

Paragon Banking Group PLC

2019 Annual Report and Accounts



paragon



CAUTIONARY STATEMENT

Sections of this Annual Report, including but not limited to the Directors' Report, the Strategic Report and the Directors' Remuneration Report may contain forward-looking statements with respect to certain of the plans and current goals and expectations relating to the future financial condition, business performance and results of the Group. These have been made by the directors in good faith using information available up to the date on which they approved this report and the Group undertakes no obligation to update these forward-looking statements. By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of the Group and depend upon circumstances that may or may not occur in the future. There are a number of factors that could cause actual future financial conditions, business performance, results or developments to differ materially from the plans, goals and expectations expressed or implied by these forward-looking statements and forecasts. Nothing in this document should be construed as a profit forecast.

CONTENTS

Financial highlights

Results in brief

Financial highlights	Page 6
----------------------	--------

A Strategic Report

The business and its performance in the year

A1	Chair of the Board's introduction	Page 10
A2	Business model and strategy	Page 12
A3	Chief Executive's review	Page 23
A4	Future prospects	Page 50
A5	Corporate responsibility	Page 53
A6	Approval of Strategic Report	Page 65

B Corporate Governance

How the business is controlled and how risk is managed

B1	Chair's statement on corporate governance	Page 68
B2	Board of Directors	Page 70
B3	Corporate governance	Page 75
B4	Nomination Committee	Page 82
B5	Audit Committee	Page 84
B6	Remuneration report	Page 93
B7	Risk management	Page 125
B8	Directors' report	Page 140
B9	Statement of directors' responsibilities	Page 144

C Independent Auditor's Report

On the financial statements

C1	Independent Auditor's Report	Page 148
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D The Accounts

The financial statements of the Group

D1	Primary financial statements	Page 160
D2	Notes to the accounts	Page 167

E Appendices to the Annual Report

Additional financial information

E1	Appendices to the Annual Report	Page 278
----	---------------------------------	----------

F Useful information

Additional information for shareholders and other users

F1	Glossary	Page 284
F2	Shareholder information	Page 286
F3	Other public reporting	Page 288
F4	Contacts	Page 290



FINANCIAL HIGHLIGHTS

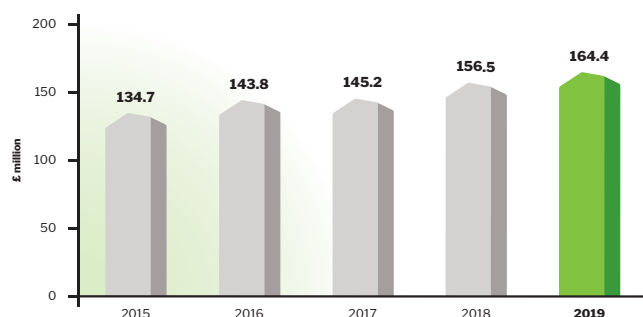
Results in brief

Financial highlights

UNDERLYING PROFIT BEFORE TAX

£164.4 million

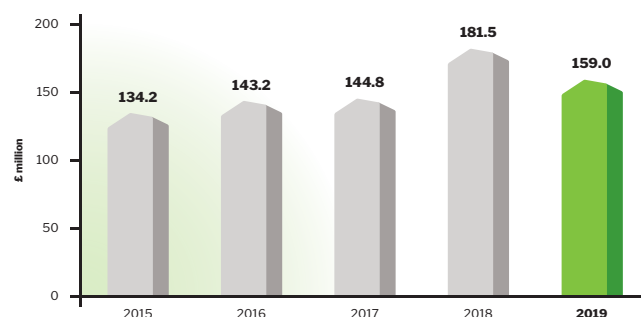
5.0% higher (2018: £156.5 million)



PROFIT BEFORE TAX

£159.0 million

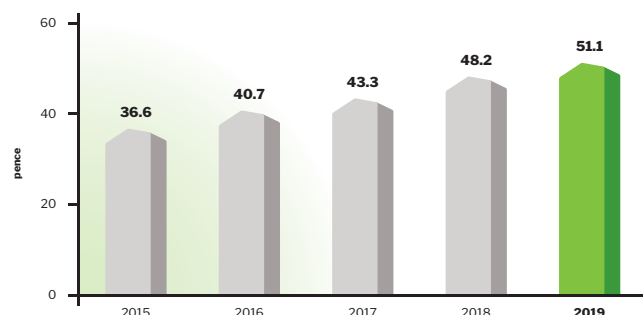
12.4% lower (2018: £181.5 million)



UNDERLYING BASIC EARNINGS PER SHARE

51.1 pence

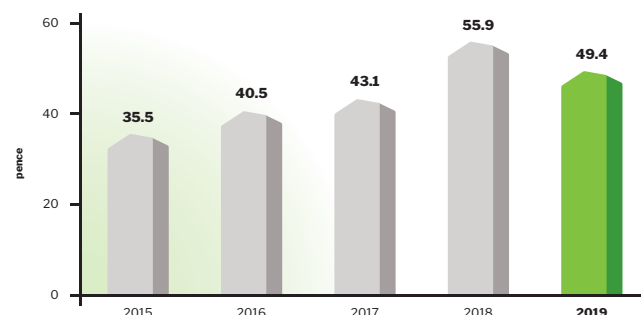
6.0% higher (2018: 48.2 pence)



BASIC EARNINGS PER SHARE

49.4 pence

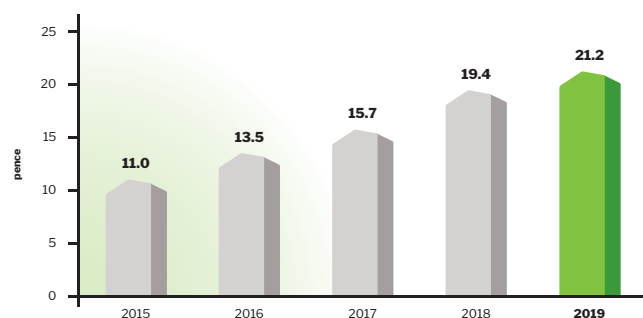
11.6% lower (2018: 55.9 pence)



DIVIDEND PER SHARE

21.2 pence

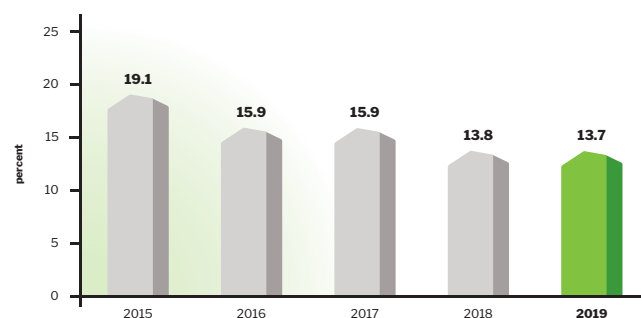
9.3% higher (2018: 19.4 pence)



CAPITAL - CET 1 ratio

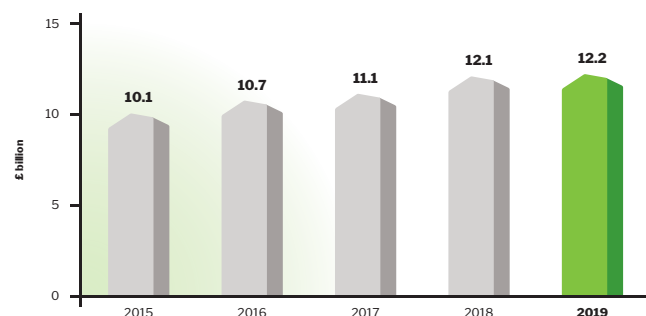
13.7%

Remains strong (2018: 13.8%)



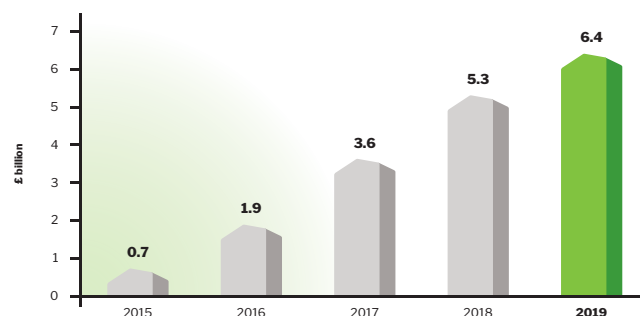
TOTAL LOANS TO CUSTOMERS £12.2 billion

0.5% higher (2018: £12.1 billion)



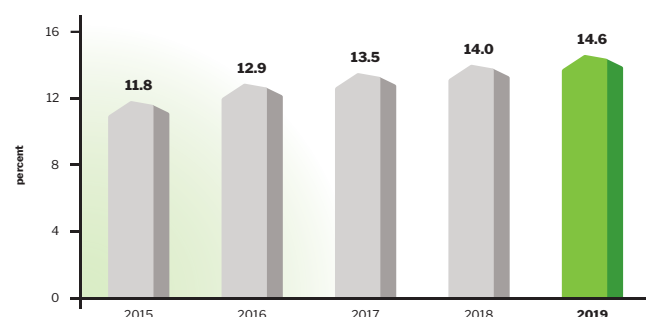
RETAIL DEPOSITS £6.4 billion

20.7% higher (2018: £5.3 billion)



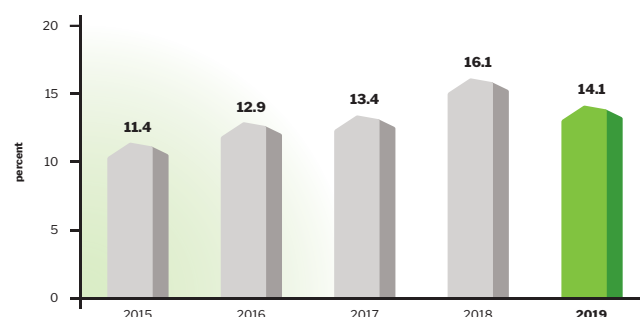
UNDERLYING RETURN ON TANGIBLE EQUITY 14.6%

(2018: 14.0%)



RETURN ON TANGIBLE EQUITY 14.1%

(2018: 16.1%)



Five year performance summary

	2015	2016	2017	2018	2019
	£m	£m	£m	£m	£m
Underlying profit before taxation	134.7	143.8	145.2	156.5	164.4
Profit before taxation	132.2	143.2	144.8	181.5	159.0
Profit after taxation	107.1	116.0	117.2	145.8	127.4
Total loans to customers	10,062.4	10,737.5	11,124.1	12,127.8	12,186.1
Shareholders' funds	969.5	969.5	1,009.4	1,095.9	1,108.4

	2015	2016	2017	2018	2019
Return on tangible equity	11.4%	12.9%	13.4%	16.1%	14.1%
Earnings per share					
- basic	35.5p	40.5p	43.1p	55.9p	49.4p
- diluted	34.8p	39.7p	41.9p	54.2p	48.2p
Dividend per ordinary share	11.0p	13.5p	15.7p	19.4p	21.2p

The exclusions from underlying results relate principally to acquisitions in prior periods and significant asset sales in the period and the preceding period, which do not form part of the day-to-day activities of the Group and which have impacted on the reported results for the year. The calculation of return on tangible equity is shown in note 55. The derivation of underlying profit before taxation and other underlying measures is described in Appendix A.

A.

STRATEGIC REPORT

The Group's business, risk profile, performance and prospects

A1	Chair of the Board's introduction <i>The year in summary</i>	Page 10
A2	Business model and strategy <i>An overview of what the Group does and the significant risks to which it is exposed</i>	Page 12
A3	Chief Executive's review <i>The financial and operational performance of the Group in the year</i>	Page 23
A4	Future prospects <i>How the Group is placed looking forward</i>	Page 50
A5	Corporate responsibility <i>The Group's impact on its employees, the environment and the community, including non-financial reporting</i>	Page 53
A6	Approval of Strategic Report <i>Approval of the Strategic Report by the Company Secretary</i>	Page 65

Chair of the Board's introduction



Fiona Clutterbuck, Chair of the Board

Despite the present economic and political uncertainties facing the UK, I am confident that the Group is well placed to respond to the challenges in its markets...

Dear Shareholder

I have the pleasure of introducing my second Annual Report and Accounts as Chair of the Board of Paragon Banking Group PLC, following a year which has seen continued progress in the Group's strategic development, after the major acquisitions of recent years, against a backdrop of an uncertain UK economy.

The year has seen two significant milestones in the development of the business. More than half of our lending portfolio now comprises balances advanced since 2014, the year Paragon Bank was authorised, whilst at the same time more than half our asset funding is derived from retail deposits, a significant change in the profile of the business over that period.

The development of the Group's Commercial Lending division, particularly the growth of newer and acquired businesses has also been particularly pleasing in the year. We continue to target investment and capital to support the Group's medium-term objective of improving net interest margin and cost efficiency, with increasing business volumes. At the same time, we aim to provide an additional, specialist choice to our customers, together with a continuing focus on customer service.

In preparing the annual report for this year we have made changes in our reporting of governance arrangements, in preparation for the introduction of a new corporate governance code in the coming year and to reflect the introduction of IFRS 9, bringing in substantial new disclosures around customer loans and derivatives. I hope you find this report useful in understanding our business and our progress in the year.

The business

The business is managed through three lending divisions, Mortgages, including buy-to-let, Commercial Lending and Idem Capital, with each division offering a range of specialist lending propositions.

The mortgages division continues its focus on specialist landlords in the private rented sector, which remains a fundamental part of the nation's housing provision.

The commercial lending division provides asset backed and other funding to SMEs and small corporates, while the development finance business provides funding particularly to small and medium scale residential developers in the UK, both underserved sectors of their respective markets.

Our Idem Capital division specialises in the acquisition of loan portfolios. The division's success builds on its extensive analytical skills and a servicing approach focussed on developing sustainable arrangements and fair outcomes for the personal lending customers it acquires.

Significant expenditure has been made in the development of the Group's business lines throughout the year and further investment in people and systems is anticipated in the year to come.

The Group's business is described more fully in Section A2

Results

The growth in the Group's new lending, up 8.5% to £2,532.4 million, together with improved margins, contributed to an increase in underlying profit by 5.0% to £164.4 million excluding items such as the £9.7 million gain on sale of PM12, which do not arise from the underlying operations of the business. Profit before tax on the statutory basis fell by 12.4% to £159.0 million, reflecting the £28.0 million gain on the disposal of Idem Capital assets reported in 2018.

This led to underlying earnings per share ('EPS') increasing by 6.0% to 51.1 pence (2018: 48.2 pence) and statutory EPS decreasing to 49.4 pence (2018: 55.9 pence). Underlying return on tangible equity reached 14.6% (2018: 14.0%), 14.1% on the statutory basis (2018: 16.1%).

Funding was enhanced with the growth of the Group's savings deposit base to £6.4 billion from £5.3 billion a year earlier, further utilisation of Bank of England facilities and a £364.3 million securitisation transaction. This increasing diversification led to retail deposits making up almost half of all Group funding.

The Group's capital position remains strong, with a regulatory Core Equity Tier 1 ('CET1') ratio of 13.7% (2018 (IAS 39): 13.8%).

The financial results and operational performance are reviewed in Section A3

Stakeholders

The Group takes its responsibility as a corporate citizen very seriously. It values its culture and views the current regulatory agenda of promoting the interests of stakeholders other than shareholders as being well aligned with its own priorities.

During the year steps were taken to embed the 'employee voice' provisions of the new Code in the Group, and I was gratified that the Group retained its Gold Investors in People status and that the number of female senior managers reached 35% of the total, our below-board Hampton-Alexander target.

The Group has always believed in the social benefits that can result from using its power as a buy-to-let lender to drive up standards in the private rented sector and from providing funds for housebuilding and has always acted to manage its environmental impact. I noted with interest the increased regulatory focus on sustainability during the year, particularly from the PRA, and am taking a close interest in the Group's progress in developing enhanced procedures in this area.

We recognise the importance of the contribution of the people who work within our businesses to the Group's results in the year and I would like to thank all of them for their hard work and dedication throughout the period.

Social responsibility issues are discussed in Section A5

Governance

Over the year my colleagues on the Board and I have spent considerable time and effort in enhancing the Group's governance process. We have updated processes to accord with the new Code, together with other new regulations and considered the results of our board evaluation. We have also finalised a new remuneration policy for shareholders' consideration at the forthcoming AGM.

As part of these developments we were able to meet with many shareholders and other stakeholder groups, and I thank them for their valuable time with us. During this exercise, I met 18 of the Group's major shareholders, representing over two-thirds of the total share capital, and the insight gained into their views of the business was extremely useful.

During the year, my board colleague John Heron, Director – Mortgages, decided to step down after being with the Group since 1986, establishing its buy-to-let business and becoming one of the leading figures in the buy-to-let sector in the UK. Peter Hartill, the Chair of the Group's Audit Committee, will also step down from the Board after nine years' service. I would like to thank both of them for their very meaningful contribution to the Group's development and the support they have given me as Chair.

In addition to our usual workload, the entire Board has been much involved with the further development of the Group's strategy, particularly the evaluation and monitoring of acquisitions and their integration into the Group. I thank my colleagues for their diligence in these matters.

The Group is committed to good corporate governance and we are confident that we are well placed to comply with the new code from the year ending 30 September 2020.

Corporate governance is discussed in Section B3

Risk

The Group continues to put considerable emphasis on the management of risk, with additional specialist resource recruited in the year and the embedding of enhanced risk management technology.

Particular focus has been given in the past year to cyber security and operational resilience capabilities, with additional investment in both systems and people. Systems for regulatory stress testing have also been enhanced. These areas will continue to be key priorities in future years. Significant focus also continues to be given to the Group's preparations for the regulatory approval process for its IRB approach for credit risk.

The Risk Management report is set out in Section B7

Shareholder returns

The positive result for the year has enabled the Board to enhance the dividends paid to shareholders, in accordance with the policy previously announced. We have declared a final dividend for the year of 14.2 pence per share, bringing the dividend for the year to 21.2 pence per share, up 9.3% from the 19.4 pence declared for 2018, subject to shareholder approval. £26.5 million (excluding costs) has also been spent on the share buy-back programme announced in July. Each of these actions enhances returns for shareholders.

Conclusion

The Group has continued to make progress towards its strategic goals. The market for a specialist, retail funded banking group, able to serve the needs of currently underserved SME, small corporate and personal borrowing and savings customers, clearly exists and the Group's strengths, experience and culture mean that it is well placed to do this.

Despite the present economic and political uncertainties facing the UK, I am confident that the Group is well placed to respond to the challenges in its markets. The Group's wealth of data and the well tested, through the cycle experience of its senior management team continues to provide the basis to deliver excellent service to its customers, strong and sustainable returns to its shareholders while enhancing its relationships with all of its stakeholders.

Fiona Clutterbuck

Chair of the Board

26 November 2019

Business model and strategy

A2.1 Paragon at a glance

Paragon is a specialist banking group. We offer a range of savings and specialist lending products to individuals and SMEs in the UK. Listed on the London Stock Exchange, we are a FTSE 250 company, headquartered in Solihull, employing 1,360 people.

Established in 1985, we originally focused primarily on buy-to-let mortgages but since gaining our banking licence in 2014, not only have we expanded our operations in buy-to-let, we have also extended into a wide range of commercial lending markets and service a range of consumer loan portfolios through our subsidiary, Idem Capital. New lending is funded principally through an online personal savings operation and our vision is to be the UK's leading specialist banking group, meeting the needs of UK consumers and businesses.

Operating model

Paragon's operations are organised into three divisions, each with responsibility for achieving asset and profit growth, with new lending funded largely by retail deposits. These are supported by the Group through the provision of capital to underpin growth and, where appropriate, with central services including loan servicing, marketing, information technology and legal support. This operating model comprises local specialism with strong centralised resources enabling economies of scale to be achieved and centres of excellence to be developed.



Mortgages

Buy-to-let mortgage finance for landlords operating in the UK's private rented sector. We also offer a range of second charge mortgage products.

- £10.3 billion loan assets
- Over 62,000 buy-to-let loan accounts
- 3.7% of all new buy-to-let mortgages in the UK

[Read more about Mortgages on page 16](#)



Commercial Lending

A range of asset-backed loan products for consumers and SMEs operating across a number of markets.

- £1.5 billion loan assets
- £43.8 million profit segment

[Read more about Commercial Lending on page 18](#)



Idem Capital

Acquisition and servicing of UK loan portfolios.

- Over 79,000 customer accounts

[Read more about Idem Capital on page 20](#)



Funding

New lending funded principally from retail savings balances, complimented by a core expertise in wholesale funding.

[Read more about Funding on page 21](#)

Building a specialist bank

In 2014 we launched a strategic transformation from a monoline lender to a diversified, specialist bank.

2014

Paragon Bank established and first savings accounts opened
Launch of three lending product lines
New lending in buy-to-let mortgages increased by 82%
Paragon re-enters motor finance market

2015

Paragon enters the SME finance market with the acquisition of Five Arrows Leasing Group
Savings deposit base grows to more than £700 million

2016

Purchase of Premier Asset Finance, one of the UK's leading asset finance brokers
Launch of property development finance proposition
Paragon Bank launches ISAs
Paragon Bank PLC moves into profit

2017

Transition into fully integrated banking group complete and Paragon Group of Companies PLC becomes Paragon Banking Group PLC
Reorganisation of the Group into three operating units

2018

Began offering finance to the legal profession with the acquisition of Iceberg
Launch of Group's first structured lending facilities
Acquisition of Titlestone accelerated progress of the Group's development finance offering

2019

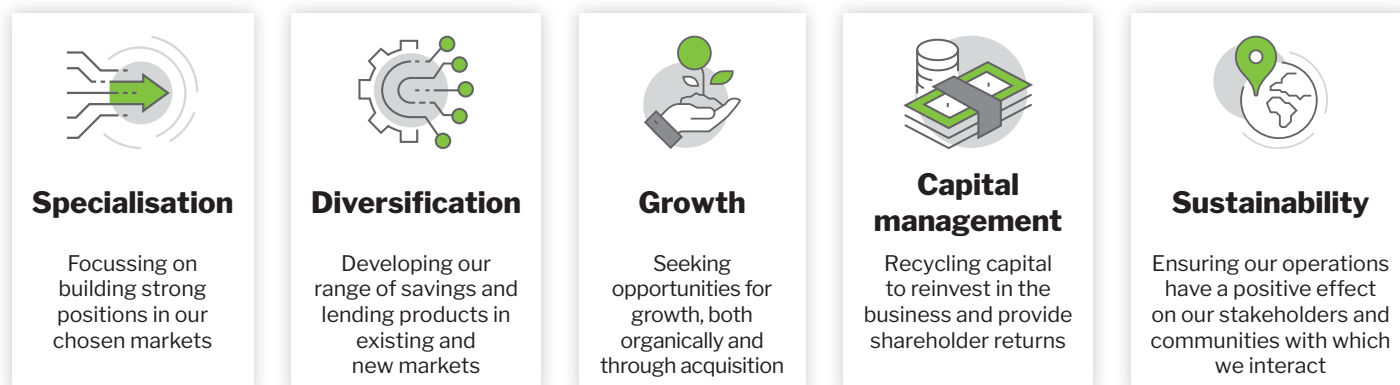
Savings deposits exceed £6 billion
Specialist landlords account for almost 90% of all new buy-to-let lending
Commercial Lending portfolio increased by 28.1%

Our business model and strategy

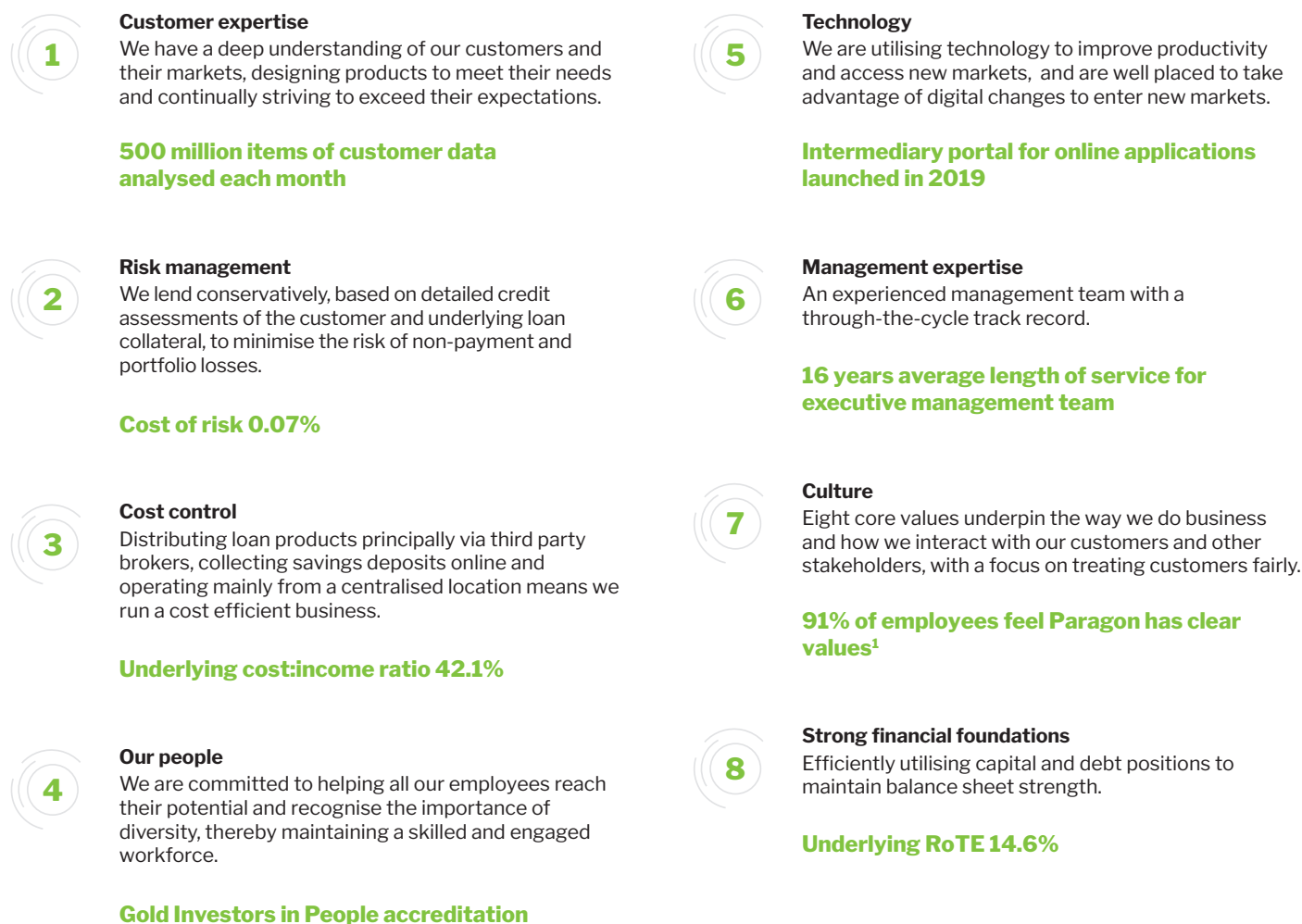
We help individuals and small businesses across the UK prosper and grow by focusing on customers in markets typically underserved by larger high street banks. We see specialisation as what makes us different, as our competitive advantage, and we seek to know more than our competitors about our customers and the markets in which we operate, the products and services we offer, and the risks we incur.

Our strategy is to build a specialist bank for our customers, which delivers sustainable growth and shareholder returns through a low risk and robust model.

Our strategic priorities



Our key differentiators



¹Investors in People report, 2019

Creating value

A broad funding base...

The Group funds its assets using a variety of sources, including retail deposits, securitisation and bond issuance. It takes care to secure competitive funding over an appropriate term to underpin its assets, cover working capital requirements and maintain a strong financial position.

See page 21

...lending on diversified loan assets...

The Group focusses on building its asset base by originated new loans, developing new products, diversifying into new markets and acquiring loan portfolios.

See pages 16 to 20

...generating growing income...

The Group generates income from interest and fees earned on its mortgage, consumer and SME loan assets. It also earns fees from third parties for administering similar loans on their behalf.

...underpinned by a customer focused culture, based on eight core values, and an engaged, skilled and diverse workforce.

Our values

Fairness	Commitment
Professionalism	Creativity
Integrity	Teamwork
Humour	Respect

This approach enables us to create value for all our stakeholders



Shareholders

See page 38

Creating long-term shareholder value through growing profits and dividends

21.2p dividend per share



Customers

See pages 16 and 18

Providing tailored lending products, expertise and working with intermediaries to help our customers achieve their lifestyle ambitions

+65 Net promoter score for savings account opening¹



Employees

See page 56

Helping all our people develop their career and reach their potential

Average training per employee in 2019: 6.9 days

(CIPD average 2.8 - 3.3 days)



Society

See page 62

Helping the UK economy grow and supporting the communities in which we operate

Charitable contributions of £24,200 in 2019



Environment

See page 58

Continually reducing our environmental impact and designing products that support positive environmental change

100% of electricity used by sites we are responsible for was from renewable energy sources in 2019

¹Net Promoter Score of +65 for savings account opening process based on online survey of 3,900 savings customers between 1 October 2018 and 30 September 2019



Mortgages

We offer residential mortgages, with buy-to-let finance for landlords operating in the UK's Private Rented Sector (PRS) being our largest market. We were one of the first lenders to pioneer buy-to-let lending and, since 1996, we have originated £22.9 billion of buy-to-let accounts. In the year to 30 September 2019, we provided 3.7% of all new buy-to-let mortgages in the UK.

Our customer-focussed approach, combined with our expertise in property valuation and risk assessment, helps us support a wide range of customers, especially landlords with large-scale property portfolios, those investing in complex properties and those operating in corporate structures.

The UK's PRS provides a vital social function, delivering accommodation for people who want the flexibility that renting provides, as well as those who cannot afford to buy and need the security of a stable home. Paragon supports socially responsible investment in the PRS by promoting high standards in accommodation, ensuring minimum energy efficiency levels, supporting professionalism in the landlord community, and working with industry and government to improve the sector.

Raising service standards

We survey mortgage intermediaries and customers on a systematic basis to identify areas for improvement. This year, acting on intermediary feedback, we refined our mortgage application process by making a number of simple but significant improvements. As a result, intermediaries are now four times more likely to recommend Paragon to a colleague or a friend.

+60

Net promoter score¹
September 2019

The underwriter was very good. Everyone I spoke to was helpful. I felt common sense was applied and it was a very good experience...

Intermediary feedback, July 2019

¹Net Promoter Score for buy-to-let mortgages at offer stage, based on telephone survey of 1,220 intermediaries between 1 October 2018 and 30 September 2019

Market drivers

The UK's PRS has more than doubled in size since 2000. Today, it comprises 4.5 million households, almost 20% of the total¹. After owner-occupation, renting in the PRS is the second most common housing tenure in the UK. Economic, social and demographic changes, together with the flexibility that renting provides, have combined to make renting in the PRS an increasingly popular choice.

Factors driving demand for PRS accommodation include:

- Low investment in social housing
- Mortgage affordability constraints
- Population growth
- Rising participation in higher education
- A tendency to settle down later in life
- Changing housing needs

In the lettings market, the latest set of results... are indicative of demand from prospective tenants rising firmly for an eighth month in a row...

Source: RICS UK Residential Market Survey, September 2019

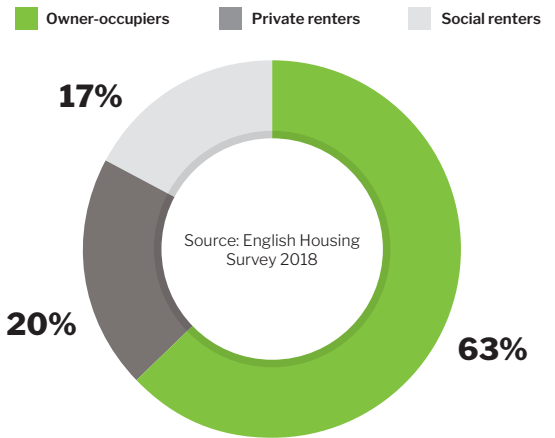
Market outlook

- Despite strong historic growth in the PRS, commentators forecast a further 1.2 million rental homes will be needed by 2023³ to keep pace with tenant demand
- Landlords are continuing to invest in rental homes in the PRS but, given the tax changes, investment is more selective
- Evidence suggests larger-scale landlords are three times more likely to buy property than their smaller-scale counterparts⁴ and Paragon is well-placed to grow its market share in this segment. At the year end, 91.4% of the buy-to-let pipeline was with specialist landlord customers

¹MHCLG, English Housing Survey 2017-2018 ²UK Finance ³Knight Frank, Multi-housing 2019 - PRS Research ⁴Paragon, PRS Trends Survey, Q2 2019

Housing tenure

The PRS makes up 20% of the English housing market



Market trends

- UK buy-to-let mortgage lending totalled £41 billion² in 2018, providing funding for approximately 35% of PRS homes
- After strong year-on-year lending growth following the financial crisis, tax changes for landlords announced in 2015 have resulted in more moderate growth
- Buy-to-let underwriting changes introduced in 2017 which encourage more detailed underwriting for larger-scale, portfolio landlords have also re-shaped the market, with specialist lenders like Paragon better equipped to service this segment





Commercial Lending

Our Commercial Lending division helps small UK businesses develop, in turn supporting the UK economy. We also help fund the UK's much needed expansion in housing and encourage investment in cleaner technologies to reduce the country's environmental footprint.

We provide finance to SMEs and small corporate customers operating in a wide range of commercial lending markets, as well as motor finance to UK based consumers. We focus on specialist assets and underserved markets in four main areas:



SME lending

A range of finance solutions for SMEs covering a wide array of sectors, including agriculture, aviation, construction, commercial vehicles and business equipment



Development finance

Competitive and flexible financing solutions targeted at experienced property developers



Structured finance

Finance for non-bank specialist lenders, either through wholesale funding or block discounting



Motor finance

Finance through approved intermediaries and dealers for cars, light commercial vehicles, motorhomes and caravans

Broker perceptions

During 2019 we undertook research with our brokers to understand how Paragon is perceived in the SME lending market and to identify potential further opportunities for improvement.

The results highlighted strengths including clear pricing and structure, flexibility, strong relationships and consistency of decision making, but identified opportunities to improve speed of processes and communication, and address variability of experiences.

Documents are now available online which should speed things up.

They've been very easy to deal with... professional, responsive – especially over the last couple of months.

Clearer on pricing, documentation and underwriting appetite.

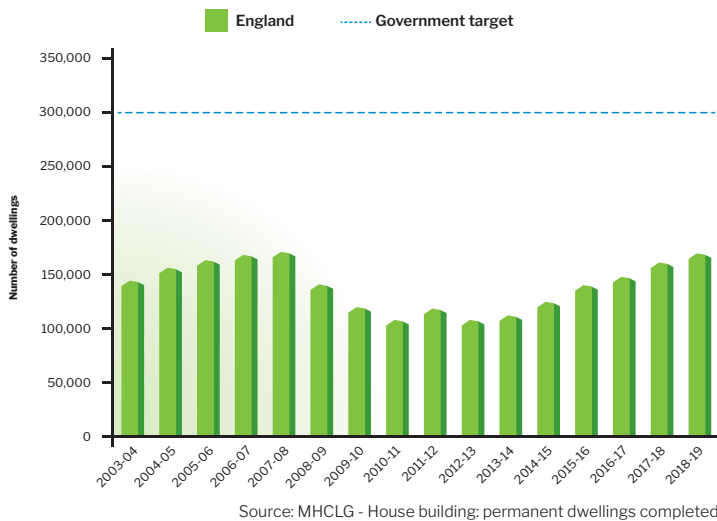
Broker feedback, May 2019

Market drivers

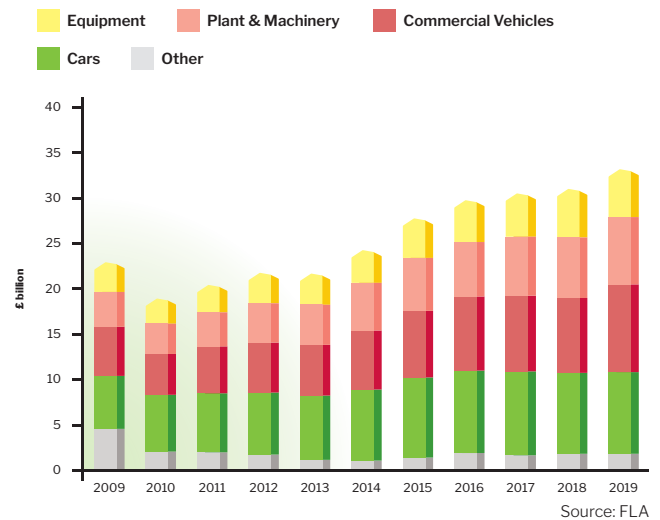
The commercial lending markets are broad and Paragon is focussed on specific asset classes. The general economic conditions within the UK influence activity in these markets and other key drivers include:

- The UK property market and rate of housebuilding driving the opportunities for development finance
- The rate of new work in commercial industries such as construction
- Uncertainty around the UK's economic future impacts buyer confidence and therefore our direct B2B and B2C lines, such as aviation and vehicle finance
- Advances in technology and SME growth continue to open up funding opportunities for our asset finance business
- Environmental concerns and the drive towards fuel efficiency prompting increased demand for lower emissions, and hybrid and electric vehicles

New homes completed



UK asset finance originations



Market trends

- The asset finance market grew by 7% in the year ended 30 September 2019¹
- The latest annual asset finance new business total (twelve months to September 2019) reached a record level of £33.2 billion¹
- Housebuilding in England continues to fall well below the Government's target of 300,000 new homes per year
- In the year ended 30 September 2019, new business in the Commercial Vehicle finance market was 14% higher than the same period in 2018¹
- Finance for new construction and agricultural equipment is relatively stable¹ but recent reports show a sharp drop in new construction work³
- In the year ended 30 September 2019, motor finance new business grew by 3% in value¹

Market outlook

- The British Chambers of Commerce forecast 1.2% growth in GDP in 2019, 0.8% for 2020, and 1.2% for 2021
- A marginal 0.7% rise in new car finance is forecast for 2019, with growth forecast to revive to 2.7% in 2020 as uncertainty around Brexit recedes²
- One million new electric vehicles ('EVs') are forecast to be sold in the UK by 2025 and 11 million by 2040 with consumers increasingly likely to purchase EVs over conventional vehicles
- The outlook for construction work remains among the weakest since 2012 as clients respond to economic and political uncertainty³

¹FLA, November 2019 ²Oxford Economics, October 2019 ³IHS Markit/CIPS UK Construction Total Activity Index

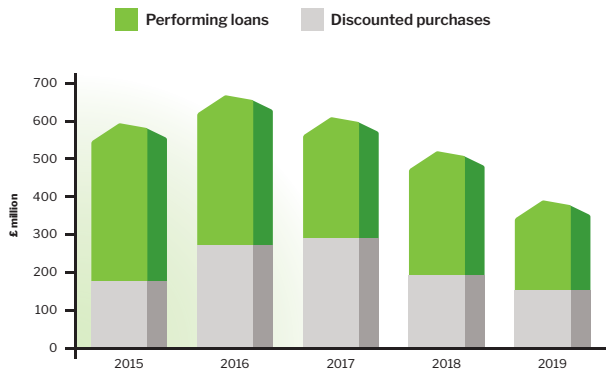


Idem Capital

Idem Capital is a leading UK loan purchaser, acquiring and servicing portfolios which include products such as leases, motor finance agreements, mortgages and unsecured loans. In addition, we offer servicing of loan portfolios for clients including banks, private equity houses and specialist lenders.

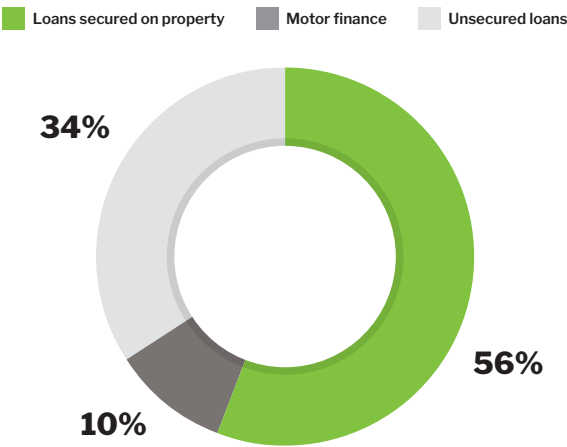
We acquire loan portfolios from financial institutions that are either restructuring or refocussing their activities and focus on the acquisition and servicing of paying (either fully or semi-performing) accounts. Idem Capital does not actively compete to acquire non-paying portfolios.

Shift towards performing loans



79,000 customers

Idem Capital loan portfolio by value



We target those portfolios where the most benefit can be derived from our core credit profiling and administration skills, focussing on disciplined analysis and evaluation of portfolio cash flows on potential acquisitions. We seek to make purchases which will augment the Group’s organic loan originations.

Idem Capital has managed more than one million customer accounts and we are proud of the reputation we have established for customer service. We assist our customers in managing their accounts and strive to create fair, affordable and sustainable repayment solutions.

Funding

The Group's principal source of funding for new lending is its range of savings products offered to UK households where the Group seeks to offer simple understandable products at competitive rates. Other funding for lending is derived from the efficient use of Bank of England funding schemes, while securitisation continues to fund much of the back book and is used tactically, including a major transaction in the year. Central funding is provided through corporate and retail bonds.

Savings

Retail deposit balances form the mainstay of the Group's funding, with the capacity to support significant balance sheet growth.

The UK household savings market is £1.2 trillion, so provides a deep and liquid source for the Group's funding. Costs for this funding remain low.

Paragon Bank offers a range of safe, simple and transparent Easy Access, ISA, Notice and Fixed Term savings accounts. Our regular survey of new savings customers demonstrates a high level of satisfaction with our products and our online application process.

The online distribution process has been augmented during the year by the addition of digital banking and wealth management platform relationships.

Central bank funding

The Group uses facilities provided by the Bank of England under the TFS, ILTR and FLS schemes to support lending growth. These schemes provide cost effective funding so long as appropriate targets are met.

Wholesale funding

The Group has a core expertise in securitisation and other debt. Securitisation and other wholesale debt markets are accessed on a tactical basis, when appropriate.

The Group launched its first SONIA referenced mortgage securitisation in the period consolidating its position as one of the main issuers in the market.




£29,000 average deposit



180,000 customers



+65 Net promoter score for savings account opening¹



£364.3 million raised in the year

¹Net Promoter Score of +65 for savings account opening process based on online survey of 3,900 savings customers between 1 October 2018 and 30 September 2019.

A2.2 Principal risks

There are a number of potential risks and uncertainties to which the Group is exposed and which could impact significantly on its ability to conduct its business successfully. These are summarised below.

Category	Risk	Description
Business	Economic	The Group could be materially affected by a severe downturn in the UK economy, as its income is wholly derived from activities within the country. The likelihood of this occurring has become more difficult to forecast given the continuing material uncertainties regarding the UK's withdrawal from the European Union ('EU'), and the unstable UK political climate. A material downturn in economic performance could reduce demand for the Group's loan products, increase the number of customers that default on their loans and cause security asset values to fall.
	Concentration	The Group's business plans could be particularly affected by any material change in the operation of the UK private rented sector and / or further regulatory intervention to control buy-to-let lending.
	Transition	Failure to manage major internal reorganisations or integrate acquired businesses safely and effectively could adversely affect the Group's business plans and damage its reputation.
Credit	Customer	Failure to target and underwrite credit decisions effectively could result in customers becoming less able to service debt, exposing the Group to unexpected material losses.
	Counterparty	Failure of an institution holding the Group's cash deposits or providing hedging facilities for risk mitigation could expose the Group to loss or liquidity issues.
Conduct	Fair outcomes	Failure to deliver fair outcomes for its customers could impact on the Group's reputation, its ability to meet its regulatory obligations and its financial performance.
Operational	People	Failure to attract or retain appropriately skilled key employees at all levels could impact upon the Group's ability to deliver its business plans and strategic objectives.
	Systems	The inability of the Group's systems to support its business operations effectively and / or guard against cyber security risks could result in reputational damage and financial loss.
	Regulation	Given the highly regulated sectors in which the Group operates, compliance failures or failures to respond effectively to new and emerging regulatory and legal developments could result in reputational damage and financial loss.
Liquidity and Capital	Funding	If access to funding became restricted, either through market movements or regulatory intervention, this could result in the scaling back or cessation of some business lines.
	Capital	Proposals by the PRA, EBA, and EU to implement changes in the Basel Capital Regime, including changes affecting lending secured on residential property could have adverse financial implications for the Group.
Market	Interest rates	Reduction in margins between market lending and borrowing rates or mismatches in the Group balance sheet could impact profits.
Pension Obligation	Pensions	The obligation to support the Group's defined benefit pension plan might deplete resources.

The Group has considered and responded to all of these risks, mitigating the exposure as far as is practicable to ensure that its risk profile remains within the Board's stated risk appetite. These risks are discussed in more detail in Section B7.5.

Chief Executive's review

A3.1 Strategy review

During the year ended 30 September 2019 the Group has maintained its specialist lending strategy, growing its loan books and improving margins whilst integrating new operations acquired or developed in the previous year.

The Group supports the needs of its consumer and SME customers and seeks to develop its presence in these markets through a combination of specialist product design, distribution and underwriting supported by an efficient operating platform and resilient technology. The Group has an outstanding through-the-cycle record in challenging markets with excellent risk metrics, reflective of the cautious and prudent approach it takes to its risk appetite alongside its highly effective operating model.

Our focus on risk and disciplined underwriting will not change going forward, while our position in the markets we serve will allow us to continue to deliver strong growth. A focus on the delivery of our organic strategy being augmented by the expansion of our proposition, where such developments provide an attractive risk and return profile.

Lending

Strong lending growth was achieved across the Group's businesses, with total new lending of £2,532.4 million, an increase of 8.5% on the previous year (2018: £2,333.2 million). Combined with the disposal of the Group's residual interest in the PM12 securitisation, these left the loan book 0.5% higher at £12,186.1 million at 30 September 2019 (2018: £12,127.8 million). More than half of this balance is now represented by loans originated since Paragon Bank was formed in 2014.

Volumes within the Mortgages segment remained broadly stable, with £1,564.4 million of advances and a portfolio acquisition of £4.2 million (2018: £1,623.2 million), with the majority of the decrease attributable to first charge owner-occupied business as the Group refocused its efforts in that area in the light of adverse market conditions. Overall the mortgage segment loan book reduced by 1.2% year-on-year to £10,344.0 million (2018: £10,473.5 million), including the £24.0 million impact of IFRS 9 transition and the disposal of £695.8 million of PM12 assets. The post-2010 buy-to-let portfolio grew by 21.1% to £5,427.7 million (2018: £4,481.8 million).

Within the buy-to-let business the strategic focus remains on specialist landlords who are becoming the core investors in the UK private rented sector. The proportion of completions where the customers were specialist landlords (operating through corporate structures and / or running large portfolios) increased from 79.3% to 88.8% of the total with a corresponding fall in simple completions. This effect is also seen in the pipeline at 30 September 2019, with 91.4% of the £911.7 million total relating to specialist cases (2018: £778.9 million with 87.8% specialist).



Nigel Terrington, Chief Executive

Strong lending growth was achieved across the Group's businesses, with total new lending of £2,532.4 million, an increase of 8.5% on the previous year...

Commercial Lending advances increased by 36.3%, to £968.0 million, compared to the previous year (2018: £710.0 million). Within this:

- The Group's development finance operation, incorporating the Titlestone business acquired in July 2018, advanced £362.9 million (2018: £136.8 million, £320.8 million on a proforma basis)
- Structured lending, launched in the second half of 2018 saw £49.7 million of new loans (2018: £40.6 million)
- SME lending, including the Iceberg professions finance operation acquired in December 2017, advanced £406.5 million, 14.6% up on the £354.7 million for 2018, at improved margins
- Motor finance lending reduced from £177.9 million to £148.9 million following a strategic focus on margin improvement

Overall, the Commercial Lending portfolio increased by 28.1% year-on-year to £1,452.1 million (2018: £1,133.2 million).

During 2018 the Group sold a material Idem Capital portfolio, recycling the capital generated to support the Titlestone acquisition which generates attractive, sustainable growth and returns. This process has continued during 2019, where strong cash flow has continued to amortise the Idem Capital balances. In the absence of new Idem Capital deals that generate an acceptable risk / reward combination, capital has again been refocused to support growth in the Commercial Lending division.

Funding

The Group continues to pursue its flexible integrated funding strategy with the increase in lending balances funded principally through an increase in the Group's retail deposit balances to £6,391.9 million, 20.7% higher than the £5,296.6 million balance at the end of 2018. This included increased diversification in the savings operation's route to market, with presences developed on external wealth management and digital banking platforms. Average pricing in the portfolio at 30 September 2019 was 1.81%, slightly higher than the 1.76% reported at 30 September 2018 but in line with the level at 31 March 2019. Retail deposits therefore represent a highly cost-effective and stable funding source.

In wholesale funding, the Group:

- launched its first SONIA referenced securitisation, raising £364.3 million through the Paragon Mortgages (No. 26) transaction
- disposed of its residual interest in the Paragon Mortgages (No. 12) PLC ('PM12') securitisation, releasing £49.8 million of cash resources and generating a profit of £9.7 million
- closed out several other legacy transactions, releasing cash to the Group

Retail deposits represent the Group's primary source of funding for new lending, whilst securitisation or other wholesale channels are used as and when conditions in those markets are attractive, and terms are appropriate.

Results

Underlying profits (before the effect of fair value movements on hedging items and the gain on PM12) increased by 5.0% to £164.4 million, from £156.5 million in 2018. Net interest income was 8.5% higher on an underlying basis at £278.4 million, 9.3% higher on a statutory basis, driven upwards by both a higher net interest margin ('NIM') and year-on-year increases in loan balances.

The Group's new mortgage lending delivers higher margins than its legacy, pre-2010 portfolio. Therefore, the run-off of the legacy assets and their replacement with new loans enhances margins overall. Together with wider margins earned through the businesses within the Commercial Lending segment, the Group's new lending activities create a structurally improving margin. NIM in the period was 2.29%, compared to 2.21% in 2018.

The Group has continued to hold strong levels of liquidity, both actual and contingent, during the period in response to the economic and political uncertainties inherent in the UK's Brexit process. Brexit has had a negative impact on sentiment across the Group's markets during the period and appears set to continue as the economic and political situation develops.

