December 2011 was as follows:

M McCaig (Chairman, appointed 2 August 2010)
Dr D Morgan (appointed 1 February 2011)
D Mills (Senior Independent Director, appointed 23 February 2011)
A Newell (Chairman of the Audit Committee appointed 20 August 2010)
Sir C McCarthy (appointed 1 February 2011)
P Williams (appointed 7 October 2010)
T Hanford (appointed 1 February 2011)
S Wilcke (Independent Director, appointed 1 February 2011)
J Wood (Interim Chief Executive, appointed 21 June 2011, resigned 10 January 2012)
M Lazenby (Chief Executive, appointed 2 August 2010, resigned 28 February 2011)
R Scruton (Finance Director, appointed 2 August 2010, resigned 30 June 2011)
N Thompsell (appointed 13 July 2010, resigned 11 August 2010)
R Finch (appointed 13 July 2010, resigned 11 August 2010)
A Golding (appointed 30 December 2011)

As at 31 December 2011, no Director held, or had held during the period, any beneficial interest in the shares of any connected undertaking of the Group. On 3 January 2012 A Golding was appointed as Chief Executive. On 28 February 2012 S Wilcke replaced M McCaig as Chairman of the Board of Directors.

UK Corporate Governance Code

The Board remains committed to the achievement of high standards of corporate governance which it considers to be central to the effective management of the Group and to maintaining the confidence of investors. Considerable progress has been made during the reporting period to continue to develop appropriate and adequate corporate governance arrangements.

Indemnity provision

During the period covered by these accounts there were no new or outstanding third party qualifying indemnity provisions in force.

Going concern

In preparing the financial statements the Directors must satisfy themselves that it is reasonable for them to consider whether it is appropriate to adopt the going concern basis.

The Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. Projections for OneSavings Bank plc have been prepared, covering its future performance, capital and liquidity, for a period in

excess of 12 months from the date of approval of these accounts. In all scenarios the projections show that

OneSavings Bank plc is dependent, until after the time at which the return to profitability is foreseen, upon the continued support of the shareholders. The Directors have a reasonable expectation that such support will be forthcoming. Therefore, the going concern basis of accounting has been used to prepare the financial statements.

Auditors

KPMG Audit Plc was appointed as Auditors to the Group in its first period of trading.

On behalf of the Board
S Wilcke
Chairman
27 March 2012

Risk management report

Introduction

The Board is responsible for ensuring that an effective framework is in place to identify and manage risks that the Group faces in the course of delivering its strategic objectives. The Group has a formal structure for managing risk, including established risk limits, reporting lines, mandates, credit risk appetite and other control procedures. The Group's risk committee structure, which was reviewed and strengthened during the period, has been designed to support an integrated approach to the identification and management of risk with two management level risk committees - the asset and liability committee ("ALCO") and the credit committee – reporting to the Board risk committee, whose responsibility it is to take a Group-wide view of the overall exposure to risk. While recognising that the system is designed to manage rather than eliminate risk of failure to achieve business objectives, it can only provide reasonable assurance and not absolute assurance against material mis-statement or loss.

Following the course of its normal business activities, the principal risks to which the Group was exposed are operational, credit, liquidity and market risk. Each of these risks, along with their current management frameworks, is considered below.

Operational risk

Operational risk, which is inherent in all business activities, is the risk of direct or indirect loss resulting from inadequate or failed internal process, people and systems or from external events. It can occur in any of the Group's businesses and includes errors, omissions, natural disasters and deliberate acts such as fraud. The Group manages this risk within an overall governance and control strategy. Within this structure, potential risk exposures are assessed to determine the appropriate type of controls to be applied. It is recognised that such risks can never be entirely eliminated and that the cost of controls in minimising these risks may outweigh the potential benefits. However, where required, the Group continues to invest in risk management and mitigation such as business continuity management and incident management. Independent assessment of the effectiveness of the management of operational risk is undertaken by the Board, Chief Executive Officer, Executive management and the internal audit team.

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's exposure to retail credit risk was managed by the credit risk committee which reported to the Board risk committee and to the Board.

Credit risk is managed within the Group's underwriting process, which seeks to ensure that borrowers only take on a debt they can afford to repay, safeguarding both themselves and the Group. Where borrowers find themselves in financial difficulty, the Group has established procedures to manage the situation to a satisfactory conclusion. Usually this involves working with the borrower to clear arrears or making other arrangements commensurate with the borrower's circumstances. In rare cases where the situation deteriorates significantly and irreparably the Group would take possession of the underlying security. In situations where the Group determines that it is appropriate in order to meet customer needs, it applies a policy of forbearance and may grant a concession. The Group considers forbearance on a case by case basis in line with industry best practice. This may arise where the Group considers that the financial stress of the customer is both short term and potentially recoverable. Such a concession , which will only be implemented after obtaining the

customer's consent, may involve capitalisation of arrears, a reduced monthly payment, conversion to an interest only repayment basis or a mortgage term extension. By dealing with arrears at an early stage and continuous monitoring, it is anticipated that a lower level of long term arrears will be achieved that also results in a favourable outcome for both the customer and the business. The impact of any such forbearance is recognised within the Group's provisioning policy.

Credit risk within the treasury function arises from the risk that counterparties will be unable to repay loans and other financial instruments that the treasury function holds as part of its liquidity portfolio. This risk is managed by restrictions on the type of assets held, and assessment of the credit worthiness of counterparties and by the maintenance of exposure limits with each counterparty and sector. The Group has no direct and limited indirect exposure to PIIGS countries, limited exposure to emerging markets and non-investment grade debt, including investments with other building societies and local authorities.

The Group's exposure to wholesale credit risk is managed by the ALCO, which reports to the Board risk committee and to the Board.

Further analysis of the Group's exposure to credit risk is provided in note 28 to the accounts.

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 becomes too expensive.

The Group's liquidity policy is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding in order to retain full public confidence in the solvency of the Group and to enable the Group to meet its financial obligations. This is achieved through maintaining a prudent level of liquid assets, through wholesale funding facilities and through control of the growth of the business.

The liquidity policy is developed, implemented and monitored by the ALCO, which also sets limits over the level and maturity profile of wholesale funding and monitored the composition of the Group balance sheet. A series of liquidity stress tests are performed each month to confirm that the limits remained appropriate. The day-to-day management is delegated to the treasury function as detailed in the Financial Risk Management Policy.

Further analysis of the Group's exposure to liquidity risk is provided in note 28 to the accounts.

Market risk

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

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

The Group is exposed to movements in interest rates reflecting the mismatch between the dates on which interest receivable on assets and interest payable on liabilities are next reset to market rates or, if earlier, the dates on which the instruments mature. The Group manages this exposure on a continuous basis through the use of derivatives within limits set by the ALCO.

The secondary market risk faced by the Group is basis risk. Basis risk arises when the Group finances an asset with a liability which re-prices from a different interest rate index. The Group manages this exposure on an ongoing basis within limits set by ALCO.

Further analysis of the Group's exposure to interest rate risk is provided in note 28 to the accounts.

Regulatory risk

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

Taxation risk

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

Internal Control

The internal control processes and effectiveness are reviewed by the Board, Executive management and the Bank's internal audit team from Ernst & Young LLP.

Capital management under Basel II

The Basel Committee on Banking Supervision introduced the Basel II framework for calculating minimum capital requirements. The EU Capital Requirements Directive ("the CRD") is the means by which Basel II was implemented in the EU. In the UK this was overseen by our regulator, the FSA. Basel II encourages a risk-based approach to determining capital adequacy. By adopting more sophisticated analytical approaches, financial institutions may be able to carry less regulatory capital for credit and operational risk.

The Group adopts the provisions relating to the calculation of minimum capital requirements and has calculated its capital requirement on a standardised basis.

The CRD requires the Group to conduct an assessment of its capital and financial resources, known as its Internal Capital Adequacy Assessment Process (ICAAP). An analysis of the components of the Group's capital is provided in note 31 to the accounts.

Corporate governance report

Introduction

On 1 February 2011, the trade, assets and liabilities of KRBS were transferred to the Bank.

The Board is committed to ensuring that best practice in corporate governance is applied throughout the Bank in a proportionate manner. As such, while the Bank is not bound by the UK Code on Corporate Governance issued by the Financial Reporting Council in May 2010 ("The Code"), the Board aims to comply with the provisions of the Code.

The Board of Directors

During 2011, the Board was chaired by M McCaig and constituted three non executive directors appointed by OSB Holdco (B Directors), three non executive directors (including the Chairman) appointed by KRPS (A Directors), two independent non-executive directors and two Executive Directors, being the Chief Executive Officer and the Finance Director (until the resignation of R Scruton). A representative from each of the A and B Shareholder also attend board meetings as observers to ensure that the views of both shareholders can be taken into account during Board discussions and also to ensure that the shareholders are kept informed on a timely basis. The structure of the Board and the presence of the observers ensure that the Board as a whole has a deep understanding of the views of its shareholders.

The Board meets formally monthly (with the exception of December in 2011), with adhoc meetings called as and when circumstances require.

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

At least once each year the Board undertakes a full strategic review of the business, usually over the course of two days.

There is a formal schedule of Matters Reserved for the Board which has formally delegated authority to a number of Committees, which are constituted under Board approved terms of reference. Day to day management of the business has been delegated to the Chief Executive Officer through the Executive Committee.

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

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

Board and Board Committee attendance record

A table showing attendance at scheduled meetings is shown on the next page. Against each director's name is shown the number of meetings he or she attended in the period to 31 December 2011. The number of meetings each director was eligible to attend is shown in brackets. The number in brackets is the maximum number of scheduled meetings that the Director was eligible to attend.

Director	Board	Audit	Risk	Remuneration	Nomination
M Lazenby (up to 20 February)	0 (1)	-	-	-	-
R Scruton (up to 30 June)	3 (5)	2 (2)	3 (4)	-	-
J Wood	6 (7)	4 (4)	7 (9)	-	-
A Newell	10 (10)	-	9 (9)	-	-
D Mills	9 (9)	4 (4)	-	2 (6)	1 (1)
Dr D Morgan	9 (10)	-	-	-	1 (1)
M McCaig	10 (10)	-	-	1 (6)	1 (1)
P Williams	10 (10)	-	-	6 (6)	-
S Wilcke	9 (10)	-	8 (9)	5 (6)	-
Sir C McCarthy	6 (10)	3 (4)	-	-	-
T Hanford	9 (10)	-	6 (9)	6 (6)	-

Board balance and independence

The Board consists of one executive director and eight non-executive directors, two of which were considered by the Board to be independent in accordance with the criteria of the Code during the period, D Mills and S Wilcke. The size and composition of the Board is kept under review to ensure an appropriate balance of skills and experience is represented on the Board. Non-executive directors play a vital role in challenging and helping develop strategy, while providing independent judgement, experience and knowledge.