The Group's cost:income ratio in the year on a statutory basis was 40.7%, compared to 37.8% in 2018. On an underlying basis (excluding fair value movements and gains) the cost:income ratio was 42.1%, increased from 40.6% in the previous year. The cost base increased by £13.3 million year-on-year, including a full year of costs from 2018 acquisitions, the increased outsourced costs of the larger savings book and significant project-related costs (including expenses associated with the Group's IRB application). The Group continued to make significant investments in technology, developing systems to provide improved service offerings to its customers and enhance operational resilience, the costs of which contributed to the increase in operational expenses in the period.

Careful cost management remains a key objective of the Group. Investments in new businesses, technologies and our IRB framework mitigate against a near term reduction in the cost:income ratio, as does the amortisation of the Idem Capital portfolio. The Board still expects to achieve significant operational leverage within the business, but now over the longer term.

The Group's loan impairment costs are now reported under IFRS 9. The overall effect of the transition to the new standard was to increase the opening provisions on the Group's loan assets by £27.2 million and reduce equity by £22.2 million, net of tax, although these changes did not impact the Group's results for the period.

IFRS 9, through its focus on expected loss levels rather than the incurred loss approach of IAS 39, accelerates provision for losses, increasing profit and loss charges on growing books, such as many of the Group's portfolios. The forward-looking calculation basis requires estimates to be made of likely future economic conditions. During the year the Group adopted a more pessimistic weighting of the economic scenarios it considers in its calculations, in response to the increased levels of economic uncertainty, which, under IFRS 9, will increase provision charges. Despite these factors, the bad debt charge increased to £8.0 million in the period, compared to £7.4 million, on an IAS 39 basis, in 2018. The bad debt charge was lower in the Mortgage division, but rose in Commercial Lending, reflecting its relative growth rate, and the consequent level of provision on performing new loans required by IFRS 9.

Buy-to-let credit performance remained strong with arrears at 30 September 2019 at 0.18%, significantly less than the market average (2018: 0.11%). Commercial Lending bad debt rates also increased slightly, although still represent a very small number of cases. Overall, our behavioural scoring models, which act as a lead indicator of financial stress in the loan books, were stronger in all significant portfolios across the period.

Throughout the year the UK interest rate outlook and capital markets were affected by Brexit-led macro-economic uncertainties, impacting on fair value exercises carried out for accounting purposes at the year end. This created a charge of £15.1 million in respect of the revaluation of derivatives held for hedging (2018: gain of £1.2 million) in the income statement and an increase in the pension scheme liability in the balance sheet of £15.0 million since 30 September 2018, with, as a consequence, a reduction of capital.

This fair value adjustment, combined with the inclusion of a £28.0 million gain on the disposal of an Idem Capital portfolio in the 2018 result, led to statutory profit before tax decreasing to £159.0 million from £181.5 million in 2018, with profit after tax reducing from £145.8 million to £127.4 million, after provision for tax at a rate of 19.9% (2018: 19.7%).

This result translates to basic earnings per share ('EPS') on an underlying basis of 51.1 pence per share, a year-on-year increase of 6.0% (2018: 48.2 pence per share) (Appendix A). On the statutory basis basic EPS reduced by 11.6% to 49.4 pence per share as a result of the fair value losses in the current period and one-off gains in the prior year (2018: 55.9 pence per share). Underlying return on tangible equity ('RoTE') at 14.6% (2018: 14.0%) continued to make progress towards the Group's long-term target of over 15% (Appendix A).

Capital and distributions

The Group maintains a strong capital position, even after the reductions in equity from IFRS 9 and the revaluation of the pension liability. On an IFRS 9 transitional basis, the Group's CET1 capital ratio was 13.7% and its total capital ratio 15.9% (2018: 13.8% and 16.2%) with the pension deficit reducing the ratio at 30 September 2019 by 20 basis points. The fully loaded CET1 and total capital ratios at 30 September 2019, excluding the IFRS 9 transitional capital relief were 13.4% and 15.7% respectively. The UK leverage ratio remained strong at 6.7% on the transitional basis, 6.6% fully loaded (2018: 6.4%).

The Company's dividend policy is underpinned by the principle of enhancing shareholder returns on a sustainable basis. The Board proposes a dividend for the year of 21.2 pence for 2019, an increase of 9.3% from the 19.4 pence in 2018. This results in a dividend cover ratio of 2.33 times, which is below the normal target of around 2.5 times but which reflects the scale of non-cash, fair value items in the 2019 results.

Following the PM12 residual sale the Company announced a share buy-back programme in July 2019, with £26.5 million (exclusive of costs) having been invested by the year end. The Company will seek the normal shareholder approval at its February 2020 Annual General Meeting ('AGM') to allow such programmes to take place in future if surplus capital becomes available.

The business has successfully pursued the strategy set out to investors, focussing on its specialist markets and maintaining a strong capital and funding base. It is well placed to deliver further progress and provide sustainable returns to shareholders. Its operating model and wide experience mean that the Group is positioned to respond quickly to the challenges, and to take advantage of the opportunities that will arise, given changes in the broader operating environment.

A more detailed discussion of the Group's performance is given below covering:

Lending review A3.2	Funding review A3.3	Capital review A3.4	Financial review A3.5	Operational review A3.6
Lending, performance and markets	Retail deposits and wholesale funding	Capital management, liquidity and distributions	Results for the period, assets and liabilities	Governance, people, risk and regulation

A3.2 Lending review

The Group's operations are organised into three divisions, based on product type, origination and servicing capabilities. This organisational and management structure has been in place throughout the year.

New business advances and investments in the year, together with the year end loan balances, by division, are summarised below:

	Advances and investments in the year		Net loan balances at the year end	
	2019 £m	2018 £m	2019 £m	2018 £m
Mortgages	1,568.6	1,623.2	10,344.1	10,473.5
Commercial Lending	968.0	710.0	1,452.1	1,133.2
Idem Capital	-	83.4	389.9	521.1
	2,536.6	2,416.6	12,186.1	12,127.8

The Group's loan book increased by 0.5% in the year, with new lending 8.5% higher than in the previous financial year and total advances and investments 5.0% higher.

A3.2.1 Mortgages

The Group's Mortgages division offers buy-to-let first charge and owner-occupied first and second charge mortgages on residential property in the UK. In all its offerings, it targets niche markets where its focus on detailed case-by-case underwriting, proven rating methodology, and robust and informed approach to property risk differentiate it from mass market and other specialist lenders.

Housing and mortgage market

The performance of the UK mortgage and housing markets has remained subdued in the face of economic concerns arising from Brexit and the wider economy. New mortgage approvals, reported by the Bank of England, in the year ended 30 September 2019, at £262.9 billion had increased by only 2.6% from the previous year (2018: £256.3 billion), with remortgaging decreasing by 0.6% and house purchase mortgages increasing by 4.9%. This level of transactions remains some 30.0% below the peak in the market when £375.8 billion of mortgages were advanced in the year ended 30 September 2007. At the same time margins on mainstream mortgage lending have been squeezed as large lenders seek to preserve volumes.

The Nationwide House Price Index reported negligible annual growth of only 0.2%, sharply reduced from the 2.0% seen in 2018, with London and the South Eastern regions of England seeing a decline in prices, although house prices there remain close to their 2017 peak. Across England, Nationwide report house prices only 17%, on average, higher than their level in 2007 with prices outside the South East, having appreciated less. Growth has been at current levels for the past two years, with expectations of future increases remaining modest.

The latest survey data, as at 30 September 2019, from the Royal Institution of Chartered Surveyors ('RICS') UK Residential Market Survey, confirms this subdued position with market confidence drifting downwards, and negative short-term expectations on demand and prices, with some of this attributed to Brexit-related concerns amongst potential buyers. However, RICS expect some improvement in the longer term.

Buy-to-let and the private rented sector

The Group's deep understanding and long-term experience of the buy-to-let mortgage market mean that it is well placed to serve the particular needs of specialist landlord customers. The impact of regulatory and tax changes on landlords in recent years has led to lenders' strategies for buy-to-let polarising, with many large lenders not offering professional buy-to-let loans. This has left the Group amongst a small number of specialist lenders addressing the professional buy-to-let mortgage market. UK Finance ('UKF') has observed that landlords with portfolios of four or more properties comprise over a quarter of the buy-to-let lending market.

The private rented sector ('PRS') lettings market remains robust with RICS reporting both demand and rental levels increasing due to restricted supply, partially as a result of amateur landlords seeking to exit the market in response to fiscal and regulatory changes over recent years. However, the English Housing Survey for 2018, published in January 2019, continues to show the PRS representing around 19-20% of households, as it has for the past five years.

These factors have led to an expectation of increasing rents, with RICS members predicting a 2% increase over the next twelve months, accelerating to 3% per annum up to 2024. This follows average rent increases of 1.3% in the year ended September 2019, reported by the Office of National Statistics (2018: 0.9%), with September data from ARLA Propertymark ('ARLA'), the landlord's trade body, showing 58% of tenants witnessing rent increases in the year (2018: 27%). ARLA data also shows more tenants renting for longer periods. These factors should benefit the Group's customers and the affordability of their loans. However, reduced supply and increased rents may present difficulties for tenants and those seeking rented accommodation.

Buy-to-let lending in the year remained stable with UKF reporting new advances of £39.9 billion, the same value as in the previous year. Much of this activity represents refinancing by landlords, with 71.4% of new advances by value representing remortgages (2018: 70.4%). The trend in favour of longer-term fixed interest rates has also continued, both across the industry and in the Group's own lending, with over half of new lending at rates fixed for five years. This trend is expected to reduce remortgage activity in the short-term as product maturity terms increase.

The numbers of new buy-to-let mortgages reported by UKF over the past four years are set out below.

Number of new buy-to-let mortgages

UKF



These overall movements do, however, conceal a more mixed picture, with smaller landlords less active while activity amongst specialist landlords remains more positive.

The Group considers that its support for the PRS, through the buy-to-let mortgage market, contributes to housing provision for a significant number of families and it seeks to use its position as a lender to drive up standards of housing provision through its interaction with its landlord customers.

Lending activity

The Group's new lending activity in the segment during the year is set out below.

	2019 £m	2018 £m
Originated assets		
First charge buy-to-let	1,480.5	1,495.5
First charge owner-occupied	11.9	56.5
Second charge	72.0	71.2
	1,564.4	1,623.2
Acquired assets	4.2	-
	1,568.6	1,623.2

Total mortgage originations in the Group reduced by 3.6% in the year. The majority of this decrease arose from owner-occupied lending, where the offering was scaled back in the year. This reflects the Group's focussed approach to balancing acceptable levels of risk and return in lending decisions.

In addition to the loans originated a further portfolio of seasoned, largely performing, buy-to-let loans was purchased from a third party in June 2019 for £4.2 million. This purchase was facilitated by the Idem Capital team but is reported within the Mortgages division as the assets are similar to the segment's other assets and administered by the mortgage servicing team.

Buy-to-let

The Group's buy-to-let lending, at £1,480.5 million, remained largely stable year-on-year, reducing by 1.0% from 2018 levels (2018: £1,495.5 million). The pipeline of buy-to-let loans in process at the year end was £911.7 million, an increase of 17.0% on the position a year earlier (2018: £778.9 million).

In the professional buy-to-let market the Group's strategy of focussing on specialist customers (those operating through corporate structures and those with larger portfolios) has delivered positive results. These are the customers best suited to the Group's service model and this targeting, coupled with a disciplined approach to underwriting and valuation, has enabled margins and retention rates to be increased while providing the customers with a high standard of support for their business needs. The analysis of the Group's new buy-to-let business by customer type is set out below.

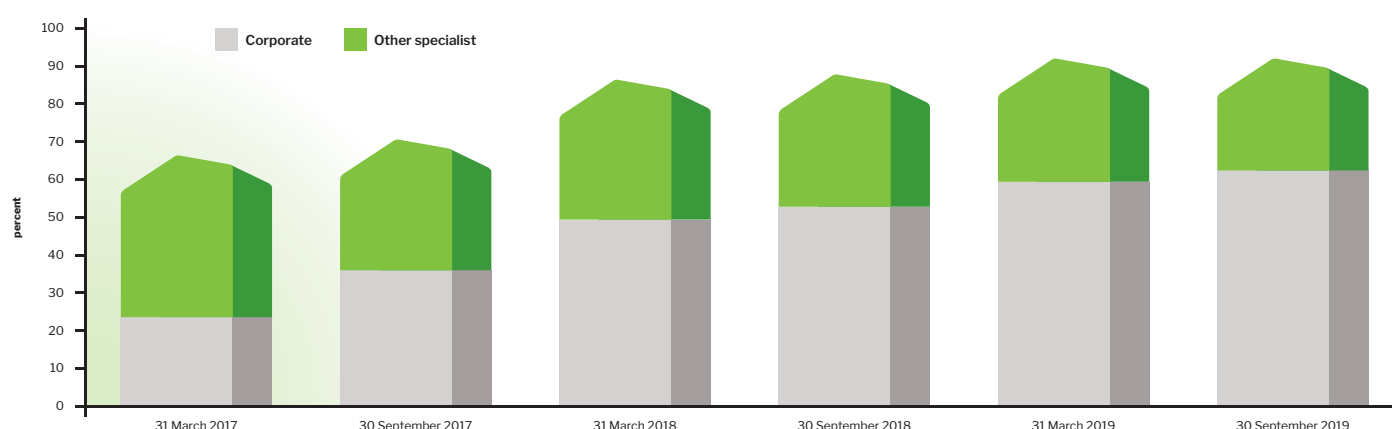
	30 September 2019 £m	30 September 2019 %	30 September 2018 £m	30 September 2018 %
Buy-to-let advances				
Corporate customers	812.4	54.9%	656.7	43.9%
Other specialist customers	502.7	33.9%	528.8	35.4%
Total specialist	1,315.1	88.8%	1,185.5	79.3%
Non-specialist	165.4	11.2%	310.0	20.7%
	1,480.5	100.0%	1,495.5	100.0%

These advances show the impact of the concentration of buy-to-let activity among more professional investors, many operating through corporate structures. This trend is set to continue into the next financial year, with 91.4% of pipeline cases relating to specialist landlord customers (2018: 87.8%). Within this, the trend for portfolio landlords to incorporate their businesses, partly as a response to recent changes in the tax regime for buy-to-let, also continued.

This trend can be seen in the analysis of the Group's buy-to-let pipeline numbers over the last three years.

Percentage of specialist pipeline cases

Number outstanding at date



The Group seeks to mitigate exposure to climate change related issues which might impact on security values, through its lending criteria. This includes ensuring that any property proposed as security generally has an Energy Performance Certificate ('EPC') rating of E or better (on a scale of A to G), and considering any property's exposure to flooding risk before it is accepted as security. A detailed review of the buy-to-let loan book in the year indicated that less than 2.5% of security properties for which data was available were situated in postcodes with medium or high flood risk.

The Group sources the majority of its new buy-to-let lending through specialist intermediaries and significant investment has been made to ensure they receive excellent service. It was therefore gratifying that in feedback from intermediaries in the period, 84% were satisfied with the process of arranging a loan offer, delivering a net promoter score at offer stage of +60. Continued improvement is expected in the coming financial year as intermediaries and customers benefit from the Group's investment in its service proposition and the enhanced technology to support it.

Other mortgage lending

The division's other first and second charge mortgage lending has been carefully managed to ensure that only lending with appropriate risks and returns is undertaken.

The Group's second charge mortgage lending has increased marginally by 1.1% during the year, but remains at modest levels. The second charge market is currently not large, with total lending in the financial year reported by the Finance and Leasing Association ('FLA') of £1,207 million (2018: £1,031 million). However, much of the increase has come from sub-prime activity, which falls outside the Group's risk appetite. The Group seeks to target only that population of customers with the strongest credit quality in this area, avoiding any form of sub-prime business, which necessarily limits the addressable market for second charge lending.

In residential mortgage lending, margins have been generally compressed and the Group has maintained credit discipline at acceptable yields, meaning that the amount of new business has fallen. The opportunities for the Group in this area principally relate to highly specialised propositions, where the Group's operational approach can be beneficial, including lending to the existing specialist landlord customer base. In the short-term only small volumes of lending are expected in this area.

Performance

The outstanding loan balances in the segment are set out below, analysed by business line.

	30 September 2019 £m	30 September 2018 £m
<i>Post-2010 assets</i>		
First charge buy-to-let	5,427.7	4,481.8
First charge owner-occupied	68.3	59.4
Second charge	171.6	141.3
	5,667.6	4,682.5
<i>Legacy assets</i>		
First charge buy-to-let	4,674.2	5,779.8
First charge owner-occupied	2.3	11.2
	10,344.1	10,473.5

At 30 September 2019, the balance on the Group's mortgage portfolio was 1.2% less than a year earlier, with £695.8 million of the reduction being due to the PM12 disposal. Excluding movements in the PM12 portfolio in the year, the mortgage book grew by 6.2%. Within those amounts the post-2010 buy-to-let book grew by 21.1%.

The annualised redemption rate on post-2010 buy-to-let mortgage assets at 10.7% (2018: 16.7%), has reduced from the high level seen in 2018. This higher level of customer retention is a result of the extending profile of product maturities and the changing focus towards specialist landlord customers. The annualised redemption rate on pre-crisis lending, at 6.7%, is similar to that seen in the year ended 30 September 2018 (2018: 6.0%), reflecting the pricing of those loans relative to current market offerings.

Arrears on the buy-to-let book as a whole have marginally increased in the year to 0.18% (2018: 0.11%), with arrears on post-2010 lending standing at 0.03% (2018: 0.01%). These arrears remain very low compared to the national buy-to-let market, with UKF reporting arrears of 0.42% across the buy-to-let sector at 30 September 2019 (2018: 0.42%). This strong performance reflects the Group's focus in underwriting on the credit quality and financial capability of its customers, underpinned by a detailed and thorough assessment of the value and suitability of the property as security.

Second charge arrears increased to 0.38% from 0.21% in the year, as the book continues to season, with performance remaining strong, while the new residential lending has yet to see any arrears, although the loans are still comparatively unseasoned.

The Group's receiver of rent process for buy-to-let assets helps to reduce the level of losses by giving direct access to the rental flows from the underlying properties, while allowing tenants to stay in their homes. At the year end, 683 properties were managed by a receiver on the customer's behalf, a reduction of 11.3% since 2018 (2018: 770 properties) as cases on the old book resolve and post-2010 cases perform well.

Outlook

The Group has established a significant market position in specialist buy-to-let which offers good prospects for future earnings and profitability, though significant expansion of volumes is not anticipated in the year ending 30 September 2020.

Although the general UK economic outlook remains uncertain, the underlying metrics within the PRS are more positive for the Group's landlord customers, with market commentators largely positive. The Group is also confident that its robust approach to valuation and the loan to value coverage in its buy-to-let book, at 67.3% (2018: 65.7%) provide significant security in the event of a downturn.

Looking forward, the Group intends to broaden its offerings to its core professional landlord customers and the intermediaries supporting them to provide both an enhanced service and additional products tailored to their needs. Despite the political uncertainties, professional landlords continue to develop their businesses and expand their portfolios. With the PRS representing a fifth of households, professional landlords are vital to the UK's housing provision and the Group sees significant business opportunities in providing them with the financial support that they require.

A3.2.2 Commercial Lending

The Group's Commercial Lending division's focus is to support UK SMEs and small corporates through the provision of various financing solutions. The division has seen significant levels of investment since 2015 through both acquisition and organic business growth.

The proposition is delivered through four key business lines: SME lending, providing finance leasing for business assets and unsecured cash flow lending to professional services firms amongst other products; development finance, including the operation acquired in 2018; structured lending; and motor finance.

The asset leasing market in the UK is substantial, covering some £79.3 billion of outstanding balances at 30 September 2019 (2018: £75.8 billion) and £33.2 billion of advances in the year then ended (2018: £30.1 billion) according to FLA data. However, a large proportion of this business is commodity lending in the hands of a small number of very large finance houses. It is the Group's strategy to target niches within this market where its particular skill sets can be best applied, and its capital effectively deployed to optimise the relationship between growth, risk and return.

The Group's commercial lending offerings target markets where there has historically been a shortage of credit, such as its development finance business which primarily supports smaller housebuilders, whose difficulties in funding new-builds have been widely reported, and the structured lending business which funds small non-bank lending operations. In each of these markets the Group's competitors are other smaller banks and similar sized lenders. They are markets in which the largest lenders have little presence, creating a credit availability issue for customers and significant opportunities for the Group.

The division's businesses comprise specialist teams, developed internally or sourced externally to provide bespoke focus to their respective markets. This was highlighted in the year when the Group's SME lending business was named as 'Best Commercial Lender' at the 2019 Lending Awards and 'Best Specialist Finance Solutions Provider' in the SME News Magazine's 2019 UK Legal Awards, while being shortlisted in several other categories. Also at the Lending Awards, the structured lending business was named 'Best Specialist Commercial Lender' for 2019.

The common themes of these business lines are a deep understanding of their markets and their customer needs together with expertise in security valuation, collections and asset recovery. In common with the rest of the Group, the division's focus is on the maintenance of strong credit standards and it does not pursue business volumes at the expense of margins.

Lending activity

A deceleration in global economic growth and continued political uncertainty in the UK during the year have had an adverse impact on UK business investment, however this has not led to a reduction in the Group's volumes.

The Group's focus across all the Commercial Lending business lines in the year has been on growing the scope of its operations to address a wider range of funding propositions for SME customers, while enhancing service, maintaining credit discipline and improving yields.

The SME leasing operation has strengthened its position in core hard-assets and expanded into soft-asset financing. The Group's development finance and structured lending businesses have also increased their scope.

The UK government retains its target of delivering 300,000 new homes by the mid-2020s, which will require a significant uplift in current construction levels (in 2017/18 222,000 new homes were built), providing opportunities for the Group's customers in the construction and property development fields.

The Group's Commercial Lending exposure has increased overall by 28.1% in the year to £1,452.1 million (2018: £1,133.2 million). The new lending activity in the segment during the year is set out below.

	2019 £m	2018 £m
Development finance	362.9	136.8
SME lending	406.5	354.7
Structured lending	49.7	40.6
Motor finance	148.9	177.9
	968.0	710.0

Development finance

The Group's development finance business was significantly expanded by the acquisition of Titlestone in July 2018. The period since then has been positive with the Group's organically developed activities being integrated with the acquisition to deliver operational efficiencies, and the focus of the combined business refined.

The Group's target customer in this market is a small to medium sized developer of UK residential property. The projects funded have an average size of approximately £5 million and are generally focussed on the more liquid parts of the residential market, avoiding developments with high unit values. While the business has been concentrated in the South-East of England to date, with 51.7% of balances at 30 September 2019 located in London and the South-East, the Group's strategic objective is to lend more widely across the UK. Central London property hot-spots have been largely avoided.

Activity in the Group's target market has held up well in the year, with enquiry levels consistent with previous periods. However, economic uncertainty has led to some developers taking longer to commence projects and there has been additional caution amongst larger scale developers, evidenced in lengthening periods between facility agreement and the first drawdown.

The successful combination of the Group's original Paragon Development Finance business with Titlestone has seen lending volumes increase from £136.8 million in 2018 to £362.9 million in 2019. However, the 2018 figure only includes post-acquisition advances. On a proforma, like-for-like basis, the 2018 volumes were £320.8 million. The underlying £42.1 million (13.1%) increase represents the distribution benefits from the combination and the maintenance of the Group's strong credit standards in this market.

Prospects for the new financial year remain encouraging, with undrawn amounts on live facilities at 30 September 2019 of £294.8 million (2018: £215.2m) and a post-offer pipeline of £160.9 million (2018: £151.5m), a large proportion of which would be expected to flow in to future completions. Market fundamentals remain strong, albeit tempered by short-term economic anxieties, and the Group's extensive property experience can be used to leverage future growth.

SME lending

The SME lending operation has strengthened its position in its core hard-asset leasing market during the period and sought to expand its soft-asset offering. It has maintained its focus on margins and sought to support its business levels through strong customer relationships and service standards.

Business generation has benefitted from an enhanced proposition and operational efficiencies arising from increasing centralisation of operations at the Group's SME lending hub in Southampton. New loan volumes in the leasing business have grown by 11.4% compared to 2018, reaching £288.7 million (2018: £259.2 million). A further £11.6 million of operating lease assets were also acquired in the year (2018: £19.3 million).

The short-term professions finance business, which includes the Iceberg operation acquired in December 2017, grew broadly in line with expectations during the period.

As part of the centralisation process significant investments have been made in technology, while the sales teams have also been strengthened across the various specialist areas of the business. These developments form the first phase of a programme of business enhancements which will sustain growth into the future.

Structured lending

The Group's structured lending business, which made its first loans in the second half of 2018 has made further progress in the year. The structured lending unit provides senior debt to the UK non-bank lending market and deploys loans to help support 'best-in-class' businesses working across consumer and commercial lending. Transactions are structured using established and robust methodologies and secured on underlying assets, with a substantial amount of over-collateralisation. The business addresses certain segments where the Group may be under-weight or has no exposure at all and where working with a recognised industry expert is preferable to organic expansion.

The team, which has built a solid reputation in the market, expanded in the year, allowing more prospects to be addressed. The structured lending business generally has a longer pipeline than other operations, with detailed negotiations required before a new loan can be agreed. There are now eight transactions in place, compared to three at the previous year end, with more prospects at various stages of development. The deals currently in progress are expected to provide further lending into the new financial year, while the business as a whole has good prospects for further expansion.

Motor finance

The Group continues to target its motor finance offerings on those specialist propositions which are not addressed by the mass-market lenders who control the majority of the market. This limits the potential to grow market share and the level of advances in 2019 has been below that achieved in 2018, in part due to a continued level of new business pricing discipline. The Group has reviewed its business model for motor finance following the publication of the FCA's review of the sector. It has identified the changes required by the FCA's proposed new rules and considers that is well placed to comply, compared to other market participants.

Across all business lines growth has been carefully controlled with credit quality and margins prioritised over expanding lending volumes and care has been taken to focus effort on those sectors or subsectors of the market most suited to the Group's business model and most likely to provide it with a good return on capital.

Performance

The outstanding loan balances in the segment are set out below, analysed by business line.

	30 September 2019 £m	30 September 2018 £m
Asset leasing	492.2	403.4
Professions finance	46.2	42.6
Invoice finance	18.5	21.8
Unsecured business lending	19.3	17.3
Total SME lending	576.2	485.1
Development finance	506.5	352.8
Structured lending	88.1	38.7
Motor finance	281.3	256.6
	1,452.1	1,133.2

Margins in the segment have remained strong and have reflected both the changing business mix and strategic initiatives to improve yields across the main product lines.

Credit quality in the development finance book has been good, and the overall performance of the projects has been in line with expectations. These accounts are monitored on a case-by-case basis by the Credit Risk function. At 30 September 2019 very few cases had been classified by the monitoring process as being likely to result in a loss, beyond a small number of Titlestone accounts identified on acquisition and allowed for in the purchase price and where refinements in fair values at the acquisition date have been reflected in the goodwill valuation during the year.

The average loan to gross development value for the portfolio at the year end, a measure of security cover, was 64.8% (2018: 63.2%).

Credit performance on the division's finance leasing portfolios remains stable, with arrears in asset leasing at 0.43% and motor finance at 1.27% (2018: 0.78% and 0.93% respectively). These compare favourably to those in the wider sector, with the FLA reporting average arrears for business leasing at 1.10% and car finance at 2.70% at 30 September 2019 (2018: 0.70% and 2.50%).

Performance in the structured lending operation has been in line with expectations, with satisfactory pricing and no serious concerns with the operation of any of the deals.

Outlook

The Commercial Lending segment has seen the greatest level of investment by the Group in the recent past, most notably through its acquisition activity in the SME lending and development finance markets. The Group has demonstrated its ability to support the needs of underserved customers in these important parts of the UK economy.

Whilst further bolt-on acquisitions to enhance existing operations remain a possibility, the Group's focus, having integrated and embedded the acquired elements into its core risk, operational and systems processes, is now to invest in technological, distribution and servicing enhancements for its commercial lending activities, optimising its proposition to customers.

The division seeks to be responsive and flexible in addressing the SME market, but its UK focus means that it is exposed to a downturn in business investment nationally. Overall, the Group has a good platform for continuing growth and increasing scale and diversity will enable a better return to be generated from its resources, control framework and investments in systems.

A3.2.3 Idem Capital

The Group's Idem Capital division includes its acquired loan portfolios, together with its pre-2010 legacy consumer accounts. Its strategic focus is on the acquisition of more specialist loan portfolios where it can enhance value through leveraging the Group's origination and collections expertise and access to funding, and which will augment the organic origination activities of the Group. It uses its analytical skills base, which it sees as a core differentiator, to identify and evaluate portfolios brought to market.

The division's profitability relies on providing a high quality service to customers when collecting on acquired assets. Many of these borrowers may have historically experienced financial difficulties, and its focus in collections activity is to generate fair outcomes for these customers, while being mindful of potential vulnerabilities.

As part of the banking group it is able to deploy expertise in a wide variety of asset classes and access the systems development resource and support functions of the wider business, enabling more complex portfolios to be addressed. It also has significant experience in working in partnership, either as an investor or administrator, giving it access to transactions which may be unattractive on a standalone basis.

As part of a wider Group, Idem Capital evaluates investments on the potential return which can be achieved on Group capital compared to alternative opportunities in other divisions, imposing a bidding discipline on potential purchases, but is also not constrained to pursue volumes in order to retain critical mass, as a monoline asset purchaser might be.

Overall, Idem Capital's success rests on understanding assets, strong analytics, advanced servicing capabilities and the efficient use of funding.

New Business

The UK loan portfolio purchase market has remained active throughout the year despite the current levels of economic uncertainty, and the Group has accessed all the significant tender processes in the period. However, conditions in the market are difficult, with levels of demand and pricing remaining high, and several very large investors being prepared to accept returns on capital below those required by the Group.

In the face of these conditions the Group has maintained its disciplined approach to pricing and quality. It continues to target only those deals where its wider capabilities in administration and funding can provide a real benefit to the project and where the projected return is attractive in comparison to the other opportunities for the deployment of its capital.

During the period no new deals were completed which were subsequently included on the division's balance sheet (2018: one deal) although the Idem Capital team was active in facilitating the £4.2 million asset purchase undertaken by the Mortgages division in the year, as noted above. In addition, the division undertook a limited number of reviews of opportunities that were ultimately not progressed.

Aside from these, the main focus of the business was on monitoring the performance of the extant portfolio and the integration of the £83.4 million motor finance portfolio purchased towards the end of the previous financial year.

The Group believes that its ability to accurately evaluate a potential acquisition is a core strength and it is not willing to compromise on credit quality or target return levels in pursuit of volumes. Idem Capital remains on the panels of all principal UK vendors.

Performance

The value of the loan balances in the segment are set out below, analysed by business line.

	30 September 2019 £m	30 September 2018 £m
Second charge mortgage loans	217.7	274.6
Unsecured consumer loans	134.7	173.7
Motor finance	37.6	72.8
	389.9	521.1

The reduction in balances is a result of the scale of collections from the brought forward loan portfolios, particularly the unsecured and motor finance balances, together with some minor asset disposals. 120 month Estimated Remaining Collections ('ERC') on acquired consumer assets reduced from £489.6 million at 30 September 2018 to £366.4 million at the year end, for the same reasons.

Overall collections from customers have held up well in the year, despite the generally negative economic forecasts for the UK. Whilst the division's second charge assets are over 10 years seasoned, offering resilience to any potential downturn, the unsecured assets are less seasoned, and their performance will continue to be carefully monitored over the coming year.

Arrears on the segment's secured lending business have risen slightly to 17.2% (2018: 15.8%), the increase arising from redemptions amongst the better performing accounts in the year. These arrears levels remain higher than the average for the sector, but this reflects the seasoning of the balances, and the inclusion of accounts which are currently making full monthly payments but had missed payments at some point in the past. Average arrears for secured lending of 8.7% at 30 September 2019 were reported by the FLA (2018: 9.4%).

None of the division's remaining portfolios at the year end were regarded as materially underperforming, with strong overall cash generation. The Group monitors actual cash receipts from acquired portfolios against those forecast in the evaluation which informed the purchase price. Up to 30 September 2019 such collections were 109.8% of those forecast to that point (2018: 109.7%).

The motor finance book acquired at the end of the previous financial year has been bedded in successfully, with collections currently ahead of plan, resulting in a reduction of 48.4% in the carrying balance, year-on-year, and only 12.1% of remaining cases in arrears at the year end. The success of this acquisition reflects the Group's strategy of targeting more specialist portfolios.

Operational improvements have continued to be made in systems, processes and employment patterns which are expected to generate operational efficiencies and improve both customer service and customer experience in future periods.

Outlook

The loan purchase market continues to offer opportunities for Idem Capital to invest in portfolios, either by itself or with partners, where its ability to leverage the skill base of the wider group can generate good returns. These deals are likely to be larger, more idiosyncratic and less frequently available than the average, which leads to an irregular flow of new accounts to the division.

The Group regards such investments as essentially opportunistic, and its firm belief is that the maintenance of strict discipline in this area is the best route to delivering an appropriate return on its investments. The division is well placed to continue the effective management of its asset base and to address appropriate business opportunities as they arise, however, in the absence of an acceptable return on investment, the Group expects to focus its capital allocation on its other operating divisions in the near term.

A3.3 Funding review

The Group's strategic funding objective is to maintain a diversified and sustainable funding base. It accesses differing mixes of funding options from time to time to ensure that pricing and availability issues in any particular funding market can be mitigated, while maintaining the flexibility to fund new business opportunities when required.

During the year the Group has continued to emphasise the central role of retail deposits within its funding mix. This has resulted in savings deposits accounting for almost half the Group's funding by the year end.

In the wholesale markets the Group issued its first SONIA referenced securitisation transaction, Paragon Mortgages (No. 26) PLC during the year. It also disposed of its residual interests in the Paragon Mortgages (No. 12) PLC securitisation and repaid several other securitisation deals, financing them on balance sheet.

In the uncertain economic climate, which has continued throughout the year, the Group maintained its policy of holding strong levels of contingent liquidity and of holding larger cash balances than might otherwise be the case, with £872.1 million of cash available for liquidity and other purposes at 30 September 2019 (2018: £962.9 million). Further contingent liquidity was provided by undrawn warehouse facilities of £200.0 million (2018: nil) and assets pre-positioned to access Bank of England facilities. The contingent liquidity policy will be kept under review in the light of the emerging economic and political environment.

The Group has also explored new routes to the savings market in the period in order to broaden its distribution, increase the market addressed and create the capacity for more flexibility in its funding.

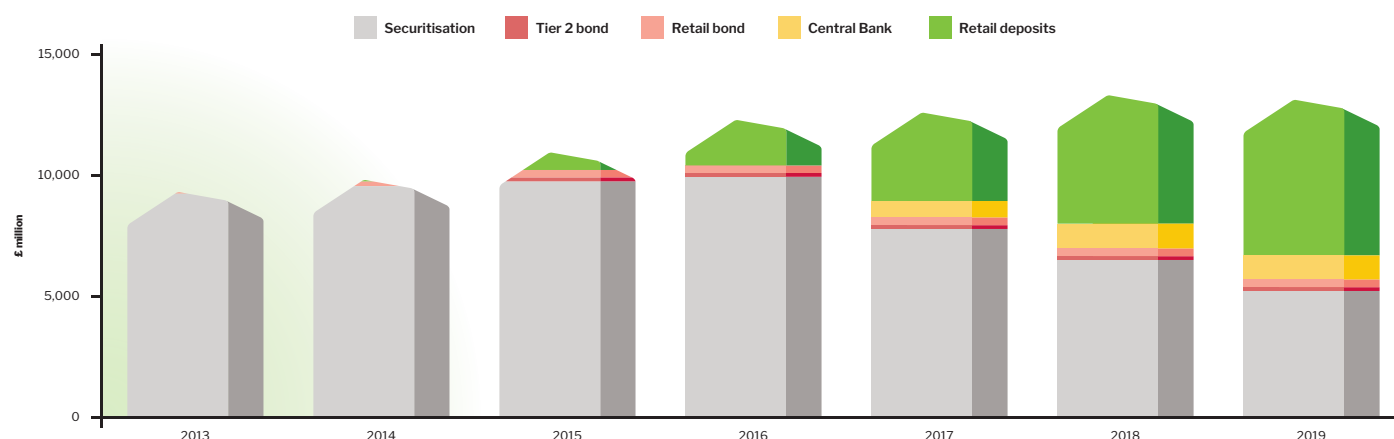
The Group's funding at 30 September 2019 is summarised as follows:

	2019 £m	2018 £m	2017 £m
Retail deposit balances	6,391.9	5,296.6	3,615.4
Securitised and warehouse funding	5,206.9	6,490.3	7,781.8
Central bank facilities	994.4	1,024.4	700.0
Tier 2 and retail bonds	446.1	445.4	444.8
Total on balance sheet funding	13,039.3	13,256.7	12,542.0
Off balance sheet central bank facilities	109.0	108.7	109.0
	13,148.3	13,365.4	12,651.0

The Group's funding has become increasingly diversified in the years following the authorisation of Paragon Bank in 2014. This is illustrated by the chart below which shows, for each of the year ends since 2013, the outstanding funding balance by type.

Funding by type (£m)

30 September 2013 – 2019



The Group continues to hold both assets and liabilities where the interest rate is set by reference to LIBOR, which will be withdrawn in 2021. A working group is in place to oversee a transition plan managing impacts on both sides of the balance sheet.

It is likely that a market consensus solution for LIBOR-linked instruments will emerge, which will then need to be implemented on a case-by-case basis. The position with regard to LIBOR linked assets, where the Group has a substantial position relating to legacy mortgage lending is likely to be more complex, with regulatory expectations playing a significant role. No new LIBOR-linked lending is undertaken without specific contractual terms addressing replacement benchmarks. The Group continues to carefully monitor emerging regulatory and market developments so that it minimises, as far as possible, any disruption on LIBOR withdrawal.

A3.3.1 Retail funding

Paragon Bank's savings business provides customers with a range of deposit options, offering value for money and competitive rates, combined with the protection provided by the Financial Services Compensation Scheme ('FSCS'). While the business currently sources the majority of deposits through its own website, it also has an increasing presence on wealth management platforms and is expanding to offer postal accounts.

Retail deposits continue to represent a reliable, cost-effective and scalable source of finance for the Group. The volume of retail deposits has continued to grow significantly during the period, in line with the Group's funding strategy, with balances at 30 September 2019, at £6,391.9 million, having increased by 20.7% over the year (2018: £5,296.6 million).

The Group's share of the overall UK savings market remains small, with opportunities identified to expand the franchise. Household savings balances reported by the Bank of England increased by 3.7% in the year ended 30 September 2019 to £1,220.9 billion (2018: £1,177.3 billion), although these deposits remain overwhelmingly with clearing banks and building societies. While this market position enhances the Group's funding flexibility, it does mean that rates may be influenced by the funding needs of other, larger, participants in the market, which are beyond the Group's control.

New entrants in the banking market have sought to access similar segments of the savings market as the Group, and therefore competition for internet-sourced deposits has increased. However, the Group's competitive position on pricing, products and service, has meant that it has been able to achieve its required funding levels at attractive prices.

Savings balances at the year end are analysed below.

	Average interest rate		Average initial balance		Proportion of deposits	
	2019 %	2018 %	2019 £000	2018 £000	2019 %	2018 %
Fixed rate deposits	2.02%	1.94%	16	19	65.0%	68.8%
Variable rate deposits	1.43%	1.36%	16	16	35.0%	31.2%
All balances	1.81%	1.76%	16	18	100.0%	100.0%

The average initial term of fixed rate deposits was 28 months (2018: 27 months).

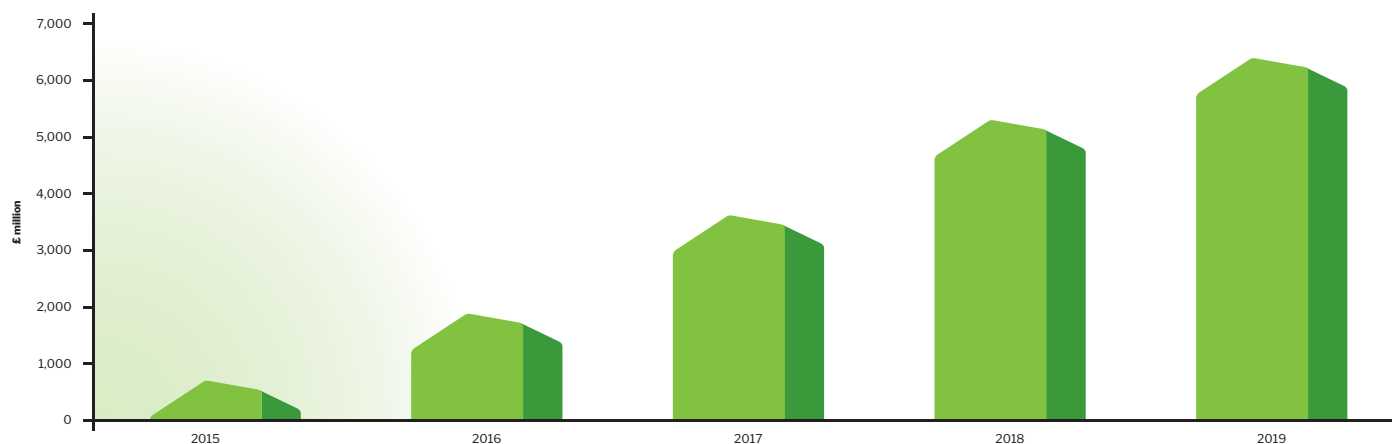
Market rates for new easy access accounts and one year deposits reported by the Bank of England have increased year-on-year, with rates on longer dated products falling, which is consistent with the picture shown above.

At 30 September 2019 the proportion of easy access deposits, which are repayable on demand, at 27.8% was a little higher than its level at the beginning of the year (30 September 2018: 25.5%), and represented £1,778.0 million of the balance (2018: £1,349.2 million). This percentage can be expected to rise going forward as the Group generates richer behavioural data to support its liquidity requirement assumptions for easy access business.

The growth of the retail funding balance since the authorisation of Paragon Bank as a deposit taker in 2014 is shown below.

Retail deposits (£m)

At 30 September 2015-2019



The core route to market for the deposit proposition is through its online presence, with traffic driven by strong repeat business flows, organic searches, a presence on price comparison websites and recommendations from industry savings experts. This has been enhanced in the period by the launch of alternative deposit sources, such as investment platforms outside the main business flow.

The first of these alternative sources, the Hargreaves Lansdown Active Savings platform came on stream in November 2018, with further relationships with Flagstone, a wealth management solution and Monzo, the digital bank, launched later in the year. These arrangements allow the Group to access an additional customer base, as the platforms target different demographics to its online direct savings channel. The Group will seek to develop such relationships further in future periods.

The Group's products, process and approach have been recognised in the industry and by customers winning the 'Best Monthly Interest Provider' award in the 2019 Money.net awards, its second consecutive victory in this category. It was also named as 'Best Online Cash ISA Provider' in the 2019 YourMoney.com Awards and 'Best Savings Provider for Existing Customers' in the 2019 Savings Champion awards.

In customer feedback 89% of those opening a savings account with the Group in the year who provided data, stated that they would 'probably' or 'definitely' take a second product (2018: 90%). The net promoter score in the same survey was +65, up from +61 for the 2018 financial year.

When customers with maturing savings balances in the year were surveyed 91% stated that they would 'probably' or 'definitely' consider taking out a replacement product with the Group (2018: 90%) with a net promoter score at maturity of +53, up from +50 for the 2018 financial year. This performance is particularly valuable to the Group, given the benefits of customer and deposit retention.

The Group's outsourced administration platform continues to meet its needs and provides a cost-effective, stable and scalable solution in the medium to long-term. The Group has a close relationship with the service provider through which it seeks to enhance both its offerings and its customer service levels.

The size and diversity of the Group's deposit base is expected to continue to expand, forming the principal funding source for new lending activities. This will be driven through expanding distribution and developing the product range to serve additional customer groups. The guarantee provided by the FSCS scheme is likely to reduce the potential for an economic downturn to impact liquidity and the profile of the Group's target customers suggests that they are likely to be more resilient than average in such circumstances.

Overall, the savings proposition provides the Group with a stable funding platform, with a focus on term funding to manage interest rate risk and the ability to limit product availability to short periods of time, giving the funding channel flexibility and manageability. The additional routes to market enhance this flexibility.

A3.3.2 Wholesale funding

The Group's wholesale funding comprises securitisation funding, warehouse debt and retail and corporate bonds. It has been one of the principal issuers of residential mortgage backed securities ('RMBS') in the UK over many years. Its Long-Term Issuer Default Rating was affirmed at BBB by Fitch in the period, albeit with a negative outlook which was applied to all the major UK banks as a result of the uncertainty surrounding the Brexit process. Fitch have stated that, all other things being equal, this would be removed in the event of a resolution.

The capital markets were largely quiet in the first six months of the period with rates less appealing than in previous periods. This was attributable to two factors, the general economic environment in the UK and the impending withdrawal of the LIBOR reference rate, which has formed the basis for interest charging on the majority of asset backed securities since the inception of that market. LIBOR is due to be withdrawn in 2021, within the lifetime of a newly issued four-year security, and UK regulators have mandated the Bank of England Sterling Overnight Index Average ('SONIA') to replace it.

No significant SONIA-linked bonds were issued before April 2019, with much of the market waiting for a standard approach to emerge. However, the first issuers came to market after that point and the levels of pricing and liquidity returned to a more normal level for the rest of the year, despite the general economic pressures.

The Group issued its first SONIA linked transaction, Paragon Mortgages (No. 26) PLC ('PM26') in June 2019. PM26, backed by seasoned buy-to-let mortgage assets, raised £364.3 million of external funding in sterling Mortgage Backed Floating Rate Notes. The senior notes, the only notes issued externally, were rated AAA by Fitch and Aaa by Moodys and bear interest at compounded SONIA plus a margin of 1.05%. It should be noted that margins above SONIA are typically larger than those above LIBOR, reflecting the risk-free nature of the SONIA rate. The deal also generated internally held rated notes which may either be sold later or used as collateral for Bank of England or other repo facilities, giving the Group enhanced funding and liquidity options.

On 27 June 2019 the Group sold its remaining investments and residual interest in the Paragon Mortgages (No. 12) PLC securitisation. While the transaction remains in place and the Group continues to manage the assets, it has no further interest in their performance and both the assets and the associated funding have been derecognised from the Group's balance sheet, realising a net profit of £9.7 million as well as crystallising its loan participation in cash. This removed £695.8 million of low yielding securitised assets from the Group's balance sheet and, consequently, reduced its encumbrance ratio, while improving yields.

During the year the Group paid down five further securitisation transactions. These included two funding legacy mortgages and the Group's remaining consumer finance transaction. These transactions between them had £95.8 million of notes outstanding at 30 September 2018 and had some of the highest funding costs among the legacy arrangements. Additionally, two transactions funding post-2010 mortgages were paid down, having reached their optional call dates. After the year end, notice was given on a further post-2010 mortgage transaction. Further such refinancing transactions should be expected over the coming years.

A further funding option is provided by wholesale warehouse funding, which provides standby capability, particularly in the event of market disruption elsewhere, where funds need to be deployed rapidly or as an alternative to retail deposit funding for liquidity purposes or in the process of building a portfolio of loan assets for securitisation. During the period a new £200.0 million facility was agreed with Bank of America Merrill Lynch, carrying an interest rate of LIBOR plus 0.95%.

A3.3.3 Central bank facilities

The Group has continued to make use of facilities offered by the Bank of England to support its lending to households and businesses. Its drawings under the Term Funding Scheme ('TFS') remain in place and provide £944.4 million of the Group's funding (2018: £944.4 million), with all drawings remaining in place until at least 2021. The Group also utilised the Indexed Long-Term Repo scheme ('ILTR') for six-month borrowings, with £50.0 million outstanding at the period end (2018: £80.0 million).

The Group's liquidity drawdown under the Funding for Lending Scheme ('FLS'), which provides liquidity of £109.0 million (2018: £108.7 million) remained in place throughout the period. The terms of this facility are such that neither the drawing nor the liquidity provided appear on the Group's balance sheet.

The Group has also pre-positioned further mortgage loans and certain other assets with the Bank of England to act as collateral for further drawings on central bank funding lines, if and when required, providing access to liquidity of up to £1,095.0 million. It can also use the retained notes in recent securitisation transactions, which are externally rated, for this purpose.

The Group will continue to utilise central bank facilities in future, subject to availability, as part of its integrated funding framework.

A3.3.4 Summary

The Group's diversified funding position, with strong wholesale and retail franchises gives it a strong position in the face of economic uncertainties. This reduces its exposure to issues affecting any particular funding source and allows it the flexibility to raise funds in accordance with its own market assessments, rather than being forced into sub-optimal transactions for short term reasons. This base delivers a robust and adaptable position going forward, supporting the Group's overall business strategy and aspirations.

Further information on all the above borrowings is given in notes 32 to 36.

A3.4 Capital review

The Group's capital policy aims to provide appropriate returns to shareholders, whilst maintaining prudent levels of capital to support its strategic objectives going forward. The maintenance of strong regulatory capital and liquidity positions to safeguard its depositors is also a principal strategic objective.

For regulatory purposes the Group's capital comprises shareholders' equity and tier 2 bonds. It has no outstanding AT1 issuance, but has the capacity to issue such securities, if considered appropriate, under an authority granted by shareholders at the 2019 AGM, which will be proposed for renewal at the forthcoming meeting.

A3.4.1 Dividends and distribution policy

The Company's previously announced dividend policy of paying out approximately 40% of consolidated earnings to shareholders remains in place, achieving a dividend cover ratio of around 2.5 times, in ordinary circumstances. During July 2019 an interim dividend of 7.0 pence per share was paid, determined, in accordance with the Group's stated policy, as 50% of the previous year's final dividend.

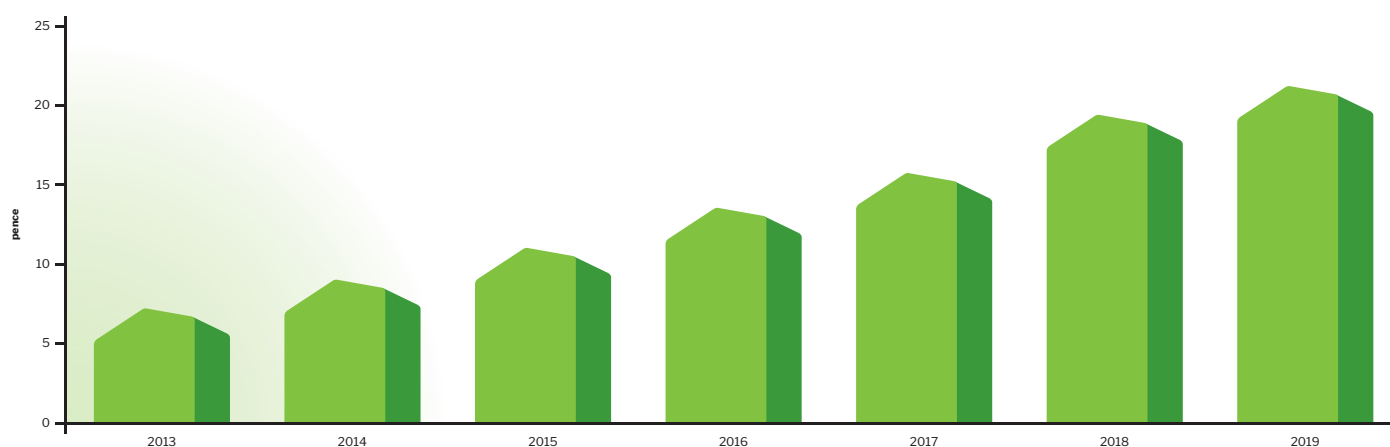
Following the completion of the PM12 residual sale on 27 June 2019 the Board considered the profit generated and the capital released by that transaction and determined that it was appropriate to return a portion of this capital to shareholders by way of a share buy-back programme. During the year the Group bought back 6.0 million of its ordinary shares at a cost of £26.7 million, including stamp duty and transaction expenses (note 44); £26.5 million excluding costs, these shares being held in treasury. Treasury shares may subsequently be cancelled.

In determining the level of dividend for the year, the Board has considered the dividend policy, and has also taken into account the impact of the buy-back programme, together with the Group's strategy, capital requirements, principal risks, the level of available retained earnings in the Company, its cash resources and the objective of enhancing shareholder value. The dividend policy is underpinned by the principle of enhancing shareholder returns on a sustainable basis and the Board is proposing, subject to approval at the Annual General Meeting on 13 February 2020, a dividend for the year of 21.2 pence for 2019, an increase of 9.3% from the 19.4 pence in 2018. This results in a dividend cover ratio of 2.33 times, which is below the normal target of around 2.5 times but which reflects the scale of non-cash, fair value items in the 2019 results.

The progress of the dividend for the year is shown in the chart below.

Dividend for the year (pence)

In respect of the years 2013 - 2019



The directors have considered the distributable reserves of the Company and concluded that such a dividend is appropriate.

A3.4.2 Regulatory capital

The Group is subject to supervision by the PRA on a consolidated basis, as a group containing an authorised bank. As part of this supervision, the regulator will issue an individual capital requirement setting an amount of regulatory capital, defined under the international Basel III rules, implemented through the Capital Requirements Regulation and Directive ('CRD IV'), which the Group is required to hold relative to its total risk exposure in order to safeguard depositors in the event of severe losses being incurred by the Group.

The Group maintains strong capital and leverage ratios, with a total capital ratio of 15.9% at 30 September 2019 (2018: 16.2%) and a UK leverage ratio at 6.7% (2018: 6.4%) (note 55(c)). The CET1 ratio, 13.7% at 30 September 2019, marginally reduced during the period (2018: 13.8%), reflecting primarily the growth in the balance sheet, offset by the impact of distributions to shareholders through buy-backs and dividends.

The Group's principal capital measures are set out below. It has been granted transitional relief on the adoption of IFRS 9, with the impact on capital being phased in over a five-year period, with only 5% of the effect being recognised in the first year. However, firms are also required to disclose capital measures as if the relief had not been given (referred to as the 'fully loaded' basis).

		2019	2018	2018
		IFRS 9	IFRS 9	IAS 39
		£m	£m	£m
CET1 capital	Basic	922.0	888.7	889.9
	Fully loaded	900.8	867.5	889.9
Total Regulatory Capital ('TRC')	Basic	1,072.0	1,038.7	1,044.8
	Fully loaded	1,050.8	1,017.5	1,044.8

The Group's CET1 capital comprises its equity shareholders' funds, adjusted as required by the CRD IV rules. TRC, in addition, includes tier 2 capital representing the Tier 2 Bonds. Additional tier 2 capital arising from credit loss allowances is no longer included in regulatory capital following the introduction of IFRS 9.

The Group's capital requirements include the Pillar 1 + 2a amount which is specific to the Group and is set by the regulator. This may include both variable and fixed components. At 30 September 2019 this requirement was £742.9 million on the transitional basis and £741.8 million on the fully loaded basis (2018 (IAS 39): £727.7 million), with the increased requirement principally driven by the growth in the Group's asset base.

The Group's capital must also cover the CRD IV buffers, the Counter-Cyclical ('CCyB') and Capital Conservation ('CCoB') buffers. These apply to all firms and are based on a percentage of total risk exposure. These buffers were both increased in the period, with the CCoB increasing from 1.875% to 2.500%, its long-term rate, from January 2019 and the CCyB increasing from 0.5% to 1.0%, from November 2018. These increases in standard CRD IV buffers have added over £75.0 million to the Group's capital requirement. Further buffers may be set by the PRA on a firm-by-firm basis but may not be disclosed.

The Group continues to maintain a healthy capital surplus, although this has been eroded by the 1.125 percentage point increase in the CRD IV buffers in the period, the introduction of IFRS 9 and the increase in the deficit on the Group's defined benefit pension plan.

The Group's capital ratios are set out below.

		2019	2018	2018
		IFRS 9	IFRS 9	IAS 39
		£m	£m	£m
CET1 capital	Basic	13.7%	13.8%	13.8%
	Fully loaded	13.4%	13.5%	13.8%
Total capital ratio	Basic	15.9%	16.2%	16.2%
	Fully loaded	15.7%	15.8%	16.2%
UK leverage ratio	Basic	6.7%	6.4%	6.4%
	Fully loaded	6.6%	6.3%	6.4%

Capital ratios remain largely in line with previous performance, with IFRS 9 transition not having a major impact.

During the year the Group has undertaken a thorough review of the risk weightings applied to its assets for capital purposes, partly in response to market concerns across the sector. This exercise confirmed the weightings being applied under the Standardised Approach for credit risk ('SA') and the appropriateness of the Group's risk weighted asset values and hence its capital measures.

The regulatory authorities in the UK and EU have also continued their work to put in place the December 2017 amendments to the Basel III capital adequacy regime, published in the BCBS document 'Basel III: Finalising post-crisis reforms'. This addresses both the SA for credit risk, presently used by the Group, and the Internal Ratings Based ('IRB') approach, which is based on firms' own internal calculations and subject to supervisory approval.

These proposals are expected to increase capital requirements under the SA for a number of asset classes, including buy-to-let lending, and introduce stricter parameters within which IRB approaches must operate. The Group has monitored developments during the year and revised its capital strategy where necessary.

The Group's project to develop an IRB approach to credit risk for capital adequacy purposes has continued throughout the year. A considerable amount of work has been completed, using both internal and external resources, generating system enhancements as well as progressing the application process. However, in September 2019, the PRA published a consultation paper (CP 21/19) which would enact significant new EBA regulations governing IRB techniques in the UK. At the same time the CP highlighted a need for firms applying for IRB accreditation to comply with certain future regulatory requirements where the authorisation process is expected to extend beyond 2020.

The Group's models already reflect the most material requirements arising from the CP, however, whilst only a consultation at this stage, the Board has decided to ensure its IRB models are fully compliant with the requirements of the CP before delivering the first part of its the application to the PRA.

A3.4.3 Liquidity

The Group's operational capital and funding requirements are also influenced by the Group's policy to hold sufficient liquidity in the business to meet its cash requirements in the short and long-term, as well as to provide a buffer under stress. There is also a regulatory requirement to hold liquidity in Paragon Bank. The Board regularly reviews liquidity risk appetite and closely monitors a number of key internal and external measures. The most significant of these, which are calculated for the Paragon Bank regulatory group on a basis which is standardised across the banking industry are set out below.

	2019	2018	Regulatory minimum
LCR – Liquidity coverage ratio	138%	144%	100%
NSFR – Net stable funding requirement	115%	113%	100%*

*Not yet a binding requirement

This shows the available liquidity at the year end to be well in excess of regulatory minimums.

A3.4.4 Capital outlook

The Board keeps the appropriate level and form of capital required by the Group under review to ensure that, in the light of the Group's strategic objectives and the economic environment in which it operates, and more specifically where there are changes in the business or in regulatory expectations, the capital position remains prudent and sustainable, for the benefit of all stakeholders.

A3.5 Financial review

The underlying economic uncertainty in the UK over the past year has been reflected in significant shifts in the interest rate yield curve which have affected the Group's results, generating fair value volatility in the profit and loss account and increasing the deficit in the Group's pension plan. However, the underlying position remained positive as the Group's long term strategy continued to bear fruit.

The Group's underlying profit in the financial year ended 30 September 2019 (appendix A) increased by 5.0% to £164.4 million (30 September 2018: £156.5 million) while on the statutory basis, including the effect of fair value losses, profit before tax decreased by 12.4% to £159.0 million (30 September 2018: £181.5 million). The underlying result also excludes a gain of £9.7 million resulting from the disposal of the Group's residual interest in the PM12 securitisation in June 2019 (the 'PM12 disposal') (2018: £28.0 million gains on asset disposals).

Earnings per share on the statutory basis reduced to 49.4 pence (30 September 2018: 55.9 pence) while increasing by 6.0% to 51.1 pence on an underlying basis (30 September 2018: 48.2 pence).

A3.5.1 Results for the year

CONSOLIDATED RESULTS

For the year ended 30 September 2019

	2019 IFRS 9 £m	2018 IAS 39 £m
Interest receivable	505.7	451.9
Interest payable and similar charges	(227.3)	(197.3)
Net interest income	278.4	254.6
Net leasing income	3.8	3.8
Gain on derecognition of financial assets	9.7	28.0
Other income	15.4	15.5
Total operating income	307.3	301.9
Operating expenses	(125.2)	(114.2)
Provisions for losses	(8.0)	(7.4)
	174.1	180.3
Fair value net (losses) / gains	(15.1)	1.2
Operating profit being profit on ordinary activities before taxation	159.0	181.5
Tax charge on profit on ordinary activities	(31.6)	(35.7)
Profit on ordinary activities after taxation	127.4	145.8

	2019	2018
Dividend – rate per share for the year	21.2p	19.4p
Basic earnings per share	49.4p	55.9p
Diluted earnings per share	48.2p	54.2p

Income

Underlying net interest income increased by 8.5% to £278.4 million from the £256.5 million for the year ended 30 September 2018 (2018 statutory basis: £254.6 million). The growth reflects improved yields in the loan book, together with the size of the average loan book, which rose by 4.5% to £12,143.4 million over the year (2018: £11,626.0 million) (appendix B).

Underlying net interest margin ('NIM') in the year ended 30 September 2019 increased to 2.29% compared to the 2.21% in the previous year (appendix B). This increase reflects the changes in product mix in the Group's balance sheet, with new buy-to-let margins exceeding those achieved on the legacy book and the growing Commercial Lending division operating on still wider margins (appendix B).

During the year the Group disposed of its residual interest in the legacy PM12 securitisation (note 7), generating a cash inflow of £49.8 million. As a result, the assets and liabilities of PM12 were derecognised from the Group's balance sheet, resulting in a net gain of £9.7 million.

Excluding the gain on disposal, other operating income was little changed at £19.2 million for the year, compared with £19.3 million in 2018.

Total underlying operating income increased by 7.9% to £297.6 million (2018: £275.8 million). Total operating income on the statutory basis, at £307.3 million (2018: £301.9 million) also included the gain on the PM12 disposal, whereas the 2018 result included a £28.0 million one-off gain on Idem Capital asset disposals arising during that year.

Costs

Underlying operating expenses increased by 11.9% to £125.2 million from £111.9 million reported in the previous year. These costs include a full year's costs relating to both the Titlestone business, acquired in the second half of the last financial year and the Iceberg business, acquired in December 2017. During the year the Group's average number of employees increased 1.2% to 1,365 (2018: 1,349) and with the Group's strategic initiatives seeing a significant level of higher-paid individuals joining the payroll in the year, employment costs increased by 8.2% year-on-year (note 10). The increase in the Group's savings balance in the period (20.7% year-on-year) also impacts operating costs, with the outsourced servicing fee set by reference to the balance outstanding, rather than simply rising in line with inflation.

The delivery of the Group's strategy depends heavily on its IT infrastructure, and during the year it made substantial investments in developments both to improve efficiency and to provide an enhanced experience to its customers, particularly in the SME market. These initiatives were ongoing at the year end and will be rolled out in the future. Further systems effort was deployed to enhance cyber-security and operational resilience. The period's costs also include expenditure of around £2.4 million on the development of the Group's IRB approach, both in internal resources and external advice, which should generate future benefits to the Group's capital position. Overall the Group estimates that these project costs comprise over £3.5 million of the cost base for the period.

This investment for the future increased the Group's underlying cost:income ratio in the period to 42.1% (appendix C) from the 40.6% recorded in 2018, although without the additional project costs and the impact of the acquisitions, this would have reduced. The control of operating costs remains a principal strategic priority of the Group and it applies a rigorous budgeting and monitoring process.

Strategic disposals, such as the PM12 disposal and the Idem Capital sale in 2018, will have improved earnings per share and RoTE, however their impact has increased the cost:income ratio as a consequence. Over the medium term, the Group targets improvements in the cost:income ratio, from scale and efficiency gains, but increases in regulatory requirements, IT investments and the impact of new operations means that progress to a lower ratio is unlikely to be linear.

Total operating expenses, which in 2018 included the costs of the Iceberg and Titlestone acquisition transactions, increased by 9.6% to £125.2 million (2018: £114.2 million), giving a cost:income ratio on a statutory basis of 40.7% (2018: 37.8%) (appendix C), with the 2018 figure deflated due to the size of the gains on derecognition in that period.

Impairment provisions

The Group has applied IFRS 9 in calculating its provisions for impairment for the first time in the year. As prior year charges are not required to be restated, the 2019 charge is not strictly comparable to that for 2018. However, the charge of £8.0 million for loan impairment has remained broadly similar to that for the previous year under IAS 39 (2018: £7.4 million). The cost of risk (the impairment charge as a percentage of average loans to customers) (appendix B) remains stable at 0.07% compared to 0.06% in 2018.

Under IFRS 9, interest is only recognised on the net value of a credit impaired (Stage 3) loan, reducing both interest receivable and impairment charges. The value of this adjustment in the year was approximately £1.0 million, reducing NIM and cost of risk by approximately 1 basis point.

Careful management of all the Group's loan books continues to be a strategic priority, for both retention and credit purposes. The credit performance of the books continues to be pleasing, with that of the buy-to-let book particularly strong, compared to market averages, with improvements in performance on acquired consumer portfolios year-on-year and credit metrics on the Group's newer portfolios also strong and in line with expectations.

Fair value movements

Yield curve movements during the period resulted in hedging instrument fair value net losses of £15.1 million (2018: £1.2 million net gains), which do not affect cash flow. The size of the movement in the period is mostly a result of market turbulence throughout the year, with the yield curve showing large fluctuations, primarily downwards, especially at month ends. Commentators have ascribed some of this to heightened political uncertainties in the UK over Brexit during the period, with these uncertainties carrying on into the new financial year.

This impacted particularly on the carrying values of swaps held for the purpose of hedging pipeline loan commitments, which cannot be included in a hedge for accounting purposes.

The fair value movements of hedged assets or liabilities are expected to be profit neutral over time, as these instruments will be held to maturity. As such, this item represents a timing difference. The Group remains economically and appropriately hedged.

Tax

Corporation tax has been charged at the rate of 19.9%, increased from 19.6% for the previous year. Materially all of the Group's operations fall within the scope of UK taxation and the standard rate of corporation tax applying to the Group in both years was 19.0%. The Group pays tax at a higher rate on profits arising within its banking subsidiary.

Profits after taxation of £127.4 million (2018: £145.8 million) have been transferred to consolidated equity, which totalled £1,108.4 million at the year end (2018: £1,095.9 million), representing a tangible net asset value of £3.71 per share (2018: £3.59 per share) and an unadjusted net asset value of £4.39 per share (2018: £4.25 per share) (appendix D).

A3.5.2 Segmental results

The Group analyses its results between three segments, which are the principal divisions for which performance is monitored:

- Mortgages, including the Group's buy-to-let, and owner-occupied first and second charge lending and related activities
- Commercial Lending, including the Group's asset leasing and motor finance activities, together with development finance, structured lending and other offerings targeted towards SME customers
- Idem Capital, including loan assets acquired from third parties and legacy assets which share certain credit characteristics with them

The Group's central administration and funding costs, principally the costs of service areas, establishment costs, and bond interest have not been allocated. Items excluded from underlying profit have also been included in unallocated costs, as these are not included in divisional results internally.

The underlying operating profits of these business segments are detailed fully in note 2 to the accounts and are summarised below.

	2019 £m	2018 £m
Segmental profit		
Mortgages	167.9	144.8
Commercial Lending	43.8	19.9
Idem Capital	48.0	78.2
	259.7	242.9
Gains on disposals	9.7	28.0
Unallocated central costs and other one-off items	(95.3)	(90.6)
	174.1	180.3

Mortgages

The Mortgages division continues to maintain a strong market position in its core specialist buy-to-let loan market. Strategically targeted operational initiatives have improved retention and enhanced NIM, while provisions remain low. As a result, the segmental profit increased 16.0% to £167.9 million (2018: £144.8 million). Net interest income increased by 12.8% to £177.8 million (2018: £157.6 million), although growth in the average loan book was only 1.8%, a result of the PM12 disposal in the year. The Group's legacy mortgage assets are lower yielding than newer business therefore asset turnover will be beneficial to margins. These effects combined to deliver a 17 basis point improvement in segmental NIM in the period.

The PM12 disposal also provided an additional one-off gain of £9.7 million, included in unallocated items above.

The costs of the division increased as a result of higher activity levels while other income reduced marginally during the period. The overall result was also affected by a reduction of the impairment charge to £1.0 million (2018 (IAS 39): £5.5 million), following the transition to IFRS 9, where an additional write down of £24.0 million was posted against reserves.

Commercial Lending

In the Commercial Lending segment, the level of new advances generated a substantial increase in loan assets, with the segment's loans to customers at 30 September 2019, at £1,452.1 million, increasing 28.4% from the position twelve months earlier (2018 (IFRS 9): £1,131.3 million). Growth was seen across all the major product lines with the development finance portfolio increasing 43.2% year-on-year, asset leasing 21.3% and structured lending 127.6%.

NIM in the division rose by 124 basis points compared with the year ended 30 September 2018, driven by the additional high-yielding development finance assets and a focus on enhancing yields elsewhere.

Segmental profit in Commercial Lending increased 120.1% in the year to £43.8 million (2018: £19.9 million). This is attributable to the contribution of operations acquired in the previous year and maturing new business lines, together with growth and enhanced focus in the ongoing sectors.

Idem Capital

The Idem Capital division's portfolios continued to generate strong operational cash flows in the year ended 30 September 2019. No new deals were completed and hence the average outstanding loan balance reduced through run-off in the period, falling by 25.0% in the last twelve months to £389.9 million (2018 (IFRS 9): £519.8 million). NIM reduced in the segment, a result of the recent strategic focus on acquiring performing books, which may have lower yields; the impact of the portfolio sale of higher yielding assets in September 2018; and strong natural portfolio amortisation. This impacted on segmental profit, which fell by 38.6% to £48.0 million (2018: £78.2 million).

A3.5.3 Assets and liabilities

The Group's assets and liabilities at the year end are summarised in the balance sheet below.

SUMMARY BALANCE SHEET

30 September 2019

	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m
Intangible assets	171.1	169.3	169.3
Investment in customer loans	12,186.1	12,100.6	12,127.8
Derivative financial assets	592.4	855.7	855.7
Free cash	225.7	238.0	238.0
Other cash	999.7	1,072.6	1,072.6
Other assets	220.5	51.7	51.7
Total assets	14,395.5	14,487.9	14,515.1
Equity	1,108.4	1,073.5	1,095.9
Retail deposits	6,391.9	5,296.6	5,296.6
Borrowings	6,648.4	7,961.2	7,961.2
Pension deficit	34.5	19.5	19.5
Other liabilities	212.3	137.1	141.9
Total equity and liabilities	14,395.5	14,487.9	14,515.1

The size of the Group's balance sheet has remained broadly similar through the year although the underlying balances evidence the continuing reshaping of its operations, with increased diversity of assets and growth in the retail deposit franchise.

The Group's loan assets include:

- Buy-to-let and owner-occupied first mortgage assets in the Mortgages segment
- Second charge mortgages, with new originations in Mortgages and purchased and similar legacy assets in Idem Capital
- Other unsecured consumer lending in Idem Capital
- Asset leasing and motor finance loans in the Commercial Lending segment, with similar purchased accounts in the Idem Capital segment
- Professions finance, invoice finance and other finance for SME businesses in the Commercial Lending segment
- Development finance loans in the Commercial Lending segment
- Structured lending loans in the Commercial Lending segment

The allocation of these loan assets between segments is set out below.

	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m
Mortgages	10,344.1	10,449.5	10,473.5
Commercial Lending	1,452.1	1,131.3	1,133.2
Idem Capital	389.9	519.8	521.1
	12,186.1	12,100.6	12,127.8

During the year the mix of the Group's assets has been altered by the PM12 disposal, increased volumes in development finance and structured lending and the continuing run-off of Idem Capital assets. Movements in the Group's loan asset balances are discussed in the lending review section (Section A3.2) while an analysis of the Group's financial assets by type is shown in note 20.

Derivatives

Movements in derivative financial assets arise principally as a result of the effect of changes in exchange rates on instruments forming cash flow hedges for the Group's floating rate notes. These movements do not impact on the Group's results, while the exchange movements have a broadly equal and opposite impact on borrowings.

The interest rate movements mentioned above have also driven significant changes in the valuation of derivatives held for hedging fixed rate loan assets or deposit liabilities, with the net carrying value switching from a £21.3 million asset at 30 September 2018 to a £70.8 million liability at the period end. For those derivatives forming part of a hedge for accounting purposes this movement is offset by the movement in the fair value adjustments against loans to customer and retail deposits.

Funding

Movements in the Group's funding, including retail deposit balances and wholesale borrowings, are discussed in the funding review section (Section A3.3), with retail deposits now forming almost half of the Group's total funding. The Group has pursued a conservative liquidity policy in the period, resulting in a focus on contingent liquidity arrangements and strong levels of liquid assets being held throughout the period.

Pension obligations

The accounting value of the deficit in the Group's defined benefit pension plan (the 'Plan') has increased over the year ended 30 September 2019. Gilt yields fell sharply over the year, resulting in a discount rate of 1.85%, 110 basis points less than at 30 September 2018. This effect was mitigated, to some extent, by the adoption of more recent market mortality assumptions and a strong performance by the Plan's investments. Together these resulted in the deficit under International Accounting Standard ('IAS') 19 increasing to £34.5 million (2018: £19.5 million). These movements also generated an actuarial loss of £16.5 million before tax which was recognised in other comprehensive income (2018: gain of £8.9 million).

While the valuation under IAS 19 is that which is required to be disclosed in the accounts, pension trustees generally use the technical provisions basis as provided in the Pensions Act 2004 to measure scheme liabilities. On this basis, the deficit at the triennial valuation date (31 March 2016) was £18.0 million and this had increased to £29.2 million at 30 September 2019 (30 September 2018: £15.2 million), representing an 80% funding level (30 September 2018: 87%).

Other assets and liabilities

Sundry assets have increased as a result of the Group's deferred tax balance becoming an asset (a result of IFRS 9 transition adjustments and the movement in the pension plan liability), together with the inclusion of £72.2 million of collateral which was required to be placed with banks as security for the Group's swap liabilities (30 September 2018: £3.8 million).

Within sundry liabilities the largest movement has been the increase in derivative liabilities to £80.5 million from £4.7 million at 30 September 2018, principally as a result of interest rate movements.

A3.5.4 Accounting changes

On 1 October 2018 the Group adopted IFRS 9 in place of IAS 39. The new standard changes the basis of provision from incurred loss to expected loss, which means that although a broadly similar bad debt charge will be posted over the life of a credit impaired account, it will be recognised earlier. The consequence of this is that a growing portfolio, such as most of the Group's loan books, will attract a higher provision charge than it would have done under the previous methodology. This has required the development of models and methodologies over a period of years, utilising the Group's historic data and its experience in modelling and analytics.

The Group published a report on its transition to IFRS 9 on 20 March 2019 which is available from the investor section of the Group's website at www.paragonbankinggroup.co.uk.

The change impacted on loan asset values on the Group's balance sheet on transition but has not had a significant impact on the profit and loss charge in the year. This was anticipated, as the accounting change is principally an acceleration of the impairment charge and is therefore a timing difference, rather than an additional loss. Within the charge, however, amounts which would have been provided in the year under IAS 39 were included in provision brought forward under the new standard, while additional provisions, particularly for new originations, were required where no provision under IAS 39 would have been booked.

The other new requirements of IFRS 9 have not had a significant impact on the Group's accounting but have required the presentation of significant additional or expanded disclosures. At the same time the Group adopted IFRS 15 – 'Revenue', but this did not have a significant impact.

The total effect of these changes was an increase in the Group's impairment provisions at 1 October 2018 of £27.2 million and a reduction in equity of £22.4 million after tax (note 62).

For regulatory capital purposes the CRR allows the impact of the transition to be phased in over a five year period, so that the initial impact on capital ratios was negligible. On a fully loaded basis the transition to IFRS 9 resulted in the Group's CET1 ratio at 1 October 2018 reducing from 13.8% to 13.5%.

The Group will continue to develop, test and validate its IFRS 9 approach as more data becomes available and market practice continues to develop.

The Group has adopted IFRS 16 – ‘Leases’ with effect from 1 October 2019. However, this change will have minimal impact on the Group's results and balance sheet, increasing both assets and liabilities by around £9.0 million and not impacting on reserves or capital (note 61).

A3.6 Operational review

A3.6.1 Management and people

The Group's people are its most significant cost, whilst also key to its future growth and development and the medium through which its culture is manifested. Over 1,300 people worked for the Group throughout the period, at its Solihull headquarters and other locations across the UK. Training and development, together with a rigorous recruitment and selection process are a key part of the Group's organic growth strategy, underpinning the strong progress made to date, and the Group's Investors in People Champion status.

Governance and management

During the period the Company continued to comply with the principles of the UK Corporate Governance Code (the ‘Code’). On 31 December 2018, Alan Fletcher and Patrick Newberry stepped down from the Board. Alan served as a director from 2009, including a lengthy term as Chair of the Remuneration Committee. Pat served first as an independent director of Paragon Bank PLC from its earliest months of operation in 2014, serving as chair of its audit committee, and joined the Board of Paragon Banking Group in 2017. Both left with the thanks of the Group and the Board for their support and dedication.

Peter Hartill, a non-executive director since 2011, and Chair of the Audit Committee and Senior Independent Director, will be retiring at the 2020 Annual General Meeting having served on the Board for nine years. The Group has progressed its search for a new Audit Committee Chair and, at the date of signing this report, hopes to be in a position to announce a new appointment, after the AGM in February 2020, subject to regulatory and Board approval.

John Heron, Director of Mortgages, has also signalled his intention to retire and will be leaving in early 2020. John joined the Group in 1986 and, as well as being the Group's longest-serving employee, he has been instrumental in establishing and building our buy-to-let mortgage offering. A robust and extensive recruitment process has completed, and the Group looks forward to welcoming Richard Rowntree to run the Mortgages division during the first quarter of 2020, subject to regulatory approval.

During the period the Group has continued its review of the requirements of the new edition of the Code, which came into force for the Company from 1 October 2019. At the same time the Group has considered the forthcoming changes in UK rules for the disclosure of Chief Executive remuneration and the director's consideration of wider stakeholder interests (‘section 172’) and new requirements for corporate governance and other new disclosures in subsidiary entities. No significant implementation issues were identified and appropriate measures to comply with the new rules have been put in place.

The Board has also considered the governance and committee structures in preparation for the Group's IRB application, as well as providing oversight to that development more generally.

The Group's third annual statement under the Modern Slavery Act 2015 was published on its website in March 2019. Relevant policies have been reviewed and updated as appropriate. All employees have completed an annual e-learning module on this subject to raise awareness and understanding.

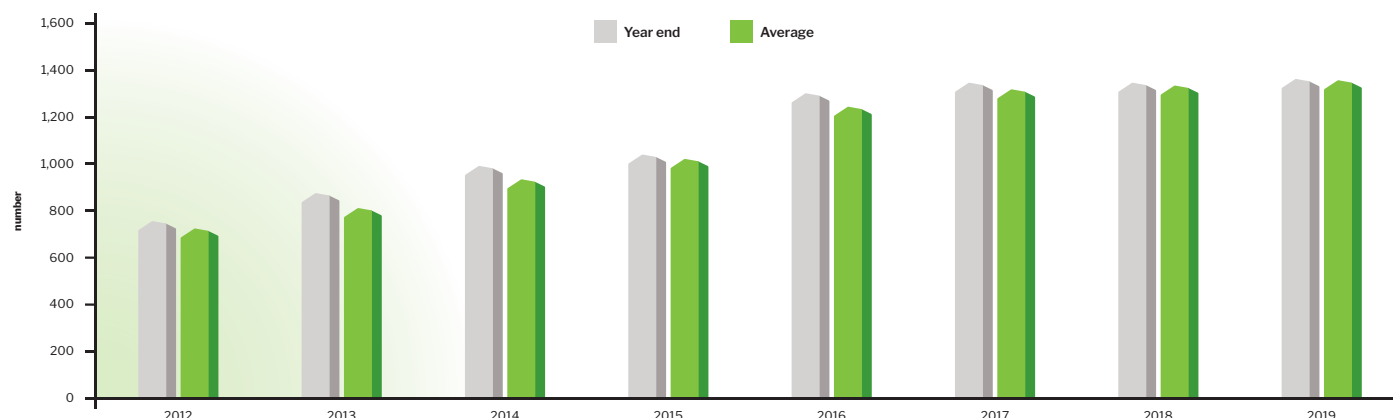
People, diversity and development

The Group continues to focus on maintaining an efficient and effective workforce, increasing employee numbers by 1.3% over the year. The Group maintains its accreditation from the UK Living Wage Foundation and minimum pay continues to meet the levels set by the Foundation.

The Group prides itself on its high levels of employee retention and long service. Its annual employee attrition rate of 11.5% is below the national average and 27.3% of its people have over ten years' service, with 11.5% having achieved over 20 years with the Group. We believe this is due to providing quality development opportunities and creating a place where people want to work, which has meant that knowledge and experience have been retained in each of our specialist areas. We believe our people are well positioned to support the Group's future growth strategy.

Employee numbers

At 30 September and average for the year



The Group has been a signatory of the Women in Finance Charter, sponsored by HM Treasury, since 2016. The Charter's objectives reflect the Group's own aspirations for gender diversity and the Group published its first set of internal targets under the Charter in January 2017.

The Group submitted its latest progress report at 30 September 2019 confirming that the Group is making excellent progress towards its targets. In particular:

- 42.7% of employees receiving management career development/leadership training are female (target 50%)
- 35.8% of the workforce are on flexible working contracts (target 10%)
- 65.9% of the flexible working available is on a part-time basis (target 50%)

Activities under the Women in Finance initiative in the year have included participating in cross-company mentoring programmes to nurture female talent and diversity training for all employees. Initiatives are also in hand to reduce the scope for unconscious bias in recruitment processes.

The Hampton-Alexander ('HA') Review published its latest report on gender diversity in the leadership of FTSE 350 entities in November 2019. The Group believes that its Women in Finance primary objective is consistent with the review's recommendation and notes that its proportion of female senior managers at the year end, as defined by HA, was 35.9% (2018: 29.1%). The Group is delighted to achieve its target of 35% well ahead of the original target date of 31 January 2022.

The Group has calculated its gender pay gap at April 2019. This calculation shows that median female pay in the Group was 31.0% less than the median male pay (2018: 30.7%). This is broadly in line with the results reported by other financial services companies and narrower than the 39.1% gap for the sector reported by the Office of National Statistics in their Annual Survey of Hours and Earnings published in October 2019. Analysis of the gender pay gap data indicates that the Group's gap arose principally as a result of the distribution of roles between the genders, highlighting the importance of the Women in Finance initiative in addressing these issues.

The Nomination Committee, as the board committee with responsibility for diversity under the new Code, has identified action on the diversity agenda as an important objective and during the year has taken a detailed interest in progress in these areas.

The Group's succession planning strategy has also been an important area of focus during the year, with all Board and executive management roles, together with their direct reports, assessed from a leadership and specialist perspective. Immediate successors are in place for these roles for the short term to provide business continuity and longer-term succession plans are being developed for those with career aspirations and strong potential.

In addition, the Group has introduced a specific senior leadership development programme focussed on those identified with high potential for future roles, to strengthen the succession plan and increase the overall talent pool required to deliver the Group's medium to long term strategy. This area will remain a priority for the Board, with the assistance of the Nomination Committee, during the forthcoming year.

The Group was proud to be reaccredited with the Investors in People Gold Standard in February 2019 for a further three years. It was particularly pleasing to note the improvement noted by the external assessors in the areas of building capability, empowering and involving people and recognising and rewarding performance, as well as maintaining overall strengths in living the organisation's values and behaviours, delivering continuous improvement and creating sustainable success. It retains its status as an Investors in People Champion, providing advice and support to other organisations.

During the year, the Group's long-standing People Forum has had its membership and terms of reference refreshed to reflect the current organisational structure. This will also provide a renewed focus on the Forum's objectives of giving all employees a voice, nurturing good employment relations, driving employee engagement and improving overall employee communications. In addition, the Forum's role is being enhanced in the light of the new Code requirements on workforce engagement and will have direct access to the Board. Regular meetings with non-executive directors will commence from November 2019, with specific outcomes from the engagement activities being reported from next year.

A3.6.2 Risk

The effective management of risk is crucial to the achievement of the Group's strategic objectives. It operates a risk governance framework designed around a formal three lines of defence model (business areas, risk and compliance function and internal audit) supervised at Board level.

During the year, the Group has continued to enhance its ability to manage all categories of risk. In particular it has focussed on:

- The development of advanced models to enhance credit risk management and support the Group's IRB application process
- Enhancement of stress testing procedures to ensure the robustness of capital and liquidity positions
- The continuing evolution and embedding of its risk appetite framework
- The enhancement of its operational risk capabilities, including the assessment of critical business services and tolerances and the embedding of its operational risk management system in business areas for use on a day-to-day basis
- The maintenance and further development of effective cyber-security controls
- The integration of the businesses acquired in the previous year to ensure they are fully captured by the risk management framework
- Continuing the embedding of robust data protection processes and controls to ensure compliance with the Data Protection Act 2018

During the year the Group has continued to review its exposure to emerging developments in the Brexit process, and the political uncertainties surrounding it, both in terms of impacts on its own activities and on the potential effect on its businesses from wider economic consequences. While the Group does not have operations outside the UK, this analysis addressed, in detail, the capital, liquidity and operational implications of the stresses which might be caused by the process. The Board assessed the output of this analysis throughout the year as the position and potential outcomes developed. The Group considers itself well placed to address the challenges arising, but the position remains uncertain and will continue to be subject to detailed monitoring going forward.

The principal challenges in the risk environment faced by the Group during the year and moving forward into 2020 include:

- The level of change in products, funding and operations which will be required in preparation for the withdrawal of LIBOR in 2021
- Heightened cyber-security risks as a result of the increasing sophistication and frequency of cyber-attacks affecting the financial services sector
- Major regulatory developments including increased focus on the impact of climate change on managing financial risks

Further details regarding the governance model, together with the principal risks and uncertainties faced by the Group, the ways in which they are managed and mitigated and the extent to which these have changed in the year are detailed within Section B7 of this annual report.

A3.6.3 Regulation

The Bank is authorised by the PRA and regulated by the PRA and the FCA. The Group is subject to consolidated supervision by the PRA and a number of its subsidiaries are authorised and regulated by the FCA. As a result, current and projected regulatory changes continue to pose a significant risk for the Group.

Whilst the Group is impacted by a broad range of prudential and conduct regulations, given the nature of its operations, the following developments currently in progress are of particular note:

- The Senior Managers and Certification Regime ('SMCR') will be extended to cover a wider section of persons employed in the financial services sector in December 2019, with the establishment from March 2020 of a Directory of Certified Regime (CR) staff. This will increase the number of the Group's employees within the SMCR and the oversight activities required to ensure compliance with the extended rules. These systems have been developed in the period and training modules for all impacted people have been delivered across the Group
- SONIA (the Sterling Overnight Index Average) administered by the Bank of England is to be established as the primary sterling interest rate benchmark by the end of 2021, in place of LIBOR. The Bank of England and the FCA are leading efforts to develop proposals to establish and transition to the new regime. Appropriate steps are being considered and will be taken to manage the transition from LIBOR where it impacts the Group's business, particularly regarding LIBOR linked lending products and borrowings
- The Bank of England, PRA and FCA published a discussion paper in July 2018 emphasising the importance of a firm understanding and ensuring its operational resilience across critical business services and processes. The Group has implemented a formal programme to both address the specificities of the paper and to align existing workstreams and activities to support wider resilience activities already being undertaken. The appointment of a dedicated Operational Resilience manager has enabled a coordinated approach to improving resilience capability
- Vulnerable customers continue to be a strong focus for the FCA, and the Group takes its responsibilities in this regard seriously. The Group welcomes the recently issued improved FCA guidance and is reviewing its current arrangements against that guidance
- In March 2019 the FCA published the results of its review of the motor finance industry, identifying concerns about some commission models used and lenders' assessments of affordability. This was followed in October 2019 by the publishing of new regulations addressing these issues. The Group has reviewed the FCA's findings and identified the required changes in its motor finance lending models. The Group believes it is well placed to accommodate these changes

- The FCA has proposed changes to its responsible lending and affordability rules to enable 'mortgage prisoners' to more easily switch mortgages, and to require inactive lenders, and administrators acting for unregulated entities, to write to certain customers highlighting the rule change, directing them to relevant sources of information. The Group has a number of accounts likely to fall into these categories and, when the FCA final rules are available, will take the appropriate action
- The PRA published policy and supervisory statements in April 2019, addressing climate change and its associated impact on the management of financial risks within firms. These will require firms to proactively identify such risks and establish appropriate systems to ensure these exposures are managed and governed. The Group is currently in the process of establishing its strategy in respect of climate change, using the PRA's suggested approach, to ensure it is well-positioned to address the challenges as they become better understood
- In December 2017 the BCBS published its 'Basel III: Finalising post-crisis reforms' document. This has clarified the proposed increase to the capital risk weights for buy-to-let lending under the revised standardised approach and the introduction of a capital output floor for IRB based on the revised standardised approach. During the period the EU, PRA and EBA have continued the process to embed the Basel III revisions into the UK regulatory framework and determine how their respective discretions should be applied. The proposed changes had been anticipated within the Group's IRB project

Certain regulations applying in the financial services sector only affect entities over a certain size, which the Group might meet within its current planning horizon. The Group considers whether and when these regulations might apply to it in the light of the growth implicit in its business plans and puts appropriate arrangements in place to ensure it would be able to comply at that point.

The Group, along with the rest of the UK corporate sector, continues to lack clear visibility on potential regulatory changes that may be introduced following the UK's exit from the EU, if and when that occurs. However, given the nature and scope of its operations, it does not have any EU passporting issues that need to be considered.

The governance and risk management framework within the Group continues to be developed to ensure that the impacts of all new regulatory requirements are clearly understood and mitigated as far as possible. Regular reports on key regulatory developments are received at both executive and board risk committees.

Overall, the Group considers that it is well placed to address all the regulatory changes to which it is presently exposed.

A3.7 Conclusion

We are delighted to report another excellent financial and operational performance, underpinned by our effective diversification strategy and focus on specialist lending. Volumes, profits and dividends are up strongly, and we are moving closer to our medium-term target of over 15% return on tangible equity.

The Group's transformation to a broadly based specialist banking group has continued over the last year. Our customers have increasingly complex needs which are supported by ongoing technology investments and the deep experience of our employees. This approach, alongside a disciplined and prudent risk appetite, has enabled us to achieve strong lending growth at improving margins, whilst maintaining an exemplary credit performance.

Whilst there is uncertainty in the environment we have prepared well and look forward with optimism to the opportunities ahead.

Nigel Terrington

Chief Executive

26 November 2019

Future prospects

The Code requires the directors to consider and report on the future prospects of the Group. In particular it requires that they:

- Explain how they have assessed the prospects of the Group and whether, on this basis, they have a reasonable expectation that the Group will be able to continue in operation (the 'viability statement')
- State whether they consider it is appropriate for the Group to adopt the going concern basis of accounting in the preparation of the financial statements presented in Section D (the 'going concern statement')

In addition, Listing Rule LR9.8.6 R(3) requires the directors to make these statements and to prepare the viability statement in accordance with the 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' published by the Financial Reporting Council ('FRC') in September 2014.

The business activities of the Group, its current operations and those factors likely to affect its future results and development, together with a description of its financial position and funding position, are described in the Chairman's Statement in Section A1 and Chief Executive's review in Section A3. The principal risks and uncertainties affecting the Group, and the steps taken to mitigate these risks are described in Section B7.5.

Section B7 of this annual report describes the Group's risk management system and the three lines of defence model which it is based upon.

Note 55 to the accounts includes an analysis of the Group's working and regulatory capital position and policies, while notes 56 to 59 include a detailed description of its funding structures, its use of financial instruments, its financial risk management objectives and policies and its exposure to credit, interest rate and liquidity risk. Critical accounting estimates affecting the results and financial position disclosed in this annual report are discussed in note 65.

Financial forecasts

The Group has a formalised process of budgeting, reporting and review. The Group's planning procedures forecast its profitability, capital position, funding requirement and cash flows. Detailed annual plans are produced for two-year periods with longer term forecasts covering a five-year period, which include detailed income forecasts. These plans provide information to the directors which is used to ensure the adequacy of resources available for the Group to meet its business objectives, both on a short-term and strategic basis.

The plans for the period commencing on 1 October 2019 have been approved by the Board and have been compiled taking into consideration the Group's cash flow, dividend cover, encumbrance, liquidity and capital requirements as well as other key financial ratios throughout the period.

Current economic and market conditions are reflected at the start of the plan with consideration given to how these will evolve over the plan period and affect the business model. The plan is compiled by consolidating separate income forecasts for each business segment and securitisation vehicle to form the top-level projection for the Group. This allows full visibility of the basis of compilation and enables detailed variance analysis to identify anomalies or unrealistic movements. Cost forecasts and new business volumes are agreed with the heads of the various business areas to ensure that targets are realistic and operationally viable.

During this process, sensitivity analysis is also carried out on a number of key assumptions that underpin the forecast to evaluate the impacts of the Group's principal risks on profit, capital, liquidity, cash flow and other key metrics. This is further stress tested as part of the Group's Internal Capital Adequacy Assessment Process ('ICAAP'), using a number of severe downside scenarios.

Risk assessment

During the year, the directors, as members or attendees of the Risk and Compliance Committee undertook reviews on a quarterly basis which included:

- Reviews of the principal risks facing the Group
- Consideration of new or emerging risks and regulatory developments
- Consideration and challenge of management's rating of the various risk categories to which the Group is exposed
- Consideration of the Group's compliance with the risk appetites set by the Board and the continuing appropriateness of these risk appetites
- Consideration of the root causes and impact of material risk events and the adequacy of actions undertaken by management to address them

During the year, directors held focussed in-depth sessions to review risk and risk management as part of the annual strategy day. The results of this exercise were fed back into the Group's risk management process.

Throughout the year, the directors received and discussed analyses of the potential impacts of the Brexit process on the Group. This included consideration of regulatory impacts, impacts on the Group's markets and customers, and impacts on the Group from general economic effects. The results of these considerations fed into the Group's forecasting and risk assessment.

In addition, the directors specifically considered the impact on risk and viability through review and approval of key risk assessments for the Group, including the ICAAP, Internal Liquidity Adequacy Assessment Process ('ILAAP') and its Recovery Plan ('RP').

At the year end the directors reviewed their on-going risk management activities and the most recent risk information available to confirm the position of the Group at the balance sheet date.

The directors concluded that those activities, taken together, constituted a robust assessment of all of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity. These principal risks are set out in Section B7.5 of the Risk Management Report.

Availability of funding and liquidity

The Group's retail deposits of £6,391.9 million (note 31), accepted through Paragon Bank, are repayable within five years, with 67.8% of this balance (£4,333.0 million) payable within twelve months of the balance sheet date. The liquidity exposure represented by these deposits is closely monitored; a process supervised by the Asset and Liability Committee. The Group is required to hold liquid assets in Paragon Bank to mitigate this liquidity risk. At 30 September 2019 Paragon Bank held £646.4 million of balance sheet assets for liquidity purposes, in the form of central bank deposits (note 19). A further £109.0 million of liquidity was provided by the Bank of England FLS, bringing the total to £755.4 million.

Paragon Bank manages its liquidity in line with the Board's risk appetite and the requirements of the PRA, which are formally documented in the Board's approved ILAAP. The Bank maintains a liquidity framework that includes a short to medium term cash flow requirement analysis, a longer-term funding plan and access to the Bank of England's liquidity insurance facilities, where pre-positioned assets would support drawings of £1,095.0 million. Holdings of the Group's own mortgage backed loan notes can also be used to access the Bank of England's liquidity facilities.

The Group's securitisation funding structures, described in note 58, ensure that a substantial proportion of its originated loan portfolio is match-funded. This proportion was reduced by the PM12 disposal in June 2019, and increased by the issue of the PM26 securitisation in July 2019. Repayment of the securitisation borrowings is restricted to funds generated by the underlying assets and there is limited recourse to the Group's general funds. Recent and current loan originations are financed through retail deposits and may be refinanced through securitisation where this is appropriate and cost-effective.

The earliest maturity of any of the Group's working capital debt is in December 2020, when the first of the Group's retail bond issues matures.

The Group's cash analysis continues to show a strong cash position, even after allowing scope for significant discretionary payments, and its securitisation investments produce substantial cash flows.

In addition to its expertise in the securitisation market, evidenced by the PM26 and new warehouse transactions in the year, the Group has demonstrated its ability to raise retail and corporate bond debt when required through its Euro Medium Term Note Programme and other programmes. The Group's access to debt is also enhanced by its corporate BBB rating, affirmed by Fitch Ratings in March 2019, and its status as an issuer is evidenced by the BBB- rating of its £150.0 million Tier 2 bond.

As described in note 55 the Group's capital base is subject to consolidated supervision by the PRA. Its capital at 30 September 2019 was in excess of regulatory requirements and its forecasts indicate this will continue to be the case.

Viability statement

In considering making the viability statement the directors considered the three-year period commencing on 1 October 2019. This aligns with the horizons used in the Group's analysis of risk and includes the two years covered by the detailed group forecast, together with one year of the less detailed forecasting period.

The directors considered:

- The Group's financial and business position at the year end, described in section A3
- The Group's forecasts, and the assumptions on which they were based
- The Group's prospective access to future funding, both wholesale and retail
- Stress testing carried out as part of the Group's ICAAP process
- The activities of the Group's risk management process throughout the period
- Risk monitoring activities carried out by the Risk and Compliance Committee
- Internal Audit reports in the year

Having considered all the factors described above the directors believe that the Group is well placed to manage its business risks, including solvency and liquidity risks, successfully.

On this basis, the directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the three-year period commencing on 1 October 2019.

While this statement is given in respect of the three-year period specified above, the directors have no reason to believe that the Group will not be viable over the longer term. However, given the inherent uncertainties involved in forecasting over longer periods, the shorter period has been adopted.

Going concern statement

Accounting standards require the directors to assess the Group's ability to continue to adopt the going concern basis of accounting. In performing this assessment, the directors consider all available information about the future, the possible outcomes of events and changes in conditions and the realistically possible responses to such events and conditions that would be available to them, having regard to the 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' published by the FRC in September 2014.

In order to assess the appropriateness of the going concern basis the directors considered the Group's financial position, the cash flow requirements laid out in its forecasts, its access to funding, the assumptions underlying the forecasts and the potential risks affecting them.

After performing this assessment, the directors concluded that it was appropriate for them to continue to adopt the going concern basis in preparing the Annual Report and Accounts.

A5

Corporate responsibility

The Group believes that the long-term interests of shareholders, employees, customers and other stakeholders are best served by acting in a socially responsible manner and aims to ensure that a high standard of corporate governance and corporate responsibility is maintained in all areas of its business and operations.

A5.1 Non-Financial Information Statement

The Group includes information on certain environmental, social and governance matters in its strategic report in accordance with sections 414CA and 414CB of the Companies Act 2006.

In addition to the description of the Group's business model, discussed in section A2, the Group's remaining disclosures are included in this section A5. This includes a discussion of the Group's risk, policies, outcomes and key performance indicators with respect to each of the areas set out in the Act, as follows:

	Area	Reference
(a)	Environmental matters	Section A5.3
(b)	Employees	Section A5.2
(c)	Social matters	Section A5.4
(d)	Respect for human rights	Section A5.5
(e)	Anti-corruption and anti-bribery matters	Section A5.6

A5.2 People

The welfare, development and engagement of the Group's employees are central to developing a strong culture, with employee capability and motivation acknowledged as being central to the delivery of the Group's strategy.

Engagement levels are monitored through external assessments, such as Investors in People ('IIP') and other external employee surveys. The most recent survey was via the IIP assessment in February 2019 which noted that across the 27 themes assessed, 100 out of 108 indicators were met with notable strengths including; a strong values-based culture, a clear people strategy that is built upon high levels of empowerment and devolved accountability, and a universal and strong sense of pride for delivering quality and high standards of customer service. The Group was recredited with the IIP Gold Standard which was first achieved in 2013 and it maintains its IIP Champion Status; a recognised best practice status awarded to less than 1% of financial services companies in the UK. The next employee engagement survey is planned to take place in June 2020.