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

Chairman and Chief Executive

The roles of Chairman and Chief Executive are held by different persons and their respective purposes are clear and distinct. The role of each is set out in their Letter of Appointment and Contract respectively and further detailed in the Board Manual. The Chairman is responsible for leading the Board and ensuring it acts effectively and communication with shareholders; the Chief Executive has overall responsibility for managing the Group and for implementing the strategies and policies agreed by the Board. The Chairman is elected by the Board and the Board is satisfied that during the period the Chairman was able to commit sufficient time to the Bank and there were no changes to any other significant commitments of the Chairman.

Appointments to the Board

Appointments to and resignations from the Board are detailed on page 8 of the Directors' report.

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

When searching for suitable Board candidates, the Nominations Committee will have regard to the existing skills matrix of the Board and look for candidates whose skills complement and enhance those already in place. The Nominations Committee will also have regard to the benefits of having a diverse board, both in terms of ethnicity and gender. All Directors must meet the FSA's fitness and proprietary standards and be registered with the FSA as an approved person to carry out the Controlled Function of a Director.

Candidates for Board positions are identified in a number of ways, including the use of external search consultants and where appropriate, open advertising.

Re-election

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

Performance evaluation

The Board undertakes a formal annual evaluation of its own performance and that of its Committees and individual Directors. Individual Non Executive Directors are assessed on a one to one basis by the Chairman. The Chairman evaluates the Chief Executive's performance and the Senior Independent Director evaluates the Chairman's performance. The Board will undertake an external Board evaluation at least every three years.

Board committees

The Board has established a number of committees with their own terms of reference, which are reviewed at least annually. During the period the governance framework of the Group was strengthened by a review of the arrangements for dealing with the assessment, monitoring and management of risk including the establishment of a Board risk committee supported by management level redefined asset and liability and credit committees. A summary of the principal Board committees is set out below.

- The audit committee chaired by A Newell met quarterly to consider all Group audit matters, the system of internal control, financial reporting and whistle blowing.
- The risk committee chaired by S Wilcke met **regularly as required** to monitor the Group's overall exposure to risk. It oversaw the identification and management of risks across the Group and the monitoring of operational, credit, liquidity, and market risks.
- The remuneration committee chaired by T Hanford considered the terms and conditions, and fees of executive and non-executive directors and executive staff salaries.
- The nominations committee chaired by D Mills was responsible for keeping under review the size, structure and composition of the Board; nominating candidates to fill Board and executive vacancies, taking into account the balance of skills, knowledge and experience on the Board; and for making appropriate recommendations to the Board.
- The merger and acquisition committee reviews all acquisition opportunities, provides appropriate recommendations to the Board and has delegated authority to oversee the due diligence and contractual documentation process of transactions approved by the Board and Shareholders.

System of internal controls

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

The Board formally approves the Bank's risk appetite and management policy framework. The systems are designed to manage the risk within the Bank's risk appetite, rather than eliminate the risk that that Bank does not meet its business objectives. The key risks facing the Bank, and the systems it has in place to manage that risk are set out in the Risk Management Report on page 10.

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

Ernst & Young provide an internal audit function to the Group. The internal audit function is responsible for independently reviewing and reporting on the adequacy and effectiveness of internal controls put in place by management. The internal audit function agrees an internal audit plan annually with the Audit Committee. The internal audit reports assist management to evaluate and improve the effectiveness of risk management, regulatory compliance, control

and governance processes and assist the Audit Committee to oversee the effectiveness of internal controls.

The Board is satisfied that during the period the Group maintained an adequate and appropriate system of internal control.

Audit committee and auditors

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

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

Financial reporting

The responsibilities of the directors in preparing the Group's accounts are set out on page 19.

Directors' remuneration report

Introduction

The purpose of this report is to outline the Board's policy for the remuneration of the Group's executive team and its non-executive Directors and explains the process for setting Directors' remuneration and how it applies the principles of the Combined Code. The Combined Code was developed by the Committee on Corporate Governance for listed companies: details can be downloaded from the Financial Reporting Council website which is www.frc.org.uk.

Remuneration of Group's executive management team

The remuneration committee is chaired by T Hanford and the remuneration of each executive director is set out in note 7 to the report and accounts.

Executive management remuneration comprises a number of elements: basic salary, annual and medium term incentive scheme and contributions to the Group pension scheme:

- Basic salary is determined by levels of responsibility, external market competitiveness and individual performance in the role. The Group's policy is to position salaries so that on average, they are in line with salary packages for comparable positions in similarly performing financial institutions, taking account of the fact that no benefits in kind – such as company cars and private medical insurance - are enjoyed by the Group's employees;

- Annual and medium term bonuses are paid at the discretion of the Board and incentives, when determined appropriate according to success in the delivery of corporate and individual objectives;

- All of the executive management team, excluding J Wood (interim CEO), are members of a contributory defined contribution pension scheme;

- Standard contractual terms for executive level appointments include notice periods of between 6 and 12 months.

Specific remuneration and terms and conditions of employment of members of the executive management team are determined annually by the Board on the basis of recommendations by the remuneration committee. The committee ensures that the Group's policy remains appropriate to attract, motivate and retain high calibre executives with the skills and experience needed to lead a business of this nature and complexity, and develop it for the long-term benefit of members.

The remuneration committee comprises three non-executive Directors, as set out in the Directors' report, with attendance by the Chief Executive as appropriate. The Chief Executive withdraws from the meeting when his own remuneration is considered. The committee is provided with executive remuneration and benefits data from comparative organisations across the financial services industry and banking sector and procures such other relevant data from independent expert sources as appropriate.

Non-executive Directors' fees

Fees for each non-executive director are set out in note 7 to the report and accounts. Non-Executive Directors are remunerated solely by fees. They do not receive any salary, bonus incentives, pension contribution or other taxable benefit.

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

Fees are determined annually by the Board on the basis of recommendations by the remuneration committee. The committee is provided with fee data from comparative

organisations across the financial services industry and banking sector and procures such other relevant data from independent expert sources as appropriate.

Summary

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

Statement of Directors’ responsibilities

The following statement, which should be read in conjunction with the independent auditor’s responsibilities set out in their audit report, is made by the Directors to explain their responsibilities in relation to the preparation of the accounts, annual business statement and Directors’ report.

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

Company law requires the Directors to prepare Group and parent company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with IFRSs as adopted by the EU and applicable law and have elected to prepare the parent company financial statements on the same basis.

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the Bank and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that complies with that law and those regulations.

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

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

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole; and
- The Directors’ report includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

Disclosure of information to Auditors

The Directors who held office at the date of approval of this Directors’ report confirm that:

- so far as they are aware, there is no relevant audit information of which the Company’s Auditors are unaware, and

- each director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the Company's Auditors are aware of that information.

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

S Wilcke
Chairman
OneSavings Bank plc

Independent Auditor's report

We have audited the financial statements of OneSavings Bank plc for the period ended 31 December 2011 set out on pages 23 to 52. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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

Respective responsibilities of Directors and auditor

As explained more fully in the Statement of Directors' responsibilities set out on page 19 and 20, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 December 2011 and of the Group's -loss for the period then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU; and
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the information given in the Directors' Report for the financial period for which the financial statements are prepared is consistent with the financial statements; and
- information given in the Corporate Governance Statement set out on pages 13 to 16 with respect to internal control and risk management systems in relation to financial reporting processes and about share capital structures is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit or:
- a Corporate Governance Statement has not been prepared by the company.

Richard Gabbertas (Senior Statutory Auditor) for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
1 The Embankment
Neville Street,
Leeds
LS1 4DW
27 March 2012

Income statements

For the period ended 31 December 2011

	Notes	**Group Period ended 31-Dec-11 £'000**
Interest receivable and similar income	2	**42,043**
Interest payable and similar charges	3	**(43,450)**
Net interest expense		**(1,407)**
Fair value gains and losses on financial instruments	4	**669**
Gain on sales of financial instruments	5	**9,035**
Fees and commissions receivable		**1,486**
Fees and commissions payable		**(2,039)**
Total income		**7,744**
Administrative expenses	6	**(17,061)**
Depreciation and amortisation	16	**(314)**
		(9,631)
FSCS and other provisions	26	**(703)**
Impairment losses	13	**(2,913)**
Loss before taxation		**(13,247)**
Taxation credit	8	**2,135**

Loss for the period	**(11,112)**

Statements of comprehensive income

For the period ended 31 December 2011

	Group Period ended 31-Dec-11 £'000
Other comprehensive income:	
Available for sale securities: valuation gains taken to equity	**2,141**
Deferred taxation relating to components of other comprehensive income	**(319)**
Other comprehensive income for the period net of taxation	**1,822**
Loss for the period	**(11,112)**
Total comprehensive expense for the period	**(9,290)**

Consolidated statements of financial position

For the period ended 31 December 2011

	Note	Group 31-Dec-11 £'000	Bank 31-Dec-11 £'000
Assets			
Liquid assets			
Cash in hand and balances with the Bank of England		**253**	**253**
Loans and advances to credit institutions		**239,661**	**237,929**
Investment securities	9	**361,337**	**361,337**
Total liquid assets	10	**601,251**	**599,519**
Loans and advances to customers			
Loans fully secured on residential property	11	**1,530,853**	**929,921**
Other loans fully secured on land	11	**109,093**	**77,133**
		1,639,946	**1,007,054**
Derivative financial instruments	28	**683**	**683**
Fair value adjustments for hedged risk		**93,498**	**93,498**
Current taxation asset		**818**	**619**
Deferred taxation asset	17	**14,918**	**12,333**
Intangible fixed assets	15	**495**	**495**
Property, plant and equipment	16	**1,858**	**1,417**
Investments in group undertakings	14	**-**	**640,920**
Other assets	18	**2,925**	**1,749**
Total assets		**2,356,392**	**2,358,287**
Liabilities			
Amounts owed to retail depositors	19	**2,081,590**	**2,081,590**
Amounts owed to credit institutions	20	**831**	**831**
Amounts owed to other customers	21	**38,394**	**38,394**
Derivative financial instruments	28	**95,222**	**95,222**
Fair value adjustments for hedged risk		**1,094**	**1,094**
Deferred taxation liability	17	**562**	**562**
Other liabilities	22	**4,551**	**4,318**
FSCS and other provisions	26	**2,537**	**2,537**
Subordinated liabilities	23	**26,842**	**26,842**
Perpetual subordinated bonds	24	**15,327**	**15,327**
		2,266,950	**2,266,717**