Employment conditions

All of the Group's employees are based in the UK and there is commitment to upholding all aspects of employment law. The Group believes that its strategic objectives are best served by building a stable permanent skill base and therefore minimises its use of short-term and temporary staff.

At 30 September 2019, employees on temporary or short-term contracts accounted for 2.1% of the workforce (2018: 0.9%) and no use was made of zero-hours contracts. The Group's annual employee turnover for the year was 11.5% (2018: 16.1%), returning to the Group's longer-term normal level.

Flexible working is actively encouraged across all areas, to promote a work-life balance for individuals and to ensure that the Group retains the skills and experience of its people. The Group monitors working practices to ensure that it complies with the Working Time Regulations to ensure no one is forced to work more than a 48 hour week over an average 17 week period. This includes the monitoring of any second jobs.

The Group generally only employs persons over the age of 18, except in connection with apprenticeship or other training arrangements.

Remuneration packages across the business are compliant with the UK's national minimum wage rates. In addition, the Group has been accredited as a Living Wage employer since June 2016, by the Living Wage Foundation. The independent Living Wage Foundation sets an hourly rate calculated according to the cost of living in the UK which is updated annually. This is a higher rate than the government's National Living Wage. Accredited employers such as the Group must not only pay this rate to their own employees, but ensure that any contractors used also undertake to do so.

When responding to changes in its business, the Group always seeks to minimise the requirement for compulsory redundancy, retraining and redeploying employees wherever possible.

The Human Resources department actively works alongside the Group's management to recruit, develop and retain capable people.

Equality and diversity

The Group is committed to providing a working environment in which employees feel valued and respected and are able to contribute to the success of the business, and to employing a workforce that recognises the diversity of its customers. The Group has invested not only in management training to ensure managers are equipped to support fair working practices, but also in educating all employees to ensure the policy is fully embedded.

The Group's aim is that its employees should be able to work in an environment free from discrimination, harassment and bullying, and that employees, job applicants, customers, retailers, business introducers and suppliers should be treated fairly regardless of:

- Race, colour, nationality (including citizenship), ethnic or national origins
- Gender, sexual orientation, marital or family status
- Religious or political beliefs or affiliations
- Disability, impairment or age
- Real or suspected infection with HIV/AIDS
- Membership of a trade union

and that they should not be disadvantaged by unjust or unfair conditions or requirements.

The Group aims to ensure that applications for employment from people with disabilities and other under-represented groups are given full and fair consideration and that all employees have access to the same training, development and job opportunities. Every effort is also made to retrain and support employees who suffer from disabilities during their employment, including the provision of flexible working to assist their return to work.

During this year, an automated recruitment system was introduced which automatically anonymises applicants at the first stage of selection. This intervention was an intended action to minimise any unconscious bias and support the Group's equality, diversity and inclusion strategy.

The Nomination Committee, as the board committee responsible for diversity issues across the Group, oversees policies and performance on diversity. While the Group is confident that there is no systematic gender bias in its recruitment or remuneration practices, it is conscious of the underrepresentation of women at senior levels in the financial services sector and it anticipates that one of the effects of its Women in Finance initiative will be to erode the gender pay gap over time by increasing female representation at senior levels.

Women in Finance

The Group understands the significance and value of building strong and diverse teams, with leaders from all backgrounds. Gender diversity is an important element of the Group's people strategy and the Women in Finance Charter was signed in 2016.

The Women in Finance Charter, which is sponsored by HM Treasury, is an initiative amongst financial services companies in the UK, aimed at promoting equality of opportunity in the workplace. The CFO is the project sponsor and progress against the Charter requirements is monitored by the executive management.

In January 2017 the Group's first set of internal targets under the charter was published on its website. They include a target of 35% female representation in senior management roles by January 2022, increasing from 26% at the time the targets were set. All of the Group's diversity targets are published on the 'Corporate Responsibility' section of the Group's website, together with annual progress updates.

The definition of senior management used in the Group's 'Women in Finance' targets is the same as that used by the Hampton-Alexander Review. The Group is pleased to confirm the proportion of female senior managers on this basis at 30 September 2019 was 35.9% (2018: 29.1%), reaching its objective significantly ahead of the target date.

Gender Pay

As required by legislation, the Group has calculated its gender pay gap as at April 2019. The results will be published on the government website and on the Group's own website and are summarised below.

	April 2019	April 2018
Median gender pay gap	33.9%	30.8%
Mean gender pay gap	41.3%	36.8%
Median bonus pay gap	1.2%	1.2%
Mean bonus pay gap	76.9%	84.6%

The median and mean pay gaps are broadly in line with the 39.1% median pay gap and 35.5% mean pay gap in the financial services sector reported by the Office of National Statistics in their Annual Survey of Hours and Earnings published in October 2019. They are also broadly in line with those for other businesses in the sector. While the gender pay gap has increased year-on-year, the Group's initial analysis of the most recent figures indicates that this is principally driven by the Titlestone acquisition undertaken between the two snapshot dates, and other changes in the staffing mix. The Group is committed to increasing the representation of women in its senior roles, which will reduce the gender pay gap in the longer term.

88.0% of male employees and 90.1% of female employees received a bonus (2018: 83.4% and 87.9%), as defined by legislation, which includes payments under the Group's profit related pay scheme. The difference between the mean and median bonuses reflects the impact of a very small number of bonus payments to executive directors and other very senior staff.

The Group analyses gender pay gap data on an ongoing basis as part of the Women in Finance initiative, to identify potential issues and determine what action might be required. However, work during the year reviewing groups of directly comparable positions did not suggest evidence of systematic gender bias or unequal pay practices.

The Group welcomes the interest in this issue generated by the public reporting of gender pay but would favour a review of the detail of the legislation in the light of experience to date to ensure all disclosures required are comparable and understandable.

Composition of the workforce

During the year the workforce has grown by 1.3% to 1,362 people (2018: 1,345). Information on the composition of the workforce at the year end is summarised below:

	2019 Females	2019 Males	2018 Females	2018 Males
Employees				
Number	711	651	711	634
Percentage	52.2%	47.8%	52.9%	47.1%
Management grade employees				
Number	115	210	98	187
Percentage	35.4%	64.6%	34.4%	65.6%
Senior managers				
Number	7	30	5	22
Percentage	18.9%	81.1%	18.5%	81.5%
Directors				
Number	2	7	2	9
Percentage	22.2%	77.8%	18.2%	81.8%

Of these employees, ethnic minority employees comprised 13.4% of the workforce (2018: 11.6%) and 1.8% of management grade employees (2018: 1.2%). The definition of 'senior manager' used in the table above is that required by the Companies Act 2006 (Strategic Report and Directors Report) Regulations 2013 which differs from that used by the Hampton-Alexander Review.

Composition of the workforce is reviewed on an annual basis and employee satisfaction with equality of opportunity is monitored as part of the regular employee surveys. Human Resources policies are reviewed regularly to ensure that they are non-discriminatory and promote equality of opportunity. In particular, recruitment, selection, promotion, training and development policies and practices are monitored to ensure that all employees have the opportunity to learn and develop according to their abilities.

In June 2019 the Group conducted its third annual diversity survey to obtain anonymous feedback from employees on their age, gender, ethnicity, sexual orientation, religious beliefs and disability. A positive response rate of 67% was received (2018: 72%) and, as expected, the survey illustrated our workforce is diverse. The results were reviewed at executive level and the action plan, agreed in line with the Group's commitment to the Women in Finance Charter, was amended where appropriate. This plan includes requiring improved diversity from external recruitment partners, providing more flexible working opportunities and the provision of mentoring support for individuals.

Health and wellbeing

The health and wellbeing of the Group's employees is an important element of its people strategy. It offers a cycle-to-work scheme, provides fruit in offices and other health benefits through employee schemes.

An internal team of emotional wellbeing volunteers, identified and trained with the support of the charity, Mind, during 2018, is now embedded and provides support to individuals experiencing issues within their personal life or at work, which may impact on their emotional, psychological or social wellbeing. Mental health awareness training was also provided to managers across the Group during the year, and a mobile app focused on developing and maintaining positive mental health strategies is provided to all Group employees.

Training and development

The Group has been accredited under the 'Investors in People' scheme since 1997 and its Gold status was confirmed again in February 2019. This demonstrates the Group's commitment to the training and development of all its employees.

In addition, the Group has held Investors in People Champion status for the last six years. This is given to organisations who are seen as pioneers in people management practices and role models in strategic leadership and is currently held by only 1% of financial services companies in the UK. It involves the Group in active networking with other organisations and offering mentoring support to smaller organisations that are working towards gaining Investors in People status.

All employees receive an appraisal at least annually. These reviews are designed to assist employees in developing their careers and to identify and provide appropriate training opportunities. Appraisals also provide a method to track individual's progress and identify opportunities to develop them into further roles, thereby supporting the Group's overall succession planning objectives.

During the year the Group joined the Women Ahead 30% Club cross-company mentoring scheme, providing 10 trained mentors to support female mentees from other companies, whilst nominating 10 female mentees to receive external mentoring support at the same time. Feedback from the first cohort was very positive and the Group will be continuing with an additional 10-person cohort for the forthcoming year.

The Group has continued to draw down on Apprenticeship Levy funds to support its development objectives and the internal Management Academy was certified with the Chartered Management Institute ('CMI') to facilitate this. There are typically over 100 people completing professional qualifications at any one time across the Group. The Group currently has 41 apprentices (3% of employees) registered under the levy scheme, utilising 47% of its levy pot in the past 12 months. These apprenticeships cover a range of specialist and operational roles including IT, finance, underwriting, and first line management. Whilst a higher take up would be desirable, the requirement for apprentices to spend 20% of their time out of the business makes identifying suitable roles challenging.

The Group provides financial support for professional development and approximately 7.7% of employees are undertaking professional qualifications at any one time. 40% of the employees achieving professional qualifications in the year were female.

During the period work has continued to embed the internal mentoring programme, accredited by the CMI, which helps to support succession planning strategy and develop future leaders. Management development has been a core focus to support the Group's wider succession planning strategy, as well as developing more female employees to increase the pool of available internal candidates. The Group held a senior leadership conference in January 2019 and two senior leadership development centres have been held during the period.

The corporate training and development strategy focusses on providing opportunities to develop all employees and is central to the achievement of the Group's business objectives. On average, employees received 6.9 days training in the year (2018: 7.5 days), which is significantly higher than the average figure quoted by the Chartered Institute of Personnel and Development ('CIPD') of between 2.8 and 3.3 days for the private sector. This included online training undertaken by all employees on various matters including regulatory requirements.

Recruitment

The Group remains committed to employing individuals from the communities in which it is based. We engage with local schools and colleges in the Solihull area, where the Group has its headquarters, through careers fairs to offer 'employability workshops' and to promote ourselves as a local employer. In addition, we have offered 11 work experience placements to local students this year.

We also run a successful 'refer a friend' scheme whereby employees receive a referral fee if an individual they refer for a role passes probation. This year 29 individuals were successfully recruited through this scheme (2018: 55).

Employees' involvement

The directors recognise the benefit of keeping employees informed of the progress of the business. The Group operates a People Forum, attended by employee representatives from each area of the business, which exists primarily to facilitate communication and dissemination of information throughout the Group and provides a means by which employees can be consulted and provide feedback on matters affecting them.

The purpose of the Forum is to encourage and develop an employee voice to support effective decision making and continual business improvement, to protect the Group's strong culture and to deliver good customer outcomes. During the year, the Forum has been restructured to reflect the current organisational structure. In addition, the People Forum has been designated as the channel through which employee views will be communicated to the Group's Board as required by the 2018 Code. The Forum will have direct contact with the Board, with regular meetings with the non-executive directors commencing from November 2019. Specific outcomes from the engagement activities will be reported in the Annual Report from 2020.

Employees at all locations are provided with regular information on the performance and plans of the Group, and the financial and economic factors affecting it, through electronic information and presentations.

The Company operates a Sharesave share option scheme and a profit sharing scheme, both of which enable eligible employees to benefit from the performance of the business.

The directors encourage employee involvement at all levels through the appraisal process and communication between directors, managers, teams and individual employees.

Involvement in industry initiatives on employment standards

This year the business has provided support to external working groups focussing on employment standards organised by industry bodies such as UKF and the FLA.

The Group's membership of the Investors in People Gold Club involves sharing best practice with other Gold Standard employers and it hosts one networking event each year.

Health and Safety

The Group is committed to providing a healthy and safe working environment for all employees, contractors and visitors to its premises, and those impacted by its operations in public areas.

The Group's principal source of health and safety related risk is in the vehicle maintenance operation of Specialist Fleet Services Limited ('SFS') undertaken at either directly controlled premises or any contracted sites. The Group aims to be compliant with all applicable health and safety legal requirements, and to ensure that best practice management standards are implemented and maintained across all operations.

Employees and contractors, are provided with appropriate levels of information, instruction, training and supervision, to empower them to take ownership of their responsibility for a healthy and safe environment and are encouraged to report any concerns in line with health and safety objectives.

The Group's occupational health and safety management system ('OHSMS') includes a health and safety policy, risk assessments, performance evaluation and regular health and safety management meetings monitoring performance, objectives and targets.

The Group has a dedicated health and safety manager who reports, ultimately, to the Chief Operating Officer, the executive committee member responsible. Health and safety incidents are classified as operational risk incidents for the purposes of the Group's risk management system and monitored through the operational risk management system and the Operational Risk Committee ('ORC').

In April 2019, the Group (excluding SFS) migrated to the new standard for OHSMS and is now certified to ISO45001:2018. Compliance is audited bi-annually by a UKAS accredited auditor.

SFS has its own health and safety manager and OHSMS. Incidents are investigated locally with access to Group resources as required. The operation is currently certificated to BS:18001 and intends to migrate to ISO45001:2018 during its next compliance audit cycle.

The number of fire marshals, first aiders and other qualified personnel is monitored, and continues to be sufficient with training and adequate cover provided in all offices. Defibrillator machines are available at all sites.

Health and safety performance continues to be good with the number of accidents and incidents remaining at a low level. During the financial year ended 30 September 2019, there were no prosecutions or any enforcement action from visits by the authorities for non-compliance in respect of health and safety matters.

During the year, only 19 incidents were reported (2018: 14), all of a minor nature with 1 lost time incident reported under the Reporting of Incidents, Disease and Dangerous Occurrences Regulations 2013 ('RIDDOR') (2018: 1).

A5.3 Environmental issues

The Group's environmental impacts can be considered under two headings, its operational impacts and the impact of its lending products. Until recent periods the focus of the Group's environmental policies has been on its own activities, which are described further below, but it is clearly true that the use to which customers put the funds which are advanced to them will also have an impact. This gives rise to two related issues:

- Climate change and other environmental factors may increase financial risks. As an example, increased flooding risk might have an adverse impact on security asset valuations
- Regulatory and governmental pressure might be brought to bear on lenders, amongst other businesses, to reduce the environmental impacts of their product chains

The Group already considers these types of issue in its underwriting and credit risk processes to some extent. Examples of how the Mortgage business manages its exposure to climate effects and seeks to promote environmentally positive behaviour by customers are given in section A3.2.1.

During April 2019 the PRA published a Policy Statement noting that climate change, and society's response to it, present financial risks which are relevant to its objectives. In its view, while the financial risks from climate change may crystallise in full over longer time horizons, they are also becoming apparent now. The Statement sets out the regulator's expectations of the type of strategic approach it expects firms to adopt in managing such financial risks.

In response to the PRA's intervention and more widespread societal concerns, the Group is developing an enhanced approach to identifying the potential impacts of climate change on its business and developing a system to managing the financial risks involved.

This process is still in its early stages and the Group will report on progress in future annual reports.

Operational Impact

The Group is mainly engaged in mortgage, consumer and commercial finance and therefore the overall environmental impact of its operations is considered to be low.

SFS leases refuse collection vehicles to local authorities throughout the UK. SFS undertake additional aftersales activities that include servicing, maintenance and breakdown support, hence has the most significant potential environmental impacts.

The main environmental impacts of the Group's other operations are limited to universal environmental issues, such as resource use, procurement in offices and business travel.

Policy

The Group complies with all applicable laws and regulations relating to the environment. Its environmental commitments are expressed in its Green Charter which is approved by the CEO and kept under regular review.

The Green Charter aims to:

- Ensure all buildings occupied by the Group are managed efficiently
- Encourage employees to conserve energy
- Promote recycling by negotiating contracts and providing facilities to enable employees to recycle office waste and other used products
- Control business travel by promoting video conferencing between sites when appropriate and provide opportunities for employees to travel to work in various ways; such as providing cycle racks
- Ensure liaison with the local community through our Responsible Business initiatives
- Ensure that redundant equipment is disposed of in accordance with the Waste Electrical and Electronic Equipment Regulations ('WEEE')
- Ensure that all fluorescent light tubes are disposed of in a safe manner, compliant with appropriate regulation
- Arrange for paper waste products to be recycled, securely, by third parties

Groupwide recycling and awareness campaigns are also run to reduce various forms of waste such as food, consumables or energy.

Risk management

The Group's environmental commitment is included within the Health, Safety and Environmental policy that is approved by the CEO and the People Director and which is publicly displayed in its buildings. Energy data is collated by Group Property, the division responsible for managing the Group's premises. Consumption figures for all locations occupied, whether directly owned or tenanted, are actively monitored. This is reported upwards to Board level.

SFS operates from several workshops around the UK and has exposure to several waste streams (oils, vehicle parts etc) that come from its workshop activities. These are effectively managed under an environmental management system that is certificated to an International Standard – ISO14001:2015. A dedicated health and safety manager has direct responsibility for environmental issues at all SFS sites.

The environmental risk inherent in the Group's operations is managed by the Group Property function, and is within the remit of the Chief Operating Officer. It is monitored within the Group's operational risk management framework and is monitored by the second line Operational Risk function and the ORC.

The Group complies with the Energy Savings and Opportunities Scheme ('ESOS'). This is a UK Government initiative, under an EU Directive, and requires the Group to identify and reduce its energy consumption. The Group is actively engaged in the data collection phase for the next Environment Agency compliance submission under ESOS due in December 2019.

Supply chain and procurement

The principal suppliers of the Group comprise its outsourced savings administrator, legal and professional services providers, building lessors and IT service providers. They therefore are exposed to similar operational environmental risks to those of the Group.

The Group remains committed to identifying, targeting and addressing inefficiencies within its supply chain. The procurement function is currently working with key suppliers to identify solutions to continue to reduce the environmental impacts of our business activities whether direct or indirectly.

All pre-printed stationery items used by the Group are from renewable sources certified by FSC. 80.3% of the purchased electricity in the year was obtained from sources certified as renewable by the Office of Gas and Electricity Markets ('OFGEM').

Environmental initiatives

The Group's environmental initiatives in the period include:

- Sourcing electricity for the Group's largest sites from 100% renewable energy sources
- Increasing the proportion of sustainably sourced paper in printers and photocopiers. This now covers approximately 93% of the Group's operations
- Notifying shareholders that half-year financial reports will only be available via our website from 2020, to reduce the environmental impact from shareholder communications

The financial year ending 30 September 2020 will see objectives being established against current energy performance to further reduce consumption through energy initiatives, new plant and technology.

Performance indicators

The environmental key performance indicators for the Group, determined having regard to the Reporting Guidelines published by the Department of Business, Energy and Industrial Strategy ('BEIS') and the Department for Environment, Food and Rural Affairs ('DEFRA') in March 2019, are set out below.

The Group does not consider it has significant environmental impacts under the headings 'Resource Efficiency and Materials', 'Emissions to Land, Air and Water' or 'Biodiversity and Ecosystem Services' set out in the Guidelines, due to the nature of its business activities.

This information is presented for the twelve months ended 30 September in each year and includes all entities included in the Group's financial statements. Information for acquired entities is included from the acquisition date. Normalised data is based on adjusted total operating income of £297.6 million (excluding the £9.7 million gain on derecognition) (2018: £273.9 million, excluding the £28.0 million gain on financial asset sales).

Greenhouse gas ('GHG') emissions

	2019 Tonnes CO ₂	2018 Tonnes CO ₂
Scope 1 (Direct emissions)		
Combustion of fuel:		
Operation of gas heating boilers	519	653
Petrol and diesel used by company cars	679	641
Operation of facilities:		
Air conditioning systems	24	20
	1,222	1,314
Scope 2 (Energy indirect emissions)		
Directly purchased electricity	995	1,163
Total scope 1 and 2	2,217	2,477
Normalised tonnes - scope 1 and 2 CO₂ per £m income	7.5	9.0
Scope 3 (Other indirect emissions)		
Fuel and energy related activities not included in scope 1 or 2	542	637
Water consumption	14	11
Waste generated in operations	21	20
Total scope 3	577	668
Total scopes 1, 2 and 3	2,794	3,145
Normalised tonnes scope 1, 2 and 3 CO₂ per £m income	9.4	11.5

CO₂ values above are calculated based on the DEFRA / BEIS guidelines published in August 2019. CO₂ values for the year ended 30 September 2018 have been restated for the revised conversion factors published by DEFRA / BEIS.

The amounts shown above for total scope 1 and scope 2 emissions are those required to be reported under the Companies Act (Strategic Report and Directors Reports) Regulations 2013. Other scope 3 emissions not reported above are not considered to be significant.

The Group continues to manage its consumption levels carefully and, in the period, continued to optimise its use of its resources. It also benefits from the reduction in GHG conversion factors applying to UK purchased electricity as the profile of generation activities in the country changes towards renewables. These factors combined to reduce the normalised emissions figure.

The Group has not been involved in any prosecutions, accidents or similar non-compliances in respect of environmental matters, nor incurred any fines in respect of such matters.

Power usage

The Group uses mains electricity and natural gas from the UK grid to provide heat, light and power to its office buildings. It also uses fuel in company vehicles and through business travel of employees. The amount of power used in the year ended 30 September 2019 is shown below.

	2019 MWh	2018 MWh	2017 MWh
Renewable electricity	3,123.5		
Other electricity	768.1		
Electricity	3,891.6	4,107.5	4,040.1
Natural gas	2,817.1	3,547.6	3,192.4
Motor fuel	3,099.9	2,913.9	3,675.9
Total	9,808.6	10,569.0	10,908.4
Normalised MWh per £m income	33.0	38.6	43.2

Consumption levels have remained broadly stable over the year. However, the normalised usage has continued to improve with more efficient utilisation of the Group's facilities.

Gas and electricity usage are based on consumption recorded on purchase invoices. Vehicle fuel usage is based upon expense claims and recorded mileage.

For the first time, in the year ended 30 September 2019, the Group has been able to report that a proportion of the electricity is sourced from renewable energy sources, as accredited by Ofgem.

The 2019 DEFRA / BEIS guidelines also require that the Group report on power usage including the impact of fuel used by company vehicles. This figure was not reported prior to this year, and additional comparative figures have been provided above.

Water usage

The Group's water usage is limited to the consumption of piped water in the UK and no water is extracted directly. Water usage in the year ended 30 September 2019 was 13,010m³ (2018: 10,155 m³), based upon consumption recorded on purchase invoices, a normalised amount of 43.7m³ per £m income (2018: 37.1m³ per £m income). A water saving initiative is in place which is intended to reduce year on year water usage across the sites where the Group has full responsibility for the premises occupied.

Waste

SFS are the Group's primary waste producers. Their vehicle servicing activities generate a variety of different waste streams – including various grades of oil, and a range of metals and plastics. These wastes are managed responsibly in accordance with an ISO14001:2015 certificated management system. Waste streams generated by SFS are disposed of in accordance with the waste hierarchy before being consigned to approved waste transfer stations under contract and Waste Transfer Notes obtained.

The Group's waste output outside SFS consists of a mixture of general office waste types which includes principally paper and cardboard with some wood, plastic and metals. The Group provides facilities in its offices for recycling paper, cardboard, newspapers, glass, plastics and aluminium and steel cans. Batteries and printer and photocopier cartridges are collected and sent for recycling.

All the Group's waste is either recycled or sent to landfill.

Amounts of waste generated in the year ended 30 September 2019 together with the methods of disposal are shown below.

	2019 Tonnes	2018 Tonnes	2017 Tonnes
Recycled	122	202	282
Landfill	187	154	169
Total	309	356	451
Normalised tonnes per £m income	1.04	1.30	1.78

Waste generation data is based upon volumes reported on disposal invoices.

A5.4 Social and community matters

The Group's activities are based wholly within the United Kingdom. It operates within the legal and regulatory framework of the UK, acknowledging the importance of corporate responsibility and citizenship in its relationships with its customers, the wider community and other stakeholders.

Where possible, it uses its lending relationships to promote good practice. In particular, its buy-to-let mortgage division demands minimum standards from landlords in the properties it funds. This form of intervention should drive up standards in the private rented sector.

Commitment to our customers

The Group's strategic objective is to be a prudent, risk focussed, specialist bank with a closely controlled, cost efficient operating model which places the delivery of fair customer outcomes at its core.

Putting customers' interests at the heart of the business is therefore integral to the achievement of that objective, and the Group's culture. We want our customers to be confident that we will always consider their needs and act fairly and responsibly in our dealings with them. We strive to ensure that all our customers can be confident that:

- Products and services are designed to meet their needs
- Our employees are appropriately skilled and experienced to provide the services they require
- The information given to them will be clear and jargon free
- Products will perform as they are led to expect
- They will not face unreasonable post-sale barriers to change a product, switch provider, submit a claim or make a complaint
- All complaints will be listened to and claims assessed carefully, fairly and promptly
- Where applicable, they will be made aware of how they can refer their complaint to the FOS
- If they are vulnerable and/or in financial difficulties, we will provide a high level of support and make sure they are signposted to sources of independent advice
- They will be made aware of the FSCS and the protection this provides for them

The desire to achieve positive outcomes for our customers is an important commercial differentiator which has helped the Group build strong relationships over many years. This is supported by a focus in employee training programmes on areas which impact on customer outcomes, such as the correct approach to working with vulnerable customers. This pro-active approach accords with the FCA's Principles for Business, particularly with regard to treating customers fairly and ensuring that all communications are clear, fair and not misleading. We ensure that we know how well we are performing in respect of these requirements, regularly adjusting what we do to deliver better customer solutions.

The Board and executive management are committed to maintaining and developing this culture across all the Group's businesses.

Complaint handling

We do not always get things right and take customer complaints very seriously. Each complaint is acknowledged promptly, and the Group works with customers to understand their feedback, investigating these fully and responding swiftly in a fair and open manner.

The Group aims to resolve complaints at the first point of contact but acknowledges that some complaints will require further specialist investigation and time to resolve. Where this is the case, regular contact is maintained with the customer to keep them informed of the progress of their complaint. The Group has also established contacts within previous service providers to ensure any relevant complaint is resolved at the earliest possible opportunity where appropriate.

Where applicable, 'Alternative Dispute Resolution' information is provided to customers to allow them to appeal to independent parties if they are not satisfied with our response. These include the FOS, the FLA and the Credit Services Association. Where customers feel the need to appeal, we co-operate fully and promptly with any settlements and awards made by these parties.

Every complaint is viewed as an opportunity to improve our business, an opportunity to identify where complaint handling is going wrong, and most importantly, an opportunity to put things right for our customers. Root cause analysis is completed on complaints to ensure appropriate corrective actions are taken to address the issue and minimise the risk of re-occurrence for other customers.

Information on the number and nature of complaints and on their resolution is reported regularly through the Conduct and Compliance Committee to the board level Risk and Compliance Committee for monitoring and, if appropriate, for action to be taken.

Supporting the community

The Group contributes to registered charities relating to financial services or serving the local communities in which it operates. Contributions of £1,522,000 (2018: £1,950,000) were made by the Group during the year to the work of the Foundation for Credit Counselling which operates the StepChange Debt Charity. The Group also contributed to charities throughout the year by way of single donations.

Other charitable contributions made in the year totalled £24,200 (2018: £25,300). The Group's main objective is to support children's and local charities, although no charity request is overlooked. During the last year the Group has helped many and varied charities and causes including: Kids Cancer Charity, 3H Fund - Helping Hands for Holidays, Lupus UK, Multiple Sclerosis Society, Chicks, Soroptimist International Solihull and District, Kids in Action and Super Hero Sport Foundation, amongst others.

Employees have also been making a difference to the local community in many ways. A volunteering programme was launched in January 2019 and to date employees have delivered 47 volunteering days (3.4% engagement), targeting issues linked to poverty. Activities have included:

- Volunteering at SIFA Fireside, a specialist centre in the centre of Birmingham dedicated to supporting the homeless people of Birmingham
- Supporting a local primary school to renovate their playground
- Volunteering at a "Ready for Work" initiative run by Business in the Community that supports getting homeless people back into the workplace

Employees also took part in education initiatives, supporting 'Life Ready' days, which provide an opportunity to talk to school students about managing finances, budgeting and implications of debt, and attending Careers Conventions at local schools.

In addition, the Group's External Relations team arranged 'the Great Mortgage Sleep Out' in November 2018 to raise awareness of homelessness, which raised £15,000 for youth homelessness charities, with 34 individuals participating.

At Christmas 2018, food parcels were collected for Christians Against Poverty, with 134 food parcels delivered to 80 families.

The Group also supports Paragon's Charity Committee, consisting of volunteer employees, which organises a variety of fundraising activities throughout the year. In the calendar year 2018, £15,772 was raised for Solihull Mind and Birmingham Children's Hospital, while in the first nine months of 2019, £15,532 has been raised for Dementia UK. All employees are given the opportunity to nominate a charity each year and a vote is carried out amongst the employees to select the charity or charities to benefit from the following year's fundraising activities.

Taxation policy and payments

Materially all of the Group's taxable income arises in the UK and therefore it has no presence in jurisdictions considered to enable tax base erosion and profit shifting.

The Group's tax strategy is to comply with all relevant tax obligations whilst cooperating fully with the tax authorities. The Group recognises that in generating profits which can be distributed to shareholders it benefits from resources provided by government and the payment of tax is a contribution towards the cost of those resources. The Group will only undertake tax planning that supports commercial activities and, in the UK context, is not contrary to the intention of Parliament.

As a group containing a bank, the Group is subject to The Code of Practice on Taxation for Banks (the 'Bank Tax Code') published by Her Majesty's Revenue and Customs ('HMRC') in March 2013. The Group has previously confirmed to HMRC that it was unconditionally committed to complying with the Bank Tax Code, and formally re-approved the Group's tax governance policies and the tax strategy outlined above.

During each financial year the Group publishes a tax strategy document for that year on its website, in accordance with the Finance Act 2016. This document addresses the following matters:

- The approach of the Group to risk management and governance arrangements in relation to UK taxation
- The attitude of the Group towards tax planning (so far as affecting UK taxation)
- The level of risk in relation to UK taxation that the Group is prepared to accept
- The approach of the Group towards its dealings with HMRC

The third such statement was published during the year and can be found in the investor relations section of the Group's website.

The published strategy is owned by the Board collectively in accordance with HMRC's published expectations. The Chief Financial Officer has been designated as the Senior Accounting Officer for tax purposes and, as such, reviews compliance with the Group's policies each year.

The Group has an open and positive relationship with HMRC, meeting with their representatives on a regular basis, and is committed to full disclosure and transparency in all matters.

The Group is resident and operates in the UK and its tax payments to the UK authorities include not only corporation tax but also substantial payroll taxes. The amounts of the Group's cash payments to UK national and local tax authorities in the year, including Pay As You Earn ('PAYE') and National Insurance ('NI') contributions deducted from employee wages and salaries were as follows:

	2019	2018
	£m	£m
Corporation tax	39.4	32.0
PAYE and NI	27.3	28.0
VAT	2.1	1.6
Stamp duty	0.1	0.2
Total national taxation	68.9	61.8
Business rates	1.4	1.1
	70.3	62.9

A5.5 Human rights

The Group respects all human rights and in conducting its business regards those rights relating to non-discrimination, fair treatment and respect for privacy to be the most relevant and to have the greatest potential impact on its key stakeholder groups of customers, employees and suppliers.

The Group's commitment to supporting its people's employment rights is described in section A5.2.

The Group operates exclusively in the UK and, as such, is subject to the European Convention on Human Rights and the UK Human Rights Act 1998.

The Board and the CEO have overall responsibility for ensuring that all areas within the Group uphold and promote respect for human rights. The Group seeks to anticipate, prevent and mitigate any potential negative human rights impacts as well as enhance positive impacts through its policies and procedures and, in particular, through its policies regarding employment, equality and diversity, treating customers fairly and information security.

The Group's policies seek to ensure that employees comply with the relevant legislation and regulations in place in the UK and to promote good practice. The Group's policies are formulated and kept up to date by the relevant business areas, authorised in accordance with the Group's governance procedures and are communicated to all employees and included in the Human Resources Policies Manual.

The Group's compliance with human rights regulation falls within its overall compliance regime, and any breaches or potential breaches would be investigated and addressed through the Group's risk management framework.

The Group supports the objective of the Modern Slavery Act 2015, in raising awareness of modern slavery and human trafficking. The Group's annual Modern Slavery Statement is published on its website and also reflected in relevant policies.

The Group is committed to ensuring that there is no modern slavery or human trafficking in its supply chains or in any part of the business and to acting ethically and with integrity in all business relationships. It actively engages with suppliers to ensure that compliance with Modern Slavery legislation is achieved.

The statement describing the Group's policies for achieving this can be found on the Group's website: www.paragonbankinggroup.co.uk.

The Group undertakes extensive monitoring of the implementation of all of its policies and has not been made aware of any incident in which the organisation's activities have resulted in an abuse of human rights or a breach of Modern Slavery legislation. No fines or prosecutions in respect of non-compliance have been incurred.

A5.6 Business practices

The Group carries out its business fairly, honestly and openly. It has a comprehensive anti-bribery and corruption policy, endorsed by the directors, covering all employees and operated throughout the Group. It will not make bribes, nor will it condone the offering of bribes on its behalf. It is the Group's policy that it will not accept bribes, nor will it agree to them being accepted on its behalf and will avoid doing business with those who do not accept its values and who may harm its reputation.

The Group carries out an annual risk assessment as required by the Bribery Act 2010 and concluded that it is not a company with a high risk of bribery. The Group conducts all of its business within the UK and its only significant outsourcing arrangement relates to the administration of its savings operations by the outsourcing arm of a major UK building society. The UK is not considered a jurisdiction with a high incidence of corrupt practices, ranking joint 11th in the Corruption Perceptions Index for 2018, out of 180 countries. However, the Group takes its responsibilities seriously and will not tolerate bribery in any form on any scale and, as such, its policies and procedures are kept under regular review. The Group will self-report any serious incidence of bribery or corruption that is identified.

The Group's policies cover the conduct of its business, the Group's interaction with suppliers and contractors and the giving or receiving of gifts and corporate hospitality. It prohibits facilitation payments. Before new suppliers are approved, the Group's procedure requires that they must be assessed against the requirements of the anti-bribery and corruption policy. The policy is updated and a risk assessment conducted on an annual basis.

All employees are required to read the Group's anti-bribery and corruption policy and undertake annual on-line training to assess their understanding. The anti-bribery culture forms part of the induction course for all new employees and is reinforced at subsequent training sessions. Any employee found to be in breach of these policies will be subject to disciplinary action. No such disciplinary action has taken place in the year ended 30 September 2019.

The CRO, in conjunction with the Head of Financial Crime, who are both part of the 'second line' Risk and Compliance function, are responsible for ensuring the Bribery Act risk assessment and resulting policies and procedures are in place and reviewed on a regular basis. They are also responsible for ensuring any changes in the law are noted and applied to the Group's policies and procedures, where appropriate.

As a financial services entity, the Group also has procedures in place to ensure it cannot be used to facilitate money laundering, sanctions abuse or other forms of financial crime. Employees receive regular annual training in these areas, with their understanding being tested and levels of completion reported to regulators. The Group's money laundering reporting officer is the Deputy CRO, who is part of the second line Risk and Compliance function.

All business heads are responsible for having the appropriate controls in place to ensure that employees adhere to the anti-bribery and corruption policies and procedures and other policies relating to business practices at all times. This is monitored as part of the Group's risk management process and reviewed, as appropriate by the Internal Audit function.

A whistleblowing hotline, run by an independent third party, is available to staff who have concerns over any aspects of the Group's business practices. This is described further in section B5.7.

The Group has not been involved in any incidents resulting in prosecutions, fines, or penalties or in similar incidents of non-compliance in respect of bribery, corruption or other illegal business practices (2018: none).

A6

Approval of Strategic Report

Section A of this Annual Report comprises a Strategic Report for the Group which has been drawn up and presented in accordance with, and in reliance upon, applicable English company law, in particular Chapter 4A of the Companies Act 2006, and the liabilities of the directors in connection with this report shall be subject to the limitations and restrictions provided by such law.

It should be noted that the Strategic Report has been prepared for the Group as a whole, and therefore gives greater emphasis to those matters which are significant to the Company and its subsidiaries when viewed as a whole.

Approved by the Board of Directors and signed on behalf of the Board.

Pandora Sharp

Company Secretary

26 November 2019

B.

CORPORATE GOVERNANCE

How the Group is run and how risk is managed

B1	Chair of the Board's statement <i>An overview of governance in the year</i>	Page 68
B2	Board of directors <i>The directors and their experience</i>	Page 70
B3	Corporate governance <i>The system of governance, how the Board operates and how the Group complies with the Code</i>	Page 75
B4	Nomination Committee <i>Policies and procedures on governance, board appointments and diversity</i>	Page 82
B5	Audit Committee <i>How the Group controls its external and internal audit processes and its financial reporting systems</i>	Page 84
B6	Remuneration <i>Policies and procedures determining how directors are remunerated</i>	Page 93
B7	Risk management <i>How the Group identifies and manages risk in its businesses</i>	Page 125
B8	Directors' report <i>Other information about the structure of the Group required by legislation</i>	Page 140
B9	Directors' responsibilities <i>Statement of the responsibilities of the directors in relation to the preparation of the financial statements</i>	Page 144

B1

Chair's statement on corporate governance



Fiona Clutterbuck, Chair of the Board

I welcome the emphasis on workforce engagement and diversity at all levels and look forward to working with the Board and management team in developing further our initiatives in these areas...

Dear Shareholder

It is with pleasure that I introduce the corporate governance report this year in what has been another significant year with most companies adopting the UK Corporate Governance Code 2018 ('the 2018 Code') during the calendar year. The 2018 Code emphasises strongly the contribution of good corporate governance in the achievement of long-term sustainable success and focusses on a number of areas that have developed in priority, rightly so, since the first introduction of the UK Corporate Governance Code in 1992, as well as being a step change from the 2016 version of the Code. In particular, I welcome the emphasis on workforce engagement and diversity at all levels and look forward to working with the Board and management team in developing further our initiatives in these areas.

As a Board we have chosen to utilise a formal workforce advisory panel, the People Forum, as the mechanism to engage with the Group's workforce. This forum has been based on an existing feedback mechanism. In addition to feedback from such meetings being advised to the Board on a regular basis there will also be attendance at the People Forum by myself and/or a non-executive director at least twice a year, with the first meeting, on executive remuneration, having taken place in November 2019. The Board and the Forum will consider other areas to discuss over the coming year, to ensure two-way communication and facilitated dialogue exists between the Board and the workforce, with information feeding into the Board's decision-making process and communications back to the workforce on how the Board has considered and acted on it.

Dialogue with shareholders and regulators, two of our key stakeholders, takes place frequently during the year and, as part of the annual regulatory and governance cycles, I, as well as a number of my Board colleagues, meet with these stakeholders. It is important to maintain and manage positively such relationships and I consider these discussions are key to ensuring the ongoing sustainability of the Group. The Group also considers its other stakeholders including its workforce, the wider community and environment; customers; brokers and other intermediaries, as appropriate, during its operating cycle.

As I noted in last year's report, the Board has adopted the Hampton-Alexander Review target of at least a third female representation on the Board by the end of 2020 and we have been working towards this target during the year. I am passionate about ensuring that the Board and the Group are diverse, reflective of the communities in which we operate, and it is one of my personal goals as Chair to improve the Group's position. Work undertaken during the year in respect of below-board Hampton-Alexander targets, as part of the Women in Finance Charter, has resulted in 'female senior managers as a percentage of total senior management' reaching its target of 35% as at 30 September 2019 and I congratulate management on reaching this milestone more than a year ahead of our target date.

With the upcoming retirement of Peter Hartill in February 2020 the Board is currently recruiting for a new Audit Committee Chair. To help ensure that we meet the Hampton-Alexander target, diversity of gender and background has been emphasised when considering candidates. It has proved a challenging recruitment, with strong candidates being in high demand. However, I am hopeful of an appointment being announced shortly after the AGM in February (subject to regulatory and Board approval). In addition, options for the appointment of a new Senior Independent Director are currently being considered. Further detail on this and the other work of the Nomination Committee during the year can be found in section B4.

Both Peter Hartill and John Heron are due to retire before the 2020 AGM and I would like to thank them personally, and on behalf of the Board, for their longstanding commitment to the Group. Peter has been the Senior Independent Director throughout my period as Chair, and as such his support and challenge have been hugely appreciated. He has considerable knowledge of the Group and its people and this experience has been invaluable to me. John is the Group's longest serving employee and his in-depth knowledge of the buy-to-let mortgage market will be greatly missed as well as his broader, very valuable contribution to Board and management discussions. Mine and the Board's best wishes for the future go to both of them.

During the year the Board undertook its triennial externally facilitated board evaluation with the assistance of Independent Board Evaluation's Ffion Hague. It was a thorough, and forward-focused evaluation and further detail can be found later in the report. We will be working on the outputs from the evaluation during the upcoming financial year and an action plan is currently being produced.

Another area that we are particularly proud of at Paragon is our strong culture, which is also highlighted in the 2018 Code. In the upcoming year, for the second time, a review of culture will be undertaken in addition to a review of the Group's risk culture. In addition, during the Investors in People assessment which took place in the financial year under review, various indicators were considered and notable strengths identified included a strong values-based culture, a clear people strategy that is built on high levels of empowerment and devolved accountability. As the Group grows in size the Board is committed to ensuring that these values remain a key element of the business.

My meetings with shareholders, and shareholder advisory bodies, as part of the remuneration review (see B6 for further detail) have frequently also touched on other governance matters, such as succession planning, diversity and workforce engagement and such discussions help to assist in the development of the governance process both at board level and within the wider organisation. I would like to thank shareholders for their continued interest in the Group and the questions and challenges they raise when we meet.

The Company will be holding its AGM on 13 February 2020 and I look forward to welcoming shareholders and discussing the Group's progress.

Fiona Clutterbuck

Chair of the Board

26 November 2019

B2

Board of directors



Fiona J Clutterbuck (Age 61)

Chair of the Board

Appointed to the Board as an independent non-executive director in 2012 and became Chair of the Board in May 2018

Experience

Fiona Clutterbuck has many years of corporate finance experience at leading UK and international investment banks, specialising in financial institutions.

During her career she has held the positions of Head of Strategy, Corporate Development and Communications at Phoenix Group, Managing Director and Head of Financial Institutions Advisory at ABN AMRO Investment Bank, Managing Director and Global Co-Head of Financial Institutions Group at HSBC Investment Bank and was a director at Hill Samuel Bank Limited.

Specific areas of expertise*

- Long term understanding of the Group, its markets and its people
- Strong and broad listed plc experience
- Strategic analysis skills
- Detailed knowledge of the executive remuneration market

Committee membership

Chair: Nomination Committee

Member: Risk and Compliance and Remuneration Committees

Current external appointments

Non-executive director of Hargreaves Lansdown PLC, chair of its remuneration committee and member of its audit, risk and nomination committees

Non-executive director of Sampo PLC (Finnish listed financial services company) and a member of its audit committee



Nigel S Terrington (Age 59)

Chief Executive

Appointed to the Board as Treasury Director in 1990, Finance Director in 1992 and became Chief Executive in 1995

Experience and expertise*

Nigel Terrington's early career began in investment banking, which included working for UBS where he ran its Financial Institutions Group. He joined the Group in 1987, becoming Treasurer shortly thereafter, before being appointed as Finance Director and then Chief Executive.

He has been Chair of the Council of Mortgage Lenders ('CML'), Chair of the Intermediary Mortgage Lenders Association ('IMLA'), Chair of the FLA Consumer Finance Division, a member of the Mortgage Board of UK Finance (previously CML) and a Board member of the FLA.

Nigel is an associate of the Chartered Institute of Bankers. In 2017, he received an Honorary Doctorate from Birmingham City University for services to the finance industry.

Overall, Nigel has expertise gained from long term, through-the-cycle, strategic and detailed understanding of the Group, its markets, its operations and its people. He saw the Group through both the 1992 and 2007 financial crises and has led the diversification of the Group from a monoline buy-to-let lender to its current broadly-based specialist banking group.

Current external appointments:

Member of HM Treasury's Home Finance Forum

Member of Bank of England's Residential Property Forum



Richard J Woodman (Age 54)

Chief Financial Officer

Appointed to the Board as Director of Corporate Development in 2012 and became Chief Financial Officer in June 2014

Experience and expertise*

Richard Woodman joined the Group in 1989 and has held various senior strategic and financial roles, including Director of Business Analysis and Planning and Managing Director of Idem Capital.

He has taken a lead role in the Group's strategic development and, in particular, in the loan portfolio acquisition programme through Idem Capital and the Group's M&A programme.

He is a member of the Chartered Institute of Management Accountants.

Broadly, Richard has expertise gained from long term, through-the-cycle, knowledge and understanding of the Group, its markets and its operations, in particular its financial management controls, liquidity and stress testing.

Current external appointments:

None



John A Heron (Age 60)

Managing Director, Mortgages

Appointed to the Board in 2003

Not seeking re-election at 2020 AGM

Experience and expertise*

John Heron joined the Group in January 1986 following a number of years in the building society industry and is the Group's longest serving employee.

John has been instrumental in the development of Paragon's buy-to-let mortgage lending programme.

As Managing Director, Mortgages, John is responsible for all aspects of the Group's mortgage business which includes the origination and management of buy-to-let and residential first and second charge mortgages.

He has been Chair of the Buy-to-Let Panel of the CML and a member of the IMLA Board.

He is a fellow of the Chartered Institute of Bankers.

John has long term, through-the-cycle, understanding of the Group, the buy-to-let lending market, its operations, its management and its people. He has been a significant leader in the buy-to-let lending market since its establishment in the late 1990s.

Current external appointments:

Member of UKF Mortgages Product Board

* All directors have broad knowledge of all areas of the Group's business but the 'areas of expertise' highlight specific areas in relation to an individual's contribution to the Group's long-term sustainable success

B2

Board of directors



Peter J N Hartill (Age 70)

Non-executive director

Non-executive director since 2011 and became Senior Independent Director in June 2018

Appointed in 2011 – eight years served

Not seeking re-election at 2020 AGM

Experience

Peter Hartill spent forty years with Deloitte, becoming a senior audit partner and a business advisor with experience across a wide range of industries and business issues. Specifically, he has considerable experience in acquisitions and disposals, capital raising, risk control and corporate governance in the financial services sector.

He is a Chartered Accountant and has been Chair of the Audit Committee since 2011.

Specific areas of expertise*

- Detailed knowledge and experience of the financial services sector, accounting and auditing practice as well as of the audit market and accounting regulations
- Detailed knowledge of the Group's financial accounting practices

Committee membership

Chair: Audit Committee

Member: Risk and Compliance, Remuneration and Nomination Committees

Current external appointments

Chair: Deeley Group Limited



Hugo R Tudor (Age 56)

Non-executive director

Appointed in 2014 – five years served

Skills and experience

Hugo Tudor spent 26 years in the fund management industry, originally with Schroders and most recently with BlackRock, covering a wide range of UK equities. He is a Chartered Financial Analyst and a Chartered Accountant.

Specific areas of expertise*

- Detailed knowledge of the investor perspective
- A strong understanding of the executive remuneration market

Committee membership

Chair: Remuneration Committee

Member: Audit and Risk and Compliance Committees

Current external appointments

Director: Damus Capital Limited

Director: Vitec Global Limited, Vitec Air Systems Limited and Vitec Aspida Limited



Barbara A Ridpath (Age 63)

Non-executive director

Appointed in 2017 – two years served

Skills and experience

Barbara Ridpath has worked in finance for most of her career, in New York, London and Paris at the Federal Reserve Bank of New York, Standard & Poor's and JPMorgan.

She was instrumental in the development of UK mortgage securitisation in the late 1980s and went on to lead the Standard & Poor's Ratings Group in Europe, the Middle East and Africa.

Specific areas of expertise*

- Strong knowledge of the operation of and implementation of operational risk management systems
- Detailed knowledge of the securitisation market

Committee membership

Member: Audit, Nomination (since 24 January 2019) and Risk and Compliance Committees

Current external appointments

Non-executive director of ORX, a trade association for operational risk professionals

Member of the Ethical Investment Advisory Group of the Church of England

Member of the International Advisory Council of the Institute of Business Ethics ('IBE') from November 2019

Commissioner of the Marshall Aid Commemoration Commission until July 2019 and member of the council and executive committee at Chatham House (the Royal Institute of International Affairs) until July 2019



Finlay F Williamson (Age 60)

Non-executive director

Appointed in 2017 – two years served

Skills and experience

Finlay Williamson was Finance Director of Virgin Money between 2009 and 2014, where he was responsible for supporting the design and delivery of the company's growth strategy, including the assessment of potential markets, the development of key propositions and the pursuit of non-organic opportunities.

Prior to joining Virgin Money, Finlay had a long career at Royal Bank of Scotland ('RBS'), where he held a number of senior finance roles, latterly as Finance Director for RBS's Manufacturing and Retail Direct divisions.

He was appointed to the Board of Paragon Bank PLC in February 2015 and was Chair of its Risk and Compliance Committee from that date.

Finlay is a Chartered Accountant and a fellow of the Chartered Institute of Bankers in Scotland.

Specific areas of expertise*

- In depth knowledge and experience of financial services sector, accounting and risk operations
- Detailed experience of overseeing the development of risk management in the Group

Committee membership

Chair: Risk and Compliance Committee

Member: Audit Committee

Current external appointments

None

* All directors have broad knowledge of all areas of the Group's business but the 'areas of expertise' highlight specific areas in relation to an individual's contribution to the Group's long-term sustainable success

B2

Board of directors



Graeme H Yorston (Age 62)

Non-executive director

Appointed in 2017 – two years served

Skills and experience

Graeme Yorston was Group Chief Executive of Principality Building Society, the 6th largest mutual in the UK. He has over 43 years' experience in financial services having carried out a number of senior roles in Abbey National (now Santander).

Graeme has served on the CBI Council for Wales, the Board of Business in the Community in Wales and was HRH Ambassador for BITC in Wales for two years. He was awarded Director of the Year in Wales by the Institute of Directors in 2016.

Graeme is a Fellow of The Chartered Institute of Banking, holds an MBA from Warwick Business School and was awarded an Honorary Doctorate in Business Administration by Cardiff Metropolitan University in 2017.

Specific areas of expertise*

- Strong retail banking sector knowledge and experience
- Detailed experience of overseeing IT systems

Committee membership

Member: Nomination, Remuneration (both since 24 January 2019) and Risk and Compliance Committees

Current external appointments

None

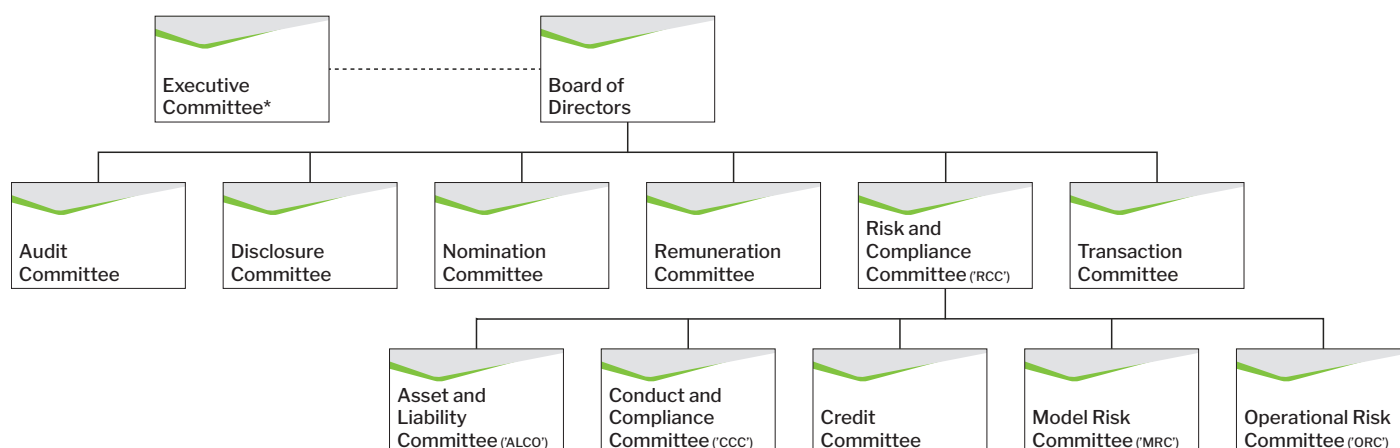
* All directors have broad knowledge of all areas of the Group's business but the 'areas of expertise' highlight specific areas in relation to an individual's contribution to the Group's long-term sustainable success

B3

Corporate governance

B3.1 Board and Committee structures

Corporate governance snapshots



* Not a board committee

Summarised information on each of the board committees is set out below.

Committee		Audit	Remuneration	Risk and Compliance	Nomination
Chair		P J N Hartill	H R Tudor	F F Williamson	F J Clutterbuck
Minimum number of meetings		4	3	4	2
Further information		Section B5	Section B6	Section B7	Section B4

Members	Independent non-executive	Audit	Remuneration	Risk and Compliance	Nomination
F J Clutterbuck	Until 10 May 2018	No	Yes	Yes	Yes
P J N Hartill	Yes	Yes	Yes	Yes	Yes
H R Tudor	Yes	Yes	Yes	Yes	Until 24 January 2019
B A Ridpath	Yes	Yes	No	Yes	From 24 January 2019
F F Williamson	Yes	Yes	No	Yes	No
G H Yorston	Yes	Until 24 January 2019	From 24 January 2019	Yes	From 24 January 2019
P Newberry	Yes	Until 31 December 2018	Until 31 December 2018	Until 31 December 2018	Until 31 December 2018

Executive Committee is not a committee of the Board but provides support to the Chief Executive Officer ('CEO') in the day-to-day running and management of the Group and, where necessary and appropriate, items discussed at Executive Committee are escalated to the Board for further discussion.

Further documentation available on the Group's website

- Matters Reserved for the Board
- Division of responsibilities – Chair, CEO and Senior Independent Director
- Terms of Reference – Audit, Nomination, Remuneration and Risk and Compliance Committees
- Internal Audit Charter

B3.2 Operation of the Governance Framework

Board leadership and company purpose

The Board of Directors is responsible for promoting the long-term, sustainable success of the Group, generating value for shareholders and contributing to wider society. It establishes the Group's overall purpose, values and strategy and ensures the delivery of these within a robust corporate governance and corporate responsibility framework. Purpose, values and strategy are described in section A2 and the corporate governance framework is described in the following pages.

Code compliance

The Board is committed to the principles of corporate governance contained in the UK Corporate Governance Code issued by the FRC in April 2016 ('the 2016 Code') and which is publicly available at www.frc.org.uk. Throughout the year ended 30 September 2019 the Company complied with the principles and provisions of the 2016 Code (with one exception, as noted below). The Board has considered the impact of the provisions of the 2018 Code, which is applicable to the Company from 1 October 2019, and has made a number of amendments to its practices and procedures which it will continue to monitor during the year to ensure compliance.

During the year under review, there was a short period when the Company was not fully in compliance with the provisions of the 2016 Code due to the period between the retirement of a director and a refresh of committee membership. The provision which the Company did not comply with, and the period of non-compliance was:

- From 1 January 2019 until 24 January 2019 there were only two independent non-executive directors on the Remuneration Committee (2016 Code provision D.2.1)

During this period no meetings of the Remuneration Committee were scheduled or held.

Committee structures

The Board operates through a number of committees covering certain specific matters, illustrated in the chart shown in section B3.1 and the membership of those committees is also shown in that section.

In addition to the regular committee structures the Board has also established a Disclosure Committee which assists in the design, implementation and evaluation of disclosure controls and procedures; monitors compliance with the Company's disclosure controls; considers the requirements for announcement; and overall determines the disclosure treatment of material market information. The Committee's members are the Chair, CEO and CFO, of which any two can form a quorum.

Further, the Transaction Committee, which reports directly to the Board, consists of the CEO and the CFO, the Director of Treasury and Structured Finance and the CRO, any two of which can form a quorum, but that quorum should include either the CEO or CFO. The Committee meets to consider potential acquisitions or disposals of loan assets by the Iden Capital business, where these are not large enough to require consideration at the Board, and also to approve, within delegated limits, wholesale term and/or revolving credit facilities proposed by the Group's Structured Lending operation.

Five main executive committees, the Asset and Liability Committee ('ALCO'), the Credit Committee, the Model Risk Committee ('MRC'), the Operational Risk Committee ('ORC') and the Conduct and Compliance Committee ('CCC'), with the membership consisting of executive directors and appropriate senior employees, report to the Risk and Compliance Committee. All of these committees are described further in the Risk Management Section B7. During the year Hugo Tudor became a permanent attendee at the Model Risk Committee as part of the Group's governance changes aligned with its application for IRB status.

In addition, the Group's Executive Committee provides support to the CEO in the day-to-day running and management of the Group.

All committees operate within defined terms of reference and sufficient resources are made available to them to undertake their duties. The terms of reference of the Board's main committees, being Audit, Nomination, Risk and Compliance and Remuneration are available on the Group's website.

Board and committee attendance

The attendance of individual directors at the regular meetings of the Board and its main committees in the year is set out below, with the number of meetings each was eligible to attend shown in brackets. Directors who are unable to attend meetings receive the papers and any comments from them are reported to the relevant meeting. Directors have attended a number of ad hoc meetings during the year in addition to the regular Board meetings and have contributed to discussions outside of the regular meeting calendar.

Director	Board	Audit Committee	Risk and Compliance Committee	Remuneration Committee	Nomination Committee
Fiona J Clutterbuck	10 (10)	-	5 (5)	4 (4)	5 (5)
Nigel S Terrington	10 (10)	-	-	-	-
Richard J Woodman	10 (10)	-	-	-	-
John A Heron	9 (10)	-	-	-	-
Peter J N Hartill	10 (10)	6 (6)	5 (5)	4 (4)	5 (5)
Hugo R Tudor	10 (10)	6 (6)	5 (5)	4 (4)	1 (1)
Barbara A Ridpath	10 (10)	6 (6)	5 (5)	-	4 (4)
Finlay F Williamson	10 (10)	6 (6)	5 (5)	-	-
Graeme H Yorston	10 (10)	1 (1)	5 (5)	3 (3)	-
Alan K Fletcher	2 (2)	-	-	-	-
Patrick J Newberry	2 (2)	1 (1)	1 (1)	1 (1)	0 (0)

Directors also attended an annual two-day strategy event, held off site, to enable further, more detailed, discussion of the Group's position and future development. This strategy event has been a regular fixture in the Group's governance calendar for a number of years and recently has also been attended by the Group's executive management group.

The Remuneration Committee held a workshop and a number of ad hoc meetings of its working group in respect of the proposed new policy during the year.

Conflicts of interest

The Board has agreed a policy for managing conflicts and a process to identify and authorise any conflicts that might arise, which was recently updated. At each meeting of the Board and its committees, actual or potential conflicts of interest in respect of any director are reviewed.

The Board recognises the benefits that can flow from non-executive directors holding other appointments but requires them to seek the agreement of the Chair before entering into any commitments that might affect the time they can devote to the Company.

Whistleblowing

The Group maintains a whistleblowing process to enable employees or other stakeholders to raise concerns anonymously. This is described further in section B5.7.

Culture

The Group is proud of its supportive culture which has been noted as part of its Investors in People accreditation (see Section A5.2), renewed at Gold level in the year. In the financial year ending 30 September 2020 it is intended that a review of the Group's culture will be undertaken which will be considered by the Risk and Compliance Committee and any necessary actions arising from that report will be considered by the Board. It is the intention that a culture review will form an annual part of the Compliance monitoring plan in future. In addition, a review of the risk culture will be undertaken by Internal Audit and reported to the Audit Committee.

The welfare, development and engagement of employees is central to Paragon's culture. There is a robust Well-Being Strategy in place with an Emotional Well-Being Team who are fully supported and invested in by keeping their knowledge current. The Group is a member of the Lord Mayor's Appeal "This is Me" which is a campaign to provide employers with the tools to change cultures relating to mental health. During the year a number of workshops have been held on increasing education in areas such as the menopause, health and well-being, nutrition and weight management. See also Section A5.2 for information relating to how the Group invests in its people.

To encourage employee participation within our communities, a scheme was introduced in the year whereby employees have a paid annual volunteer day to use at a charity of their choice. Further detail on other charitable activities can be found at A5.4.

Board and stakeholders

The Board, in its deliberations and decision-making processes takes into account the views of the Group's stakeholders and, where applicable, considers the impact of those decisions on the communities and environment within which the Group operates. While good corporate governance is important to the Board, so too is maintaining a reputation for high standards of business conduct in all of the Group's operations, and management of conduct risk is a key part of the risk management framework. Section A5 sets out information on corporate responsibility including the Group's people policies and engagement with employees, its involvement in industry initiatives, its support for the community and its environmental, social and conduct impacts.

The People Director and the executive directors report to the Board regularly on the views of the Group's employees and the impact of new projects on the workforce is taken into account. With the 2018 Code applying to the Company from 1 October 2019 the channels for interactions between employees and the Board have been reviewed and strengthened, with the People Forum becoming the formal workforce advisory panel as provided for by the 2018 Code. For further information on the operation of the People Forum, see section A5.2 and the Chair's introduction. For information on investing in and rewarding the workforce see section A5.2.

Regard is had to the impact of principal strategic decisions on employees, for example, due diligence on potential acquisitions will consider remuneration packages in the target in comparison to Group employees. Performance on the integration of employees of acquired entities, post-acquisition, will be reported at board level.

A number of its brokers, contractors and other suppliers are of significant importance to the Group's operations and a close relationship is maintained, and reported to the Board, to help ensure that the Group runs effectively.

The Group also endeavours to maintain an open and transparent relationship with its various regulators, including the PRA and FCA. Its relationship with HMRC and the principles it applies to its tax affairs are described in section A5.4. Interactions with the PRA during the year have included meetings with the Chair and other non-executive directors as well as those involving executive directors.

Shareholders

The Board encourages communication with the Company's institutional and private investors. All shareholders have at least twenty working days' notice of the AGM at which the directors and committee chairs are available for questions. The AGM is held in London during business hours and provides an opportunity for directors to report to investors on the Group's activities, to answer their questions and receive their views. At all general meetings shareholders have an opportunity to vote separately on each resolution and all proxy votes lodged are counted and the balances for, against and directed to be withheld in respect of each resolution are announced.

The Chair, CEO and CFO have a full programme of meetings with institutional investors during the course of the year and investors' comments are communicated to all members of the Board, enabling them to develop an understanding of major shareholders' views of the Group, and take those views into account when determining strategy. During the year ended 30 September 2019 meetings were held with investors from the UK, Europe and North America. From time to time other presentations are made to institutional investors and analysts to enable them to gain a greater understanding of important aspects of the Group's business, including, this year on the introduction of IFRS 9.

The Chair of the Board, the Chair of the Remuneration Committee and the Company Secretary consulted with a number of the Company's larger shareholders during Summer 2019 to discuss remuneration policies and other corporate governance matters. The Company made approaches to all its significant shareholders and meetings were held with 18 shareholders representing approximately 69% of total voting rights. The comments received were considered by the Remuneration Committee in determining the Group's approach to executive compensation and amendments made to the initial proposals. In addition, the results of all of these meetings were reported to the Board so that all directors were made aware of shareholder views.

The Senior Independent Director is also made aware of views expressed by shareholders to other members of the Board, via the Company's brokers or through the Investor Relations team and is available to meet with shareholders should they wish. Such meetings can be arranged via the Company Secretary.

Division of responsibilities

Currently the Board consists of the Chair, three executive directors and five independent non-executive directors. At the start of the year the Board included six independent non-executive directors, and a non-independent non-executive director Alan Fletcher. Patrick Newberry and Alan Fletcher resigned on 31 December 2018. All the directors bring a broad and valuable range of experience to the Company and further details, together with other biographical details, are set out in Section B2. The Chair's other business commitments are also set out in the biographical details section.

Throughout the year the independent non-executive directors have formed the majority of the Board and consequently the balance between independent and non-independent directors has been appropriate. There is a strong non-executive representation on the Board, including the Senior Independent Director, providing effective balance and challenge. The non-executive directors meet with the Chair, from time to time, without the presence of the executive directors. All non-executive directors are appointed for fixed terms. The Chair was considered independent on appointment.

All directors have access to the advice and services of the Company Secretary, who is responsible to the Board for ensuring that board procedures are complied with. Both the appointment and removal of the Company Secretary are matters for the Board as a whole.

The division of responsibilities between the Chair, CEO and Senior Independent Director is clearly established, set out in writing, agreed by the Board and is available on the Group's website.

Matters reserved for the Board

The schedule of matters reserved for the Board, which was reviewed during the year and is available on the Group's website, details the key matters for which the Board is responsible, including:

- Promoting the long-term sustainable success of the Company and Group, generating value for shareholders and contributing to wider society
- Setting and confirming the Group's purpose, values and strategy in a manner that aligns with and promotes the Group's culture
- Approving major capital projects and material acquisitions and disposals
- Approving the annual corporate plan including the business plan, operating and capital expenditure budgets and any material changes to them ensuring that the necessary resources are in place for the Group to meet its objectives and measure performance against those objectives
- Approving the Company's dividend and corporate governance arrangements
- Establishing procedures to manage risk, oversee the internal control framework and determine the nature and extent of the principal risks the Group is willing to take in order to achieve its long-term strategic objectives
- Ensuring that the workforce can raise any matters of concern in confidence and, if they wish, anonymously and that there are no negative repercussions from doing so

Matters considered by the Board

The Board has reviewed a number of discrete projects/items during the year as follows:

- Monitored and reviewed the Group's ongoing project for the submission of its application to the PRA in respect of IRB
- Discussed future IT strategy in particular for SME lending but also on a groupwide basis
- Discussed the integration of the Titlestone acquisition as well as the re-positioning of Paragon Development Finance
- With the Nomination Committee, considered the appointment of a new Audit Committee Chair/Senior Independent Director and other changes to the structure of its committees
- Addressed various governance regulation changes including the 2018 Code
- Considered and managed the potential impact of Brexit and other macro-economic uncertainties on the Group

In addition, it regularly receives, reviews and considers reports on the following matters:

- Strategic matters
- Potential acquisition opportunities
- Business performance
- Results, management accounts and financial commentary
- Operational reports from business areas
- Treasury and funding matters
- Legal and governance matters
- The work of the Board's committees
- Matters arising from subsidiary company board and management meetings
- Investor relations and shareholder feedback

All directors receive sufficient relevant information on financial, business and corporate issues prior to meetings.

Subsidiary governance

A number of the corporate entities within the Group are regulated either by the PRA and the FCA or solely by the FCA. The Company has oversight of these entities as part of its overall responsibility for the management of the Group and also to ensure that the Group's values and standards in regulated spheres are met.

Since the completion of the strategic reorganisation of the Group in September 2017 the directors of the Company have also comprised the Board of Paragon Bank PLC. The boards of both companies meet jointly in most circumstances and the meetings described earlier in the report (with the exception of the meetings of the Nomination Committee) were joint meetings. Oversight of Paragon Bank PLC, consequently, forms an intrinsic part of the board and committee meetings of the Company. Consequently, although Paragon Bank PLC may not be obliged to report its corporate governance arrangements against the 2016 Code, it has, since September 2017, had arrangements similar to those of the Company, excepting that it has no external shareholders.

Composition, succession

Composition and succession for the Board and senior management are considered within the Nomination Committee's report.

Board evaluation

The Board, individual directors and the Board's main committees are reviewed annually, with this year's review being an externally facilitated triennial review as required by the 2016 Code.

A number of providers were considered to undertake this important review, with Independent Board Evaluation ultimately being appointed. The lead review work was undertaken by Ffion Hague. Neither Independent Board Evaluation nor Ffion Hague have undertaken any other work for the Group and have no other connection with the Group.

The evaluation considered the performance of the Board and its Committees and all individual directors (except John Heron, who is due to retire and it is not intended to replace the executive director element of his role), including the Chair. The evaluation process consisted of detailed interviews in June 2019 with every board member. All participants were interviewed for 1.5 hours by Ffion Hague according to a set agenda, tailored for the Board. In addition, the Group's People Director, Chief Risk Officer, Director of Internal Audit and Company Secretary were also interviewed.

Draft conclusions were discussed with the Chair and subsequently discussed with the Board at its meeting in July 2019 with Ffion Hague present. Ffion Hague gave individual feedback to committee chairs on the performance of each committee and discussed the report on the Chair's performance with the Senior Independent Director. This report was subsequently discussed with the Chair. In addition, the Chair received a report with feedback on individual directors (excluding John Heron). Discussion and review of the performance of the executive directors took place at the Remuneration Committee meeting in September 2019 that considered remuneration packages for 2019/20.

A schedule of follow up matters was considered by the Board in October 2019 and actions will be refined and monitored over the next financial year.

The broad message across all contributors to the review was that the Board was covering the appropriate ground, took its responsibilities very seriously and was capable of very effective challenge, for example where acquisition decisions were being considered.

More detailed findings from the evaluation included the following against which progress will be reported next year.

Issue	Recommendation / Action
Board	
Board composition and induction	Certain skills gaps to be filled through future appointments with an emphasis on public company experience. Skills matrix to be updated and regularly reviewed by Nomination Committee, with enhanced training on bespoke topics for non-executive directors.
Succession planning	Succession plans to be enhanced with an emphasis on recruiting for public company experience and training internal candidates. A long-serving executive team requires enhanced succession planning with the depth and range of executive team experience to be enhanced. The Board will identify opportunities to meet high-potential individuals throughout the business as part of its greater focus on succession planning.
Agendas, papers and presentations	Maximising efficiency through condensing presentations, challenging the need for extraneous detail and ensuring all papers are distributed well in advance of meetings. Revised templates to be used to ensure a standard approach to presentations with an appropriate limit on length. Enhanced metrics for non-financial issues to be produced, particularly in relation to customers and employees. Work has commenced on revising presentation methods and styles and will continue during the year.
Board and committee interaction	Enhanced committee reporting to be implemented. Greater challenge in all meetings to be encouraged, with sufficient time allocated for each topic as appropriate.
Nomination Committee	
Succession planning for the Executive Directors to be a key focus for the year ahead.	This will be incorporated, in detail, into the Committee's annual timetable.
Risk and Compliance Committee	
Tighter procedure around committee papers and discipline around the separation between the Committee and main board should be adopted.	Work has commenced to revise presentation methods and styles as noted above, and this will be particularly emphasised for the Risk and Compliance Committee.

Training

The non-executive directors have received presentations during the year on various aspects of the Group's activities. The Board has dedicated one and a half days to training annually and will undertake additional training as required by the Group's strategy and operational needs. By way of example, the Board has received training/updates on such matters as IRB and IFRS9 as well as operational resilience and cyber security during the year. In addition, training has been provided by external advisers on topics such as the economy, and the markets and regulatory environments in which the Group operates or is considering operating in.

The non-executive directors also completed a variety of the regular training modules that are mandatory for all employees. Subjects covered in the year included modern slavery, equality and diversity, health and safety, data protection, money laundering, financial crime, whistleblowing, business continuity, information security and conduct risk.

The Chair concluded her induction programme during the year and this covered such areas as Asset Finance, Savings and operational resilience.

Ongoing development opportunities for all directors will be provided, as required, during the forthcoming financial year. A training schedule is maintained by the Group's Human Resources department.

At the Annual General Meeting the Chair will confirm to shareholders, when proposing the re-election of any non-executive director, that, following formal performance evaluation, the individual's performance continues to be effective and demonstrates commitment to the role. The letters of appointment of the non-executive directors will be available for inspection at the Annual General Meeting.

Audit, risk and internal control

Information on how the Group has applied the provisions of the 2016 Code relating to audit, risk and internal control is set out in section B5.

The directors' responsibility for the financial statements is described in Section B8.

Remuneration

Information on how the Group has applied the provisions of the 2016 Code relating to remuneration is set out in the Directors' Remuneration Report in Section B6.

Nomination Committee

Operation of the Committee

The Committee currently comprises three independent non-executive directors and the Chair of the Board who also chairs the Committee. Additionally, during the year, Patrick Newberry was a member of the Committee until 31 December 2018 and on 24 January 2019 Graeme Yorston was appointed in his place, while Barbara Ridpath replaced Hugo Tudor. Therefore, throughout the year, all of the Committee's members were independent non-executive directors. The Chair was considered independent on appointment as Chair of the Board.

The Committee's role includes:

- Ensuring that there is a formal, rigorous and transparent procedure for the appointment of new directors to the Board of Directors of the Company; to lead the process for Board appointments and make recommendations to the Board. Ultimate responsibility for any appointment remains with the Board
- Keeping under review the structure, size and composition of the Board (including its skills, experience, independence, knowledge and diversity) and making any recommendations it deems necessary to ensure that it is effective and able to operate in the best interests of shareholders and other stakeholders
- Considering re-appointment of directors, re-election of directors and the independence of non-executive directors
- Ensuring that plans are in place for orderly succession to positions on the Board and senior management and overseeing the development of a diverse pipeline for succession to the Board and senior management roles
- Overseeing the Group's initiatives on management diversity, with a particular focus on its participation in external programmes, such as the Women in Finance Charter and reporting such as gender pay reporting

During the coming financial year, the Committee will take on the additional responsibility of monitoring workforce engagement on behalf of the Board.

Issues considered by the Committee during the year

Succession planning - Board

During the year the Committee initiated a search for a new Audit Committee Chair due to the impending retirement of Peter Hartill. This search was undertaken in conjunction with an external management consulting company (Korn Ferry) which has no other connection with the Group or any individual director. A candidate list which emphasised diversity of gender and background was requested and received from Korn Ferry. The search involved candidate interviews with various members of the Board and senior management to ensure cultural fit and the capacity for the candidate to devote sufficient time to the appointment as well as the competence in accounting and auditing necessary for the Audit Committee Chair role.

The Committee considered the balance of skills, experience, independence and knowledge on the Board and in the light of this a description of the role and capabilities required for these appointments was prepared.

In January 2019 the Committee also reviewed the structure of the Board committees following changes to the Board and it proposed that Graeme Yorston cease to be a member of the Audit Committee and became a member of the Remuneration Committee, Hugo Tudor cease to be a member of the Nomination Committee and that Barbara Ridpath be appointed to the Nomination Committee. This was part of the Committee's role to keep under review the structure, size and composition of the Board's Committee and to ensure that each non-executive director has sufficient time to undertake their committee responsibilities as well as broadening the skills base for recently appointed directors to ensure future successful operation of the committees. These changes were agreed by the Board on 24 January 2019.

Succession plans for the Board and senior management were reviewed during the financial year. The tenure of non-executive directors is monitored by the Committee. Emergency cover is in place for the executive directors and their direct reports.

Succession planning – senior management

The Human Resources department has a wider succession development plan for senior management roles across the Group, prioritising those positions likely to require recruitment within the next five years. The Committee has received reports during the year on the Group's senior leadership development programme and will continue to monitor this on a regular basis. Further information can be found in Section A5.2.

Risk mitigation for the loss of senior employees will continue to include the ongoing development of employees, as well as work to further validate potential candidates for senior positions. Development work on potential candidates occurs with those employees remaining in their current roles, as this training is undertaken so as to minimise business impact while ensuring that candidates are enabled to undertake a more senior role in due course. The Group's preference, where possible, is that internal candidates are developed and supported to undertake senior roles as this assists in the ongoing maintenance of its strong culture and values. In addition, the senior leadership development programme is also focusing on increasing the diversity of the Group's talent pool in support of the overall approach to equality and diversity.

Board skills matrix

The Committee considered a revised skills matrix at its September 2019 meeting following the outputs from the Strategy Event in June 2019. The revised matrix will reflect the strategy of the Group becoming a technology-enabled specialist bank by 2025 and as such includes skills consideration on such matters as demonstrating sound knowledge of the UK financial services sector; understanding capital requirements and liquidity models; insight into the application of technology in a financial services environment; and understanding the specialist lending sector.

Diversity

The Group recognises the importance of diversity, including gender diversity, at all levels of the organisation. The Group strongly values diversity on the Board, not only of gender, but also of experience and background, recognising the contribution such diversity can make towards achieving the appropriate balance of skills and knowledge which an effective board of directors requires. The Board is committed to ensuring, in line with the Hampton-Alexander Review recommendations, that female directors will comprise 33% of the Board by the end of 2020 and, as noted above, the Committee is endeavouring to make progress towards this target, despite a challenging market, with the candidate list that was considered for the role of Audit Committee Chair.

The Board has always believed, and continues to believe, in appointing the best person to any role regardless of gender or other points of diversity and this belief is reflected and operates across all appointments made by the Group. However, the Board recognises that measurement and publication of targets can assist in driving forward change and developing a talent pipeline in a sector where gender diversity has been difficult to achieve. For this reason, the Group signed up to HM Treasury's Women in Finance Charter initiative during 2016 and agreed targets in respect of gender and ethnic diversity amongst the Group's senior management.

By the end of September 2019 slightly in excess of 35% of senior roles, using the Hampton-Alexander measure, were female, meaning that the Group had achieved its Women in Finance Charter commitment for 35% of senior management roles to be held by women by 2022, in advance of that date. The Board will review the targets for Women in Finance during the upcoming year.

During the year the Committee reviewed the Group's gender pay report and supporting analysis. It closely monitored changes since the previous report and considered the underlying challenges with the reporting and in the management structure that make balancing gender pay difficult for the Group, as is the case for other financial services firms. This will continue to be a focus for the Committee.

As is clear from the existence of the Women in Finance initiative, obtaining full diversification of gender in the financial services sector is particularly challenging given the size of the female talent pool across the industry. Similar issues apply to advancing diversity of ethnicity in the sector. The targets adopted reflect the Board's commitment to ensuring that diversity considerations throughout the Group are wider than gender. The Committee regularly reviews the Group's Equality, Diversity and Inclusion Policy to ensure good practice is achieved and that policies are compliant with the 2016 Code requirements.

The Group's diversity policies are described in Section A5.2. The Equality, Diversity and Inclusion policy was updated during the year to reflect the 2018 Code. Information on the composition of the workforce, including the gender balance of those in senior management and their direct reports, is given in Section A5.2 and the Group's gender pay statistics are also discussed in that section.

Workforce engagement

The Committee will, in the future, receive an annual report on workforce engagement, as noted in the Chair's statement, and this will form part of its monitoring and reviewing responsibilities under the 2018 Code. In addition to the enhanced role for the People Forum, an overarching framework of workforce engagement will coordinate current employee feedback methods. These include formal structured engagement surveys (which occur in depth on an 18-month cycle as well as more regularly on ad-hoc topics), yearly employee presentations, appraisals, one-to-ones and team meetings, as well as less formal structures such as senior leaders 'walking the floor'. The results from these will be gathered by the People Director and reported to the Executive Committee and the Conduct and Compliance Committee, with the effectiveness of these channels assessed and reported on an annual basis to the Nomination Committee. All employee feedback, either using the existing methods or through the People Forum consultations with the relevant Board member(s), will be collected and analysed to distil a wide range of views for the Board to consider as part of its decision-making process.

B5

Audit Committee

B5.1 Statement by the Chair of the Audit Committee



Peter Hartill, Chair of the Audit Committee

The introduction of IFRS 9 in the period has impacted on the most significant judgemental areas of the Group's accounting...

Dear Shareholder

The year ended 30 September 2019 has been one which has seen significant developments in the auditing, accounting and reporting landscape affecting the Group combining to provide the Committee with a full agenda.

The introduction of IFRS 9 in the period has impacted on the most significant judgemental areas of the Group's accounting with the Committee having to consider the appropriateness of transition adjustments as well as the embedding of the new rules on a business as usual basis.

At the same time, the Committee had to consider changes to its remit required by the introduction of the new Code from 1 October 2019, as well as potential regulatory changes affecting accounting, reporting and auditing in the UK, including those which might arise from the various potential outcomes of the Brexit process.

Internally, as described in Section B4, the membership of the Committee was reviewed following Board changes to enable the remaining non-executive members to provide greater focus on the Committee's remit. The Committee was also subject to review as part of the external board effectiveness assessment (see section B3.2) and welcomed Sarah Mayne as the Group's new Internal Audit Director.

This activity has taken place against a background of growth and change in the Group's business, increasing regulations and guidance and increased focus on audit and reporting issues across the corporate sector as a whole.

As a Committee, our responsibility is to ensure that financial information published by the Group properly presents its activities to all stakeholders and other interested parties in a way that is transparent, useful and understandable, as well as overseeing the effective delivery of both external and internal audit services.

During the year, the Committee met five times and its principal activities were as follows:

- The review of the annual and half-yearly financial statements to ensure these properly present the Group's activities in accordance with accounting standards, law, regulations and market practice
- The consideration of the appropriateness and application of the Group's accounting policies for the recognition of interest income and loan impairment amongst other significant accounting issues
- In particular, considering the impact on accounting for credit losses of the transition to IFRS 9 from 1 October 2018. This included assessment of the approach adopted, assumptions made and disclosures provided in the Group's external and internal reporting

- The review of other financial information published by the Group, such as Pillar III disclosures required by banking regulations
- The supervision of the process leading to the appointment of a new Internal Audit Director and her induction into the business
- The supervision of the internal audit function and consideration of its findings
- Overseeing the integration of the Titlestone operation acquired in the year ended 30 September 2018 into the Group's financial reporting and control framework
- Approval of new terms of reference for the Committee to ensure compliance with the 2018 Code from 1 October 2019
- Considering the Group's readiness to address other forthcoming accounting changes which will affect it, such as IFRS 16

In the financial year ending 30 September 2020 the Committee's main priorities will include:

- Continued monitoring of the Group's IFRS 9 impairment processes in the light of best practice developments and actual outturns
- Considering ongoing developments in the regulatory environments surrounding accounting, reporting and auditing and ensuring the Group is well positioned to respond appropriately
- Ensuring that the Group's control processes evolve alongside developments in the business

This will be my last report as Audit Committee Chair, having announced my intention to stand down from the Board at the next AGM. I would like to thank my colleagues on the Committee, the Group's Internal Audit and Finance teams and the external auditors, both KPMG and the previous incumbents, Deloitte, for their contributions to the Committee's deliberations over the nine years I have served as Chair. These nine years have seen momentous changes in the Group's business, its regulatory landscape and the accounting standards affecting it, and I do not expect any reduction in the pace of change - I wish my successor well in dealing with it.

I commend this report to shareholders and ask you to support the resolutions concerning the reappointment of KPMG LLP ('KPMG') as auditors and their remuneration at the AGM in 2020.

Peter Hartill

Chair of the Audit Committee

26 November 2019

B5.2 Operation of the Committee

The Audit Committee currently comprises four independent non-executive directors of the Company whose relevant experience is set out in Section B2. Additionally, Patrick Newberry served as a member of the Committee until his resignation from the Board on 31 December 2018 and Graeme Yorston was a member of the Committee until 24 January 2019. The terms of reference of the Committee include all matters indicated by Disclosure and Transparency Rule DTR 7.1 and the Code. New terms of reference, aligned with the 2018 Code, were approved in September 2019. The Committee's key responsibilities include:

- Monitoring the integrity of the Group's financial reporting
- Reviewing the Group's risk management and internal control systems
- Monitoring and reviewing the effectiveness of the Group's Internal Audit function
- Monitoring the relationship between the Group and the external auditor

It also provides a forum through which the Group's external and internal audit functions report to the non executive directors, and the effectiveness of these functions is assessed.

The Internal Audit Director reports to the Chair of the Committee. She attends all meetings of the Committee and also reports regularly to the Risk and Compliance Committee.

The Committee considers that, as a whole, it possesses the competence relevant to the sector in which the Group operates that the Code requires. Peter Hartill has competence in accounting and auditing while other committee members have experience in various aspects of the financial services industry.

The Committee meets at least four times a year and has an agenda linked to events in the Group's financial calendar. Meetings generally take place before the half year and year end reporting dates in March and September and before the approval of results in May and November. The Committee normally invites the Chair of the Board, the executive directors, Chief Risk Officer, Group Financial Controller, Internal Audit Director and a partner and other representatives from the external auditor to attend meetings of the Committee, although it reserves the right to request any of these individuals to withdraw.

For part of each meeting the Committee meets separately with representatives of the external auditor and with the Internal Audit Director without any other persons present.

The Committee approves and monitors progress against the Group's Internal Audit Plan. It assesses the adequacy of resources available to the Internal Audit function and it receives reports of internal audit reviews conducted across the Group.

From time to time, when there are major changes in the Group's accounting policies or audit arrangements in progress, the Chair of the Committee has held meetings with shareholders and is prepared to meet investors in the future to discuss such matters.

Details of the Committee members' attendance at meetings and the Board's evaluation of the Committee's effectiveness are given in Section B3.2.

B5.3 Significant issues addressed by the Committee in relation to the Financial Statements

The Committee considers whether the accounting policies adopted by the Group are suitable and whether significant estimates and judgements made by the management are appropriate. In evaluating the Group's financial statements for the year ended 30 September 2019 the Committee considered particularly:

- The calculation of interest income under the Effective Interest Rate ('EIR') method for both internally originated and purchased loan assets and the Group's borrowings
- The levels of impairment provision against loan assets and, in particular, the transition to the impairment requirements of IFRS 9 in the period
- The requirement for any impairment provision against the purchased goodwill carried in the Group's balance sheet
- The derecognition of the assets and liabilities of the Paragon Mortgages (No. 12) PLC ('PM12') securitisation
- The valuation of the deficit in the Group's defined benefit pension scheme
- The viability statement which the Group is required to make under the Code
- The Group's capital and funding position and the Group forecasts for future periods

The Committee also considered whether this Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy.

In each of these areas the Committee was provided with papers discussing the position shown in the accounts, the underlying market conditions and assumptions and the methodology adopted for any calculations. The papers also detailed any changes in approach from previous periods. These were reviewed in detail and discussed with the relevant Group employees and the results of this work were considered, together with the results of testing by the external auditor. There were no material or significant disagreements between the management and the external auditor.

Particular matters which the Committee focused on in each of these areas were:

Matter	Particular areas of focus
Interest income and expense recognition	<p>As required by IFRS 9, the Group recognises income from loan balances on an EIR basis, which is intended to produce a constant yield throughout the behavioural life of the loan, taking account of such matters as costs of procurement, and initially fixed or discounted interest rates. The calculation therefore rests on assumptions about the future behaviour of the Group's customers. A similar approach is taken to assessing interest on borrowings, where redemption profiles and anticipated refinancing dates influence expense recognition.</p> <p>The Committee assessed the appropriateness of the assumptions made, considering performance of the portfolios against expectations and the impact of changes in product specifications.</p> <p>Redemption profiles used in the modelling of mortgage books and the availability of alternative offerings in the market were areas of particular focus.</p> <p><i>Further information on these estimates can be found in note 65b to the accounts, and the interest income and expense recognised on this basis is shown in notes 4 and 5.</i></p>
Loan impairment	<p>IFRS 9 requires that companies provide for expected future credit losses on any financial asset held on the balance sheet on the amortised cost basis.</p> <p>As a forward-looking measure, the determination of such provisions is heavily dependent on the use of judgement and estimation techniques to evaluate the likelihood of loss on accounts and the potential amount of any loss, should one occur.</p> <p>In order to satisfy itself that the process applied by the Group resulted in an appropriate level of provisioning in accordance with IFRS 9, the Committee considered particularly:</p> <ul style="list-style-type: none"> • The methods used to estimate probabilities of loss and potential losses • The assumptions used as inputs in these calculations • The economic projections used in deriving future loss expectation • The definitions of significant increase in credit risk, credit impairment and default for expected credit loss ('ECL') purposes <p>To substantiate these decisions, the Committee considered actual results in the year compared to those predicted by the impairment methodology and the continuing relevance of historical information used in the process based on present economic conditions, lending and account administration practices.</p> <p>Particular consideration was given to the Group's receiver of rent portfolios and the level to which their ultimate loss levels accorded with expectations. The Committee also reviewed the appropriateness and adequacy of additional provisions made for particular cases and factors not allowed for in the impairment process.</p> <p><i>Further information on these estimates can be found in note 65a to the accounts, the impairment charge for the year and the movements in provision for impairment are shown in note 23.</i></p> <p><i>The Group's exposure to credit risk is discussed in note 57.</i></p>
Goodwill impairment	<p>The Group is required to assess, at the end of the year, whether the carrying value of the acquired goodwill balance in its accounts, which is not subject to amortisation under IFRS, remains appropriate or whether any impairment has occurred. This includes both newly acquired goodwill and goodwill arising from previous acquisitions.</p> <p>In considering whether any impairment of goodwill had occurred the Committee considered particularly the Group's forecasts for the cash flows to be generated by the acquired businesses and their reasonableness in the light of current trading performance and the Group's strategy for these operations.</p> <p><i>The potential impairment of goodwill is discussed in notes 65c and 29.</i></p>

Matter	Particular areas of focus
Derecognition of assets and liabilities	<p>During the year, the Group disposed of its residual interest in the PM12 securitisation transaction. IFRS 9 requires the directors to consider whether the terms of this transaction meet the criteria set out in the Standard for derecognition of the assets and liabilities of the securitisation.</p> <p>The Committee considered the contractual terms of the transaction, the changes brought about in the Group's risk exposures and the detailed rules set out in the standard. They also took account of views expressed by external technical experts.</p> <p><i>The nature of this judgement is discussed in note 64 and the financial effect of the transaction is discussed in note 7.</i></p>
Pension deficit	<p>The deficit on the Group's defined benefit pension plan is valued in accordance with IAS 19, which requires an actuarial valuation of the plan liabilities. Such a valuation is based on assumptions including market interest rates, inflation and mortality rates in the Plan.</p> <p>In order to satisfy itself as to the appropriateness of these assumptions, the Committee considered their derivation and the market data underlying them. These were compared to market benchmarks and advice from the Group's actuarial advisers. The Committee also considered benchmarking data provided by the external auditor.</p> <p><i>Further information on the Plan deficit, the basis of valuation and the assumptions underlying it can be found in note 41 to the accounts, along with an analysis of sensitivities to the more significant assumptions.</i></p>
Viability statement	<p>The Board is required by the Code and the Listing Rules to make a viability statement in the Annual Report. The Committee has been asked to express an opinion to the Board as to whether this statement could properly be made.</p> <p>The Committee considered aspects of the work of the Board and its various committees which addressed the Group's business model, risk profile, access to funds and future strategy. They also considered guidance issued by the FRC and stress testing which had been carried out in the year.</p> <p><i>A fuller discussion of the directors' consideration of the viability statement is set out in Section A4.</i></p>
Capital and funding	<p>The Board is required by the Code and the Listing Rules to make a going concern statement in the Annual Report. The Committee has been asked to express an opinion to the Board as to whether this statement could properly be made.</p> <p>The Committee considered the Group's detailed forecasts and the implicit cash and capital requirements. The Committee discussed availability of funding, potential stress events and the impact of the economic environment.</p> <p><i>A fuller discussion of the directors' consideration of the going concern statement is set out in Section A4.</i></p>
Internal Control and Risk Management	<p>The Board is required to make statements in the Annual Report and Accounts relating to the Group's systems of internal controls and risk management.</p> <p>The Committee considered an evaluation prepared by the Risk function, together with the findings of internal audit reports in the year and its own engagement with the management information of the Group and the executive directors. On the basis of these activities the Committee concluded that it could advise the Board that the statements were appropriate.</p> <p><i>The Board statements on internal control and risk management are set out in Section B3.</i></p>
Fair, balanced and understandable	<p>The Board is required by the Code to state whether, in its view, the Annual Report is fair, balanced and understandable. The Committee has been asked to express an opinion to the Board as to whether this statement could properly be made.</p> <p>The Committee considered the draft Annual Report for the financial year, as a whole, satisfying itself that the process for the preparation and review of its various sections, was appropriate. The Committee especially focussed on areas where disclosure requirements had changed or where new activities were to be reported on. Based on this exercise, and the Committee's own understanding of the business in the year, it determined whether the Annual Report, overall, portrayed the Group's activities, position and results properly.</p>

The discussion of future accounting changes required by IAS 8 (note 62) is an output of the ongoing IFRS 16 implementation project which the Committee has considered during the period and the Committee reflected upon whether the disclosure made in the accounts was appropriate.

The Committee was able to reach satisfactory conclusions on all of these areas and therefore resolved to commend the Annual Report to the Board for approval, and to advise the Board that it can conclude that the Annual Report is fair, balanced and understandable.

Earlier in the year the Committee had considered each of these areas, where applicable, in the same manner in concluding that it could commend the Group's half-yearly financial report for the six months ended 31 March 2019 to the Board for approval.

The Committees consideration of the financial statements for the year ended 30 September 2018, which took place in the year under review, is discussed in the Audit Committee report for that year.

B5.4 Other financial reporting matters considered by the Committee

IFRS 9 Transition

On 20 March 2019, the Group published a report outlining the financial and capital impacts of its transition to IFRS 9 as at 1 October 2018. The Committee considered this report and the basis on which it was prepared, in the same way as detailed for the year end under 'Loan Impairment'. It also considered its communications with the external auditors on the subject of IFRS 9 to the date of approval. Following this consideration, the Committee was able to commend the transition report for Board approval as a fair representation of the impact of transition.

Pillar III report

The CRR requires that a firm's Pillar III report is subject to the same review processes as its annual report and accounts. The Committee therefore reviewed the Group's Pillar III report, considering whether it included all material matters required by the CRR and its supporting requirements, and whether it formed a fair representation of these matters.

Correspondence with FRC

During the year, the Group's financial statements were reviewed by the Conduct Committee of the FRC. Such reviews are based on the annual report and accounts alone, and do not benefit from detailed knowledge of the Group's business or individual transactions reported upon, but are carried out by FRC staff who have an understanding of the relevant legal and accounting frameworks. FRC reviews provide no assurance as to the correctness of accounts, they consider only compliance with reporting requirements and the FRC accepts no liability to the Group or third parties in respect of them.

The Group prepared a response to the FRC which was presented to the Committee together with appropriate supporting information. These were considered by the Committee who also consulted with the external auditor before the response was provided to the FRC.

Following receipt of the response, the FRC closed its enquiry. The FRC's observations have been considered in drafting the financial statements for the year ended 30 September 2019, particularly in the compilation of the new and extended disclosures under IFRS 7, required for the first time this year.

B5.5 External auditor

The Committee is responsible for assessing the effectiveness of the external audit process, for monitoring the independence and objectivity of the external auditor and for making recommendations to the Board in relation to the appointment and remuneration of external auditors. The Committee is also responsible for developing and implementing the Group's policy on the provision of non-audit services by the external auditor, which was reviewed in the year.

Audit tendering

On 24 September 2014, the Competition and Markets Authority finalised its investigation into the audit market and published The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 (the 'Order'). The provisions of the Order are consistent with requirements introduced by European legislation. The Order first applied to the Group from the beginning of the year ended 30 September 2016 and requires that only the Committee can agree the fees and terms of service of the external auditors, initiate and supervise a tendering process or recommend the appointment of an external auditor to the Board following a tender process. The Group has complied with the requirements of the Order during the year.

KPMG were appointed as auditors, following a competitive tender process, with effect from the year ended 30 September 2016 at the Annual General Meeting in February 2016. The financial year ended 30 September 2019 is the fourth reported on by KPMG. Simon Clark has served as engagement partner since the year ended 30 September 2018. He has been involved in the audit assignment since KPMG's appointment.

The Group is therefore not subject to a legal requirement to undertake an audit tender until ten years have elapsed, and will report to shareholders no later than after the completion of the fifth year (the year ending 30 September 2020), and in each subsequent year thereafter, its conclusions on whether a further tender is in the Group's interest at that time.

Other than the legal requirements of the Order and the general constraints imposed by the current structure of the UK audit market, the Committee has not identified any factors which might restrict its choice of external auditor.

Audit effectiveness

The Committee has considered the effectiveness of the external audit for the year ended 30 September 2019 and the Group's relationship with the external auditor, KPMG, on an on-going basis, and has conducted a formal review of the effectiveness of the annual audit before commending this Annual Report to the Board. This review consisted of the following steps:

- A list of relevant questions was considered by senior management who submitted their responses in writing to the Committee in advance of the meeting convened to consider the Annual Report
- The Committee members considered their experience of the audit process in advance of that meeting
- At the meeting the Committee discussed the results of the exercise with the senior financial management of the Group, without the external auditor present
- The Committee then addressed the evaluation, as appropriate, with the external auditors

The Committee was able to conclude, on the basis of this exercise and its experience over the year, that the external audit process remained effective and that the auditor was independent and objective, up to the signing date of this report. A further review will be carried out following the completion of audit procedures on all Group companies and reported on in next year's Annual Report.

The effectiveness review addressing the conduct of the 2018 audit, undertaken at the time of approval of the 2018 Group accounts was updated once the external audit process for all Group companies had been completed and affirmed the original conclusion, that the external audit was independent and objective and that the audit process was effective for that financial year.

In conjunction with the effectiveness review, before recommending the re-appointment of the External Auditor, the Committee must consider whether they are able to provide the required service to the appropriate standard and are independent of the Group. To this end, the Committee considered whether KPMG's understanding of the Group's business, their access to appropriate financial services and regulatory specialists within their firm, both locally and nationally, and their understanding of the sectors in which the Group operates were appropriate to the Group's needs.

As part of this exercise the Committee also considered the transparency report presented by the external auditor and the FRC's most recent audit inspection review on KPMG, published in July 2019. In this report the FRC noted that while results at KPMG had improved year-on-year, the firm remained subject to increased regulatory scrutiny. The Committee received a presentation from the external auditor which described the steps being taken by the firm to enhance audit quality and discussed this and the FRC findings with the audit partner and other representatives.

As a result of these exercises the Committee concluded that it would recommend to the Board that a resolution to reappoint KPMG as external auditor for the year ending 30 September 2020 should be proposed at the forthcoming AGM.

Independence policy

Both the Committee and the external auditor have safeguards in place to avoid any compromise of the independence and objectivity of the external auditor. The Committee considers the independence of the external auditor annually and the Group has a formal policy for the engagement of its external auditor to supply non-audit services, reviewed, most recently, in September 2019. The policy is designed to ensure that neither the nature of the service to be provided nor the level of reliance placed on the services could impact the objectivity of the external auditor's opinion on the Group's financial statements.

The policy precludes the appointment of the external auditor to provide any service where there is involvement in management functions or decision making, or any service on which management might place primary reliance in determining the adequacy of internal controls, financial systems or financial reporting. It also precludes the external auditor from providing tax or remuneration advice. Internal audit services may not be provided by the external auditor. The Committee must approve any engagement of the external auditor for non-audit work, except where the fee involved is clearly trivial. The policy sets out rules for the employment of former employees of the external auditor and procedures for monitoring such persons within the organisation.

The Committee reviews, on a regular basis, the levels of fees paid to all major accounting firms to identify any matters which might impact on those firms' ability to tender for the group audit at any future date.

Fees paid to the external auditor

Fees paid to the external auditor are shown in note 13 to the accounts. No services other than services required to be provided by external auditors by legislation or regulation, such as the review of half-yearly financial information and profit verification for regulatory purposes, were provided by KPMG.

Audit fees of Group entities for the year have increased by 16.4% to £1,352,000 (2018: £1,161,000). This was a result of an increase in scope as a result of acquisitions and additional work related to the introduction of IFRS 9.

No fees were paid to KPMG, the Group's external auditor, for non-audit services during the year (2018: £68,000, excluding VAT).

The EU Audit Regulation (which is directly applicable in the UK for the time being) contains a 70% cap on non-audit fees for services provided to EEA Public Interest Entities ('PIEs') including audit-related services other than those services required by EU or national law. The calculation applies for the first year commencing after June 2019 which means that this restriction applies from the Group's year ending 30 September 2020. Non-audit fees paid to the auditor for the year ending 30 September 2020 should be no more than 70% of the average of the audit fees for 2017, 2018 and 2019, expected to be approximately £750,000.