Equity	**89,442**	**91,570**
Equity		
	89,442	**91,570**
Total equity and liabilities	**2,356,392**	**2,358,287**

Statement of Changes in Equity

For the period ended 31 December 2011

Group	**Share capital £'000**	**Share premium £'000**	**Transfer reserve £'000**	**AFS Reserve £'000**	**Retained earnings £'000**	**Subscribed Capital £'000**	**Total £'000**
Balance at date of incorporation	-	-	-	-	-	-	-
Transfer of business 1 February 2011	-	26,000	(12,818)	-	-	22,000	**35,182**
Capital injection 1 February 2011	76	49,924	-	-	-	-	**50,000**
Loss for the period	-	-	-	-	(11,112)	-	**(11,112)**
Coupon paid on PSBs	-	-	-	-	(1,450)	-	**(1,450)**
Other comprehensive income	-	-	-	1,822	-	-	**1,822**
Additional capital injection 31 August 2011	285	14,715	-	-	-	-	**15,000**
Balance at 31 December 2011	361	90,639	(12,818)	1,822	(12,562)	22,000	**89,442**

Bank	**Share capital £'000**	**Share premium £'000**	**Transfer reserve £'000**	**AFS Reserve £'000**	**Retained earnings £'000**	**Subscribed Capital £'000**	**Total £'000**
Balance at date of incorporation	-	-	-	-	-	-	-
Transfer of business 1 February 2011	-	26,000	(15,231)	-	-	22,000	**32,769**
Capital injection 1 February 2011	76	49,924	-	-	-	-	**50,000**
Loss for the period	-	-	-	-	(6,571)	-	**(6,571)**
Coupon paid on PSBs	-	-	-	-	(1,450)	-	**(1,450)**
Other comprehensive income	-	-	-	1,822	-	-	**1,822**
Additional capital injection 31 August 2011	285	14,715	-	-	-	-	**15,000**
Balance at 31 December 2011	361	90,639	(15,231)	1,822	(8,021)	22,000	**91,570**

Statements of cashflows

For the period ended 31 December 2011

	Group Period ended 31-Dec-11 £'000
Cash flows from operating activities	
Loss before taxation	**(13,247)**
Depreciation and amortisation	**314**
Interest paid on subordinated liabilities	**1,245**
Interest paid on 7.875% PSBs	**1,120**
Increase in impairment of loans and advances	**(3,202)**
Decrease in taxation movements	**163**
Cash generated from operations	**(13,607)**
Changes in operating assets and liabilities	
Increase in loans and advances to credit institutions	**(17,654)**
Increase in loans and advances to customers	**(102,156)**
Increase in derivative financial instruments and fair value adjustment for portfolio hedged risk	**(1,641)**
Increase in other assets	**(1,008)**
Increase in amounts owed to retail depositors	**376,193**
Decrease in amounts owed to credit institutions and other customers	**(88,466)**
Increase in provisions and other liabilities	**2,368**
	167,636
Cash flows from investing activities	
Cash and cash equivalents acquired	**70,683**
Purchase of investment securities	**(172,392)**
Sale and maturity of investment securities	**82,003**
Purchase of property, plant and equipment	**(279)**
Purchase of intangible assets	**(459)**
	(20,444)
Cash flows from financing activities	
Coupon paid on 6.591% PSBs	**(1,450)**
Capital injection	**65,000**
Interest paid on subordinated liabilities	**(1,245)**
Interest paid on 7.875% PSBs	**(1,120)**
	61,185
Net increase in cash and cash equivalents	**194,770**

Analysis of the balances of cash as shown in the balance sheet

Cash and cash equivalents at date of incorporation:

Cash and cash equivalents at 31 December 2011:	
Cash in hand and balances with the Bank of England	**253**
Loans and advances to credit institutions repayable on demand	**194,517**
	194,770
Movement in cash and cash equivalents in period	**194,770**

1. Accounting Policies

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

a. Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) 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 an historical cost basis, as modified by the revaluation of available for sale financial assets, derivative contracts and financial assets held at fair value through the income statement.

On 1 February 2011, the business of KRBS was transferred in to the Bank. Further information about this is provided in Note 33.

As permitted by section 408 of the Company Act 2006, no income statement is presented for the Bank. No comparatives are provided as this is the first reporting period for the Group.

b) Going Concern

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

Projections for OneSavings Bank plc have been prepared, covering its future performance, capital and liquidity, for a period in excess of 12 months from the date of approval of these accounts. In all scenarios the projections show that OneSavings Bank plc is dependent, until after the time at which the return to profitability is foreseen upon the continued support of the shareholders. The Directors have a reasonable expectation that such support will be forthcoming.

The Board has therefore concluded that the Bank has sufficient resources to continue in operational existence for the foreseeable future, and as a result it is appropriate to prepare these financial statements on a going concern basis.

c) Basis of consolidation

The Group accounts include the results of the Bank and its subsidiary undertakings. Subsidiaries are fully consolidated from the date on which control is transferred to the Group and are de-consolidated from the date that control ceases. Upon consolidation inter-company transactions, balances and unrealised gains on transactions are eliminated.

In the Bank accounts investments in subsidiary undertakings are stated at cost less provision for any impairment. All subsidiaries are wholly owned. Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated in the Group accounts. 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

d) Foreign currency translation

The consolidated financial statements are presented in sterling which is the functional currency of the Group. Foreign currency transactions are translated into sterling using the exchange rates prevailing at the date of the transactions. Monetary items denominated in foreign currencies are re-translated at the rate prevailing at the period end. Foreign exchange gains and losses resulting from the re-translation and settlement of these items are recognised in the income statement.

e) Segmental reporting

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

The Group operates solely within the retail financial service sector and within the UK and Channel Islands. The chief operating decision maker assesses the performance of the Group as a whole and as such no detailed segmental analysis is required.

f) Taxation including deferred taxation

The charge for taxation is based on the result for the period and takes into account current and deferred taxation. Where items are recognised directly in equity the associated taxation charge or credit is also recognised in equity.

Current taxation is the expected taxation payable on the taxable income and gains in the period.

Deferred taxation is provided in full, using the balance sheet liability method, on temporary differences arising between the taxation bases of assets and liabilities and their carrying amounts in the financial statements. Deferred taxation is determined using the taxation rates and laws that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred taxation asset is realised or the deferred taxation liability is settled.

Deferred taxation assets are recognised gross on the balance sheet and only recognised to the extent that recovery is probable.

Deferred taxation relating to the fair value re-measurement of available for sale investments, which are charged or credited directly to the available for sale reserve, is also credited or charged directly to the available for sale reserve and is subsequently recognised in the income statement together with the deferred gain or loss.

g) Interest income and expense

Interest income and interest expense for all interest bearing financial instruments measured at amortised cost are recognised in the income statement using the effective interest rate (EIR) method. The effective interest rate 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.

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

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

h) Fees and commissions

Fees and commissions which are an integral part of the effective interest rate of a financial instrument are recognised as an adjustment to the effective interest rate 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.

i) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months to maturity from the date of acquisition including cash, non-restricted balances with central banks and certificates of deposit.

j) Intangible assets

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

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

Amortisation is charged to the income statement by equal instalments over the estimated useful life of the software, which is
generally five years. These assets are reviewed for impairment on an annual basis.

k) Property, plant and equipment

The directly attributable costs of additions and major alterations to office premises, equipment, fixtures and motor vehicles are capitalised. 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 are determined by comparing the net disposal proceeds with the carrying amount of the asset and are included in the income statement.

The balance sheet value represents the original cost less cumulative depreciation. The costs less estimated residual values of assets are depreciated by equal instalments over their estimated useful economic lives as follows:

Freehold land and buildings	50 years
Equipment, fixtures and vehicles	5 years

The cost of repairs and renewals is charged to the income statement in the period in which the expenditure is incurred.

l) Financial assets and liabilities

Purchases and sales of financial assets and liabilities are accounted for at trade date. The Group classifies its financial assets and liabilities in accordance with IAS 39 into the following categories:

(i) Loans and receivables: which are predominantly mortgage loans and advances to customers and money market advances that are not quoted in an active market. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest rate method, less impairment losses. Where exposures are hedged by derivatives designated and qualifying as fair value hedges, the carrying value of the loans and advances so hedged includes a fair value adjustment for the hedged risk only.

(ii) Financial assets at fair value through the income statement: are assets:

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

The fair values are quoted market prices (where there is an active market) or are based on valuation techniques (where there is no active market or the securities are unlisted). Valuation techniques include the use of recent arm’s length transactions, discounted cash flow analysis and other commonly used valuation techniques. During the period, no financial assets were designated at fair value through the income statement.

(iii) Available for sale financial assets: comprise securities held for liquidity purposes (certificates of deposit, treasury bills and money market instruments in the nature of loans and advances to credit institutions). These assets are non-derivatives that are designated as available for sale and not categorised in any other financial asset categories. These are held at fair value with movements being taken to equity, except for impairment losses which are taken to the income statement. Profit or loss is recognised in the income statement on disposal. Available for sale financial assets are derecognised when the rights to receive the cash flows have expired or the Group has transferred substantially all the risks and rewards of the ownership.

(iv) Held to maturity investments: are non-derivative financial assets with fixed or determinable payments and fixed maturity where the Group intends to hold to maturity (Floating Rate Notes). Assets are held at amortised cost using the effective interest rate method less any impairment.

(v) Financial liabilities: are held at amortised cost. The Group classes the 7.875% perpetual subordinated bond as a financial liability as it was issued with terms that include no discretion over the payment of interest. Interest is recognised on an EIR basis.

m) Derivative financial instruments and hedge accounting

The Group uses derivative financial instruments (interest rate swaps and floors) 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 in the balance sheet at their fair value with changes in their fair value going through the income statement. Fair values are calculated by discounting cash flows at prevailing interest rates.