The Group actively considers other providers for the type of non-audit services typically provided by accounting firms. It maintains on-going relationships relating to tax, remuneration and regulatory advice with firms other than the external auditor's firm and considers discrete projects on a case-by-case basis. The Group has engaged with a number of firms, including some outside the 'big four' largest audit firms for assignments during the year, assessing each firm's appropriateness for the particular assignment before an appointment was made. Fees paid to audit firms (excluding VAT), excluding the Group audit and related fees, can be analysed as shown below:

	2019	2018
	£000	£000
Auditors – KPMG	-	68
Other big four firms	2,393	926
Other firms	6	3
	2,399	997

The Group maintains relationships with all of the major accounting firms and considers a variety of providers for this type of assignment.

B5.6 Internal Audit

The Committee is responsible for considering and approving the remit of the internal audit function, approving the internal audit plan, and ensuring it has adequate resources and appropriate access to information to enable it to perform its function effectively and in accordance with the relevant professional standards. The Committee also ensures that the internal audit function has adequate standing and is free from management or other restrictions which may impair its independence.

Operations

During the year, the Committee considered and approved the annual internal audit plan, which is based on an assessment of the key risks faced by the Group. Progress in respect of the plan is monitored throughout the year and the Committee assesses, on an ongoing basis, whether the internal audit function has sufficient and appropriate skilled resources to complete the plan. With the approval of the Committee, the audit plan and the related resource requirement may be revised during the year, based on the ongoing assessment of the key risks or in response to the requirements of the Group.

The Internal Audit Director met regularly throughout the year with the Chair of the Committee to discuss progress against plan, outstanding agreed actions, and departmental resourcing. Ahead of finalisation of the audit plan for the year ending 30 September 2020, the Chair of the Committee met with the Internal Audit Director to discuss audit planning priorities, key business risks and assess current resourcing.

During the year, the appointment process for the Group's new Internal Audit Director was finalised and she took up her appointment in November 2018. Following her appointment, she underwent a thorough programme of familiarisation with the Internal Audit function and the Group's activities and, following this, considered potential enhancements to the Internal Audit approach.

At the request of the PRA, as part of a market-wide review, during the year ended 30 September 2019, internal audit has undertaken specific review work to assess the adequacy of management information provided to the Board to measure and monitor operational resilience against risk appetite. This review was co-sourced under an agreement with a third-party accounting firm on a subject matter expertise basis. Certain other technical or specialist reviews of the first and second line have also been undertaken including an element of co-sourced input where it was deemed by the Internal Audit Director that such skills would complement and develop those of the internal team.

All internal audit reports are circulated to the Board. Significant findings of internal audit reports are discussed at meetings of the Committee throughout the year. Overdue actions graded medium or above are reviewed and challenged at both the Committee and the Risk and Compliance Committee.

Effectiveness

The Committee assesses the effectiveness of the Internal Audit function by reference to standards published by the Chartered Institute of Internal Auditors. In 2019, the Committee considered the output of an internal quality assessment prepared on this basis and concluded that the function was satisfactory.

An external quality assessment ('EQA') was last commissioned in 2018 to benchmark internal audit activities against best practice and peers. Progress on the EQA actions arising from this review has been reported to and monitored by the Committee in the year to ensure they are being properly addressed.

As a matter of policy, the Committee intends to commission an EQA at least every five years.

B5.7 Whistleblowing

The Group has an established procedure whereby employees can make disclosures regarding malpractice within the Group on a confidential basis, in accordance with the Public Interest Disclosure Act 1998 ('PIDA'). The policy also makes provision to ensure that no employee making such a disclosure suffers any detriment by doing so. A whistleblowing service is operated for the Group, at arm's length, by a third-party charity, Protect. This process was supervised by the Committee during the year and any amendments to the policy required the approval of the Chair of the Committee.

During September 2019, responsibility for receiving and acting on whistleblowing reports was transferred from the Committee to the Board, in accordance with the requirements of the 2018 Code. The Committee will retain responsibility for reviewing the operation of the process.

There is a right of appeal, currently to the Chair of the Committee, where the employee is dissatisfied with the outcome and his decision is final in all cases.

To ensure that the policy is embedded in the operations of the Group all employees received training on the requirements of PIDA and the Group's policy during the year and were tested to ensure their understanding. There were also internal publicity campaigns promoting the whistleblowing procedures.

During the year ended 30 September 2019, a small number of whistleblowing incidents were investigated. Each matter was fully reviewed by the Whistleblowing Committee and subsequently considered by the Committee. The investigation found that none of the incidents were material in nature. Whilst actions did arise following the investigations, these were minor.

B6

Remuneration report

This report covers the activities of the Remuneration Committee for the year ended 30 September 2019 and sets out the remuneration details for the executive and non-executive directors of the Company. It has been prepared in accordance with Schedule 8 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, as amended, and the principles of the Code.

This report consists of the Statement by the Chair of the Committee (B6.1), the Annual Report on Remuneration (B6.2) and the full Remuneration Policy (B6.3) proposed to apply from the close of the Annual General Meeting to be held on 13 February 2020.

B6.1 Statement by the Chair of the Remuneration Committee

Dear Shareholder

The philosophy underpinning the Group's remuneration policy remains unchanged and continues to be adopted throughout the organisation; seeking to recognise fairly and equitably the contributions of all employees within the Group. For executive directors, the aim is to ensure that their rewards are aligned with the interests of shareholders through the achievement of both the Group's shorter term and strategic objectives, whilst meeting the core objective of being motivating and retentive. The Committee listened to the feedback at the 2019 AGM and recognised the need to alter the approach to determining short term incentive awards, in particular to remove the scalar in the year ended 30 September 2019 for the executive directors. The results of this are set out in the Annual Report on Remuneration.

Business performance

The year saw growth in the Group's loan books, with new lending up 8.5% to £2,532.4 million which contributed to an increase in underlying profit by 5.0% to £164.4 million. Profit before tax on the statutory basis fell by 12.4% to £159.0 million following a £28.0 million gain on Idem Capital assets in 2018. This led to underlying EPS increasing by 6.0% to 51.1 pence (2018: 48.2 pence) and statutory EPS decreasing to 49.4 pence (2018: 55.9 pence).

Funding was enhanced with the continued growth of the Group's savings deposit base to £6.4 billion from £5.3 billion a year earlier, whilst continuing to access the capital markets through the latest securitisation. The Group's capital position remains strong, with a regulatory CET1 ratio of 13.7% (2018: 13.8%), representing a more efficient capital position enhanced by the sale of a legacy residual securitisation investment and accompanying share buy-back.

Variable pay earned in the year

Reflecting on shareholder feedback, during the year the Committee made some changes to the operation of the annual bonus. These changes reflect current best practice and support the introduction of the new policy set out below. The personal scalar element has been removed from the bonus framework and the assessment of performance has transitioned to a scorecard of performance metrics: 30% financial performance, 30% strategic and future value, 20% risk management, 20% personal performance.



Hugo Tudor, Chair of the Remuneration Committee

The philosophy underpinning the Group's remuneration policy remains unchanged... seeking to recognise fairly and equitably the contributions of all employees within the Group...

The Committee has reflected the strong performance in the year when applying the existing remuneration policy and changes made to the operation of the bonus following shareholder feedback at the 2019 AGM. Performance bonuses of 89.4% of maximum for Mr N S Terrington, Mr R J Woodman and Mr J A Heron have been awarded. In reaching its decision the Committee has reviewed performance against a number of financial and risk-based targets, as well as taking individual performance into account.

This year's bonus awards reflect the executive directors' excellent performance in achieving an increase in underlying profit, RoTE, NIM progression and new lending (details of which are noted further in the report) within a turbulent and uncertain external environment and replacing income lost through the amortisation of the Idem Capital portfolio. The objectives are detailed in section B6.2.2, including disclosure of the target range for the year ended 30 September 2019, as well as retrospective disclosure for the year ended 30 September 2018. This year's target range is being disclosed immediately following the financial year for the first time in response to shareholder feedback.

Long term incentive awards under the Paragon Performance Share Plan ('PSP') which were granted in December 2016 are due to mature in December 2019. These awards are subject to performance conditions related to a Total Shareholder Return ('TSR') performance condition, measured against a bespoke comparator group of listed financial services entities (50% of the award), EPS growth (25% of the award) and for the first time a risk condition based on factors including regulatory, customer, conduct, operational, credit, capital and liquidity risks (25% of the award).

The performance of the business over the three-year performance period was very strong, leading to the TSR element vesting in full, and the EPS (22.94% out of a possible 25.00%) and risk (22.50% out of a possible 25.00%) elements vesting at near maximum. The outcome of the risk condition has been independently assessed by the Committee, supported by the Chair of the Risk and Compliance Committee and the Group's Chief Risk Officer. The Committee has considered the financial underpin for these awards, which for the 2016 award was different for Bank employees at the time prior to vesting, and agreed that based on this evaluation, 95.44% of these awards will vest on 1 December 2019.

Shareholder engagement and key changes to the remuneration structure for 2020

The current remuneration policy was approved by shareholders at the 2017 AGM to apply for a period of three years. Therefore, the Group's remuneration policy must be put to the shareholders again at the 2020 AGM and, consequently, the Committee undertook a full and comprehensive review of the policy during the year. Since the 2019 AGM, an active dialogue with the majority of the Group's major shareholders has been maintained and a series of productive and helpful consultations have taken place with me, the Chair of the Board and the Company Secretary. A total of 18 shareholders took part in these consultations, equating to approximately 69% of total voting rights (based on the Company's total voting rights as at 30 September 2019) and I am extremely grateful for their constructive feedback. These meetings were positive in tone whilst appropriately challenging and, importantly, have helped to shape the Committee's thinking in the design of the new policy.

Continued strong and sustainable growth for the Group will mean it is likely to be subject to increased financial services specific remuneration requirements during the lifetime of the new policy. As a result, the Committee is proposing a significant restructuring of the balance between fixed and variable pay for the executive directors, as well as potentially longer time horizons on pay in due course, and the key changes are set out below.

The policy is intended to apply for the three years following the 2020 AGM, in line with the legal requirement. In developing the new policy, the Committee had four key objectives:

- Responding to shareholder feedback

Defining a balanced set of metrics which reward fairly, drive the Group's strategy, align to the Group's values, promote a strong culture and are supported by shareholders

- Addressing regulatory requirements over the lifetime of the new policy

The Committee anticipates the Group, during the policy lifetime, becoming subject to increased levels of remuneration regulation as a larger firm (known as a Level 2 CRD IV firm). Consequently it needs to rebalance pay to ensure compliance with the 2:1 variable pay cap in readiness for this change now, so that shareholders have full visibility of the remuneration changes ahead

- Delivering alignment with the 2018 Code

Develop policies which will be compliant going forward including improving alignment on pension provision

- Meeting the Committee's remuneration philosophy

Apply the same reward principles throughout the Group to motivate and retain senior management and key roles critical to the delivery of the Group's strategy, rewarding fairly for strong performance and delivering a balanced package of fixed and variable pay, short and long term incentives with a focus on using equity

To reflect the objectives and to meet the requirements of CRD IV the Committee is proposing to:

- Introduce a cap on variable remuneration of twice fixed remuneration
- Increase the base salary of the CEO and CFO by 19% to support in rebalancing remuneration
- Introduce a fixed role-based allowance, paid in shares and released in five equal annual tranches
- Reduce pension contributions from 45% of salary to 20% of salary for incumbent executive directors to align with average contributions made to the wider workforce. For new external hires, pension contributions to be 10% of salary
- Reduce the maximum annual bonus opportunity from 200% of salary to 150% of salary
- Reduce the maximum annual PSP opportunity from 200% of salary to 180% of salary
- Reduce weighting on relative TSR under the PSP with awards granted under the new policy assessed against a broader scorecard of metrics: 25% relative TSR, 25% EPS, 25% risk, 25% customer and people metrics
- Introduce a two year holding period post vesting for the PSP
- Introduce a formal post-employment shareholding requirement to align executive directors' interests further with those of shareholders
- Extend malus and clawback provisions to ensure the Committee has the appropriate authority to reduce remuneration in the appropriate scenarios
- Introduce significantly extended deferral and retention variable pay requirements once the Group becomes a PRA Level 2 remuneration firm to align with regulatory rules and expectations for Senior Managers

The impact of all of these changes is for the cash paid to executive directors to be slightly lower but with the addition of the role-based allowance the non-variable element of the package increases by approximately 18%. At maximum the total package increases by about 3.5% reflecting an inflationary increase for the year. We considered carefully the argument to reduce this, reflecting the greater certainty from a higher non-variable package, but, in light of the significant deferrals that arise from CRD IV, we believe that this would be unreasonable.

Overall, variable pay will continue to be a key component of reward but is rebalanced to address the fact the Group is on the cusp of Level 2 status. Pension is significantly reduced to bring closer alignment with provision for the average of the workforce and variable pay will be more heavily geared to long term and equity incentives. The role-based allowance will deliver further value in equity and extending this allowance over five years will drive shareholder alignment.

The most important challenge for the Committee will be to continue to ensure that the remuneration policy remains appropriately structured to retain and motivate the executive directors, whilst providing alignment with shareholders and, critically, directly linking to the achievement of the Group's strategy.

I commend this report to shareholders and ask you to support the resolutions to approve the Company's Directors' Remuneration Report and the new remuneration policy set out in Section B6.3.

Hugo Tudor

Chair of the Remuneration Committee

26 November 2019

B6.2 Annual report on remuneration

Remuneration summary

The information provided in this section is not subject to audit

Aligning our pay principles to our strategy during the year ended 30 September 2019:

The success factors on which the Group's strategic priorities are based	Translation into reward principles and structure	
	Bonus	Performance share plan
Credit quality	Risk measures and future value of new business	Risk assessment
Loan pricing	Future value of new business and financial performance	EPS growth and TSR
Funding	Risk measure and financial performance	EPS growth, TSR and risk assessment
Strong financial foundations	Financial performance	Relative TSR, EPS and risk assessment
Efficient utilisation of the Group's capital base	Risk measures	Relative TSR and risk assessment
Cost control	Profit measures and personal objectives	EPS growth
A customer focused culture	Personal objectives	Risk assessment includes customer engagement measures
These success factors deliver enhancement of shareholder value and align with the Group's reward structure		

At a glance summary of remuneration during the year ended 30 September 2019:

	Salary increase	Salary £000	Bonus earned as % of maximum	PSP vesting
N S Terrington	3%	503	89.4%	95.44%
R J Woodman	3%	317	89.4%	95.44%
J A Heron	3%	268	89.4%	95.44%

The annual report on remuneration includes:

- The Remuneration Committee, its key responsibilities and advisers (B6.2.1)
- The remuneration of the directors for the year ended 30 September 2019 (B6.2.2)
- How the remuneration policy will be applied to the directors in the year ending 30 September 2020 (B6.2.3)
- Other disclosures required by the Regulations (B6.2.4)
- Policy for executive and non-executive directors for approval at the AGM in 2020 (B6.3)

B6.2.1 The Remuneration Committee, key responsibilities and advisers

The information provided in this section is not subject to audit

Committee membership during the year ended 30 September 2019

The members of the Committee during the year were:

Hugo Tudor	Chair
Fiona Clutterbuck	Member all year
Peter Hartill	Member all year
Graeme Yorston	From 24 January 2019
Patrick Newberry	Until 31 December 2018

None of the non-executive directors who sit on the Committee has any personal financial interest (other than as a shareholder) or conflict of interest arising from cross-directorships or day-to-day involvement in running the business.

Key responsibilities

The Committee determines the Company's policy on executive remuneration, including pension rights and compensation payments of the executive directors. It sets the remuneration for each of the executive directors, the Chair of the Board, the Company Secretary, all Senior Management and Certification Regime personnel under the rules of the PRA/FCA which includes the Director of Internal Audit and the Chief Risk Officer.

The Committee will also review workplace remuneration and related policies and the alignment of incentives and rewards with culture; and when setting the policy for executive director remuneration, take into account those matters.

It will also consider the Group remuneration policy for all employees (excluding executive directors) and review and approve the Group's schedule of Material Risk Takers, under financial services regulatory remuneration rules.

No director contributes to any decision about his or her own remuneration.

The terms of reference for the Committee are available on the Group's website.

Attendees

The CEO, People Director, Chief Risk Officer, Company Secretary, other non-executive directors (including the Chair of the Risk and Compliance Committee) and external remuneration advisers attend by invitation.

Advisors

During the year, the Committee considered advice from:

- Deloitte LLP ('Deloitte') who were appointed as the Committee's independent advisor in February 2016 following a review process. Deloitte is a founder member of the Remuneration Consultants Group and as such voluntarily operates under its Code of Conduct in relation to executive remuneration in the UK. This supports the Committee's view that all advice received during the year was objective and independent

The total fees paid to Deloitte for advice to the Committee during the year amounted to £160,000 (including VAT). Deloitte provided other professional services to the Group during the year including share scheme advice, regulatory support, customer contact support and co-sourced internal audit services

- The CEO, the Chair of the Risk and Compliance Committee, the People Director and Chief Risk Officer in determining remuneration for the year for executive directors and senior management

Statement of voting at Annual General Meeting

The table below sets out actual voting in respect of the resolutions to approve the Annual Report on Remuneration at the Company's AGM on 14 February 2019 and the Remuneration Policy at the AGM on 9 February 2017.

Resolution	Votes for	% for	Votes against	% against	Total votes cast	Votes withheld
Annual Report on Remuneration	170,875,932	86.36	26,986,282	13.64	197,862,214	6,557,937
Remuneration Policy	195,090,537	95.06	10,145,210	4.94	205,235,747	4,242

B6.2.2 Directors' remuneration for the year ended 30 September 2019

The information provided in this section has been audited

Single total figure of remuneration for executive directors

Year ended 30 September 2019	N S Terrington £000	R J Woodman £000	J A Heron £000	Total £000
Fixed remuneration				
Salaries and fees	503	317	268	1,088
Allowances and benefits ¹	14	12	12	38
Benefits in kind from the performance of duties ²	11	-	15	26
Pension allowance	226	143	121	490
Variable remuneration				
Cash bonus	687	437	372	1,496
Deferred bonus	212	129	107	448
Dividend on vested deferred bonus ³	-	-	25	25
Share awards	1,222	769	651	2,642
Total	2,875	1,807	1,571	6,253

Year ended 30 September 2018	N S Terrington £000	R J Woodman £000	J A Heron £000	Total £000
Fixed remuneration				
Salaries and fees	489	308	260	1,057
Allowances and benefits ¹	14	12	12	38
Benefits in kind from the performance of duties ²	7	-	20	27
Pension allowance	220	138	117	475
Variable remuneration				
Cash bonus	672	428	364	1,464
Deferred bonus	207	126	105	438
Dividend on vested deferred bonus ³	-	16	-	16
Share awards ⁴	817	515	436	1,768
Total	2,426	1,543	1,314	5,283

1. "Allowances and benefits" includes private health cover, fuel benefit and company car provision or company car allowance (£10,000 to £12,000).
2. "Benefits in kind from the performance of duties" – the Company reimburses executive directors in respect of certain travel costs incurred in connection with the performance of their duties. The Group has been advised that the reimbursement of some of these costs constitutes a taxable benefit in kind. The Group has agreed to provide an allowance to these directors to cover the tax liability. The amounts shown represent the payments HMRC treats as taxable together with an allowance to cover the tax.
3. Dividend on vested bonus is the accrued dividends to the date of exercise paid on deferred bonuses which were exercised during the year. Under the policy which was adopted at the 2017 AGM, dividends will accrue to the point of vesting on deferred share awards made in respect of the year ended 30 September 2017 and thereafter.
4. The share awards value for the year ended 30 September 2018 has been restated to reflect the market value of the shares under the PSP that vested on 22 December 2018 as at that date.

Pension allowance and pension accruals

Nigel Terrington, Richard Woodman and John Heron were members of the Paragon Pension Plan ('the Plan'), the Group's defined benefit pension plan, until 30 September 2016. Following which time, they took a cash equivalent transfer of benefits in the Plan, receiving a lump sum value on a no gain, no loss basis and have no further entitlement.

The executive directors had previously ceased pension accrual under the Plan in return for a cash supplement calculated, as a percentage of salary, to equate to the cost of the Group's contributions towards future service benefits had each individual stayed within the Plan for their future service accrual. This supplement was assessed every three years and was last assessed by the Group's actuaries during 2017. Following this assessment, recognising the substantial cost to the Group of meeting these obligations, the Committee asked the executive directors to agree to fix this cash supplement at 45% of base salary so that the Group would have known costs associated with pension provision. For all three directors, the fixed percentage was a lower amount than their actual contractual entitlement based on the most recent figures presented by the Group's actuaries.

These contributions in respect of further pension provision for each of the directors are shown as 'pension allowance' in the single total figure of remuneration table. The change to 45% was made with effect from 1 April 2017, and no compensation was paid or payable to the executive directors in respect of this change.

Annual bonus

The annual bonus for the year ended 30 September 2019 was based on performance against business, financial and risk measures and personal strategic objectives. The personal element was altered part way through the year in response to shareholder feedback at the 2019 AGM with the scale factor removed and a broader range of financial measures considered by the Committee. Consequently, the bonus award allocation was as follows:

Balanced scorecard of objectives	Maximum award	Bonus outcome
Financial performance Operating profit Return on tangible equity Net Interest Margin ("NIM") progression Net loan increases	30%	23.6%
Future value and strategic development Development activities Pipeline Embedded value Liability management	30%	25.8%
Risk management Operation within levels for risk tolerance metrics agreed by the Board	20%	20.0%
Personal performance Delivery against personal objectives	20%	20.0%
Total	100%	89.4%

Balanced scorecard assessment

Performance for the year and the resulting award levels in respect of the business element were as follows:

Measure	Weighting	Threshold	Target	Stretch	Actual	Outcome	Overall
Financial performance	30%						
Underlying profit	45%	£160.0m	£164.0m	£170.0m	£164.4m	24.1	
Underlying RoTE	40%	14.0%	14.25%	14.50%	14.60%	40.0	
Underlying NIM progression	10%	0.02%	0.05%	0.08%	0.08%	10.0	
Net loan increases	5%	3.0%	5.0%	7.5%	7.0%	4.5	
						78.6	23.6%
Future value & strategy	30%	Qualitative assessment by the Committee of:					
Development activities	25%	Development activities during the year PM12 disposal Expanded savings addressable market			PM12 disposal at premium to book value with enhancement to capital ratios Retail funding now exceeds £6.4bn	20.0	
Pipeline	25%	The pipeline and its support for the delivery of the following year's strategy assessed by reference to mix, trends, yield and quality considerations			Underlying NIM at 2.29% and underlying RoTE at 14.6%	23.0	
Embedded value	25%	New originations during the year assessed by reference to diversification strategy, credit standards and yield considerations			Specialist buy-to-let lending 88.8% of total at £1,315.2m, including a high proportion of five-year products at good margin. Total non-buy-to-let lending at £1,057.9m	20.0	
Liability management	25%	Qualitative assessment by the Committee of achievements during the year			First SONIA securitisation Savings addressable market expanded from £130bn to £225bn through proposition development	23.0	
						86.0	25.8%
Risk	20%						
<ul style="list-style-type: none">Strong capital ratioStrong liquidity ratios with proactive management to counter potential Brexit threatsBest in class credit risk managementTotal number of complaints and operational losses remained well within appetiteConduct Risk framework further embedded with increased quality assurance focusProgress in operational resilience risk management						20.0	20.0%
Personal performance	20%						
As detailed in the directors' individual performance below						20.0	20.0%

Individual performance assessments

The following overarching objectives were applicable to all executive directors:

- Provide strategic leadership to deliver the business plan aligned to the Group's strategy
- Deliver the planned financial performance within the parameters of the Group's risk appetite
- Safeguard fair outcomes for customers to ensure they are central to the Group's operations
- Ensure secure and stable platforms are in place to deliver longer term strategic goals
- Embed the restructure across processes, systems and ways of working to maximise value
- Ensure the Group meets all risk, compliance and regulatory requirements
- Comply with the Senior Managers and Certification Regime and ensure it is embedded
- Protect the Group's strong culture with capable and motivated employees

The directors' individual objectives, in addition to those above, and the assessments made are set out below:

Executive director	Individual targets	Actual performance
N S Terrington	In addition to strong leadership, delivery of the Group's business plan and financial performance, upholding our corporate values, ensuring our customers are at the heart of everything the Group does and extending the Paragon brand and all within the Group's risk management framework, the following annual personal objectives were agreed:	
	Broaden the Group's presence as a leading UK specialist lender	Specialist buy-to-let lending 88.8% of total at £1,315.2m (2018: £1,185.5m)
	Deliver strong organic new business generation	Total non-buy-to-let lending £1,051.9m (2018: £837.7m)
	Actively assess M&A opportunities to broaden the Group's diversification strategy	Continued proactive assessment of a number of potential opportunities to diversify the Group's strategy
	Drive the business towards the optimisation of RoTE on a sustainable basis over the medium term	Volume and margin management and financial risk management has positioned the Group for future growth with underlying NIM at 2.29% and underlying RoTE at 14.6%
	Develop an increased awareness of conduct risk to appropriately control and monitor inherent and residual risks	Conduct risk increasingly embedded with enhanced QA and improved complaints monitoring
	Build a succession plan pipeline for Executive Committee roles	Implementation of senior leadership development programme with a cohort of 21 internal high potential individuals

Executive director	Individual targets	Actual performance
R J Woodman	In addition to strong leadership, delivery of the Group's business plan and financial performance, upholding our corporate values, ensuring our customers are at the heart of everything we do and extending the Paragon brand and all within the Group's risk management framework, the following annual personal objectives were agreed:	
	Optimise the Group's funding costs to support lending activities	Retail funding from customers' deposits now exceeds £6.4bn Paragon Mortgages (No. 12) PLC executed providing enhancement to capital ratios
	Continue to advance the Group's application for IRB authorisation	IFRS 9 first full year delivered without any issues Considerable increase in activity to the point the application is ready for submission, including the creation of a bespoke stress testing framework
	Ensure actions progress to support the Group's diversity targets	Women in Finance Charter target achieved 16 months ahead of original plan
	Continue to provide oversight of the funding required and liquidity management	Strong performance during a particularly busy year for transactions, system changes and pricing Further strong progress in reducing Group encumbrance levels towards sector norms
	Continue to provide oversight and management of the investor relations programme including equity analysts	Strong engagement with analyst community

Executive director	Individual targets	Actual performance
J A Heron	In addition to strong leadership, delivery of the Group's business plan and financial performance, upholding our corporate values, ensuring our customers are at the heart of everything we do, management of all buy-to-let activities, lending controls and customer engagement, all within the Group's risk management framework, the following annual personal objectives were agreed:	
	Achieve £1,612.4m of buy-to-let and second charge mortgage originations	Lending in line with the levels indicated to the market with a strong pipeline and an outstanding credit performance
	Enhance the customer and intermediary experience through redefined processes	NPS averaging +65 compared to +45 for the sector, strong and successful launch of an intermediary portal
	Develop bespoke commercial underwriting offering with individual terms and pricing	Yields and NIM maintained notwithstanding industry wide pressures, leading to a more favourable business mix than originally planned

Annual bonus outcome

The resulting bonuses for the year ended 30 September 2019 were as follows:

Executive director	Financial performance	Future value and strategy	Risk	Personal performance	Total	Total	Cash	Share value
						£000	£000	£000
N S Terrington	23.6%	25.8%	20.0%	20.0%	89.4%	899	687	212
R J Woodman	23.6%	25.8%	20.0%	20.0%	89.4%	566	437	129
J A Heron	23.6%	25.8%	20.0%	20.0%	89.4%	479	372	107

25% of amounts awarded in excess of £50,000 are deferred into nil cost options under the Deferred Share Bonus Plan ('DSBP') which can be exercised after three years. No further performance conditions apply to the deferred shares.

Retrospective disclosure of business element targets for the year ended 30 September 2018

The threshold and maximum performance targets in relation to the business element performance conditions for the financial year ended 30 September 2018 are no longer considered commercially sensitive and are therefore disclosed below. Actual performance has also been provided for reference.

Measure	Threshold performance	Target	Maximum	Actual
Financial performance				
Adjusted operating profit	£148.9m	£156.8m	£164.6m	£156.5m
Future value of new business				
Lending	£2,221.8m	£2,338.7m	£2,455.6m	£2,333.2m
Debt purchase investments	£54.0m	£60.0m	£66.0m	£83.4m
Risk	<p>The future value of new business was written in line with the Group's required return and risk appetite.</p> <p>The Group operated within the risk tolerance levels set by the Board for capital ratios, liquidity positions, new business and operational and regulatory risk. It also developed its plan to mitigate longer term strategic risk.</p>			

Performance Share Plan

Awards vesting in respect of the year ended 30 September 2019

Awards granted in December 2016 under the Group's PSP are subject to performance conditions measured over the three financial years ended 30 September 2019.

Performance condition	Weighting	Threshold vesting for 25% of maximum award	Maximum vesting	Actual performance	Vesting outcome
Relative TSR*	50%	Median performance	Upper quartile performance	Above upper quartile	100.00%
EPS growth	25%	RPI plus 3% p.a.	RPI plus 7% p.a.	RPI plus 6.56% p.a.	91.74%
Risk	25%	n/a	n/a	90%	90.00%
Total as a % of maximum award					95.44%
Total as a % of salary at grant					190.88%

* The comparator group for TSR purposes agreed at the time of grant was: Aldermore Group PLC, Arrow Global Group PLC, Barclays PLC, Close Brothers Group PLC, CYBG PLC, Lloyds Banking Group PLC, Metro Bank PLC, OneSavings Bank PLC, Provident Financial PLC, Royal Bank of Scotland Group PLC, Shawbrook Group PLC, Secure Trust Bank PLC and Virgin Money Holdings (UK) PLC.

There is straight-line vesting between the threshold and maximum for the TSR and EPS conditions and no reward below threshold performance. The risk metric measures the Group's performance against six equally weighted risk categories - material regulatory breaches, customer service, management of liquidity and capital risk, credit losses against risk appetite, management of conduct risk, material risk events over the performance period. The performance of the Group against these metrics was independently assessed by the Committee, supported by the Chair of the Risk and Compliance Committee and the Group's Chief Risk Officer, and the outcome reflects the strong level of performance over this period.

Vesting was also subject to the Committee's determination, in respect of the financial underpin, whether the level of vesting reflected the overall financial performance of the Group.

The vesting percentage has been reviewed by the Committee and details of the shares which will vest on 1 December 2019 are set out below.

	Total shares granted	Vesting outcome	Total shares awarded ¹	Share price ² £	PSP value £000
N S Terrington	262,114	95.44%	250,161	4.3706	1,222
R J Woodman	165,074	95.44%	157,546	4.3706	769
J A Heron	139,753	95.44%	133,380	4.3706	651

1. In accordance with the rules of the PSP, participants are entitled on exercise to additional value equal to the dividends that would have been paid on vested shares in respect of dividend record dates between the grant date and vesting date. Accordingly, the share award values also include £0.5130 per vested share in respect of such dividends.
2. The PSP value has been estimated using the average closing share price for the three months ended 30 September 2019. The actual value of the awards will not be known until the awards vest in December 2019, as it will be based on closing share price at that date.

Awards granted during the year ended 30 September 2019

On 14 December 2018 the following awards were granted under the PSP with a face value of 200% of salary.

Executive director	Salary £000	Percentage grant	Face value of grant £000	Share price ¹ £	Number of shares
N S Terrington	503	200%	1,006	4.4300	227,156
R J Woodman	317	200%	634	4.4300	143,059
J A Heron	268	200%	537	4.4300	121,117

1. Based on the average closing mid-market price of the Company's shares on each of the five dealing days following the announcement of the Company's results for the financial year ended 30 September 2018, being the price used to determine the number of shares in accordance with the Directors' Remuneration Policy.

The PSP awards are subject to the following performance conditions, with a performance period of the three years ending 30 September 2021:

Performance measure	Weighting	Threshold vesting for 25% of maximum award	Maximum vesting
Relative TSR	50%	Median performance	Upper quartile performance
EPS	25%	Basic EPS of 60 pence	Basic EPS of 68 pence or more
Risk	25%	Based on an assessment of a balanced scorecard of risk and compliance factors (see below)	

There is straight-line vesting between the threshold and maximum for the TSR and EPS conditions and no reward below threshold performance.

In addition, prior to any awards vesting under any element, the Committee must be satisfied that the individual's performance and the underlying financial performance of the Company are satisfactory given the level of vesting.

Reflecting the Group's evolution and growth, the Committee determined that achievement of absolute EPS targets would be more appropriate than measuring EPS growth relative to RPI as was indicated in the Directors' Remuneration Report last year (particularly given the external economic climate). The Committee is satisfied that these absolute EPS targets are no less stretching than the relative growth targets originally proposed but are more relevant and transparent for all stakeholders.

Relative TSR measure

The comparator group for the purposes of the relative TSR condition is:

Amigo Holdings PLC	Arrow Global Group PLC	Barclays PLC	Charter Court Financial Services Group PLC
Close Brothers Group PLC	Funding Circle Holdings PLC	Lloyds Banking Group PLC	Metro Bank PLC
OneSavings Bank PLC	Provident Financial PLC	Royal Bank of Scotland Group PLC	Secure Trust Bank PLC
S&U PLC	Virgin Money UK PLC		

Risk measure

The risk management performance condition is assessed by reference to risk management performance and the application of a strong risk culture across the Group taking into account:

Material regulatory breaches	Customer service	Management of liquidity and capital risk
Credit losses against risk appetite	Management of conduct risk	Material risk events over the performance period

Disclosure of assessment against performance of the risk element will be made in the Annual Report on Remuneration for the year of vesting.

Chairman and non-executive director fees

	Year ended 30 September 2019			Year ended 30 September 2018		
	Fees £000	Benefits £000	Total £000	Fees £000	Benefits £000	Total £000
Chair of the Board						
F J Clutterbuck	255	14	269	159	5	164
Non-executive directors						
A K Fletcher ¹	16	-	16	65	-	65
P J N Hartill	95	-	95	88	-	88
P J Newberry ²	16	-	16	65	-	65
B A Ridpath	65	-	65	65	-	65
H R Tudor	85	-	85	70	-	70
F F Williamson	85	-	85	85	-	85
G H Yorston	65	-	65	65	-	65
Total	682	14	696	662	5	667

1. Resigned from the Board on 31 December 2018. In addition to the fees earned as a non-executive director, Mr A K Fletcher served as a director of the Corporate Trustee of the Plan and received £4,000 (2018: £15,000) during the year in respect of that appointment from Paragon Finance PLC, the sponsoring company of the Plan and a subsidiary of the Group, while serving as a director of the Company.
2. Resigned from the Board on 31 December 2018.

Directors' share interests

The interests of the executive directors in the shares of the Company at 30 September 2019 (including those held by their connected persons) were:

	N S Terrington Number	R J Woodman Number	J A Heron Number
Unvested awards subject to performance conditions			
PSP ^{1,2}	432,348	272,286	230,518
Unvested awards not subject to performance conditions			
DSBP	138,897	84,059	63,503
Sharesave	12,026	12,026	-
Total unvested awards	583,271	368,371	294,021
Vested but unexercised awards			
PSP ²	542,090	437,218	133,380
DSBP	168,232	63,482	-
Total vested but unexercised awards	710,322	500,700	133,380
Shares beneficially held	781,269	226,051	274,723
Total interest in shares	2,074,862	1,095,122	702,124

Awards exercised in the year³

PSP	-	-	100,440
DSBP	-	-	41,150
Sharesave	-	-	7,216
Total awards exercised in the year	-	-	148,806

- In addition to the unvested PSP awards in the table, each executive director holds a tax qualifying option under the Company Share Option Plan ('CSOP') over 6,279 shares at an exercise price of £4.7776 per share, as part of the awards granted on 8 December 2017. If a CSOP option is exercised at a gain, the number of shares the director will receive under the PSP will be reduced by the same value, to ensure that the total pre-tax benefit is not increased by the grant of the CSOP options. Therefore, the value of each award, in aggregate, is equivalent to that of a PSP award and the CSOP options may be disregarded in determining the value.
- For the purposes of the table above the awards granted in December 2016 are assumed to be vested but unexercised in respect of the percentage which it is estimated will vest (95.44%) and to have lapsed in respect of the balance.
- The PSP and DSBP awards were exercised on 27 June 2019, when the share price was £4.3446. The Sharesave awards were exercised on 5 August 2019 when the share price was £3.9240.

The interests of the Chairman and the non-executive directors at 30 September 2019, which consist entirely of ordinary shares, beneficially held, were as follows:

	2019
F J Clutterbuck	8,372
P J N Hartill	7,000
B A Ridpath	2,358
H R Tudor	100,000
F F Williamson	3,000
G H Yorston	2,307

As at 31 October 2019, the last practicable date prior to approving this Report, the Company has not been advised of any changes to the interests of the directors and their connected persons as set out in the tables above.

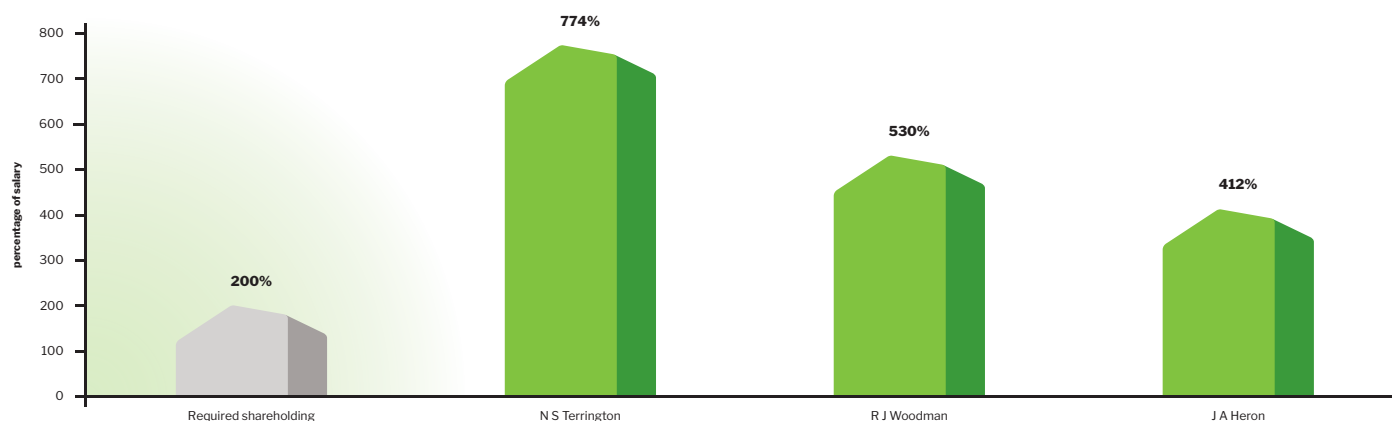
Share ownership guidelines

All executive directors are encouraged to hold a minimum number of shares in the Company with a value of 200% of their salary, calculated at 31 December each year. The valuation for shares held before 1 January 2017 is based on the average price of the Company's shares over a rolling three-year period. For shares acquired after that date the valuation is based on the market value of the shares at the date of acquisition. The value, net of income tax and national insurance, of vested but unexercised shares granted under the DSBP and under the PSP count towards the aggregate shares held by each director in respect of the policy.

The chart below compares the executive directors' holdings at 30 September 2019 to those required by the guidelines, expressed in value terms as a percentage of salary at 30 September 2019.

Directors' shareholding guidelines

30 September 2019



At 30 September 2019, all of the executive directors' holdings were in accordance with guideline levels.

B6.2.3 Application of remuneration policy for the year ending 30 September 2020

The information provided in this section of the Directors' Remuneration Report is not subject to audit. The details set out are subject to shareholder approval of the new policy at the 2020 AGM.

Executive directors

Base salary

To reflect the rebalancing of fixed and variable pay in readiness for Level 2 banking status during the life of the new policy, the salaries of Nigel Terrington and Richard Woodman will increase by 19%, backdated to 1 October 2019, subject to approval at the 2020 AGM.

The salary for John Heron was increased by 3% from 1 October 2019, in line with the level of increases for the Group's wider workforce. Mr Heron is retiring prior to the proposed policy for the year ending 30 September 2020 being put to shareholders for approval.

	Salary with effect from	
	1 October 2019	1 October 2018
	£	£
N S Terrington	598,754	503,150
R J Woodman	377,087	316,875
J A Heron	276,350	268,275

Allowances and benefits and pension contributions

Pension contributions will reduce from 45% of salary to 20% of salary for incumbent executive directors to align with average contributions made to the wider workforce. For new external hires pension contributions will be 10% of salary.

A fixed role-based pay allowance will be introduced, paid in shares over five years and released in five equal annual tranches. The allowance is structured to meet all fixed pay tests within the EBA guidelines. The allowance will be £140,000 p.a. for Mr N S Terrington and £90,000 p.a. for Mr R J Woodman. No role-based allowance will be payable to Mr J A Heron as he intends to retire from the Group prior to the Annual General Meeting in February 2020.

Allowances and benefits remain unchanged other than pension contributions and the introduction of a fixed role-based pay allowance to meet the requirements of CRD IV.

Annual bonus

The annual bonus structure is based on a revised scorecard of measurements; 30% on financial performance, 30% on future value of new business and strategic management, 20% on risk management and 20% on personal performance.

The Committee has chosen not to disclose, in advance, the performance targets for the forthcoming year as these are felt to be commercially sensitive. Retrospective disclosure of the targets and performance against them will be set out in next year's Annual Report on Remuneration except to the extent that any measure/target remains commercially sensitive.

The maximum award will reduce to 150% of salary (previously 200%). Executive directors will continue to be required to defer 25% of amounts awarded in excess of £50,000 in shares. The Committee may require higher levels of deferment or the executive may elect to defer a greater proportion. However, it is anticipated that deferral arrangements will remain unchanged until such point as the Group becomes a larger banking group and therefore subject to PRA level 2 remuneration requirements.

PSP awards

Award levels for executive directors is reduced to 180% (previously 200%) of base salary. The performance conditions and targets are summarised below:

Performance measure	Weighting	Threshold vesting for 25% of maximum award	Maximum vesting
Relative TSR	25%	Median performance	Upper quartile performance
Basic EPS	25%	60.0p	67.0p or more
Risk	25%	50% weighting on an assessment from the Chief Risk Officer of the six key elements of the Group's risk appetite: regulatory breaches, customer service, conduct, operational, capital and liquidity and credit losses	
		50% weighting on a strategic risk assessment to reflect the management of risk with regard to the delivery of the Group's medium term strategy	
Customer and people	25%	50% weighting on Customer elements which are not disclosed due to commercial sensitivity but will be on vesting. This element will be evaluated by the Chair of the Risk and Compliance Committee	
		50% weighting on People elements, which will consider employee engagement, voluntary attrition and diversity targets compared to industry averages	

There is straight-line vesting between threshold and maximum and no reward for below threshold performance.

In addition, prior to any awards vesting, the Committee must be satisfied that the individual performance and underlying financial performance of the Group are satisfactory given the level of vesting.

Relative TSR test

The comparator group for the purposes of the relative TSR test for the 2019/20 grant will be:

Amigo Holdings PLC	Arrow Global Group PLC	Barclays PLC	Close Brothers Group PLC
Funding Circle Holdings PLC	Lloyds Banking Group PLC	Metro Bank PLC	OneSavings Bank PLC
Provident Financial PLC	Royal Bank of Scotland Group PLC	Secure Trust Bank PLC	S&U PLC
Virgin Money UK PLC			

Chair of the Board's and non-executive directors' fees

	Fee with effect from	
	1 October 2019	1 October 2018
	£000	£000
Chair of the Board's fee	255	255
Base fee for non-executive directors	65	65
Additional fee for Senior Independent Director	10	10
Additional fee for chairs of committees ¹	20	20

1. The additional fee for chair of committees is currently payable to the Chairs of the Remuneration, Audit, and Risk and Compliance Committees, but would be payable for the chairing of such additional committees as might be authorised by the Board.

B6.2.4 Other information

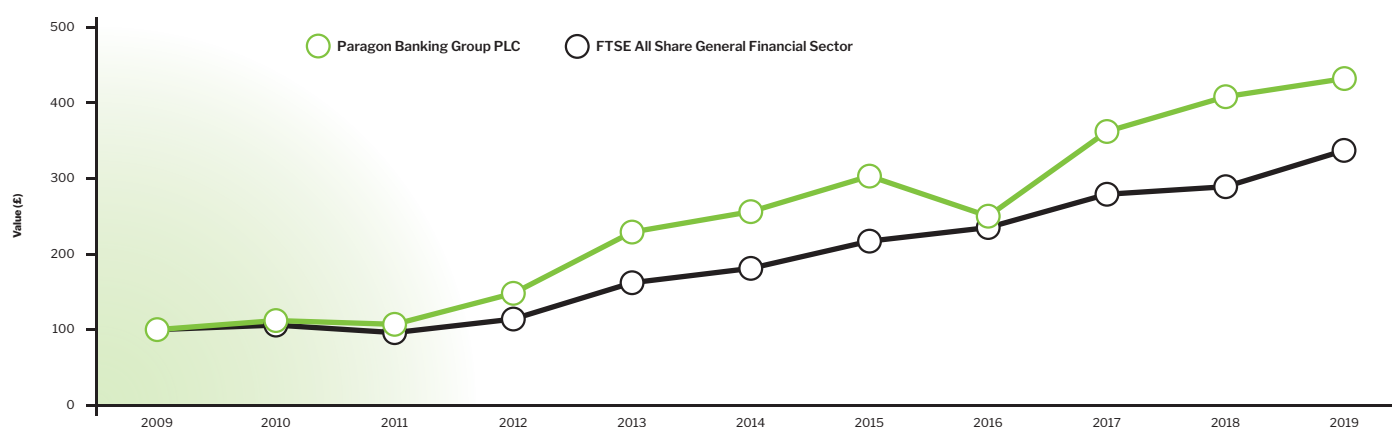
The information provided in this section of the Directors' Remuneration Report is not subject to audit

Performance graph and table

The following graph shows the Company's TSR performance compared with the performance of the FTSE All Share General Financial sector index. This graph shows the value, by 30 September 2019, of £100 invested in Paragon Banking Group PLC on 30 September 2009, compared with £100 invested in the FTSE General Financial sector index. The General Financial sector has been selected for this comparison because it is the sub-sector index that contains the Company's shares.

Ten-year return index for the FTSE All Share General Financial Sector

Ten years ended 30 September 2019



The following table shows the total remuneration, as included in the single figure table, and the amount vesting under short-term and long-term incentives as a percentage of the maximum that could have been achieved, in respect of the CEO, Mr N S Terrington, over the past ten years.

	Single figure of total remuneration	Annual bonus earned against maximum opportunity	Long-term incentive vesting outcome against maximum opportunity
	£000	%	%
2019	2,875	89.4	95.44
2018	2,426	90.0	72.47
2017	2,305	90.0	63.51
2016	1,956	75.0	50.00
2015	2,546	100.0	100.00
2014	3,113	100.0	100.00
2013	2,655	85.0	100.00
2012	2,565	87.5	100.00
2011	2,382	87.5	58.60 and 85.10
2010	1,209	75.0	58.60

Percentage change

The following table shows the change in certain aspects of the remuneration of the CEO, Mr N S Terrington:

Component	2019	2018	Change
	£000	£000	%
Salary	503	489	3
Benefits ¹	14	14	-
Benefits in kind in performance of duties ²	11	7	57
Bonus	899	879	2

1. 'Benefits' includes private health cover, fuel benefit and company car provision or company car allowance.

2. 'Benefits in kind from the performance of duties' arise where the Group reimburses executive directors in respect of certain travel costs incurred in connection with the performance of their duties. The Group has been advised that the reimbursement of some of these costs constitutes a taxable benefit in kind. The Group has agreed to provide an allowance to Mr Terrington to cover the tax liability. The amount shown represents the payments HMRC treats as taxable together with an allowance to cover the tax.

The Group's pay review taking effect on 1 October 2018 awarded average percentage increases in wages and salaries to employees as a whole of 3.10% (1 October 2017: 3.21%).

The Group awarded average bonus levels for the year ended 30 September 2019 of 3.71% (2018: 2.98%).

The nature and level of benefits available to employees in the year ended 30 September 2019 was broadly similar to that in the previous year.

CEO pay ratio

The table below sets out the CEO pay ratio at the 25th, median and 75th percentile employees within the Group. The Group used Option A as defined in The Companies (Miscellaneous Reporting) Regulations 2018, as this calculation methodology was considered to be the most accurate method. The 25th, median and 75th percentile pay ratios were calculated using the full time equivalent remuneration (prepared in the same manner as those for the single figure table) for all UK employees during the financial year. Certain employees participate in discretionary bonus schemes and long term incentive schemes.

	Base salary	Total remuneration	CEO pay ratio
25th percentile	£21,000	£24,000	119:1
50th percentile	£29,000	£32,000	90:1
75th percentile	£53,000	£54,000	53:1

Base salaries shown above are the base salaries relating to the relevant identified employees.

The Group aims to provide a competitive remuneration package which is appropriate to promote the long-term success of the Group and to apply this policy fairly and consistently to attract and motivate staff.

Relative importance of spend on pay

Set out below is a summary of the Group's levels of expenditure on pay and other significant cash outflows.

	Note	2019 £m	2018 £m	Change £m
Wages and salaries	10	62.6	57.2	5.4
Dividend paid	45	54.0	43.1	10.9
Loan advances and investment in portfolios		2,536.6	2,416.6	120.0
Corporation tax paid	46	39.4	32.0	7.4

Loan advances and investment in portfolios is shown above as this is the principal application of cash used to generate income for the Group. Corporation tax is contributed out of profit to the UK Government.