All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative.

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

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

Where there is an effective hedge relationship for fair value hedges, the changes in fair value of the hedged item arising from the hedged risk are taken to the income statement. The fair value changes of both hedged item and the derivative substantially offset each other to reduce profit volatility. To qualify for hedge accounting at inception, the hedge relationship must be clearly documented and the derivative must be expected to be highly effective in offsetting the hedged risk.

In addition, effectiveness must be tested throughout the life of the hedge relationship.

The Group discontinues hedge accounting when testing demonstrates that a derivative is not or has ceased to be highly effective as a hedge, the derivative ceases through expiry or sale etc or the underlying item matures, is sold or is repaid.

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

n) Impairment of financial assets

The Group assesses at each balance sheet date whether there is evidence that a financial asset or a portfolio of financial assets that is not carried at fair value through profit or loss is

impaired. A financial asset or portfolio of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of the asset and prior to the balance sheet date ('a loss event'), and that loss event or events has had an impact on the estimated future cash flows of the financial asset or the portfolio that can be reliably estimated.

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

For loans and receivables and held to maturity investments, the amount of impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate.

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

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

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

Following impairment, interest income is recognised using the original effective rate of interest which was used to discount the future cash flows for the purpose of measuring the impairment loss.

When a loan is uncollectible, it is written off against the related provision. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the provision for loan impairment in the balance sheet.

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

o) 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 have not been recognised.

p) Employee benefits – Defined contribution scheme

Obligations for contributions to defined contribution pension arrangements are recognised as an expense in the income statement as incurred.

q) Judgements in applying accounting policies and critical accounting estimates

The Group makes judgements which affect the amounts recognised in the financial statements. In addition, estimates and assumptions are made which could affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are regularly reviewed based on past experience, expectations of future events and other factors. The key areas where estimates and judgements are made are as follows:

(i) Impairment of financial assets: Provisions are calculated using twelve month delinquency roll rates and one year probability of defaults on different segments of the mortgage book. These rates, along with forced sale discounts are applied to calculate the expected losses. Judgement needs to be exercised in deciding how to apply historic experience to current market conditions. The most critical estimate is of the level of house prices where a variance of 10% equates to a change of £2.4m in provision.

(ii) Fair values: The fair values used in the financial statements, including those for derivative financial instruments and available for sale assets, are, where market values are not available, calculated using valuation techniques utilising discounted cash flow models using yield curves based on observable market data.

(iii) Effective interest rate: To calculate the appropriate EIR the Group makes a number of assumptions relating to the expected lives of financial instruments, likely redemption profiles and the anticipated level of early repayment charges. These estimates are reviewed in each reporting period to ensure they reflect current performance.

If the level of early repayment charges is increased by 1%, the carrying value of mortgages would decrease by £0.1m with corresponding charge to the income statement.

(iv) Deferred taxation: Deferred taxation 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 taxation is mainly dependent on the projection of future taxable profits and future reversals of existing taxable temporary differences.

Taxation losses were incurred in the Bank during the period. Management has evaluated the factors contributing to the losses to determine whether the factors leading to the losses are temporary or indicative of a permanent decline in earnings.

Management's projections of future taxable income are based on the Bank's business plan, which includes the income benefit of organic lending growth and the acquisition of further asset books, as well as ongoing taxation planning strategies. These projections also take account of anticipated credit losses, based on the Bank's economic outlook, and changes in regulatory capital requirements. The assumptions regarding asset acquisitions and anticipated credit losses are the most subjective areas of judgement in management's projection of future taxable income. Management's forecast supports the recoverability of the deferred taxation asset, through the generation of sufficient taxable income over a reasonable period.

Notes to the accounts
For the period ended 31 December 2011

2. Interest receivable and similar income

	Group Period ended 31-Dec-11 £'000
On loans fully secured on residential property	**59,179**
On other loans	**3,852**
On loans to subsidiaries	**-**
On investment securities:	
Interest and similar income	**3,985**
On other liquid assets:	
Interest and similar income	**647**
Net expense on derivative financial instruments	**(25,620)**
	42,043

Included within interest receivable is £2,737k in respect of interest accrued on impaired financial assets.

3. Interest payable and similar charges

	Group Period ended 31-Dec-11 £'000
On retail deposits	**40,163**
Perpetual Subordinated Bonds	**1,043**
On deposits and other borrowings	
Subordinated liabilities	**1,142**
Other wholesale borrowings	**1,094**
Net expense on derivative financial instruments	**8**
	43,450

4. Fair value gains and losses on financial instruments

	Group Period ended 31-Dec-11

	£'000
Hedge ineffectiveness on effective hedges	(1,903)
Net gains on unmatched swaps	2,572
	669

5. Gain on sales of financial instruments

The Bank routinely buys and sells liquidity assets in order to confirm the ease with which cash can be realised, and the robustness of the valuations assigned to such assets. During the reporting period, the prevailing direction of longer-term interest rates was downwards, leading to significant increases in the carrying value of fixed rate liquidity assets. This led to the realisation of a net gain of £9.0m on the sale of financial instruments.

6. Administrative expenses

	Group Period ended 31-Dec-11 £'000
Staff costs (see below)	4,733
Fees payable to the Group auditors and their associates (see below)	452
Property rentals under operating leases	341
Consultants and interim management costs	3,131
Legal costs	1,802
VAT expense	1,460
Postage, telephone and travel	1,171
Other administrative expenses	3,971
	17,061

Auditors remuneration: Fees payable to the Group auditors and their associates for:	Group Period ended 31-Dec-11 £'000
Audit of the Bank and Group accounts	126
Audit of the Group's subsidiary undertakings	30
Other services pursuant to such legislation	1
Other services relating to taxation	6
Services relating to corporate finance transactions entered into or proposed to be entered into by or on behalf of the	210

Bank or the Bank’s subsidiaries	
All other services	**79**
	452

Staff numbers and costs

The average number of persons employed by the Group (including executive directors) during the period was 254.

	Group
	Period ended
	ended
	31-Dec-11
The aggregate costs of these persons were:	**£'000**
Salaries	**4,020**
Social security costs	**345**
Other pension costs	**368**
	4,733

7. Directors' emoluments and transactions

	Salary & fees £'000	**Other benefits £'000**	**Contributio n to personal pension policy £'000**	**Period ended 31-Dec-11 Total £'000**
Executive Directors' emoluments - 2011				
J Wood	**280**	**-**	**-**	**280**
M J Lazenby	**32**	**511**	**6**	**549**
R Scruton	**100**	**181**	**20**	**301**
Total executive emoluments	**412**	**692**	**26**	**1,130**

The figures above include £692k compensation for loss of office during the period.

Non-executive Directors' emoluments

	Period ended 31-Dec-11 £'000
A Newell	**40**

D Mills	**40**
Dr D Morgan	**32**
M McCaig	**48**
P Williams	**32**
S Wilcke	**87**
Sir C McCarthy	**32**
T Hanford	**32**
	343
Total Directors' emoluments	**1,473**

Stephan Wilcke's remuneration includes £32k paid directly to a charity: Multiple Sclerosis Resource Centre Ltd.

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

At 31 December 2011 there were no outstanding loans granted in the ordinary course of business to Directors and their connected persons.

8. Tax (credit) / expense

		Group
	months	**Period ended**
	31-Dec-10	**31-Dec-11**
	£'000	**£'000**
UK corporation taxation on losses for the period	-	**-**
Adjustments in respect of earlier periods relating to subsidiaries	-	**(192)**
Total current taxation	-	**(192)**
Deferred taxation		
Total deferred taxation (see note 17)		**(1,943)**
Total taxation credit	-	**(2,135)**

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

Loss before taxation		**(13,247)**
Loss multiplied by the weighted average rate of	-	**(3,497)**

corporation taxation in the UK at 26.4% taxation effects of:		
Expenses not deductible for taxation purposes	-	**18**
Adjustments in respect of earlier periods	-	**224**
Re-measurement of deferred taxation - change in taxation rate	-	**1,120**
Total tax expense / (credit)	-	**(2,135)**

9. Loans and advances to credit institutions

	Group	**Bank**
	31-Dec-11	**31-Dec-11**
	£'000	**£'000**
Loans and advances to credit institutions have a remaining maturity as follows:		
Repayable on demand	**194,517**	**193,469**
In one year or less	**44,936**	**44,460**
In more than one year but not more than five years	**208**	**-**
In more than five years	**-**	**-**
	239,661	**237,929**

10. Investment securities

	Group and Bank
	31-Dec-11
	£'000
Government investment securities	**231,744**
Other investment securities:	
Listed	**9,422**
Unlisted	**120,171**
	361,337

Investment securities have remaining maturities as follows:	
Repayable on demand	**-**
In one year or less	**228,987**
In more than one year but less than five years	**71,225**
In more than five years	**61,125**
	361,337

The directors of the Bank consider that the primary purpose of holding investment securities is prudential. These securities are held as liquid assets with the intention of use on a continuing basis in the Bank's activities and hence are classified as financial assets, held as available for sale or held to maturity as appropriate.

Movements during the year of investment securities held as available for sale financial assets are analysed as follows:

	Group and Bank 31-Dec-11
	£'000
At date of incorporation	-
Transfer of business 1 February 2011	**250,038**
Additions	**172,392**
Disposals and maturities	**(74,000)**
Changes in fair value	**2,141**
At 31 December 2011	**350,571**

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

	Group and Bank 31-Dec-11
	£'000
At date of incorporation	**-**
At date of transfer of business 1 February 2011	**18,769**
Maturities	**(8,003)**
At 31 December 2011 (31 December 2010)	**10,766**

11. Loans and advances to customers

	Group	**Bank**
	31-Dec-11	**31-Dec-11**
	£'000	**£'000**
Loans fully secured on residential property	**1,530,853**	**929,921**
Other loans fully secured on land	**109,093**	**77,133**
	1,639,946	**1,007,054**

Maturity analysis

Advances secured on residential property and other loans are repayable from the date of the balance sheet as follows:

	Group	Bank
	31-Dec-11	31-Dec-11
	£'000	£'000
In not more than three months	19,235	16,989
In more than three months but not more than one year	19,592	17,537
In more than one year but not more than five years	91,808	64,664
In more than five years	1,541,603	935,310
	1,672,238	1,034,500
Less: impairment losses on loans and advances (see Note 12)	(32,292)	(27,446)
	1,639,946	1,007,054

On 1 November 2011, the Bank purchased a book of mortgages from another financial institution. This book had a gross asset value of £196m and was purchased for £140m, the discount primarily reflecting the low average rate payable. These mortgages are recorded at amortised cost, the discount being amortised over the anticipated life of the assets.

It should be noted that this analysis may not reflect actual experience of repayments, since many mortgage loans are repaid early.

12. Provision for impairment losses on loans and advances

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

	Loans fully secured on residential property		Other loans fully secured on land		2011		
	Individual	Collective	Individual	Collective	Individual	Collective	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Group							
At date of incorporation	-	-	-	-	-	-	-
Transfer of business 1 February 2011	17,369	920	16,825	380	34,194	1,300	35,494
Write offs in period	(6,115)	-	-	-	(6,115)	-	(6,115)
Recoveries of amounts previously provided	-	-	-	-	-	-	-
Charge/(credit) for the period net of recoveries	2,953	(40)	-	-	2,953	(40)	2,913
At 31 December 2011	14,207	880	16,825	380	31,032	1,260	32,292
Bank							
At date of incorporation	-	-	-	-	-	-	-
Transfer of business 1 February 2011	14,719	671	16,825	371	31,544	1,042	32,586

Write offs in period	**(6,115)**	**-**	**-**	**-**	**(6,115)**	**-**	**(6,115)**
Recoveries of amounts previously provided	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Charge/(credit) for the period net of recoveries	**537**	**(207)**	**616**	**29**	**1,153**	**(178)**	**975**
At 31 December 2011	**9,141**	**464**	**17,441**	**400**	**26,582**	**864**	**27,446**

13. Impairment losses

		Group
	##	**31-Dec-11**
	£'000	**£'000**
Impairment losses on loans and advances to customers (see note 12)	-	**2,913**
	-	**2,913**

14. Related parties and investments in group undertakings

The Bank has the following subsidiary undertakings, all of which are wholly owned.

	Class of shares	**Activity**	**Country of Registration**	**Interest & Similar Expense**	**Balance due to / from Bank**
Jersey Home Loans Ltd	Ordinary	Mortgage provider	England	558	(16,557)
Jersey Home Loans Ltd	Ordinary	Mortgage provider	Jersey	13,910	(496,027)
Easioption Ltd	Ordinary	Holding company	England	-	-
Guernsey Home Loans Ltd	Ordinary	Mortgage provider	England	1,666	(52,564)
Guernsey Home Loans Ltd	Ordinary	Mortgage provider	Guernsey	1,460	(67,275)
Reliance Property Loans Ltd	Ordinary	Mortgage provider	England	(126)	(5,467)
Easiprocess Private Ltd	Ordinary	Back office processing	India	-	(1,595)
EasiOption BPO Services Private Ltd	Ordinary	Back office processing	India	-	(1,435)

All the above subsidiaries have a 31 December period end date.

All the above investments are reviewed annually for impairment. All the subsidiaries are actively trading or operating and fully funded by the Bank; based on management's assessment of the future cashflows of each entity, no impairment has been recognised.

In addition to the above subsidiaries the Bank has transactions with KRPS, the majority shareholder. KRPS provides the agency services to the Bank. The commission charged to and payable by the Bank as 31 December 2011 was £751k.

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

	2011		
	£'000		
	Shares in subsidiary undertakings	Loans to subsidiary undertakings	Total
At date of incorporation			
Transfer of business 1 February 2011	-	631,397	**631,397**
Additions	-	26,900	**26,900**
Repayments	-	(17,377)	**(17,377)**
At 31 December 2011	-	640,920	**640,920**

Transactions with Key Management Personnel

The Board considers the key management personnel to comprise executive and non executive directors. Details of remuneration paid and mortgage loans made to key management personnel and connected persons are set out in note 7.

Key management personnel held deposits and shares with the group of £25,676

15. Intangible fixed assets

	Group and Bank
	31-Dec-11
	£'000
Cost	
At date of incorporation	**-**
Transfer of business 1 February 2011	**2,219**
Additions	**459**
At 31 December 2011	**2,678**
Amortisation	
At date of incorporation	**-**
Transfer of business 1 February 2011	**2,090**
Charged in period	**93**
At 31 December 2011	**2,183**
Net book value	
At 31 December 2011	**495**

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

16. Property, plant and equipment

Group

	Freehold land and buildings £'000	Equipment, fixtures and vehicles £'000	31-Dec-11 Total £'000
Cost			
At date of incorporation	-	-	-
Transfer of business 1 February 2011	1,259	5,767	7,026
Additions	-	279	279
At 31 December 2011	1,259	6,046	7,305
Depreciation			
At date of incorporation	-	-	-
Transfer of business 1 February 2011	182	5,044	5,226
Charged in period	18	203	221
At 31 December 2011	200	5,247	5,447
Net book value			
At 31 December 2011	1,059	799	1,858

Bank

	Freehold land and buildings £'000	Equipment, fixtures and vehicles £'000	31-Dec-11 Total £'000
Cost			
At 1 January 2011 (1 October 2009)	-	-	-
Additions	1,259	4,190	5,449
Disposals	-	275	275
	-	-	-
At 31 December 2011	1,259	4,465	5,724
Depreciation			
At date of incorporation	-	-	-
Transfer of business 1 February 2011	182	4,024	4,206
Charged in period	18	83	101

On disposals	-	-	-
At 31 December 2011	**200**	**4,107**	**4,307**
Net book value			
At 31 December 2011	**1,059**	**358**	**1,417**

17. Deferred taxation

	Group	**Bank**
Deferred taxation asset	**31-Dec-11**	**31-Dec-11**
	£'000	**£'000**
At date of incorporation	-	-
Transfer of business 1 February 2011	**11,789**	**11,789**
Reclassified from current taxation	**1,186**	-
Income statement credit	**1,943**	**544**
At 31 December 2011	**14,918**	**12,333**
This represents:		
Carried forward taxation losses	**14,586**	**12,214**
Accelerated taxation depreciation	**332**	**119**
	14,918	**12,333**
Deferred taxation liability		
At date of incorporation	-	-
Transfer of business 1 February 2011	**243**	**243**
Fair value gains on available for sale assets	**319**	**319**
At 31 December 2011	**562**	**562**

The 2012 Budget on 21 March 2012 announced that the UK corporation tax rate will decrease from 26% to 22% by 1 April 2014. A reduction in the UK corporation tax rate from 26% to 25%

was initially enacted on 5 July 2011 and was expected to be effective from 1 April 2012. However, after the Budget on 21 March 2012 it was announced that the rate will decrease from 26% to 24% on 1 April 2012 instead, though this rate has not yet been enacted. As a result, a rate of 25% has been used to calculate the deferred tax balance. The effect of the announced further 3% rate reduction will further reduce the company's deferred tax assets and the rate at which they will be reversed. Refer to note 1(f) and note 1(q)(iv) for further detail in relation to key judgements on deferred taxation.
Recovery time horizons are based on the Board Approved Business Plan that projects the Bank's trading position out to 2015.

18. Other assets

	Group	Bank
	31-Dec-11	31-Dec-11
	£'000	£'000
Prepayments	1,330	1,330
Value added taxation repayable	419	419
Other assets	1,176	-
	2,925	1,749

19. Amounts owed to retail depositors

	Group and Bank
	31-Dec-11
	£'000
Amounts owed to retail depositors	2,081,590

Repayable from the date of the balance sheet in the ordinary course of business as follows:

On demand	674,527
In not more than three months	129,562
In more than three months but not more than one year	576,755
In more than one year but not more than five years	700,746
	2,081,590

20. Amounts owed to credit institutions

	Group and Bank
	31-Dec-11
	£'000

Repayable from the date of the balance sheet in the ordinary course of business as follows:

In not more than three months	**831**
	831

## 21. Amounts owed to other customers	**Group and Bank 31-Dec-11 £'000**
Repayable from the date of the balance sheet in the ordinary course of the business as follows:	
In not more than three months	**18,569**
In more than three months but not more than one year	**18,822**
In more than one year but not more than five years	**1,003**
	38,394

22. Other liabilities	Group 31-Dec-11 £'000	Bank 31-Dec-11 £'000
Falling due within one year		
Tax deducted at source from interest paid	**1,434**	**1,434**
Other creditors	**9**	**9**
Accruals and deferred income	**3,108**	**2,875**
	4,551	**4,318**

23. Subordinated liabilities	Group and Bank 31-Dec-11 £'000
Linked to LIBOR (London Interbank Offered Rate):	
Floating rate Subordinated Liabilities 2015	**3,002**
Floating rate Subordinated Liabilities 2016	**2,996**
Floating rate Subordinated Liabilities 2017	**5,642**

Linked to the average standard mortgage rate of the five largest building societies:	
Floating rate Subordinated Liabilities 2017	**5,039**
Fixed rate:	
6.45% Subordinated Liabilities 2024	**10,163**
	26,842

Subordinated liabilities are repayable at the dates stated or earlier at the option of the Bank with the prior consent of the Financial Services Authority. All Subordinated Liabilities are denominated in sterling.

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

24. Perpetual Subordinated Bonds

	Group and Bank 31-Dec-11 £'000
7.875% sterling perpetual subordinated bonds	**15,327**

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

	Group and Bank		
	31-Dec-11		
	Number of Shares		
	Ordinary A shares	**Ordinary B shares**	**Convertible Preference shares**
Transfer of business 1 February 2011	**26,000**	**-**	**-**
Capital injection 1 February 2011	**-**	**17,426**	**32,574**
Additional capital injection 31 August 2011	**-**	**2,571**	**282,240**
As at 31 December 2011	**26,000**	**19,997**	**314,814**

	Group and Bank		
	31-Dec-11		
	£000's		
	Value	**Premium**	**Total**

Ordinary A shares	**26**	**25,974**	**26,000**
Ordinary B shares	**20**	**63,883**	**63,903**
Convertible Preference shares	**315**	**782**	**1,097**
As at 31 December 2011	**361**	**90,639**	**91,000**

At 31 December 2011, the share capital comprised 45,997 fully allotted and paid up ordinary shares and 314,814 convertible preference shares. All of these instruments have a par value of £1.