Executive directors' share interests

The individual interests of the executive directors under the PSP are as follows:

	Award date	Market price	At 1 October 2018 Number	Awarded Number	Lapsed Number	Exercised Number	At 30 September 2019 Number	Exercisable from
N S Terrington	18/12/2014	409.60p	103,548	-	-	-	103,548	18/12/2017
	22/12/2015	362.70p	188,381	-	-	-	188,381	22/12/2018
	01/12/2016 [†]	369.40p	262,114	-	11,953	-	250,161	01/12/2019
	08/12/2017*	483.20p	205,192	-	-	-	205,192	08/12/2020
	14/12/2018	401.00p	-	227,156	-	-	227,156	14/12/2021
R J Woodman	10/12/2013	345.30p	69,525	-	-	-	69,525	10/12/2016
	18/12/2014	409.60p	91,508	-	-	-	91,508	18/12/2017
	22/12/2015	362.70p	118,639	-	-	-	118,639	22/12/2018
	01/12/2016 [†]	369.40p	165,074	-	7,528	-	157,546	01/12/2019
	08/12/2017*	483.20p	129,227	-	-	-	129,227	08/12/2020
	14/12/2018	401.00p	-	143,059	-	-	143,059	14/12/2021
J A Heron	22/12/2015	362.70p	100,440	-	-	100,440	-	22/12/2018
	01/12/2016 [†]	369.40p	139,753	-	6,373	-	133,380	01/12/2019
	08/12/2017*	483.20p	109,401	-	-	-	109,401	08/12/2020
	14/12/2018	401.00p	-	121,117	-	-	121,117	14/12/2021

[†] For the purpose of the table above, these awards are assumed to be vested in respect of the percentage which it is assumed will vest (95.44%) and to have lapsed in respect of the balance.

* On 8 December 2017 each executive director was granted CSOP options over 6,279 shares, at an exercise price of £4.7776 per share, as part of his PSP award. If a CSOP option is exercised at a gain, the number of shares that may be delivered under the PSP will be reduced at exercise by the same value to ensure that the total pre-tax benefit is not increased by the grant of the CSOP options.

The individual interests of the executive directors under the DSBP are as follows:

	Award date	Market price	At 1 October 2018	Awarded	Exercised	At 30 September 2019	Exercisable from
			Number	Number	Number	Number	
N S Terrington	10/12/2013	345.30p	55,302	-	-	55,302	10/12/2016
	18/12/2014	409.60p	52,888	-	-	52,888	18/12/2017
	22/12/2015	362.70p	60,042	-	-	60,042	22/12/2018
	01/12/2016	369.40p	44,493	-	-	44,493	01/12/2019
	08/12/2017	483.20p	42,055	-	-	42,055	08/12/2020
	14/12/2018	401.00p	-	52,349	-	52,349	14/12/2021
R J Woodman	18/12/2014	409.60p	26,965	-	-	26,965	18/12/2017
	22/12/2015	362.70p	36,517	-	-	36,517	22/12/2018
	01/12/2016	369.40p	26,742	-	-	26,742	01/12/2019
	08/12/2017	483.20p	25,517	-	-	25,517	08/12/2020
	14/12/2018	401.00p	-	31,800	-	31,800	14/12/2021
J A Heron	18/12/2014	409.60p	19,249	-	19,249	-	18/12/2017
	22/12/2015	362.70p	21,901	-	21,901	-	22/12/2018
	01/12/2016	369.40p	17,849	-	-	17,849	01/12/2019
	08/12/2017	483.20p	19,217	-	-	19,217	08/12/2020
	14/12/2018	401.00p	-	26,437	-	26,437	14/12/2021

The individual interests of the executive directors under the Sharesave Plan are as follows:

	Award date	Option price	At 1 October 2018	Awarded	Exercised	At 30 September 2019	Exercisable from
			Number	Number	Number	Number	
N S Terrington	20/06/2016	249.44p	12,026	-	-	12,026	01/08/2021
R J Woodman	20/06/2016	249.44p	12,026	-	-	12,026	01/08/2021
J A Heron	20/06/2016	249.44p	7,216	-	7,216	-	01/08/2019

B6.3 Policy report

The information provided in this part of the Directors' Remuneration Report is not subject to audit

Introduction

This part of the Directors' Remuneration Report sets out the directors' remuneration policy that is proposed to apply from the close of the Annual General Meeting to be held on 13 February 2020. The policy, once approved, will apply until the Annual General Meeting in 2023, unless revised by a vote of shareholders ahead of that time.

Summary of Proposed Changes

The Company's current directors' remuneration policy was approved at the 2017 AGM with over 95% votes in favour, and took effect from the date of that meeting.

As highlighted in the Remuneration Committee Chair's statement, in light of recent corporate governance developments and the Group likely to become subject to more stringent banking remuneration rules on the transition from a smaller Level 3 bank to a Level 2 CRD IV bank during the life of this policy, it was necessary to undertake a detailed review of the remuneration policy to ensure full compliance and alignment with market practice.

With this regulatory change in mind, the remuneration policy has been drafted with sufficient flexibility to ensure that we are able to remain compliant as the regulatory status of the bank changes. It is the Committee's intention that the revised remuneration policy will apply in two stages.

As a result of the revised 2018 Code the following changes are being proposed:

- **Pension** – reduction in the maximum pension contribution to 20% of salary for all incumbent executive directors to align with the average contributions made in respect of the wider workforce. New executive directors would receive a maximum pension contribution of 10% of salary
- **PSP** – introduction of a post-vesting holding period of two years for awards granted in respect of financial year 2019/20 and any subsequent year when the Group is not a Level 2 bank
- **Post-employment shareholding guidelines** – executive directors will now be required to retain an interest in the Company's shares for two years following cessation of employment
- **Malus and clawback** – extension of the provisions under which malus and clawback provisions can be applied to variable pay. We have also taken the opportunity to align with market practice and regulatory expectations
- **Discretion** – introduction of a discretion enabling the Committee to apply judgement to all variable pay outcomes

Additionally, in anticipation of the Group's transition from a Level 3 to a Level 2 bank, further changes are proposed to rebalance the remuneration package in light of the CRD IV bonus cap requirements and significantly extend the deferral and holding periods applicable to variable pay, as follows:

- **Role-based allowance** – introduction of a role-based allowance for all executive directors to reflect market practice for dealing with compliance with the bonus cap requirement. Each quarter the executive directors will receive shares which will be subject to release over a period of five years from the relevant payment date, with a proportion of the shares released in equal tranches on each anniversary
- **Bonus** – reduction in opportunity from 200% to 150% of salary. On transition to a Level 2 bank, bonuses will no longer ordinarily be deferred as a result of the significantly extended deferral and holding periods attached to PSP awards, however 50% of annual bonus awards will be paid in shares that will be subject to a one year holding period
- **PSP** – reduction in opportunity from 200% to 180% of salary. On transition to a Level 2 bank, vesting will occur in equal tranches between the third and seventh anniversary of grant. A further 12-month post-vesting holding period will apply to each tranche

Elements of the remuneration policy for executive directors

The executive directors receive a combination of fixed and performance-related elements of remuneration. Fixed remuneration consists of salary, benefits, pension scheme contributions or alternative retirement benefit provision and a role-based allowance. Performance-related remuneration consists of participation in the annual bonus plan (including deferral) and the award of shares under the PSP. The performance-related elements of remuneration are intended to represent an appropriate proportion of executive directors' potential total remuneration.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Base salary			
To provide a competitive, fixed cash component that reflects the scope of individual responsibilities and recognises sustained individual performance in the role.	<p>Remunerate fairly for individual performance, having regard to the importance of motivation.</p> <p>Base salaries are typically reviewed annually, taking into account a number of factors including (but not limited to) the value of the individual, the scope of their role, their skills and experience and their performance.</p> <p>The Committee also takes into account pay and conditions of employees in the Group as a whole, business performance and prevailing market conditions.</p>	<p>While there is no maximum salary, if the Committee is satisfied with the individual's performance, increases will normally broadly follow those awarded for the rest of the organisation, in percentage of salary terms.</p> <p>Increases above the level awarded for the rest of the organisation may be awarded in appropriate circumstances which may include, but are not limited to:</p> <ul style="list-style-type: none"> • Changes in the scope or responsibilities of a director's role; • Development or performance in role; • A change in the size and/or complexity of the business; • Change in market practice or a director's salary substantially falling behind a market competitive rate; and/or • External factors such as changes in regulatory requirements 	Whilst no formal performance conditions apply, an individual's performance in role is taken into account in determining any salary increase.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Benefits			
To provide market levels of benefits on a cost-effective basis.	<p>Private health cover for the executive and their family, life insurance cover of up to seven times' salary and company car or cash alternative.</p> <p>Other benefits may be offered from time to time taking into account individual circumstances.</p>	<p>Private health care benefits are provided through third party providers and therefore the cost to the company and the value to the director may vary from year to year.</p> <p>Whilst no absolute maximum level of benefits has been set, the level of benefits provided is determined taking into account individual circumstances, overall cost to the business and market practice.</p>	None.
Retirement benefits			
To provide competitive post-retirement benefits.	Executive directors receive an annual contribution to the Company defined contribution pension scheme or a cash supplement in lieu of contribution (or a combination thereof).	Maximum 20% of salary for incumbent executive directors and 10% of salary for newly recruited executive directors.	None.
Fixed role-based allowance			
To maintain a competitive remuneration package with an appropriate balance of fixed and variable remuneration, with delivery in shares for shareholder alignment.	<p>Annual allowance paid quarterly or at any other frequency that the Committee deems appropriate, on the basis that the after tax value is delivered in shares which are released to the executive director on a pro-rata basis over a five year period (or such other period as may be determined by the Committee from time to time).</p> <p>The role-based allowance is non-pensionable and is not taken into account for annual bonus and PSP purposes.</p> <p>The Committee retains the discretion to amend the retention period and/or pay the fixed role-based allowance in cash if required to do so to meet any regulatory requirements.</p>	<p>The fixed role-based allowances are determined based on the role, skills and responsibility of each individual and taking into account market competitiveness of total remuneration.</p> <p>The maximum role-based allowance is £140,000 p.a. for the CEO and £90,000 p.a. for the CFO. Any other executive director (including those appointed during the period for which this policy applies) may be eligible for a role-based allowance of up to 25% of salary.</p> <p>The fixed role-based allowance will be payable with effect from 1 October 2019, subject to approval of this policy at the forthcoming AGM.</p>	None.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Annual bonus			
<p>To incentivise executives to achieve specific, predetermined goals that drive delivery of the Company's operational objectives.</p> <p>To reward individual performance.</p> <p>To encourage retention and alignment with shareholders' interests through deferral of a proportion of bonus, awarded in shares.</p>	<p>Each executive director's annual bonus is based on a mix of financial and non-financial performance measures, measured over one year.</p> <p>The annual bonus is non-pensionable. Malus and clawback apply to the annual bonus as described in the notes to this table.</p> <p>A portion of the annual bonus may be deferred and/or may be paid in shares, dependent on the regulatory status of the bank and at the discretion of the Committee. Awards under the DSBP can take the form of a nil-cost option with a ten-year life, a conditional award of shares or an award of forfeitable shares. The use of this deferral is described below.</p>	<p>Maximum annual bonus potential is 150% of salary in respect of any given financial year.</p> <p>For target performance, a bonus of 75% of salary will be awarded, with additional amounts being awarded for exceptional performance.</p> <p>If a bonus is based on a strategic measure or personal objective, the Committee will determine the extent of vesting between 0% and 100% based on its assessment of the extent to which the measure or objective has been achieved.</p> <p>For performance below threshold, no bonus is payable.</p>	<p>The performance targets are set by the Committee at the start of the year with input, as appropriate, from the Chair of the Board and Chief Executive.</p> <p>Performance measures and their weightings are reviewed annually to maintain appropriateness and relevance.</p> <p>Performance is assessed against a range of measures, with at least 50% relating to financial metrics and any balance reflecting non-financial measures (including risk) and/or achievement of key personal and strategic measures.</p>

Implementation in 2019/20 and any other year in which the Group is not a Level 2 bank:

25% of amounts awarded in excess of £50,000 will be deferred under the DSBP, to be satisfied in shares, over a deferral period of three years. Higher levels of deferral may be required by the Committee or, with the approval of the Committee may be elected for by the director. The Committee retains discretion to pay the whole of the bonus in cash in circumstances where the amount to be deferred would, in the opinion of the Committee, be so small as to make operation of the DSBP unduly administratively burdensome.

Awards may include the right to receive a number of shares determined by reference to dividends that would have been paid on shares in respect of dividend record dates between grant and vesting, which may assume the reinvestment of dividends.

Implementation as a Level 2 bank:

After the Group becomes a Level 2 bank for regulatory purposes, the PSP will be the primary vehicle for meeting the deferral requirements under the PRA remuneration requirements, although the Committee retains the right to defer such portion of an annual bonus award and over such deferral period as it determines to ensure that regulatory requirements are met.

50% of the bonus earned will be paid in cash, and 50% will be paid in shares. Any shares delivered will normally be immediately vested and may take the form of shares which must be retained for at least 12 months, or a right to acquire shares at the end of the holding period. In the former scenario, the executive director may sell shares to cover the tax liability arising on the award. In the latter scenario, the award may include the right to receive a dividend equivalent in respect of dividend record dates over the holding period. Where an award is subject to a deferral period and does not benefit from dividends or dividend equivalents to meet regulatory requirements, the number of shares to be awarded may be determined using a share price discounted for the expected dividend yield.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Performance Share Plan ('PSP')			
<p>To incentivise executives to achieve enhanced returns for shareholders.</p> <p>To encourage long-term retention of key executives.</p> <p>To align the interests of executives and shareholders.</p>	<p>An annual award of shares subject to continued service and performance conditions assessed over a three-year performance period.</p> <p>The performance conditions used are reviewed on an annual basis to ensure they remain appropriate.</p> <p>Awards are structured as nil cost options with a ten-year life, a conditional award of shares or an award of forfeitable shares.</p> <p>Implementation of the vesting rules is described below the table.</p> <p>Malus and clawback apply to the PSP as described below this table.</p>	<p>Maximum award is 180% of salary in respect of any financial year.</p> <p>25% of the awards will vest for threshold performance, with full vesting taking place for equalling or exceeding the maximum performance target.</p> <p>In determining the number of shares subject to an award, the market value of a share shall, unless the Committee determines otherwise, be assumed to be the average share price for the five days following the announcement of the Company's results for the previous financial year.</p> <p>Where awards do not receive dividends or dividend equivalents to meet regulatory requirements, the number of shares to be awarded may be determined using a share price discounted for the expected dividend yield.</p>	<p>The Committee will take into consideration prior performance when assessing the value of the PSP grant.</p> <p>Forward-looking performance is measured against a long-term scorecard of challenging performance measures that reflect the Company's strategic priorities. Performance conditions may include financial measures (e.g. adjusted EPS and/or relative TSR), and non-financial measures which may include risk-based, people and/or customer measures.</p> <p>Performance measures and their weightings, where multiple measures are used, are reviewed annually to maintain appropriateness and relevance.</p>

Implementation in 2019/20 and in respect of any other year in which the Group is not a Level 2 bank:

Awards will normally vest at the end of the three year performance period and be subject to an additional two year holding period before they are released to the participant.

The holding period may be operated on the basis that the executive director is required to retain the after tax value of shares for the holding period, or that the award will only be "released", so that the executive director is entitled to acquire vested shares, at the end of that period.

Awards may include the right to receive a dividend equivalent in respect of dividend record dates between grant and release, which may assume the reinvestment of dividends.

Implementation as a Level 2 Bank:

When the Group becomes a Level 2 bank for regulatory purposes, at the end of the performance period, the performance outcome will be used to assess the percentage of the awards that will vest. These shares will then normally vest in five equal tranches, with the first vesting on or around the third anniversary of the grant date and the last instalment vesting on or around the seventh anniversary of the grant date, in accordance with the PRA remuneration rules.

Each vested tranche will be subject to an additional one year holding period, taking the form of shares which must be retained for at least the holding period, or a right to acquire shares at the end of the holding period. In the former scenario, the executive director may sell shares to cover the tax liability arising on award. In the latter scenario, the award may include the right to receive a dividend equivalent in respect of dividend record dates over the holding period.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Sharesave Plan			
To provide all employees with the opportunity to become shareholders on similar terms.	<p>Periodic invitations are made to participate in the Company's Sharesave Plan.</p> <p>A savings contract over three or five years with the funds used on maturity either to purchase shares by exercising options or returned to the participant.</p> <p>The option is granted at a discount to the share price at the time of grant of up to 20%.</p> <p>The Sharesave Plan provides tax benefits in the UK subject to satisfying certain HMRC requirements and is operated on an 'all employee' basis.</p>	HMRC monthly savings limits apply.	None.

Malus and clawback

Annual bonus and PSP awards are subject to malus and clawback provisions in exceptional circumstances including the following:

- If a higher payment than would otherwise have been the case is paid as a result of a material misstatement of a group company's results
- Any error or inaccurate or misleading information or assumptions relating to a financial year
- If the participant is dismissed for misconduct
- If an individual was party to behaviour that resulted in serious reputational damage to a group company or a relevant business unit
- Occurrence of a material corporate failure in a group company or a relevant business unit
- If there is reasonable evidence of employee misbehaviour or material error
- A group company or relevant business unit suffers a material failure of risk management, taking account of the individual's proximity to and/or responsibility for the event

For up to three years following the payment of a cash bonus, the Committee may claw back any amount up to the gross amount of any cash bonus. DSBP and PSP awards may be reduced or cancelled before vesting or clawed back for up to two years after vesting. However, following the Company's transition to a Level 2 firm for regulatory purposes, any incentive awards may be reduced or cancelled before vesting or clawed back for a period of up to seven years from the grant date. This may be extended to ten years in the event of ongoing internal/regulatory investigation at the end of the seven-year period.

Shareholding guidelines

All executive directors are requested to hold a number of shares in the Company with a market value of 200% of their salary. The guideline must be met within a reasonable timeframe (typically expected to be within five years of appointment) and executive directors are normally required to retain 50% of the shares acquired on the vesting of fixed role-based allowance, annual bonus, PSP or DSBP awards (after sales to cover tax) until the guideline is met.

The number of shares, net of income tax and national insurance, subject to share-based awards that are no longer subject to further performance requirements granted under the fixed role-based allowance, annual bonus, DSBP and PSP count towards the aggregate shares held by each director for these purposes.

Reflecting best practice, the Committee has adopted a post-cessation shareholding requirement, effective from the adoption of this new policy. This requires that for two years following cessation, an executive director must retain such of his 'relevant' shares as have a value (as at cessation) equal to their shareholding guideline. If the executive director holds less than the required number of 'relevant' shares at any time, he must retain the 'relevant' shares he holds. Shares, which the executive director has purchased are not 'relevant' shares for these purposes.

Operation of share plans

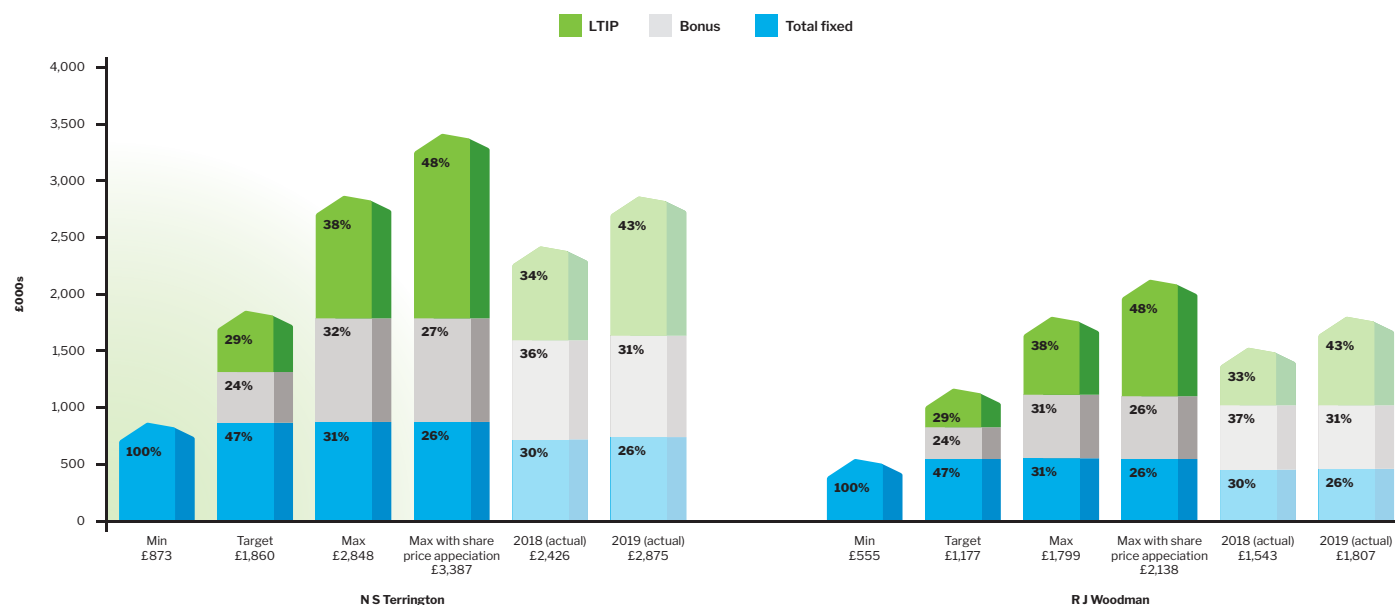
Awards under the Company's share plans (and any applicable performance conditions) may be adjusted in the event of any variation of the Company's share capital, demerger or special dividend.

Awards under the Company's share plans may vest early in the event of demerger, special dividend or other event which the Committee considers would affect the Company's share price, or in the event of a change of control. The extent to which PSP awards will vest will be determined taking into account the extent to which performance conditions have been satisfied (as assessed by the Committee) and, unless the Committee determines otherwise, the proportion of the vesting period that has elapsed.

Awards granted over shares may be settled in cash, in whole or in part. The Company does not intend to settle awards, or dividend equivalents on awards, granted to executive directors in cash and would do so only where the particular circumstances make that appropriate, for example where there is a regulatory restriction on the delivery of shares or to enable the payment of tax liabilities relating to the award.

Illustrations of the application of the remuneration policy

The chart below illustrates the remuneration opportunity provided to each executive director at different levels of performance for the coming year, compared to their actual remuneration in the last two years:



Notes:

The basis of calculation for the above graphs and key assumptions used are as follows:

	Minimum	Target	Maximum	Maximum with 50% share price growth
Fixed elements of remuneration	<ul style="list-style-type: none"> Total fixed pay is based on the latest salary and role-based allowance Estimated cash cost to the company of benefits and pension contributions received under the remuneration policy 			
Annual bonus (pay-out as % of maximum opportunity)	0%	50%	100%	100%
PSP (vesting as % of maximum opportunity)	0%	50%	100%	100% plus 50% share price growth

As Sharesave awards are provided on an all employee basis, they have not been included in the above analysis.

Elements of the remuneration policy for the Chair and non-executive directors

The Chair receives a fee, a company car or cash alternative and is eligible for private health cover on an individual or family basis in the same way as the executive directors. Non-executive directors are remunerated solely by fees. Neither the Chair nor the non-executive directors are eligible to participate in any of the Company's fixed role-based allowance, incentive or pension schemes and they are not entitled to receive compensation for early termination of their terms of engagement.

Benefits may also be provided to non-executive directors related to the performance of their duties (for example, travel and subsistence).

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Salary and fees			
To ensure that the Group can attract and retain the appropriate number and mix of non-executive directors with the correct experience to provide balance, oversight and challenge.	<p>Non-executive director fees are reviewed on a periodic basis and are subject to the Articles of Association. The Chair's fee is set by the Committee, whilst the non-executive directors' fees are determined by the Board.</p> <p>The Board will exercise judgement in determining the extent to which non-executive directors' fees are altered in line with market practice, given the requirement to attract and retain the appropriate skills and given the expected time commitments.</p> <p>Non-executive directors are paid an annual base fee with additional fees for additional roles (for example, Senior Independent Director or chair of a board committee).</p> <p>Non-executive directors may be eligible to receive benefits such as travel and other reasonable expenses.</p>	<p>The Board will review fees periodically to assess whether they remain competitive and appropriate in light of changes in roles, responsibilities and/or time commitment of the non-executive directors. Increases above those awarded for the rest of the organisation may be made to reflect the periodic nature of any review.</p> <p>The Articles of Association of the Company contain a maximum level of fees that can be paid annually to non-executive directors (currently £2,000,000). This is reviewed by the Board from time to time.</p> <p>Where benefits are provided to non-executive directors, they will be provided at a level considered to be appropriate, taking into account individual circumstances.</p>	None.

Choice of performance measures and approach to target setting

Annual bonus

The choice of the performance measures applicable to the annual bonus scheme reflects the Committee's belief that incentives should be appropriately challenging and tied to the achievement of financial and non-financial measures (including risk and other strategic measures) and key personal objectives.

The Committee reviews the measures each year and varies them as appropriate to reflect the priorities for the business in the year ahead. A sliding scale of targets is set for each measure to encourage continuous improvement and encourage the delivery of above-target performance.

PSP

The Committee will take into consideration prior Group and individual performance when assessing the value of the PSP grant level for executive directors.

Forward-looking performance is measured against a long-term scorecard of financial and non-financial performance measures that reflect the Company's strategic priorities.

Financial metrics could include EPS, which would measure long-term profitability, and/or TSR that considers shareholder value creation as a measure of market expectations of future performance. Other non-financial metrics could include risk or customer and people measures that would provide a focus on key measures of Company's long-term sustainability. Any risk metrics would be assessed across a range of quantitative and qualitative measures which are business critical.

Discretion

The Committee retains the flexibility to make adjustments to the formulaic vesting level of incentive awards in instances where the outcome would otherwise be unreflective of the wider shareholder experience and/or materially inappropriate in the context of unexpected or unforeseen circumstances relating to the Company.

Changes to performance conditions

If an event occurs which results in the annual bonus or PSP performance conditions and/or targets being deemed no longer appropriate (i.e. a material acquisition or divestment) then the Committee will have the ability to adjust the measures and/or targets and alter weightings so that the conditions achieve their original purpose.

Recruitment and conditions of service

Policy on recruitment and promotion

Salaries for newly recruited directors will be set to reflect their skills and experience, the Company's intended pay positioning and the market rate for the role. If it is considered appropriate to appoint a new director on a below market salary (for example, to allow the director to gain experience in the role) the individual's salary may be increased to a market level by way of a series of above inflation increases over such period as the Committee determines, subject to their performance and development in the role. A new appointment may also be offered a fixed role-based allowance that reflects the individual's role, skills and responsibilities, up to the permitted maximum set out in the policy table.

A new appointment would be offered benefits comparable to existing directors, other than, as described above, in respect of pension provision, as well as other reasonable expenses such as legal, tax equalisation and relocation costs (if necessary, on a net of tax basis).

The prevailing maximum bonus opportunity for existing directors will not be exceeded for any newly recruited director and would be pro-rated to reflect the proportion of the year worked. It may be necessary to set different performance measures and targets initially and/or to vary the proportion of the annual bonus that will be deferred and the deferral period, dependent on the timing of the appointment and the nature of the role taken up. Guaranteed bonuses will not be offered.

Long-term incentive awards will be granted in line with the policy outlined for existing directors, with the same maximum opportunity for any newly recruited director. Awards may be granted shortly after an appointment (subject to the Company not being in a prohibited period).

The maximum level of variable remuneration that may be awarded (excluding buyout awards as referred to below) is 330% of salary.

The Committee may make payments or grant awards to a newly recruited executive to buy out entitlements (for example, bonus and share awards) which will lapse on the executive's departure from a previous position. In doing so, the Committee will take into account relevant factors, including performance conditions attached to the lapsing arrangements and the time over which they would have vested. The approach to buy-out awards is intended to be in line with the PRA remuneration rules, which state that the terms of any replacement awards should be no more generous than the award forfeited on departure from the former employer.

In the event that an existing employee is promoted to the Board, any contractual commitments made to the employee prior to such promotion will continue to be honoured even if they would not otherwise be consistent with the policy prevailing when the commitment is fulfilled.

Notice periods and terms of engagement

The Chair and executive directors hold one year rolling contracts in line with current market practice and the Committee reviews the terms of these contracts regularly. The current service contracts for the executive directors are dated as follows:

	Contract Date
N S Terrington	1 September 1990 (as amended 7 January 1993, 16 February 1993, 30 October 2001 and 10 March 2010)
R J Woodman	8 February 1996 (amended 10 March 2010)
J A Heron	1 September 1990 (amended 14 January 1993, 8 February 1993 and 10 March 2010)

All new executive directors will have service contracts that are terminable by the Company on a maximum of twelve months' notice.

Chair and non-executive director appointments are for three years unless terminated earlier by, and at the discretion of, the director or the Company. The required notice period is one year for the Chair and three months for the non-executive directors.

Current terms of engagement for the Chair and non-executive directors apply for the following periods:

Director	Period of engagement
F J Clutterbuck	10 May 2018 to 9 May 2021
P J N Hartill	11 February 2017 to 10 February 2020
B A Ridpath	20 September 2017 to 19 September 2020
H R Tudor	24 November 2017 to 23 November 2020
F F Williamson	20 September 2017 to 19 September 2020
G H Yorston	20 September 2017 to 19 September 2020

Policy on termination payments

The Company has discretion to make a payment in lieu of notice in respect of all or part of the notice period. Any such payment would consist of salary, benefits and pension for the relevant part of the notice period. Specific change of control provisions or entitlements to enhanced redundancy payments are excluded.

Fixed Role-Based Allowance

Executive directors will be entitled to receive their fixed role-based allowance in respect of any notice period (or any notice period that would have applied but for the making of a payment in lieu of notice). Ordinarily the fixed role-based allowance will be paid at the usual time.

Shares subject to a fixed role-based allowance for the notice period and for previous fixed role-based allowance payments will be released over the originally anticipated period, although the Committee has discretion to release shares early in specific circumstances, for example, in the event of the death of an executive director.

Annual Bonus for the year of cessation

The payment of annual bonuses will be at the discretion of the Committee on an individual basis and the decision as to whether or not to award an annual bonus in full or in part will be dependent on a number of factors, including the circumstances of the individual's departure. For example, in certain good leaver situations (injury or disability, redundancy, employment transferred outside the Group, or any other reason the Committee decides) a bonus may be payable at the Committee's discretion, based on an assessment of performance. Any annual bonus award amounts paid will be pro-rated for time in service during the annual bonus period and will, subject to performance, be paid at the usual time and in the usual form (although the Committee retains discretion to pay the annual bonus award earlier in appropriate circumstances).

Unvested DSBP Awards

For awards granted under the DSBP, good leaver status would result in awards vesting at the usual time, unless the Committee determines they should vest earlier in appropriate circumstances. In other circumstances, DSBP awards will lapse.

Bonus awards subject to a holding period

If an individual leaves employment during a holding period, the default position will be for the holding period to continue for its originally anticipated length. The Committee may end the holding period early.

Unvested PSP Awards

The default treatment for outstanding unvested PSP awards will be that they lapse on cessation of employment. In good leaver circumstances (as described above), unvested awards will continue until the normal vesting date, vest subject to the satisfaction of the performance conditions, and be released at the end of the originally anticipated holding period. However, the Committee may permit the award to vest and be released at cessation subject to the satisfaction of the performance conditions (as assessed by the Committee) or vest and be released at the end of the performance period subject to the satisfaction of the performance conditions. In any such case, the extent of vesting will be reduced to reflect the proportion of the vesting period that has elapsed at the date of cessation, unless the Committee determines otherwise.

PSP Awards subject to a holding period

If an individual leaves employment during a holding period, the default position will be for the holding period to continue for its originally anticipated length. The Committee may permit the award to be released early, subject to any regulatory considerations. If the holding period is operated on the basis that the executive director is only entitled to acquire vested shares at the end of the holding period, the award will lapse if the executive director is dismissed for misconduct.

Other payments

The leaver provisions for any buyout award granted in connection with the recruitment of a director would be determined at the time of grant.

Any statutory entitlements or sums to settle or compromise claims in connection with the termination would be paid as necessary. In the appropriate circumstances, outplacement services, legal fees and relocation expenses may be provided at normal market rates for directors, along with payments in respect of accrued holiday.

There are no obligations in the non-executive directors' letter of appointment that could give rise to payments for loss of office.

Consideration of employment conditions elsewhere in the Group

There is no employee representative on the Committee. However, employees have the opportunity to make comments on any aspect of the Group's activities through employee forums and surveys and the views of employees are taken into account by Human Resources. One of the duties of the People Director is to brief the Board on employee views and, as a regular invitee to Committee meetings, this ensures that decisions are made with appropriate insight to employees' views. In addition, the People Forum will consider the relationship between executive remuneration and pay and reward across the Group on a regular basis.

Directors and senior executives participate in the annual bonus scheme, which is designed to incentivise executives to achieve specific, predetermined goals, reward individual performance and encourage retention through deferral of a proportion of the bonus. All employees whose performance has been exceptional are eligible for a discretionary bonus.

Directors and senior employees are eligible to participate in the PSP. The plan is in place to encourage the long-term retention of key executives who are considered to have the potential to influence shareholder value creation and awards are not offered to employees generally.

Employees below director and head of function level are eligible to participate in the Group's profit related pay scheme, which pays out a flat sum to all eligible staff based on a percentage of the Group's profits.

In determining pay levels for the employees as a whole, the Group annually considers externally provided benchmark levels for comparable jobs as well as individual development and performance. The general level of increase resulting from this review informs the Committee's deliberations on appropriate pay levels for the executive directors, together with external data specific to their roles which is used to ensure that the levels of remuneration are appropriate.

Consideration of shareholders' views

The Committee considers shareholder feedback received in relation to the AGM each year at a meeting shortly following the AGM. This feedback, plus any additional feedback received during any meetings from time to time, is then considered as part of the Company's annual review of remuneration policy.

In addition, the Chair of the Committee and the Chair of the Board regularly engage directly with major shareholders and their representative bodies and report their views back to the Committee, who take them into account when formulating any material changes to the remuneration policy. During the year under review, for the purposes of discussing this proposed policy, shareholders representing 69% of the Company's equity (based on the total voting rights as at 30 September 2019) were contacted and account was taken of their views in shaping the policy.

Details of votes cast for and against the resolution to approve last year's remuneration report and the resolution to approve the Directors' Remuneration Policy at the 2017 AGM along with any matters relating to remuneration discussed with shareholders during the year are set out in the Annual Report on Remuneration.

Legacy arrangements

The Committee retains discretion to make any remuneration payment or payment for loss of office outside the policy (including the exercising of any discretion available in respect of any such payment) outside of this Remuneration Policy:

- Where the terms of the payment were agreed before this Remuneration Policy came into effect, provided in the case of any payment whose terms were agreed after 2 February 2014 and before this Remuneration Policy became effective, the remuneration payment or payment for loss of office was permitted under the Company's relevant former Directors' Remuneration Policy
- Where the terms of the payment were agreed at a time when the relevant individual was not a director of the Company and, in the opinion of the Committee, the payment was not in consideration of the individual becoming a director of the Company

For these purposes, 'payment' includes the satisfaction of awards of variable remuneration and, in relation to an award over shares, the terms of the payment are agreed at the time the award is granted.

B6.4 Approval of Directors' Remuneration Report

The information provided in this part of the Directors' Remuneration Report is not subject to audit

This Directors' Remuneration Report, section B6 of the Annual Report and Accounts, including the Statement by the Chair of the Committee, the Annual Report on Remuneration and the Policy Report, has been prepared in accordance with Schedule 8 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 as amended and has been approved by the Board of Directors.

Signed on behalf of the Board of Directors

Hugo Tudor

Chair of the Remuneration Committee

26 November 2019

B7

Risk management

B7.1 Risk and Compliance Committee Chair's Report

Dear Shareholder

I am pleased to write to you again as Chair of the Risk and Compliance Committee to explain how we, as a committee, have discharged our responsibilities in the last year.

Our primary responsibility continues to be the maintenance of oversight of the effectiveness of the Group's risk management framework and of the Group's systems and controls for compliance with its statutory and regulatory obligations. The Committee also oversees the risk culture within the Group to ensure that this is adequately embedded and is supportive of the overall risk appetite set by the Board.

In discharging its responsibilities, the Committee relies on the support of the Group's Chief Risk Officer ('CRO'). Malcolm Hayes, who had held that position first with Paragon Bank then for the Group, since the Bank's licensing in 2014, informed me this year of his intention to retire. The Committee and I would like to thank him for his role in the development of the risk management system over that period and wish him well for the future.

During the year, the Committee supervised the search for a new CRO and an appointment is expected to be made shortly, subject to regulatory approval.

The Committee has maintained an agenda that has balanced standing review items with coverage of new or materially heightened risks and deeper dives into areas considered worthy of greater focus.

Standing items covered in each meeting have included:

- Reviews of the principal risks facing the Group
- Consideration of new or emerging risks and regulatory developments
- Consideration of the potential impact of key regulatory developments
- Consideration and challenge of management's rating of the various risk categories to which the Group is exposed
- Consideration of the root causes and impact of material risk events and the adequacy of actions undertaken by management to address them

In addition, during the last year, the Committee:

- Reviewed the Group's risk appetite to ensure it remained consistent with the delivery of the Group's strategic objectives, proposing any required changes to the Board
- Monitored and reviewed the potential impacts on the Group of the Brexit process, given the continuing uncertainty around the terms on which the UK might leave the EU



Finlay Williamson, Chair of the Risk and Compliance Committee

Our primary responsibility continues to be the maintenance of oversight of the effectiveness of the Group's risk management framework...

- Continued to monitor progress in respect of the Group's strategic decision to seek regulatory approval to enhance credit risk management by implementing an IRB approach
- Considered regular focussed reviews of key risk areas including credit risk, capital risk, liquidity and market risk, conduct risk and across the different categories of operational risk
- Considered reviews on specific areas of focus including cyber security and operational resilience. This included monitoring the progress of the Group in addressing the approach to operational resilience proposed in the regulatory discussion paper in 2018
- Reviewed, challenged and approved the Management Responsibilities Map
- Reviewed, challenged and approved the terms of reference of each of the executive risk committees
- Reviewed, challenged and approved the Compliance Monitoring Plan ('the Compliance Plan') and subsequent updates to the Compliance Plan
- Reviewed, challenged and approved the Money Laundering Reporting Officer's annual report
- Considered and challenged reports in relation to ICAAP, ILAAP and RP recommending approval to the Board
- Challenged and approved various key risk policies

During the coming year, the Committee's priorities will include:

- Completing the appointment of a new CRO and supervising their induction
- Reviewing the Group's risk appetite to ensure it remains consistent with delivery of the Group's strategic objectives and proposing any required changes in risk appetites to the Board
- Continuing to review the potential impacts on the Group of the political and economic consequences of UK's decision to withdraw from the EU as details of the terms of exit and the basis of the future relationship become clearer
- Reviewing and challenging the Group's submissions to the PRA, in relation to its strategic decision to seek regulatory approval to implement an IRB approach for credit risk
- Reviewing and challenging reports in relation to ICAAP, ILAAP and RP ahead of approval by the Board
- Continuing its focus on ensuring that customers receive fair outcomes, including monitoring the treatment of vulnerable customers, and ensuring that the management of conduct risk remains a key priority for the Group
- Overseeing a review of the Group's culture and any actions identified by it
- Monitoring the Group's adherence to the FCA and PRA requirements in relation to the Senior Managers and Certification Regimes as they are expanded across the financial services sector
- Providing continued oversight and review of the operational resilience strategy and capability in light of further requirements which may result following the expected publication of a regulatory consultation paper by the end of 2019
- Ensuring the Group is well prepared to face the increasing challenges posed by climate change and the impact this may have on the Group's risk profile
- Monitoring the impact on the Group of the scheduled withdrawal of LIBOR as the primary sterling interest rate benchmark and proposals to replace it using SONIA derived measures
- Undertaking deep dives in relation to specific risk categories and business areas on both a rolling and ad hoc basis

Overall, I am pleased to confirm that in the last year the Committee has again, in my view, met its key objectives and carried out its role effectively.

As I look to the year ahead, it is clear that the economic, political and regulatory environment within which the Group operates will remain challenging. In particular, the level of uncertainty surrounding the basis of the UK's departure from the EU remains high, with the status of its future trading relationships remaining extremely unclear. Whilst I remain confident that the Group has the skills and experience to manage the risks it is likely to encounter in the year ahead, we remain vigilant to the need to reinforce these should circumstances change materially.

Finlay Williamson

Chair of the Risk and Compliance Committee

26 November 2019

B7.2 Risk governance

The Risk and Compliance Committee assists the Board in fulfilling its responsibilities for risk management and comprises the independent non-executive directors and the Chair of the Board. Its terms of reference, which were reviewed and approved by the Board in October 2019, include all matters indicated by the 2018 Code.

The Committee's responsibilities include reviewing:

- The effectiveness of the Group's risk management framework and the extent to which risks inherent in the Group's business activities are controlled within the risk appetite established by the Board
- The effectiveness of the Group's systems and controls for compliance with statutory and regulatory obligations, as well as its obligations under significant contracts
- The appropriateness of the Group's risk culture, to ensure it supports the Group's stated risk appetite
- The effectiveness of the Group in addressing issues requiring remedial attention to ensure actions are completed in a timely manner and minimise the potential for risk appetite thresholds to be exceeded

The Risk and Compliance Committee provides oversight and challenge to the Group's enterprise-wide risk management arrangements. The Committee is supported by an executive level Asset and Liability Committee, Conduct and Compliance Committee, Credit Committee, Model Risk Committee and Operational Risk Committee.

The Committee meets at least four times a year and normally invites the executive directors, Chief Risk Officer ('CRO'), Chief Operating Officer and Internal Audit Director to attend its meetings. However, it reserves the right to request any of these individuals to withdraw or to request the attendance of any other Group employee. The Committee meets with the CRO at least once a year, without the presence of executive management, to discuss their remit and any issues arising from it.

The Committee also has the opportunity to meet with the Internal Audit Director and/or the external auditor without the presence of executive management to discuss any matters that any of these parties believe should be discussed privately.

Agenda items for regular meetings of the Committee include:

- Reviewing the Group's principal risks
- Receiving and considering reports relating to the Group's consolidated risk profile
- Receiving and considering reports relating to the Group's performance against the Board's risk appetite and the progress of any resulting management actions to restore performance within approved target ranges
- Reviewing and approving the Compliance Plan and the proposed management actions to address any adverse reports
- Reviewing any proposed material changes to the Group's risk appetite prior to approval by the Board
- Reviewing and approving the Group's Recovery Plan ('RP') prior to approval by the Board
- Receiving reports relating to key regulatory developments affecting the Group
- Reviewing the Group's conduct strategy and receiving reports from management on conduct risk
- Receiving reports from the Money Laundering Reporting Officer on compliance with anti-money laundering requirements
- Reviewing material operational risk events to assess the effectiveness of the Group risk and control assessment framework
- Reviewing the timeliness, effectiveness and progress of any executive management actions required to remediate issues identified
- Reviewing the Group's capital and liquidity adequacy assessments and stress testing analysis
- Considering the minutes of its executive sub-committees

The structure of the executive committees reporting to the Committee and their reporting lines is illustrated below:



Each of the executive committees operates within terms of reference formally approved by the Risk and Compliance Committee. The primary functions of each of these committees are described below.

Asset and Liability Committee ('ALCO')

ALCO comprises heads of relevant functions and is chaired by the CFO.

The principal purpose of ALCO is to monitor and review the financial risk management of the Group's balance sheet. As such, it is responsible for overseeing all aspects of market risk, liquidity risk and capital management as well as the treasury control framework. ALCO operates within clearly delegated authorities, monitoring exposures and providing recommendations on actions required. It also monitors performance against appetite on an on-going basis and makes recommendations for revisions to risk appetites to the Risk and Compliance Committee.

Conduct and Compliance Committee ('CCC')

The CCC comprises heads of relevant functions and is chaired by the Deputy CRO.

The CCC is responsible for overseeing the Group's conduct risk and compliance arrangements. The Committee considers conduct risk information such as details of conduct breaches; systems and procedures for delivering fair outcomes to customers; the product governance framework; monitoring reports; and employee incentive schemes. It also considers product reviews from a customer perspective. With respect to compliance, the CCC is responsible for overseeing the maintenance of effective systems and controls to meet conduct-related regulatory obligations. It is also responsible for reviewing the quality, adequacy, resources, scope and nature of the work of the Compliance function, including the annual Compliance Plan.

Credit Committee

The Credit Committee comprises senior managers from the risk, finance and collections functions and is chaired by the CRO.

The Credit Committee approves credit risk policies in respect of customer exposures and defines risk grading and underwriting criteria for the Group. It also provides guidance and makes recommendations in order to implement the Group's strategic plans for credit. The committee oversees the management of the credit portfolios, the post origination risk management processes and the management of past due or impaired credit accounts. It also monitors performance against appetite on an on-going basis and makes recommendations for revisions to the credit risk appetites to the Risk and Compliance Committee. The Committee also operates the Group's most senior lending mandate.

Model Risk Committee ('MRC')

The MRC comprises senior managers from risk, finance and the main business areas and is chaired by the CRO.

The role of the MRC is to review and make recommendations on all material aspects of the rating and estimation processes in relation to key credit and finance models. The MRC also acts as the 'Designated Committee' for IRB purposes, approving all material aspects of IRB rating systems.

Operational Risk Committee ('ORC')

The ORC comprises heads of relevant functions and is chaired by the CRO.

The ORC is responsible for overseeing the Group's operational risk and business risk management arrangements, including those systems and controls intended to counter the risk that the Group might be used to further financial crime. The Committee remit includes risks arising from personnel, technology, and environmental matters within the business. The Committee considers key operational risk information such as key risk indicators, themes within risk registers, emerging risks, loss events, control failures, and operational resilience measures.

It also monitors performance against appetite on an on-going basis and makes recommendations for revisions to the Risk and Compliance Committee.

B7.3 Risk management culture

The Board is committed to maintaining an effective risk management framework that is consistent and commensurate with the nature, complexity and risk profile of the business and is responsive to both internal and external events. The Group's inherently conservative risk appetite is expressed through the culture promoted by the Board and senior management. This has resulted in historically low levels of credit and operational losses and the absence of any material conduct issues affecting customers.

The following risk principles are designed to support and protect the Group's strategic goals:

- Risk management is used to protect the Group's customers, shareholders, creditors and its reputation
- The fair treatment of customers and the delivery of fair outcomes, particularly for those customers considered to be vulnerable, is central to the Group's risk management approach
- The Group encourages a risk culture that has robust risk management at the heart of all decision-making within an open and transparent environment
- The Group only carries out business where the potential risk to itself and its customers has been considered together with the potential reward and where the residual risk exposure is within its defined risk appetite
- The Group utilises appropriate risk management processes to ensure that risks are identified, assessed, prioritised and managed in a consistent way
- Appropriate, timely and accurate risk management information is maintained and developed to support business decisions and to ensure the Group operates within its agreed risk appetite

An independent Risk and Compliance function provides an effective second line oversight capability together with a source of specialist support and advice for business areas in relation to the management of risk.

B7.4 Risk management framework

Introduction

The Group's risk management framework is designed to enable management to identify and focus attention on the risks most significant to its objectives and to provide an early warning of events that put those objectives at risk. The framework includes:

- The Risk and Compliance Committee and its sub-committees as described in B7.2
- A suite of risk policies, which include policies addressing:
 - o Conduct risk (including dealing with vulnerable customers and handling complaints)
 - o Credit risk
 - o Treasury risk
 - o Operational risk
 - o Data protection
 - o Information security
 - o Health and safety
 - o Business continuity
 - o Outsourcing and supplier risk
 - o Anti-money laundering
 - o Anti-bribery and corruption
 - o Market abuse
 - o Whistleblowing
 - o Conflicts of interest

- Dedicated teams within the Risk and Compliance function covering particular risk areas, led by experienced specialists, as described below
- Risk Champions appointed within all business areas to support the embedding of an effective risk culture across the Group
- A well-established and experienced Internal Audit function, supported by ongoing co-source arrangements with external providers when specific specialist skills are required

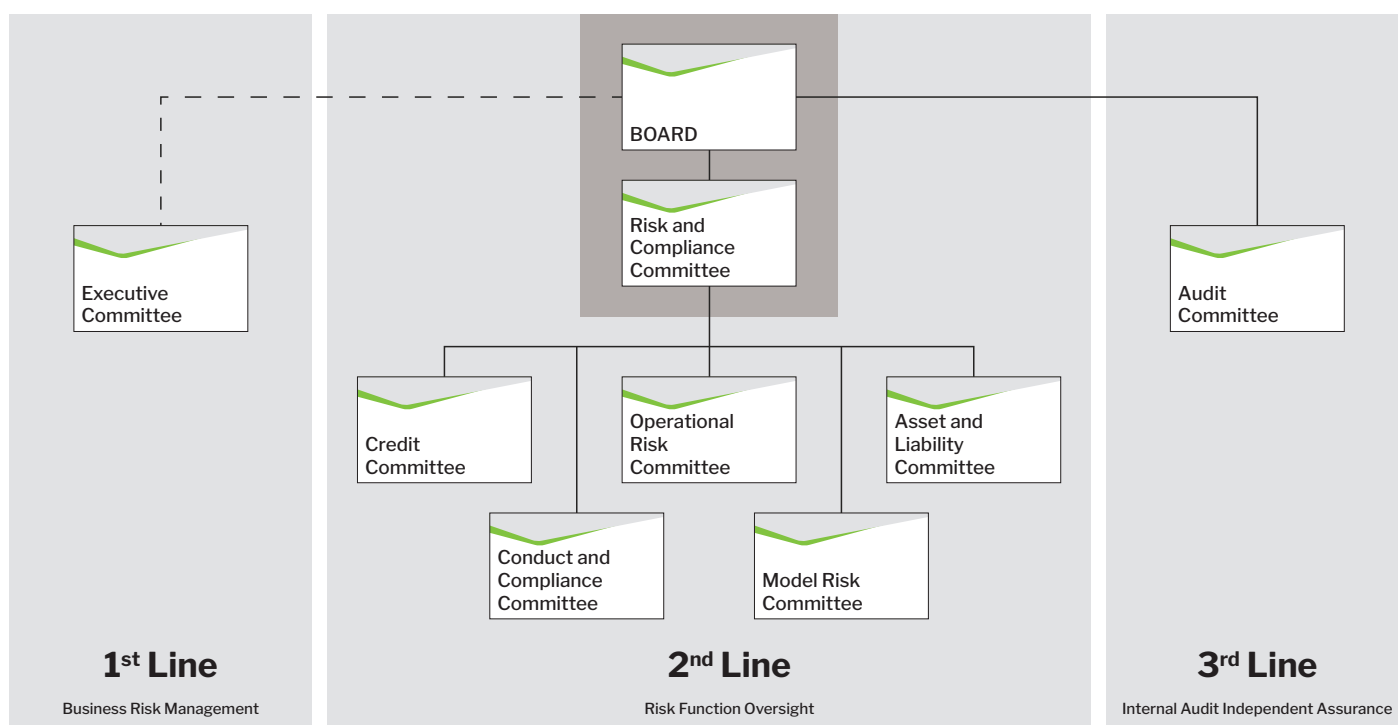
Three lines of defence model

The committee structures outlined above form the cornerstone for the governance of risk in a management framework organised within a three lines of defence model as follows:

- The *first line of defence*, comprising executive directors, together with managers and employees in operational and support areas, holds primary responsibility for designing, operating and monitoring risk management and control processes
- The *second line of defence* is provided by the Risk and Compliance function which is responsible for providing risk oversight and guidance to the first line, in addition to providing independent challenge and review. The function is overseen by the Risk and Compliance Committee and its supporting executive committees
- The *third line of defence* is provided by the Internal Audit function which is responsible for reviewing the effectiveness of the first and second lines of defence. This function is overseen by the Audit Committee

In addition, there are further external levels of control that complement the three internal layers, provided by the external audit process and the monitoring activities of regulatory bodies.