Both A & B Ordinary share have veto rights appropriate for a participant in a joint venture arrangement providing they retain a certain percentage of the ordinary shares of the Bank. The convertible preference share holders have preferential rights in relation to any dividends that may be declared by the board of the Bank.

Perpetual Subordinated Bonds

In addition to the PBSs in note 24, the Bank has issued £22m 6.591% PSBs which are classified as equity, as full discretion can be exercised by the directors over the payment of the coupon. The classification of these PSBs means that any coupon payments on them are now treated within equity rather than through the Income Statement.

Transfer Reserve

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

AFS Reserve

The AFS reserve of £1.8m represents the cumulative net change in the fair value of investments securities measured at fair value through other comprehensive income net of deferred tax.

26. FSCS and other provisions

In common with all regulated UK deposit takers, OneSavings Bank plc pays levies to the FSCS to enable the FSCS to meet claims against it. The FSCS levy consists of two parts: a management expenses levy and a compensation levy. The management expenses levy covers the costs of running the scheme and the compensation levy covers the amount of compensation the scheme pays, net of any recoveries it makes using the rights that have been assigned to it. During 2008 and 2009 claims were triggered against the FSCS in relation to Bradford & Bingley plc, Kaupthing Singer & Friedlander Ltd, Heritable Bank plc, Landsbanki Islands hf, London Scottish Bank plc and Dunfermline Building Society.

The FSCS meet these current claims by way of loans received from HMT. The terms of these loans were interest only for the first three years, and the FSCS seek to recover the interest cost, together with ongoing management expenses, by way of annual management levies on members over this period. The Bank pays levies to the Financial Service Compensation Scheme (‘FSCS’) to enable the FSCS to meet claims against it.

The FSCS provision at 31 December 2011 represents management expense levies for the scheme years triggered (which includes the liability as incurred by KRBS) but not yet invoiced and the £2.4m provision at that date is an estimate of the levy for the scheme years 2010/2011, 2011/2012 and 2012/2013. The management expenses levy for scheme years 2010/2012 and 2011/2012 have been calculated using the agreed funding rate of 12 months

LIBOR + 30bps. Negotiations between HM Treasury ('HMT') and FSCS on the appropriate funding rate for the HMT loans for the period from 1 April 2012, on which the management expenses levy for scheme year 2012/2013 will be based have been agreed as being funding rate of 12 months LIBOR + 100bps.

On 8 March 2012 HMT and the FSCS announced that additional levies will be made on industry participants in order to recover expected capital shortfalls on loans made to failed institutions by the FSCS. The current estimate of the shortfall to be recovered is £802m and this will be recovered in three approximately equal instalments beginning in scheme year 2013-14. As a result of this an increased provision for FSCS levies is likely to exist in the financial statements for the year ending 31 December 2012.

The regulatory provisions is in respect of customer claims and the timing of payment is expected to be in next five years.

Movement in provisions:	**Group and Bank FSCS**	**Group and Bank Regulatory provisions**
	31-Dec-11	**31-Dec-11**
	£'000	**£'000**
As at date of incorporation	-	-
Transfer of business 1 February 2011	1,186	648
Paid during the period	-	-
Net charge/(release) for the period	1,201	(498)
At 31 December 2011	**2,387**	**150**

27. Financial commitments

a. There were no capital commitments for the Group contracted but not provided for as at 31 December 2011.
b. Operating leases

	Group and Bank **31-Dec-11**
Total commitments under operating leases	**£'000**
Land and buildings	
Within one year	**68**
Within two to five years	**8**
	76

	Group	**Bank**
	31-Dec-11	**31-Dec-11**

	£'000	£'000
c) Undrawn mortgage loan facilities	**26,326**	**17,356**

Subject to satisfaction of previously agreed loan to values, the Group is committed to £26.3m (Bank: £17.4m) of undrawn mortgage loan facilities relating to its flexible mortgages.

28. Risk management and financial Instruments

Overview

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

Types of financial instrument

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

The group uses derivative instruments to manage various aspects of market rate risk. Instruments used for risk management purposes include derivative financial instruments ("derivatives") which are contracts whose value is derived from one or more of underlying price, rate or index inherent in the contract or agreement, such as interest rates. Derivatives are solely used by the Group, to reduce the risk of loss arising from changes in market value. Derivatives are not used for speculative purposes.

Types of derivatives and uses

The derivative instruments used by the Group in managing its balance sheet risk exposures are interest rate swaps and floors. These are used to protect the Group from exposures arising principally from fixed rate mortgage lending, deposit funding and subscribed capital. An interest rate swap is a contract to exchange one set of interest rate cash flows for another. Such swaps result in the economic exchange of interest rates. No exchange of principal takes place. Instead, interest payments are based on notional principal amounts agreed at the inception of the swap. The duration and maturity profile of the interest rate swap reflects the nature of the exposures arising from the inception of the swap. The duration and maturity profile of the interest rate swap reflects the nature of the exposures arising from the underlying business activities.

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

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

Financial risks

The principal risks to which the Group is exposed are operational, credit and liquidity and market risk. Each of these is considered below.
The Group has adopted the standardised approach for analysing credit risk and assessment of capital requirements. This approach considers risk weightings as defined under Basel II principles.

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 classes of financial instruments to which the Group is most exposed are loans and advances to customers, loans and advances to credit institutions and investment securities. The maximum exposure to credit risk is represented by the carrying amount of each financial asset.

Credit risk - loans and advances to customers

Credit risks associated with mortgage lending revolves largely around the housing market and levels of employment. A recession and/or high interest rates could cause pressure within the market, resulting in rising levels of arrears and repossessions.

All loan applications are assessed with reference to the Group's lending policy. Changes to policy are approved by the Board and the approval of loan applications is mandated.

As the economic environment changed, ALCO has regularly monitored and reviewed lending activity, in its view, taking appropriate actions to re-price products and adjust lending criteria in order to control risk and manage exposure. Significant changes were recommended to the Board for subsequent inclusion in the Group's Lending Policy Statement.

The following table shows an analysis of the Group mortgage portfolio by borrower type at the year end:

	Group		**Bank**	
Loans and advances to customers	**31 December 2011**		**31 December 2011**	
	£'000	**%**	**£'000**	**%**
Residential mortgages	**1,257,452**	**75%**	**778,645**	**75%**
Buy To Let mortgages	**288,489**	**17%**	**160,881**	**16%**
Commercial mortgages	**126,297**	**8%**	**94,974**	**9%**
Total	**1,672,238**	**100%**	**1,034,500**	**100%**

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

Loan to value analysis by band:

31 December 2011

Band	Residential	Buy To Let	Commercial	Total	
	£'000	£'000	£'000	£'000	
0 - 50%	**632,602**	**52,120**	**16,534**	**701,256**	**42%**
50% - 60%	**183,100**	**36,041**	**16,711**	**235,852**	**14%**
60% - 70%	**210,321**	**67,796**	**26,786**	**304,903**	**18%**
70% - 80%	**130,692**	**59,822**	**22,353**	**212,867**	**13%**
80% - 90%	**68,724**	**29,130**	**3,519**	**101,373**	**6%**
>90%	**32,013**	**43,580**	**40,394**	**115,987**	**7%**
Total	**1,257,452**	**288,489**	**126,297**	**1,672,238**	**100%**

31 December 2010

Band	Residential	Buy To Let	Commercial	Total	
	£'000	£'000	£'000	£'000	
0 - 50%	488,408	22,490	12,735	523,633	51%
50% - 60%	104,428	13,646	8,227	126,301	12%
60% - 70%	111,322	38,326	17,105	166,753	16%
70% - 80%	56,132	33,048	17,554	106,734	10%
80% - 90%	14,963	14,896	1,092	30,951	3%
>90%	3,392	38,475	38,261	80,128	8%
Total	778,645	160,881	94,974	1,034,500	100%

Analysis of mortgage portfolio by arrears and collateral held

The table below provides further information on the mortgage portfolio by payment due status:

Not impaired:

	Group		Bank	
Status	31 December 2011		31 December 2011	
	Mortgage balance £'000	Collateral £'000	Mortgage balance £'000	Collateral £'000
Not past due	**1,398,316**	**1,398,117**	**849,561**	**849,369**
Past due up to 3 months	**140,910**	**140,910**	**89,558**	**89,558**
Past due 3 to 6 months	**19,171**	**19,069**	**10,038**	**9,936**
Past due 6 to 12 months	**13,342**	**13,166**	**7,584**	**7,423**
Past due over 12 months	**5,482**	**5,455**	**3,314**	**3,285**

Possessions	**1,217**	**1,217**	**1,217**	**1,217**
	1,578,438	**1,577,934**	**961,272**	**960,788**

The table above includes assets that are in possession but where the expected recoverable value is more than the mortgage balance. The collateral amount is capped to the mortgage balance where it exceeds the carrying value of the mortgage balance to eliminate the effect of over-collateralisation.

Impaired:

	Group		**Bank**	
Status	**31 December 2011**		**31 December 2011**	
	Mortgage balance £'000	**Collateral £'000**	**Mortgage balance £'000**	**Collateral £'000**
Not past due	**15,178**	**12,596**	**5,609**	**4,811**
Past due up to 3 months	**17,334**	**14,504**	**16,151**	**13,542**
Past due 3 to 6 months	**3,822**	**3,822**	**-**	**-**
Past due 6 to 12 months	**14,987**	**11,497**	**11,222**	**7,733**
Past due over 12 months	**32,803**	**16,872**	**30,571**	**14,640**
Possessions	**9,676**	**8,062**	**9,676**	**8,062**
Total	**93,800**	**67,353**	**73,229**	**48,788**

The collateral amount is capped to the mortgage balance where it exceeds the carrying value of the mortgage balance to eliminate the effect of over-collateralisation.

Impaired mortgages above do not include balances that are past due if the recoverable value is more than the mortgage balance. £41.1m of loans not past due have been renegotiated and would have been past due and impaired if their terms had not been renegotiated.

Provision for mortgages differs from the gap between the mortgage balance and collateral to the extent that:

a. In individually identified cases where the recoverable value is less than the mortgage balance, an impairment percentage has been applied
b. For cases subject to collective impairment where the recoverable value is less than the mortgage balance, an impairment percentage based on management assessment has been applied.

Collateral held against mortgages that are past due and impaired is set out below:

To the extent the Group is able to realise the collateral held in relation to secured loans that are either past due or impaired, this would be capped to the amount outstanding on an individual loan basis.

Collateral held against Mortgages	**Group**		**Bank**	
	31 December 2011		**31 December 2011**	
	Mortgage	**Collateral**	**Mortgage**	**Collateral**

	balance		balance	
	£'000	**£'000**	**£'000**	**£'000**
Past due but not impaired	**180,122**	**179,817**	**111,711**	**111,419**
Impaired	**93,800**	**75,416**	**73,229**	**48,788**
Total	**273,923**	**259,319**	**184,940**	**160,207**

Geographical analysis by region

An analysis of Mortgages by region is provided below:

	Group			
Region	**31 December 2011**		**Bank 31 December 2011**	
	£'000	**%**	**£'000**	**%**
East Anglia	**27,962**	**1.7%**	**27,487**	**2.7%**
East Midlands	**48,202**	**2.9%**	**47,936**	**4.6%**
Greater London	**328,96**	**19.7%**	**327,320**	**31.6%**
North	**16,092**	**1.0%**	**15,671**	**1.5%**
North West	**59,594**	**3.6%**	**59,110**	**5.7%**
South East	**376,805**	**22.5%**	**375,981**	**36.3%**
South West	**72,488**	**4.3%**	**72,013**	**7.0%**
Wales	**16,732**	**1.0%**	**16,613**	**1.6%**
West Midlands	**48,297**	**2.9%**	**47,821**	**4.6%**
Yorkshire & Humberside	**22,956**	**1.4%**	**21,983**	**2.2%**
Jersey	**512,072**	**30.6%**	**-**	**-**
Guernsey	**119,507**	**7.1%**	**-**	**-**
Northern Ireland	**4,002**	**0.2%**	**4,002**	**0.4%**
Isle of Man	**11,154**	**0.7%**	**11,154**	**1.1%**
Scotland	**7,410**	**0.4%**	**7,409**	**0.7%**
Total	**1,672,238**	**100.0%**	**1,034,500**	**100.0%**

Credit risk - investment securities, loans and advances to credit institutions and derivative financial instruments

The Group holds treasury instruments in order to meet liquidity requirements and for general business purposes. The credit risk arising from these investments is closely monitored and managed by the Group's treasury department within the guidelines laid down in the Financial Risk Management policy approved by the Board and reported to ALCO monthly.

As at 31 December 2011 one of the Group's treasury portfolio exposures - Glitnir: £1.6million against which impairment provision has been made of £1,076,000 - was both past due and impaired. There are no assets held as treasury instruments whose terms have been renegotiated.

The Group has limited exposure to emerging markets (Indian operations) and to non investment grade debt, including investments with building societies and local authorities. The ALCO is responsible for approving treasury counterparties.

Ratings	**Group** **31 December 2011**					
	AAA	**AA**	**A**	**Less than A rating**	**Unrated building societies**	**Total**
	£'000	£'000	£'000	£'000	£'000	£'000
Certificate of deposit	-	47,238	91,516	4,553	10,035	153,342
Call accounts	1,213	-	194,511	-	-	195,724
Time deposits	8,146	1,276	-	-	-	9,422
Floating rate notes	5,011	2,509	3,246	-	-	10,766
Treasury bills	147,507	-	-	-	-	147,507
Gilts	84,237	-	-	-	-	84,237
Total	**246,114**	**51,023**	**289,273**	**4,553**	**10,035**	**600,998**
Percentages	41.0%	8.5%	48.1%	0.8%	1.7%	100.0%

Ratings	**Bank** **31 December 2011**					
	AAA	AA	A	Less than A rating	Unrated building societies and local authority	**Total**
	£'000	£'000	£'000	£'000	£'000	£'000
Certificate of deposit	-	47,238	91,516	4,553	10,035	153,342
Call accounts	1,213	-	192,779	-	-	193,992
Time deposits	8,146	1,276	-	-	-	9,422
Floating rate notes	5,011	2,509	3,246	-	-	10,766
Treasury bills	147,507	-	-	-	-	147,507
Gilts	84,237	-	-	-	-	84,237
Total	**246,114**	**51,023**	**287,541**	**4,553**	**10,035**	**599,266**
Percentages	41.2%	8.4%	48.0%	0.8%	1.7%	100.0%

Industry sector/asset class	**Group** **31 December 2011**		**Bank** **31 December 2011**	
	£'000	**%**	£'000	**%**
Financial institutions				
Banks	**536,156**	**89.2%**	**534,424**	**89.2%**
Building societies	**64,842**	**10.8%**	**64,842**	**10.8%**

Total	**600,998**	**100.0%**	**599,266**	**100.0%**

	Group		**Bank**	
Geographical exposure	**31 December 2011**		**31 December 2011**	
	£'000	%	£'000	%
United Kingdom	**545,922**	**90.9%**	**545,923**	**91.2%**
Europe except United Kingdom	**47,587**	**7.9%**	**47,587**	**7.9%**
Australia	**2,509**	**0.4%**	**2,509**	**0.4%**
America	**3,247**	**0.5%**	**3,247**	**0.5%**
India	**1,733**	**0.3%**	**-**	**-**
Total	**600,998**	**100.0%**	**599,266**	**100.0%**

The Group did have £10m of exposure to a significant UK financial institution which is based in Spain which matured on 3 January 2012 at par.

The Group also monitors exposure concentrations against a variety of criteria including industry sector/asset class and country of risk. To avoid refinancing risks associated with any one counterparty, sector or geographical region the Board has set appropriate limits. These are contained in the Financial Risk Management 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 becomes too expensive. The Group increased its minimum level of liquidity, above its normal target range, in response to the current credit crisis.

The Group's liquidity policy is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding in order to retain full public confidence in the solvency of the Group and to enable the Group to meet its financial obligations. This is achieved through maintaining a prudent level of liquid assets, through wholesale funding facilities and through control of the growth of the business.

The development and implementation of the liquidity policy is the responsibility of ALCO, with day-to-day management delegated to Treasury as detailed in the Financial Risk Management Policy. A series of liquidity stress tests are performed each month to confirm that the limits remain appropriate. ALCO is responsible for setting limits over the level and maturity profile of wholesale funding for monitoring the composition of the Group balance sheet.

For each material class of financial liability a contractual maturity analysis is provided in notes 19 to 21.

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

Group and Bank	Up to 3	3 - 12	1 - 5	More than	Total
As at 31 December 2011	months	months	years	5 years	

	£'000	£'000	£'000	£'000	£'000
Amounts owed to retail depositors	790,098	599,051	771,929	-	2,161,078
Amounts owed to credit institutions and other customers	18,965	18,963	1,090	-	39,018
Derivative financial instruments	431	2,838	17,252	81,019	101,540
Other liabilities	4,551	-	-	-	4,551
Subordinated liabilities	65	1,048	11,543	19,663	32,319
Perpetual subordinated bonds	599	1,188	2,366	15,000	19,153
Total liabilities	814,709	623,088	804,180	115,682	2,357,659

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

Market risk

Market risk is the risk of potential adverse change in Group income or the value of Group 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.

Interest rate risk

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

The Group is exposed to movements in interest rates reflecting the mismatch between the dates on which interest receivable on assets and interest payable on liabilities are next reset to market rates or, if earlier, the dates on which the instruments mature. The Group manages this exposure on a continuous basis within limits set by ALCO and the Board, through the use of derivatives. After taking into account the various derivatives entered into by the Group, the interest rate sensitivity at period end is assessed by considering a parallel shift in interest rates at that date: if interest rates increases by 200 basis points and all other variables were constant, the Group's annual profit after taxation and equity for 2011 would increase by £3.2 million. If the interest rate goes down to zero, the Group's profit after taxation would decrease by £1.6 million.

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

Fair value adjustments for hedged risk

This represents the fair value adjustments to the carrying value of mortgage assets, amounts owed to credit institutions and other customers, subordinated debt and subscribed capital as a result of portfolio hedging.

Fair values of financial assets and financial liabilities

The following table gives a comparison of book and fair values of some of the Group's financial assets and liabilities as at the period end. The Group does not undertake transactions for trading or speculative purposes. Market values have been used to determine

fair values but where these are not available the financial instruments have been valued by discounting cash flows at prevailing interest rates.

	Group 31 December 2011				
	Positive	Positive	Negative	Negative	**Principal/**
	Book value	Fair value	Book value	Fair value	**Notional**
	£'000	£'000	£'000	£'000	**£'000**
Cash and balances with the Bank of England	253	253	-	-	**253**
Loans and advances to credit institutions	239,661	239,661	-	-	**241,358**
Investment securities	361,337	361,341	-	-	**343,651**
Loans and advances to customers	1,639,946	1,758,635	-	-	**1,699,946**
Amounts owed to retail depositors	-	-	(2,081,590)	(2,107,399)	**(2,057,974)**
Amounts owed to credit institutions	-	-	(831)	(832)	**830**
Amounts owed to other customers	-	-	(38,394)	(39,092)	**38,115**
Subordinated liabilities	-	-	(26,842)	(29,011)	**26,650**
Perpetual subordinated bonds	-	-	(15,327)	(17,547)	**15,000**
Derivatives	683	683	(95,222)	(95,222)	**1,677,050**
Total	2,241,880	2,360,573	(2,258,206)	(2,289,103)	

	Bank 31 December 2011				
	Positive	Positive	Negative	Negative	Principal/
	Book value	Fair value	Book value	Fair value	Notional
	£'000	£'000	£'000	£'000	£'000
Cash and balances with the Bank of England	253	253			253
Loans and advances to credit institutions	237,929	237,929			239,625
Investment securities	361,337	361,341			343,651
Loans and advances to customers	1,007,054	1,089,105			1,067,054
Investments in group undertakings	640,920	640,920			640,920
Amounts owed to retail depositors			(2,081,590)	(2,107,399)	(2,057,974)
Amounts owed to credit institutions			(831)	(832)	830
Amounts owed to other customers			(38,394)	(39,092)	38,115
Subordinated liabilities			(26,842)	(29,011)	26,650
Perpetual subordinated bonds			(15,327)	(17,547)	15,000
Derivatives	683	683	(95,222)	(95,222)	1,677,050
Total	2,248,176	2,330,231	(2,258,206)	(2,289,103)	

Effective interest rate

The table below summarises the effective interest rate for monetary financial instruments not carried at fair value through the income statement.

	Group	Society
	2011	**2011**
Assets		
Liquid assets	**1.09%**	**1.09%**
Loans and advances to customers	**3.75%**	**3.75%**
Investments in group undertakings	**0.00%**	**2.95%**
Liabilities		
Amounts owed to retail depositors	**2.96%**	**2.96%**
Amounts owed to credit institutions and other customers	**2.12%**	**2.12%**
Subordinated liabilities	**4.49%**	**4.49%**
Perpetual subordinated bonds	**7.88%**	**7.88%**

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

Level 1 - quoted prices (unadjusted) in active markets for identical assets and liabilities

Level 2 - inputs other than quoted prices included within level 1 that are observable for the asset or liability either directly or indirectly

Level 3 - inputs for the asset or liability that are not based on observable market data

Group	**Notes**	**Level 1**	**Level 2**	**Level 3**	**Total**
		£'000	£'000	£'000	£'000
31 December 2011					
Financial assets					
Available for sale					
Government investment securities		231,744	-	-	**231,744**
Transferable investment securities - unlisted		-	108,881	-	**108,881**
Transferable investment securities - listed		-	9,422	-	**9,422**
Derivative financial instruments					
Interest rate swaps		**-**	683		**683**
		231,744	**118,986**	**-**	**350,730**
Financial liabilities					

Derivative financial instruments				
Interest rate swaps	**-**	**(95,222)**	**-**	**(95,222)**
	-	**(95,222)**	**-**	**(95,222)**

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

Level 1

The most reliable fair values of derivative financial instruments and available-for-sale assets are quoted market prices in an actively traded market.

Level 2

These are valuation techniques for which all significant inputs are taken from observable market data. These include valuation models used to calculate the present value of expected future cash flows and may be employed either when no active market exists or when there are quoted prices available for similar instruments in active markets.

Where discounting techniques are used in respect of derivatives, management have chosen to use LIBOR rather than the Overnight Index Swap ('OIS') rate. This will be reviewed when derivative clearing is introduced. No Credit ('CVA') or Debit ('DVA') value adjustments have been made in respect of credit risk in the fair value of the Group's derivative financial instruments.

In considering which similar instruments to use, management take into account the sensitivity of the instrument to changes in market rates and the credit quality of the instrument.

Basis risk derivatives are valued using discounted cash flow models, using observable market data and will be sensitive to benchmark interest rate curves.

Level 3

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

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

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

29. Pension scheme

Defined contribution scheme:

The amount charged to the Income Statement 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 charged to the Income Statement amounted to £368k.

Defined benefit scheme:

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

The Scheme Trustees, having taken actuarial advice, decided to wind up the Scheme rather than continue to operate it on a "paid up" basis. The winding up is largely complete. As at 31 December 2011 the liability to remaining members is £1.6k matched by Scheme assets.

30. Capital Management

The Group is governed by its capital management policy. The objectives of the Bank's capital management policy are to efficiently manage the capital base to optimise shareholder returns whilst maintaining capital adequacy and satisfying key stakeholders such as customers and regulators.

The Bank's prime objectives in relation to the management of capital are to comply with the requirements set out by the Financial Services Authority (FSA), the Bank's primary prudential supervisor, to provide a sufficient capital base to cover business risks, maintain a targeted credit rating and to support future business development.

The Bank has implemented Basel II requirements in measuring operational and credit risks under the standardised approach. Under Pillar I of Basel II, the Bank calculates its minimum capital requirements based on 8% of RWAs. The FSA then applies a multiplier to this amount to cover risks under Pillar II of Basel II and generate an Individual Capital Guidance (ICG). As instructed by the FSA, the Bank manages its capital on a consolidated basis and hence the Bank's capital position is not disclosed separately.

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

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

During the period the Group complied with the capital requirements set out by the FSA.

Capital and funding position	**2011**
	£'000
Tier 1 Capital	
Permanent share capital	361
Transfer reserve	(12,818)
Retained losses	(12,562)
Share premium account	90,639
Deductions from tier 1 capital	(495)
Total tier 1 capital after deductions	**65,125**

Tier 2 Capital	
Perpetual subordinated bonds	37,327
Available for sale reserve	1,822
Collective provisions	1,260
Subordinated liabilities	26,842
Deductions from tier 2 capital	(797)
Total tier 2 capital after deductions	**66,454**
Excess of Tier 2 over Tier 1	(1,329)
Total regulatory capital	**130,250**

31. Adoption of new and revised International Financial Reporting Standards

At 31 December 2011, a number of standards and interpretations, and amendments thereto, had been issued by the IASB, which are not effective for the Group's consolidated financial statements or the separate financial statements of OneSavings Bank plc as at 31 December 2011.

Standards and Interpretations issued by the IASB but not endorsed by the EU

Standards applicable in 2013

In May 2011, the IASB issued IFRS 10 'Consolidated Financial Statements' ('IFRS 10'), IFRS 11 'Joint Arrangements' ('IFRS 11') and IFRS 12 'Disclosure of Interests in Other Entities' ('IFRS 12'). The standards are effective for annual periods beginning on or after 1 January 2013 with early adoption permitted. IFRSs 10 and 11 are to be applied retrospectively. Under IFRS 10, there will be one approach for determining consolidation for all entities, based on the concept of power, variability of returns and their linkage. This will replace the current approach which emphasises legal control or exposure to risks and rewards, depending on the nature of the entity. IFRS 11 places more focus on the investors' rights and obligations than on structure of the arrangement, and introduces the concept of a joint operation. IFRS 12 includes the disclosure requirements for subsidiaries, joint arrangements and associates and introduces new requirements for unconsolidated structured entities. The Group is currently assessing the impact of IFRS 10 and 11, but it is impracticable to quantify their effect as at the date of publication of these financial statements.

In May 2011, the IASB also issued IFRS 13 'Fair Value Measurement' ('IFRS 13'). This standard is effective for annual periods beginning on or after 1 January 2013 with early adoption permitted. IFRS 13 is required to be applied prospectively from the beginning of the first annual period in which it is applied. The disclosure requirements of IFRS 13 do not require comparative information to be provided for periods prior to initial application.

IFRS 13 establishes a single source of guidance for all fair value measurements required or permitted by IFRSs. The standard clarifies the definition of fair value as an exit price, which is defined as a price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions, and enhances disclosures about fair value measurement. The group is currently assessing the impact of IFRS 13 and it is not practical to quantify the effect as at the date of publication of these financial statements, which will depend on final interpretations of the

standard, market conditions and the Group's holdings of financial instruments at 1 January 2013.

In December 2011, the IASB issued amendments to IFRS 7 'Disclosures – Offsetting Financial Assets and Financial Liabilities' which requires the disclosures about the effect or potential effects of offsetting financial assets and financial liabilities and related arrangements on an entity's financial position. The amendments are effective for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods. The amendments are required to be applied retrospectively.

Standards applicable in 2014

In December 2011, the IASB issued amendments to IAS 32 'Offsetting Financial Assets and Financial Liabilities' which clarified the requirements for offsetting financial instruments and addressed inconsistencies in current practice when applying the offsetting criteria in IAS 32 'Financial Instruments: Presentation'. The amendments are effective for annual periods beginning on or after 1 January 2014 with early adoption permitted and are required to be applied retrospectively. The Group is currently assessing the impact of these clarifications but it is impracticable to quantify their effect as at the date of publication of these financial statements.

Standards applicable in 2015.

In November 2009, the IASB issued IFRS 9 'Financial Instruments' ('IFRS 9') which introduced new requirements for the classification and measurement of financial assets. In October 2010, the IASB issued additions to IFRS 9 relating to financial liabilities. Together, these changes represent the first phase in the IASB's planned replacement of IAS 39 'Financial Instruments: Recognition and Measurement' ('IAS 39') with a less complex and improved standard for financial instruments.

Following the IASB's decision in December 2011 to defer the effective date, the standard is effective for annual periods beginning on or after 1 January 2015 with early adoption permitted. IFRS 9 is required to be applied retrospectively but prior periods need not be restated.

The second and third phases in the IASB's project to replace IAS 39 will address the impairment of financial assets measured at amortised cost and hedge accounting.

The IASB did not finalise the replacement of IAS 39 by its stated target of June 2011, and the IASB and the US Financial Accounting Standards Board have agreed to extend the timetable beyond this date to permit further work and consultation with stakeholders, including reopening IFRS 9 to address practice and other issues. The EU is not expected to endorse IFRS 9 until the completed standard is available. Therefore, the Group remains unable to provide a date by which it plans to apply IFRS 9 and it remains impracticable to quantify the impact of IFRS 9 as at the date of publication of these consolidated financial statements.

32. Post balance sheet events

On 3rd January 2012, a further mortgage book of £20m was purchased.

33. Transfer of business

On 1 February 2011 the assets and liabilities of KRBS were transferred to OneSavings Bank plc. No deemed change of control of these assets and liabilities was assumed as the members of KRBS became members of KRPS. OneSavings Bank plc is controlled jointly by KRBS and OSB Holdco Ltd. No adjustments were therefore required on transfer to OSB to the book value of the assets and liabilities which had been included in the final Cessation Accounts of KRBS.

The book value of net assets transferred from KRBS Reliance Building Society as at 1 February 2011 is set out below:

.

	£'000
Assets	
Liquid assets	
Bank of England	232
Loans and advances to credit institutions	97,941
Investment securities	268,807
Total liquid assets	366,980
Loans and advances to customers	
Loans fully secured on residential property	1,406,700
Other loans fully secured on land	127,888
Derivative financial instruments	99
Fair value adjustments for hedged risk	47,301
Current taxation asset	1,805
Deferred taxation asset	11,789
Intangible fixed assets	129
Property, plant and equipment	2,069
Other assets	1,917
Total assets	**1,966,677**
Liabilities	
Shares	1,705,397
Amounts owed to credit institutions	15,160
Amounts owed to other customers	112,531
Derivative financial instruments	51,114
Fair value adjustments for hedged risk	62
Deferred taxation liability	243
Other liabilities	2,886
FSCS and other provisions	1,834
Subordinated liabilities	26,951
Perpetual subordinated bonds	37,317
Total liabilities	**1,953,495**
Net assets	**13,182**
Transfer Reserve	12,818
Value attributed to the shares issued to A Ordinary shareholder	**26,000**