The way in which the three lines of defence model aligns with the wider governance framework is illustrated below:



The risk management framework is intended to provide a structured and disciplined approach to the management of risk within agreed appetites thereby supporting the achievement of the Group's strategic objectives. The key objectives of the risk management framework are to:

- Promote an appropriate risk culture across the Group ensuring risk is considered as part of key strategic and business decision making
- Establish standards for the consistent identification, measurement, monitoring, management and reporting of risk exposure and loss experience
- Outline the approach that will be taken in respect of setting and defining risk appetite and risk tolerances
- Promote risk management and the proactive reduction of the frequency and severity of risk events, driving control improvements where necessary
- Facilitate adherence to regulatory requirements, including threshold conditions, capital standards and to support the regulatory requirements associated with the ICAAP, ILAAP and RP
- Provide senior management and relevant committees with risk reporting that will be relevant and appropriate, enabling timely action to be taken in response to the information included within these reports

The Group publishes further information on its risk management system and risk profile in its Pillar III report, which can be found on the investor relations section of the Group's website at www.paragonbankinggroup.co.uk.

Risk management function

The Group's Risk and Compliance function is headed by the CRO, who reports directly to the CEO. The key responsibilities of the CRO are to:

- Develop and maintain the risk management framework covering all areas of the Group
- Develop and maintain risk policies within that framework, ensuring these are consistent with the Board's risk appetite
- Ensure that risks generated by the business are measured, monitored, controlled and reported on a timely basis
- Ensure compliance with all new and existing regulatory requirements
- Maintain open and constructive engagement with the regulatory authorities

The CRO is also responsible for the effective day-to-day running of the Risk and Compliance function and its relationship with the Board, its committees and senior management as well as for championing the Group's risk culture, providing support and advice to employees in the discharge of their risk responsibilities.

During the year there has been further recruitment at all levels within the Risk and Compliance function to bolster the division's strength and ensure that its size, structure and resources remain appropriate. This also allows the Group to benefit from the wider perspective provided by experienced external hires. The current function includes the following dedicated specialist second line areas which ultimately report to the CRO:

- Credit Risk
- Liquidity and Market Risk
- Conduct and Compliance Risk
- Operational Risk
- IT and Cyber Security Risk
- Data Protection
- Property Risk
- Financial Crime
- IRB Development

B7.5 Principal risks and mitigation




The Group is exposed to a number of principal risks and uncertainties that arise from the operation of its business model and strategy. A summary of those risks and uncertainties which could prevent the achievement of the Group's strategic objectives, how the Group seeks to mitigate those risks and the change in the perceived level of each risk in the last financial year are described below. These risks are discussed in more granular detail in the Group's Pillar III report, published on the Group website.


This analysis represents the Group's gross risk position as presented to, and discussed by, the Risk and Compliance Committee as part of its ongoing monitoring of the Group's risk profile.



This summary should not be regarded as a complete statement of all potential risks and uncertainties faced by the Group but rather those which the Group believes have the potential to have a significant impact on its financial performance and future prospects.



To identify and control the risks to which it is exposed, the Group employs a risk management framework. As part of this framework, principal risks are identified and assessed within the key categories of Business Risk, Credit Risk, Conduct Risk, Operational Risk, Liquidity and Capital Risk, Market Risk, and Pension Obligation Risk.


The changes in the perceived level of each risk in the last financial year are indicated using the symbols shown below:

		
Risk Increasing	Risk Decreasing	Risk Stable

BUSINESS RISK		
Economic risk		
Description	Mitigation	
<p>The potential for a deterioration in the UK's economic conditions is harder to forecast given the continuing material uncertainties as to the terms on which the UK will leave the EU.</p> <p>Given that its income is wholly derived from activities within the UK, the Group could be materially affected by a severe downturn in the UK economy, which could reduce demand for the Group's loan products, increase the number of customers that default on their loans and cause security asset values to fall.</p>	<p>The Group closely monitors political and economic developments in the UK and overseas, with support from leading independent macro-economic and other advisors. This information supports the senior management's review of objectives each year and helps inform business plans for each of the Group's principal trading operations.</p> <p>As a lender and acquirer of credit portfolios, exposure to any material deterioration in economic conditions is inevitable. The Board's defined strategy is to limit this risk by operating as a specialist lender in carefully chosen markets where its employees have significant levels of experience and expertise.</p> <p>The Group also uses stress testing to assess its expected performance under a range of operating conditions. This provides the Board with an informed understanding and appreciation of the Group's capacity to withstand shocks of varying severities. In addition to considering the credit implications of such economic stress, the Board also considers the operational and liquidity implications of such scenarios, which would include the potential to increase liquidity coverage ratios, access contingent liquidity and further strengthen key risk and servicing functions as and when required.</p>	
Change	<p>Whilst UK economic performance has again been broadly stable in the last financial year, the near-term outlook has continued to remain uncertain given a lack of clarity as to the basis of the UK's withdrawal from and future relationship with the EU. This continuing uncertainty has led to the overall risk assessment being considered to have increased further in the last year.</p>	

BUSINESS RISK		
Concentration risk		
Description		Mitigation
<p>Lending to customers investing in the UK private rented sector forms a substantial part of the Group's advances and assets.</p> <p>It is therefore exposed to any systemic deterioration in performance of the sector, which will be influenced by underlying factors such as house prices, supply of rental property, and demographic changes.</p> <p>The buy-to-let sector has been subject to a high level of fiscal and regulatory intervention in recent years. Where such changes make buy-to-let less attractive or viable to customers' businesses, the Group is exposed to adverse consequences.</p> <p>Concentration risks may also arise within other business lines, affecting their performance.</p>		<p>The Group has a very deep understanding of the private rented sector built up over many years of successful operations in the buy-to-let market. This includes a long history of performance data through several economic cycles together with regular independently conducted research commissioned over many years.</p> <p>The Group seeks to use this expertise constructively by playing an active role in shaping the development of policy for the private rented sector.</p> <p>Given its specialist knowledge of the sector and its historically prudent approach to underwriting, the Group has been well placed to respond effectively to the various regulatory changes introduced in recent years in relation to buy-to-let lending.</p> <p>A suite of concentration risk metrics is monitored by the Bank's Credit Risk function and reported monthly through the Credit Committee on to the Risk and Compliance Committee. Potential areas of concentration relating not just to loan products but also covering borrower, asset, or large exposure risk for example, are therefore managed within defined limits.</p> <p>The Group also continues to exploit opportunities to diversify the range of its activities and income streams, consistent with its strategic objective of operating as a prudent, risk focussed specialist lender.</p>
Change	<p>The Group continues to have significant exposure to buy-to-let lending but, due to its specialist knowledge of the sector, it has been able to respond positively to regulatory changes in recent years. The Group's diversification strategy has also positioned it to reduce its reliance on this product line.</p> <p>In the longer term, changes to the UK taxation regime and greater regulatory intervention in the sector may reduce demand and availability of buy-to-let lending products. However, the Group continues to be confident in its ability to operate successfully in this evolving environment.</p>	
Transition risk		
Description		Mitigation
<p>The Group has made a number of acquisitions in previous periods.</p> <p>While there have been no acquisitions in the current accounting period, any failure to manage effectively the transition and implementation risks resulting from previous material corporate acquisitions may impact adversely on the Group's financial performance and its reputation.</p>		<p>The Board's M&A strategy is that the Group will only consider acquisitions in areas of business that it understands, and which are complementary to its existing activities.</p> <p>Extensive pre-acquisition due diligence is always undertaken with support from respected, high quality advisors. Formal governance arrangements are applied to any proposed acquisition and to subsequent integration projects, with regular progress reporting to the executive team and the Board.</p> <p>Where necessary, enhancements are made to the risk and control frameworks of acquired businesses to ensure these are aligned to those within the wider Group.</p>
Change	Ongoing integration activity has been successful and with no new acquisitions undertaken, transition risk has reduced.	



CREDIT RISK		
Customer risk		
Description		Mitigation
<p>Failure to screen potential borrowers, underwrite new business, and manage repayments effectively could expose the Group to the risk of unexpected material losses.</p> <p>Recoverable amounts on loans may also be affected by adverse movements in security values such as house and commercial asset prices.</p>		<p>The Group has comprehensive policies in place that set out detailed criteria which must be met before loans are approved.</p> <p>Credit policies incorporate limits for concentration risks arising from factors such as large exposures to counterparties, geographical areas or types of lending.</p> <p>The Group uses a range of sources to inform expectations of key external factors such as interest rate movements, house price inflation, property rental inflation and asset depreciation which are in turn used to guide policy and underwriting.</p>
Change	<p>The Group's arrears rate and cost of risk have remained very low, reflecting the maintenance of robust, proven credit disciplines, generally stable economic conditions and the credit quality of its borrowers. The potential for any credit deterioration due to changing economic conditions, particularly given current uncertainties regarding the UK's future relationship with the EU, is being monitored closely across all Group portfolios.</p> <p><i>The Group's approach to the management of credit risk and the systems in place to mitigate that risk on both originated and purchased assets are further described in note 57 to the Group Accounts.</i></p>	
Counterparty risk		
Description		Mitigation
<p>The Group is exposed to the failure of counterparties with which it places deposits, or which provide hedging agreements to mitigate interest rate and foreign exchange risk.</p>		<p>The Group has a strictly controlled number of approved treasury counterparties. To be approved, counterparties must meet specific credit rating criteria.</p> <p>Exposure to approved counterparties is monitored intra-day by senior management within the Group's Treasury function with all trading performed within approved limits.</p> <p>The credit quality of all treasury counterparties and the Group's exposure to them is reported monthly to ALCO.</p> <p>Treasury counterparties are typically highly rated banks and, for all cash deposits and derivative positions held within the Group's securitisation structures, they must comply with criteria set out in the financing arrangements, which are monitored externally.</p> <p>Where a counterparty to the Group's cross-currency basis swaps fails to meet the required credit criteria they are obliged under the terms of the instruments to set aside a cash collateral deposit.</p>
Change	<p>The credit quality of the treasury counterparties with whom the Group transacts has been maintained during the year and this risk is therefore considered to have remained stable.</p>	

CONDUCT RISK		
Customer fair outcomes		
Description		Mitigation
<p>The Group provides a broad range of financial services products across a number of brands to consumers and small business customers.</p> <p>As a result, the Group is exposed to potential conduct risk should it fail to deliver fair outcomes for its customers.</p> <p>Systemic poor customer treatment may lead to regulatory censure, reputational damage and resulting reductions in profitability.</p>		<p>The Group has a formal Conduct Risk Management framework which includes a number of detailed policies and standards addressing the fair treatment of customers. At the centre of these is the Conduct Risk Policy, underpinned by additional policies and standards. This sets out the Group's overarching approach to the management of conduct risk as part of a framework within which business areas are required to develop systems and processes to identify, measure, manage, monitor and report risks in accordance with stated risk appetites.</p> <p>The management of conduct risk within the Group is tailored to the specific product and customer type concerned. Business areas dealing with consumers have dedicated quality and control teams which validate process adherence and the delivery of fair treatment for customers. This may also include a dedicated customer support team to manage customers deemed to be vulnerable.</p> <p>The Conduct and Compliance Committee ('CCC') has a remit which includes overseeing the fair treatment of customers.</p> <p>The CCC also receives items for review and / or approval, such as product governance submissions, conduct risk related policies and standards, business area incentive schemes, compliance monitoring outputs and regulatory communications.</p> <p>The Compliance function has a formal monitoring plan which is focussed on conduct risk and the fair treatment of customers, particularly those that are defined as vulnerable, or in financial difficulty. The plan is reviewed and approved on at least an annual basis by the RCC.</p> <p>Management actions to address any adverse compliance monitoring or Internal Audit reports are overseen at the CCC, ORC and RCC.</p> <p>The Group's approach to employee remuneration means that very few staff are included in financial incentive schemes. All schemes are required to be approved by the CCC before implementation and then reviewed by the CCC at least annually.</p>
Change	<p>The Group operates in areas which are highly regulated and where continuing changes to the regulatory conduct landscape heighten the potential risk of financial losses or censure. In response to this, the Group has continued to develop and embed its conduct risk management framework during the year.</p>	

OPERATIONAL RISK


People risk

Description	Mitigation
<p>The Group is exposed to the risk that it is unable to recruit and retain skilled senior management and key personnel at all levels.</p> <p>Failure to maintain the necessary skill base within its workforce could have a material impact on the Group's ability to deliver its business plan and strategic objectives.</p> <p>This is a particular risk in respect of key specialist and executive positions, where the institutional knowledge of the incumbents would be very difficult to replicate in the short term.</p>	<p>The Group manages and controls its key person dependency risk through effective succession planning, recruitment, development and retention strategies.</p> <p>External remuneration and reward structures are monitored to ensure the Group remains competitive and is able to recruit and retain key personnel.</p> <p>A range of employee benefits are offered in addition to base salaries including a defined contribution pension scheme, Sharesave Plan and an annual profit related pay scheme for most employees.</p> <p>A Senior Leadership Development Programme and Manager and Team Leader Academies have been created to develop pools of strong, capable individuals with the potential to fill future managerial and specialist roles within the business.</p> <p>The Group has been accredited under the 'Investors in People' scheme since 1997 and has held Champion status in the scheme since May 2014. This accreditation is awarded to a very small proportion of organisations who are seen as pioneers in people management practices and role models in strategic leadership.</p>
<p>Change</p>	<p>A strong employment market and particularly buoyant demand for skilled financial services staff has again been a feature of the last financial year. This has led to continued strong competition to recruit and retain employees. Despite the increasingly competitive external environment, the Group remains confident in its ability to manage this risk.</p> <div data-bbox="1157 761 1356 828"> </div>


OPERATIONAL RISK		
Systems risk		
Description	Mitigation	
<p>The Group is exposed to the risk that its IT infrastructure and systems are unable to support its operational needs.</p> <p>This includes the risk that the Group's processes fail to offer adequate protection against the threat of cyber-crime.</p> <p>Failure in Group IT systems, either in terms of capacity or security, however caused, could result in detriment to customers, regulatory censure and reputational damage, while failure to match market levels of functionality could have an adverse impact on business volumes. All of these factors could materially impact income and profitability.</p> <p>This risk also includes the potential that the Group's key outsourcing arrangements with third parties could expose it to material loss or reputational damage.</p>	<p>The Group has a formally agreed IT strategy which ensures that priority is given to those areas which are most critical to the delivery of the Group's strategy and business plan. It maintains an ongoing programme of investment in IT infrastructure and systems. The Group also employs a robust vendor management process to select and monitor third party IT suppliers.</p> <p>Over the last twelve months the Group has continued to invest in new technology and services to maintain and increase its defence in depth strategy to protect its operational capability. The implementation of a new Security Operations Centre service has added third party security expertise to support the Group's existing specialist resource.</p> <p>A formal Cyber Incident Response Plan is in place to ensure the Group is well placed to deal with any issues or events. This is regularly reviewed and approved by the RCC.</p> <p>There is ongoing focus on the information security management system (ISO27001:2005) to which the Group is certified, to ensure that controls, testing and user awareness are maintained and improved.</p> <p>Change programmes are closely managed with robust control and testing processes to ensure that system developments meet operational requirements and are effectively implemented.</p>	
Change	<p>The Group has continued to invest significantly in order to further enhance its operational resilience. However, the Group recognises that while it continues to develop, and maintain a secure IT infrastructure, the increased sophistication of cyber-crime attacks continues to be a significant risk for the business in common with the rest of the financial services sector.</p>	
Regulatory risk		
Description	Mitigation	
<p>The Group is exposed to the risk that its financial performance and reputation could suffer significantly if it fails to identify, interpret and comply with relevant regulatory and legal obligations.</p> <p>The customers and market sectors to which the Group supplies products, and the capital markets from which it obtains some of its funding, have been subject to increasing legislative and regulatory intervention over recent years.</p>	<p>The Group has Risk and Compliance and Legal teams who review key regulatory and legal developments to assess the impact on the Group's operations. These teams then work with business areas to provide advice on the implementation of appropriate measures to meet identified requirements. Expert external advice is also sought where necessary. Major regulatory or legal change initiatives are subject to formal change governance with progress reporting to the RCC.</p> <p>All employees are required to undertake regulatory training and testing to ensure appropriate levels of competence are maintained. Those in relevant specialist roles are also required to adhere to formal regulatory training and competence regimes.</p> <p>The Compliance and Financial Crime functions maintain formal second line monitoring plans. Progress against the plan and the issues identified within individual reviews are reported to the CCC and the RCC to ensure that regulatory requirements have been satisfactorily embedded, and any lessons learnt are applied across all relevant areas of the Group.</p> <p>Similarly, the Financial Crime function provides independent oversight of business areas' adherence to anti-money laundering and financial crime requirements.</p> <p>During 2018-19 key regulatory initiatives have included the focus on operational resilience and the impact of climate change. Work has commenced in both these areas and will develop during 2019-20 as further clarity is received around regulatory expectations.</p>	
Change	<p>Whilst the Group considers that it continues to have robust arrangements in place, the increasing scope and complexity of regulatory regimes heightens the potential risk arising from any failure to comply with current regulations or to respond effectively to new and emerging ones.</p>	


LIQUIDITY AND CAPITAL RISK


Funding risk

Description	Mitigation	
<p>The Group relies on its access to various sources of funding to finance the origination of new business, portfolio acquisitions and working capital. If access to funding became restricted, either through market movements or regulatory intervention, this might result in the scaling back or cessation of some business lines.</p> <p>Retail deposit taking is central to the Group's funding plans and therefore changes in market conditions could impact the ability of the business to maintain the level of liquidity required to sustain normal business activity.</p>	<p>The Group maintains a diversified range of both retail and wholesale medium and long-term funding sources to cover future business requirements and liquidity to cover shorter term funding needs.</p> <p>Internally, comprehensive treasury policies are in place to ensure sufficient liquid assets are maintained and that all financial obligations can be met as they fall due.</p> <p>The Group, through Paragon Bank, is authorised to accept retail deposits. As such, it is subject to regulation by the PRA. The Group aims to ensure that sufficient liquid assets are held, at all times, to mitigate the liquidity risk inherent in deposit taking.</p> <p>The Group has an experienced structured finance function who maintain relationships with major participants in the capital markets and who have been instrumental in many securitisation and debt issues. This gives it access to capital markets when required.</p> <p>The Company has a BBB investment grade credit rating from Fitch to support maintenance of its access to funding markets.</p>	
Change	<p>The Group remains well funded with sufficient liquidity to meet all its financial obligations as they fall due.</p> <p>It is well placed to access future funding from a wide range of sources to meet its future funding requirements. During the year, the Group demonstrated its ability to access the securitisation market for additional funding on an ongoing basis, and its Fitch rating was confirmed. Although there has been strong competition for retail deposits, the overall risk is considered to have remained stable.</p>	

Capital risk

Description	Mitigation	
<p>The changes made in the Basel III capital regime by the BCBS regarding minimum capital requirements from 2021 could impact on the Group.</p> <p>The BCBS changes include increases in risk weights for residential real estate exposures where repayment is materially dependant on cash flows generated by the property, which may include certain categories of buy-to-let lending. The Group's capital requirements would, therefore, be increased to some extent.</p>	<p>In order to further enhance its existing robust credit management capabilities and to mitigate the risks of the proposed BCBS changes, the Group took a strategic decision in 2016 to seek the necessary regulatory approval to implement an IRB approach for credit risk.</p> <p>In support of this, the Group appointed an experienced director of IRB to lead this initiative. A formal IRB project has since been initiated with support from respected external specialist advisors to enable the Group to commence its application process with the relevant regulatory authorities during the first half of the new financial year.</p> <p>The Group's IRB plan is well progressed, however a consultation paper produced in September 2019 highlighted a need for aspirant firms to comply with certain future regulations and requirements where the authorisation process extends beyond 2020. Whilst only a consultation at this stage, the Board has decided to ensure its IRB models are fully compliant with this requirement before making its first submissions to the PRA. The timing of the application will reflect the requirements of the Policy Statement that will result from the consultation process.</p>	
Change	<p>During the year, the UK and European authorities developed their approach to the implementation of the Basel III changes. The impacts of their decisions were considered, and the proposed changes have been incorporated within the Group's IRB project.</p> <p>These developments did not change the Group's assessment of the likely impact of these changes.</p> <p><i>Further information on the Group's management of capital risk is given in note 55 to the Group Accounts.</i></p>	

MARKET RISK		
Interest rate risk		
Description		Mitigation
<p>The Group is exposed to the risk that changes in interest rates may adversely affect its net income and profitability.</p> <p>In particular, the Group's profitability is determined by the difference between the interest rates at which it lends and those at which it borrows.</p> <p>Changes in market interest rates could therefore materially impact the Group's profits as a result of significant mismatches between its assets and liabilities.</p>		<p>This risk is managed through Board approved risk appetite limits with comprehensive treasury policies in place to ensure that the risk posed by changes and mismatches in interest rates are effectively managed.</p> <p>The Board's risk management framework for Interest Rate Risk in the Banking Book ('IRRBB') continues to evolve in line with updates in regulatory guidance on methods expected to be used by banks for controlling such risks.</p> <p>Day-to-day management of interest rate risk within Board approved limits is the responsibility of Treasury with control and oversight provided by ALCO which reports to the RCC.</p> <p>The Group seeks to match the structure of assets and liabilities by using appropriate financial instruments, such as interest rate swaps or cap agreements and fixed rate retail liabilities.</p>
Change	<p>The Group's interest risk exposure profile, relative to its balance sheet has remained broadly similar and therefore associated risk levels remain generally stable compared to previous periods. The approach to managing the risks has, however, been enhanced to reflect the EBA's guidelines.</p> <p><i>Further information regarding the Group's management of interest rate risk is given in note 59 to the Group Accounts.</i></p>	

PENSION OBLIGATION RISK		
Pension obligation risk		
Description		Mitigation
<p>The Group operates a defined benefit pension scheme and defined contribution pension schemes in the UK.</p> <p>There is a risk that the Group's commitments under its defined benefit scheme expose it to the risk that the assets of the scheme may be insufficient to meet its liabilities, either due to adverse investment performance or inaccurate assumptions, including future inflation levels, members' salaries or mortality rates.</p>		<p>The Group's defined benefit scheme ('the Plan') was closed to new members with effect from February 2002. Since that time, new employees have been invited to join the Group's defined contribution pension scheme which carries no investment or mortality risk for the Group.</p> <p>To mitigate the risks inherent in its exposure to the Plan, the Group conducts regular asset-liability reviews in conjunction with the Trustee. These reviews are used to assist the Trustee and the Group to determine the optimal long-term asset allocation with regard to the structure of liabilities within the Plan.</p> <p>The results of the reviews also assist the Trustee in managing the volatility in the underlying investment performance and the risk of a significant increase in the scheme deficit by providing information used in investment strategy decisions.</p> <p>The Plan is subject to triennial formal valuation by the Plan actuary. The valuation process as at 31 March 2019 is currently in progress, and will include the agreement of a recovery plan between the Trustees and the Group which will aim to clear the deficit in the Plan. This is will be agreed during the year ending 30 September 2020.</p>
Change	<p>Despite short-term fluctuations caused by market instability in interest rates and asset prices, the Group considers the underlying long-term funding position for the Plan to be robust and sustainable.</p> <p><i>Further details of the Group's exposure to the Plan are given in note 41 to the Group Accounts.</i></p>	

B8

Directors' report

The directors of Paragon Banking Group PLC (registered number 2336032) submit their Report prepared in accordance with Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ('Schedule 7'), which also includes additional disclosures made in accordance with the requirements of the UK Listing Authority.

Directors and their interests

The directors of the Company during the year were:

F J Clutterbuck
N S Terrington
R J Woodman
J A Heron
A K Fletcher* (resigned 31 December 2018)
P J N Hartill*
H R Tudor*
P J Newberry* (resigned 31 December 2018)
B A Ridpath*
F F Williamson*
G H Yorston*

* Non-executive directors throughout the year.

The directors' interests in the shares of the Company are disclosed in the Directors' Remuneration Report in Section B6. There have been no changes in the directors' interests in the share capital of the Company since 30 September 2019.

During the year, Mr H R Tudor sold all of his interest in the Company's 6.00% sterling denominated notes due 2020 (2018: £300,000 held).

Other than as stated above, the directors had no interests in securities issued by the Company. The directors have no interests in the shares or debentures of the Company's subsidiary companies.

The appointment and replacement of the Company's directors is governed by the Articles of Association of the Company (the 'Articles'), the Code, the Companies Act 2006 and related legislation, and the individual service contracts and terms of appointment of the directors. The powers of the directors, and their service contracts and terms of appointment, are described in the Corporate Governance section, in Sections B3 and B6. The Articles may only be amended by the Company's shareholders in general meeting.

Under Article 161 of the Articles, the Company has qualifying third party indemnity provisions for the benefit of its directors, which were in place throughout the year and which remain in force at the date of this report, in the form of directors' and officers' liability insurance. The directors' and officers' liability insurance covers directors of all of the Company's subsidiary entities.

Under Article 85 of the Articles certain directors are required to submit themselves for reappointment. In accordance with the Code, however, the Board has decided that it is appropriate for all directors to submit themselves for reappointment on an annual basis. Accordingly, all current directors, other than Mr Hartill and Mr Heron, who have announced their intention to step down from the Board before the meeting, will retire and seek reappointment at the AGM.

None of the directors has a service contract with the Company requiring more than 12 months' notice of termination to be given.

A director has a statutory duty to avoid a situation in which he or she has, or can have, an interest that conflicts or possibly may conflict with the interests of the Company. A director will not be in breach of that duty if the relevant matter has been authorised in accordance with the Articles by the other directors. The Articles include the relevant authorisation for directors to approve such conflicts.

None of the directors had, either during or at the end of the year, any material interest in any contract of significance with the Company or its subsidiaries.

Capital structure

Details of the issued share capital of the Company, together with details of movements in its issued share capital in the year, are given in note 42 to the accounts. The Company has one class of ordinary shares which carries no right to fixed income. Each ordinary share carries the right to one vote at general meetings of the Company. The rights and obligations attaching to ordinary shares are set out in the Articles.

There are no specific restrictions on the size of a member's holding or on the transfer of shares. Both of these matters are governed by the general provisions of the Articles and prevailing legislation. The Articles may be amended by special resolution of the shareholders. The directors are not aware of any agreements between holders of the Company's shares in respect of voting rights or which might result in restrictions on the transfer of securities.

Details of employee share schemes are set out in note 12 to the accounts. Votes attaching to shares held by the Group's employee benefit trust are not exercised at general meetings of the Company.

The Company presently has the authority to issue ordinary shares up to a value of £86.8 million and to make market purchases of up to 26.0 million £1 ordinary shares, granted at the AGM on 14 February 2019. These authorities expire at the conclusion of the forthcoming AGM on 13 February 2020 and resolutions will be put to that meeting proposing that they be renewed.

Purchase of own shares

On 27 June 2019, the Group announced a share buy-back programme of £30.0 million. During the year, 6,048,852 £1 ordinary shares (2018: 5,106,641) having an aggregate nominal value of £6,048,852 (2018: £5,106,641), were purchased under this programme. The reasons for this purchase were set out in an announcement published on the regulatory news service of the London Stock Exchange at that time. Total consideration paid in the year was £26.7 million, including costs (2018: £25.2 million).

All of the shares acquired under this programme were held initially as treasury shares.

On 31 July 2019, 21,630,434 of the treasury shares acquired under these programmes were cancelled. These shares had a nominal value of £21,630,434 and represented 8.32% of the issued share capital excluding treasury shares at that time.

The number of treasury shares held at 30 September 2019 was 5,218,702 (2018: 20,800,284), representing 2.04% of the issued share capital excluding treasury shares (2018: 7.98%). The maximum holding of treasury shares during the year was 21,769,034 (2018: 20,800,284) representing 8.37% of the issued share capital excluding treasury shares at that time (2018: 7.98%).

Dividends

The directors recommend a final dividend of 14.2p per share (2018: 13.9p per share) which, taken with the interim dividend of 7.0p per share (2018: 5.5p per share) paid on 26 July 2019, would give a total dividend for the year of 21.2p per share (2018: 19.4p per share).

Major shareholdings

Notifications of the following major voting interests in the Company's ordinary share capital, notifiable in accordance with Chapter 5 of the FCA's Disclosure and Transparency Rules or section 793 of the Companies Act 2006, had been received by the Company as at 30 September 2019 and at 31 October 2019, being a date not more than one month before the date of the notice convening the forthcoming AGM.

Shareholder	31 October 2019		30 September 2018	
	Ordinary Shares	% Held	Ordinary Shares	% Held
Royal London Asset Management Limited	18,020,262	7.03%	18,020,262	7.03%
Prudential PLC Group of Companies*	-	-	18,012,554	7.03%
M&G PLC*	16,933,305	6.60%	-	-
Franklin Templeton Fund Management Limited	13,061,935	5.01%	13,061,935	5.10%
Dimensional Fund Advisors LP	13,033,648	5.08%	13,033,648	5.08%
Norges Bank	11,007,893	4.29%	11,007,893	4.29%

*Following the demerger of Prudential plc and M&G PLC, the holding previously held by the Prudential PLC Group of Companies is now held by M&G PLC.

Percentage holdings are calculated based on the total voting rights at the relevant date.

Significant agreements

The Company is not party to any significant agreements that would take effect, alter or terminate following a change of control of the company.

The Company does not have any agreements with any director or employee that would provide compensation for loss of office or employment resulting from a takeover of the Company, except that provisions of the Company's share based remuneration arrangements may cause awards granted to employees under such plans to vest in such circumstances.

Research and development

During the year, the Group undertook certain projects to develop its IT capabilities which met the definition of research and development set out in the guidelines issued by the Department of Business Innovation and Skills in 2010. Claims in respect of these activities were made in the Group's tax returns. The amounts involved were modest in the context of the Group accounts.

Political expenditure

Company law requires the disclosure of political donations and political expenditure by any Group company. During the year ended 30 September 2019 no such payments were made (2018: £nil).

Auditors

The directors have taken all reasonable steps to make themselves and the Company's auditors, KPMG LLP ('KPMG'), aware of any information needed in preparing the audit of the Annual Report and Financial Statements for the year, and, as far as each of the directors is aware, there is no relevant audit information of which the auditors are unaware.

The directors, having considered the requirements for rotation of auditors, the length of service of KPMG and the conduct of the audit concluded there was no present need to retender the audit. Therefore, a resolution for the reappointment of KPMG, who have expressed their willingness to continue in office, as the auditors of the Company is to be proposed at the forthcoming AGM. The evaluation process is described more fully in the Audit Committee Section B5.

Annual General Meeting

The Annual General Meeting of the Company will take place on 13 February 2020 in London. A notice convening the AGM is being circulated to shareholders with this Annual Report and Accounts.

Listing Rule LR9.8.4

There are no matters which the Company is required to report under Listing Rule LR9.8.4, other than the fact that the trustees of its employee share ownership trust (note 44) have waived their right to receive dividends on any shares held from time to time. As these shares are held on the consolidated balance sheet, this has no effect on the amounts reported by the Group.

Information presented in other sections

Certain information required to be included in a directors' report by Schedule 7 can be found in the other sections of the Annual Report, as described below. All of the information presented in these sections is incorporated by reference into this Directors' Report and is deemed to form part of this report.

- Commentary on the likely future developments in the business of the Group is included in the Strategic Report (Section A)
- A description of the Group's financial risk management objectives and policies, and its exposure to risks arising from its use of financial instruments are set out in note 56 to the accounts and related notes
- Information concerning directors' contractual arrangements and entitlements under share based remuneration arrangements is given in Section B6, the Directors' Remuneration Report
- Information concerning the employment of disabled persons and the involvement of employees in the business is given in Section A5.2 – 'People'
- Disclosures concerning greenhouse gas emissions are given in Section A5.3 – 'Environmental Issues'
- Disclosures concerning events taking place after the balance sheet date are set out in note 32 to the accounts.

Rule DTR7.2.1 of the Disclosure Guidance and Transparency Rules requires the Group's disclosures on Corporate Governance to be included in the Directors' Report. This information is presented in Sections B3, B4, B5, B6 and B7 and the information in these sections is incorporated by reference into this Directors' Report and is deemed to form part of this report.

Rule DTR4.1.5 of the Disclosure Guidance and Transparency Rules requires that the annual report of a listed company contains a management report containing certain prescribed information. This Directors' Report, including the other sections of the Annual Report incorporated by reference, comprises a management report for the Group for the year ended 30 September 2019, for the purposes of the Disclosure Guidance and Transparency Rules.

Section B8 of this Annual Report, together with the other sections of the Annual Report incorporated by reference, comprise a directors' report for the Company which has been drawn up and presented in accordance with, and in reliance upon, applicable English company law and the liabilities of the directors in connection with this report shall be subject to the limitations and restrictions provided by such law.

Approved by the Board of Directors and signed on behalf of the Board.

Pandora Sharp

Company Secretary

26 November 2019

Statement of directors' responsibilities

in respect of financial statements

The directors are responsible for preparing this Annual Report, including the consolidated and company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare consolidated financial statements for the Group and separate financial statements for the Company in respect of each financial year. In respect of the financial statements for the year ended 30 September 2019, that law includes the Companies Act 2006 ('the Act') and Article 4 of the IAS Regulation. That law requires the directors to prepare the consolidated financial statements in accordance with IFRS as adopted by the EU and they have also elected to prepare the financial statements of the Company in accordance with IFRS as adopted by the EU.

International Accounting Standard 1 – 'Presentation of Financial Statements' requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's ('IASB') 'Framework for the Preparation and Presentation of Financial Statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRS.

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 Company and the Group's profit or loss for the year. In preparing each of the consolidated and Company financial statements the directors are also required to:

- Select suitable accounting policies and apply them consistently
- Make judgements and estimates that are reasonable, relevant and reliable
- State whether the consolidated financial statements have been prepared in accordance with IFRS as adopted by the EU and whether the company financial statements have been prepared in accordance with the Act
- Assess the ability of the Group and the Company to continue as a going concern, disclosing, as applicable, matters related to going concern
- Use the going concern basis of accounting unless they intend to liquidate the Company and / or the Group or to cease operation or they have no realistic alternative to doing so
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information
- Provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance

The directors are responsible for keeping adequate accounting records for the Company which are sufficient to record and explain its transactions, disclose with reasonable accuracy at any time its financial position and enable them to ensure that its financial statements comply with the requirements of the Act.

They are responsible for the implementation of such internal control processes as they deem necessary to enable the preparation of financial statements which are free from material misstatements, whether due to fraud or error, and 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 the preparation of a strategic report, directors' report, directors' remuneration report and corporate governance statement which comply 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 (www.paragonbankinggroup.co.uk). Legislation in the UK governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

Confirmation by the Board of Directors

Each of the current directors confirms that, to the best of their knowledge:

- The financial statements, prepared in accordance with IFRS as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and of the Group taken as a whole
- The Directors' Report, including those other sections of the Annual Report incorporated by reference, comprises a management report for the purposes of the Disclosure Guidance and Transparency Rules, and includes a fair review of the development and performance of the business and the consolidated position of the Group taken as a whole, together with a description of the principal risks and uncertainties that it faces
- The Annual Report (including the consolidated and company financial statements), taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy

Approved by the Board of Directors and signed on behalf of the Board.

Pandora Sharp

Company Secretary

26 November 2019

A stylized logo featuring a bright green diagonal line that runs from the top right towards the bottom left. The background is a dark charcoal grey. On the right side, within the dark area, is the white text 'C.' in a clean, sans-serif font. The green line has a slight curve and ends in a small white square at the bottom right.

C.

INDEPENDENT AUDITOR'S REPORT

Report by the independent auditor of the Company, KPMG LLP, on the financial statements

Independent auditor's report

To the members of Paragon Banking Group PLC

1. Our opinion is unmodified

We have audited the financial statements of Paragon Banking Group PLC ("the Company") for the year ended 30 September 2019 which comprise the:

- Consolidated Income Statement
- Consolidated Statement of Comprehensive Income
- Consolidated and Company Balance Sheets
- Consolidated and Company Cash Flow Statements
- Consolidated and Company Statements of Movements in Equity
- Related notes, including the accounting policies in note 63, other than the disclosures labelled as unaudited in note 55.

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 30 September 2019 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU);
- the Parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.


Basis for opinion


We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the audit committee.


We were first appointed as auditor by the shareholders on 9 February 2016. The period of total uninterrupted engagement is for the four financial years ended 30 September 2019. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed public interest entities. No non-audit services prohibited by that standard were provided.


2. Key audit matters: our assessment of risks of material misstatement


Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.



Key audit matter	Our response
<p>The impact of uncertainties due to the UK exiting the European Union on our audit</p> <p>Risk vs 2018: </p> <p><i>Refer to the Chief Executive's Review</i></p> <p>Unprecedented levels of uncertainty</p> <p>All audits assess and challenge the reasonableness of estimates, in particular as described in impairment allowances on loans to customers, interest receivable on loan accounts, recoverability of goodwill and valuation of the defined benefit pension scheme obligation, below, and related disclosures and the appropriateness of the going concern basis of preparation of the financial statements (see below). All of these depend on assessments of the future economic environment and the Group's future prospects and performance.</p> <p>In addition, we are required to consider the other information presented in the Annual Report including the principal risks disclosure and the viability statement and to consider the Directors' statement that the Annual Report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group and Parent position and performance, business model and strategy.</p> <p>Brexit is one of the most significant economic events for the UK and at the date of this report its effects are subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown.</p>	<p>We developed a standardised firm-wide approach to the consideration of the uncertainties arising from Brexit in planning and performing our audits. Our procedures included:</p> <ul style="list-style-type: none"> • Our Brexit knowledge – We considered the directors' assessment of Brexit-related sources of risk for the Group's business and financial resources compared with our own understanding of the risks. We considered the directors' plans to take action to mitigate the risks. • Sensitivity analysis – When addressing impairment allowances on loans to customers, interest receivable on loan accounts, recoverability of goodwill and valuation of the defined benefit pension scheme obligation and other areas that depend on forecasts, we compared the directors' analysis to our assessment of the full range of reasonably possible scenarios resulting from Brexit uncertainty and, where forecast cash flows are required to be discounted, considered adjustments to discount rates for the level of remaining uncertainty. • Assessing transparency – As well as assessing individual disclosures as part of our procedures on impairment allowances on loans to customers, interest receivable on loan accounts, recoverability of goodwill and valuation of the defined benefit pension scheme obligation on our audit we considered all of the Brexit related disclosures together, including those in the strategic report, comparing the overall picture against our understanding of the risks. <p>Our results</p> <p>As reported under Impairment allowances on loans to customers, interest receivable on loan accounts, recoverability of goodwill and valuation of the defined benefit pension scheme obligation, we found the resulting estimates and related disclosures of Impairment allowances on loans to customers, interest receivable on loan accounts, recoverability of goodwill and valuation of the defined benefit pension scheme obligation and disclosures in relation to going concern to be acceptable. However, no audit should be expected to predict the unknowable factors or all possible future implications for a company and this is particularly the case in relation to Brexit.</p>

Key audit matter	Our response
<p>Impairment allowances on loans to customers</p> <p>Risk vs 2018: </p> <p>(£41.9 million; 2018: £54.2 million)</p> <p><i>Refer to the Audit Committee Report, accounting policy note and note 23 (financial disclosures).</i></p> <p>Subjective estimate</p> <p>IFRS 9 was implemented by the Group on 1 October 2018. This new and complex standard requires the Group to recognise expected credit losses ('ECL') on financial instruments, which involves significant judgement and estimates and resulted in an increase in credit loss provisions. A significant proportion of the increase relates to the Group's receiver of rent portfolio. The quantum and timing of cashflows as well as the realisation rate are key assumptions in the provision calculation in that portfolio.</p> <p>The key areas where we identified greater levels of director judgement and therefore increased levels of audit focus in the Group's implementation of IFRS 9 are:</p> <p>Economic scenarios – IFRS 9 requires the Group to measure ECLs on a forward-looking basis reflecting a range of future economic conditions. Significant management judgement is applied to determining the economic scenarios used and the probability weightings applied to its lending portfolios.</p> <p>Significant Increase in Credit Risk ('SICR') – For the portfolios the criteria selected to identify a significant increase in credit risk is a key area of judgement within the Group's ECL calculation as these criteria determine whether a 12 month or lifetime provision is recorded.</p> <p>Model estimations – Inherently judgemental modelling is used to estimate ECLs which involves determining Probabilities of Default ('PD'), Loss Given Default ('LGD'), and Exposures at Default ('EAD').</p> <p>The LGD models used in the portfolios are the key drivers of the Group's ECL results and are therefore the most significant judgemental aspect of the Group's ECL modelling approach.</p> <p>The effect of these matters is that, as part of our risk assessment, we determined that the impairment of loans to customers has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. The financial statements disclose the sensitivities estimated by the Group.</p> <p>Disclosure quality</p> <p>The disclosures regarding the Group's application of IFRS 9 are key to understanding the change from IAS 39 as well as explaining the key judgements and material inputs to the IFRS 9 ECL results.</p>	<p>Our audit procedures included:</p> <ul style="list-style-type: none"> • Controls testing: We performed end to end process walk-throughs to identify the key systems and controls used in the ECL processes. We tested the relevant general IT and applications controls over key systems used in the ECL process. • Test of details: Key aspects of our testing involved: <ul style="list-style-type: none"> - Testing the key inputs and assumptions impacting the Group's overall ECL calculation to assess their reasonableness. This included performing sensitivity analysis to understand the significance of certain assumptions; benchmarking procedures to compare the Group's key assumptions to comparable peer group organisations; and assessing the key assumptions against the Group's historical experience; - Performing credit file reviews over individual loans in the Group's various loan portfolios on a risk assessed sample basis to assess the reasonableness of the ECL measured on certain loans; and - Performing recalculations of the ECL measured on certain portfolios on a samples basis. • Our financial risk modelling expertise: We involved our own financial risk modelling specialists in evaluating certain IFRS 9 models. We used our knowledge of the Group and our experience of the industry that the Group operates in to independently assess the appropriateness of the Group's IFRS 9 models and key components. • Our economic scenario expertise: We involved our own economic specialists to assist us in assessing the appropriateness of the Group's methodology for determining the economic scenarios used and the probability weightings applied to them. We also assessed key economic variables used which included agreeing samples of economic variables to external sources as well as the overall reasonableness of the economic forecasts by comparing the Group's forecasts to our own modelled forecasts. As part of this work we assessed the reasonableness of the Group's considerations of the ECL impact of economic uncertainty, including Brexit. • Assessing transparency: We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the Group's overall ECL. As a part of this, we assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the key judgments and assumptions made was sufficiently clear. <p>Our results</p> <p>The results of our testing were satisfactory and we considered the credit impairment charge, provision recognised and the related disclosures to be acceptable.</p>

Key audit matter	Our response
<p>Interest receivable on loan accounts</p> <p>Risk vs 2018: </p> <p>(£449.3 million; 2018: £408.9 million)</p> <p><i>Refer to the Audit Committee Report, accounting policy note and note 4 (financial disclosures).</i></p> <p>Subjective estimate</p> <p>The recognition of interest receivable on loan accounts under the effective interest rate ('EIR') method requires the directors to apply judgement, with the most critical estimate being the loans' expected behavioural life for originated assets and estimated remaining collections ('ERCs') for acquired loan portfolios.</p> <p><i>Originated assets:</i></p> <p>The expected life assumptions utilise repayment profiles which represent how customers are expected to pay. These profiles extend significantly into the future which creates a high level of estimation uncertainty and subjects the judgement to future market changes. The Group makes its expected life assumptions based on its forecasting process which incorporates both historical experience and judgemental overlays by management.</p> <p>The cohorts of loans and advances which require the most judgement are buy-to-let products which were originated by the Group post-2010</p> <p><i>Acquired loan portfolios:</i></p> <p>For the Group's acquired debt portfolio, the risk is that estimated future cash collections are not reflected by actual cash receipts. Given the nature of the Group's debt portfolios, estimation of future cash collections requires significant judgement to make assumptions about the value, probability and timing of expected future cash flows for each type of asset class within a portfolio.</p> <p>The effect of these matters is that, as part of our risk assessment, we determined that interest receivable on loan accounts has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. The financial statements disclose the sensitivities estimated by the Group.</p>	<p>Our procedures included:</p> <p><i>Originated assets:</i></p> <ul style="list-style-type: none"> • Historical comparison: We critically assessed the Group's analysis and key assumptions over the repayment profiles by comparing them to the Group's historical trends and actual portfolio behaviour; this included assessing the appropriateness of the cohort segmentation and the treatment of product switches; and • Sensitivity analysis: We performed sensitivity analysis over the repayment profiles by applying alternative profiles based upon the above procedures. <p><i>Acquired loan portfolios:</i></p> <ul style="list-style-type: none"> • Historical comparison: We critically assessed the Group's cash flow forecasts by comparing them to current and past performance of the Group's portfolios, including recent cash collections. <p><i>Both portfolios:</i></p> <ul style="list-style-type: none"> • Assessing transparency: We critically assessed the adequacy of the Group's disclosures about the sensitivity of the interest receivable on loan accounts to changes in key assumptions reflected in the inherent risk; and • Controls: We tested management review controls over the approval of the Group's repayment profiles; <p>Our results</p> <p>We found the resulting estimate of interest receivable on loan accounts and the related disclosures to be acceptable (2018: acceptable).</p>

Key audit matter	Our response
<p>Recoverability of goodwill</p> <p>Risk vs 2018: </p> <p>(£164.4 million; 2018: £162.2 million)</p> <p>Refer to the Audit Committee Report, accounting policy note and note 29 (financial disclosures).</p> <p>Forecast-based valuation:</p> <p>Goodwill is significant and at risk of irrecoverability due to changes in market factors since acquisition. The estimated recoverable amount is subjective due to the inherent uncertainty involved in forecasting future cash flows and deriving an appropriate discount rate to reflect the time value of money.</p> <p>In calculating the recoverable amount, the directors made assumptions over the following key inputs; profitability growth, the discount rate and the long-term growth rate.</p> <p>The effect of these matters is that, as part of our risk assessment, we determined that the recoverable amount has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. The financial statements (note 29) disclose the sensitivity estimated by the Group.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none"> • Historical comparisons: We compared the Group's previous forecasting with actual results; • Benchmarking assumptions: We compared the Group's assumptions to externally derived data in relation to key inputs such as projected economic growth and discount rates, and challenged management on the forecast business performance; • Sensitivity analysis: We performed breakeven analysis and applied alternative scenarios based on the assumptions noted above; • Assessing transparency: We critically assessed whether the Group's disclosures about the sensitivity of the outcome of the impairment assessment to changes in key assumptions reflected the risks inherent in the valuation of goodwill. <p>Our results</p> <p>We found the resulting carrying amount of goodwill and the related disclosures to be acceptable (2018: acceptable).</p>

Key audit matter	Our response
<p>Valuation of the defined benefit pension scheme obligation</p> <p>Risk vs 2018: </p> <p>(£147.3 million, 2018: £121.0 million)</p> <p>Refer to the Audit Committee Report, accounting policy note and note 41 (financial disclosures).</p> <p>Subjective estimate</p> <p>The audit risk associated with this key audit matter increased during the year as a result of market volatility in the key assumptions used in the calculations.</p> <p>The Group operates a defined benefit pension scheme which has been closed to new members for several years. At year-end, the Group holds a net defined benefit pension scheme liability on the statement of financial position, which includes gross pension obligations.</p> <p>Small changes in the assumptions and estimates used to value the Group's pension obligation (before deducting scheme assets) would have a significant effect on the Group's net defined benefit obligation.</p> <p>The effect of these matters is that, as part of our risk assessment, we determined that the valuation of the defined benefit pension scheme obligation has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole. As a result we have included this as a key audit matter. The financial statements disclose the sensitivity estimated by the Group.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none"> • Evaluation of actuary: We evaluated the competence, independence and objectivity of the Group's actuary in assessing the Directors' reliance upon their expert valuation services. • Benchmarking assumptions: We critically assessed, using our own actuarial specialists, the key assumptions applied, such as the discount rate, inflation rate and mortality/life expectancy against externally derived data and internal experience. • Assessing transparency: We assessed the adequacy of the Group's disclosures in respect of the sensitivity of the obligation to the actuarial assumptions. <p>Our results</p> <p>We found the valuation of the defined benefit scheme obligation and the related disclosures to be acceptable (2018: acceptable).</p>

Key audit matter	Our response
<p>Recoverability of Parent company's investment in subsidiaries</p> <p>Risk vs 2018:  </p> <p>(£940.7 million; 2018: £984.4 million)</p> <p>Refer to the accounting policy note and note 30 (financial disclosures).</p> <p>Low risk, high value</p> <p>The carrying amount of the Parent company's investments in subsidiaries represents 80.3% (2017: 70.9%) of the company's total assets.</p> <p>Their recoverability is not at a high risk of significant misstatement or subject to significant judgement. However, due to their materiality in the context of the Parent company financial statements, this is considered to be the area that had the greatest effect on our overall Parent company audit.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none"> • Tests of detail: Comparing the carrying amount of 100% of investments with the relevant subsidiaries' draft balance sheets to identify whether their net assets, being an approximation of their minimum recoverable amount, were in excess of their carrying amount and assessing whether those subsidiaries have historically been profit-making. <p>Our results</p> <p>We found the resulting carrying amount of the investments in subsidiaries to be acceptable (2018: acceptable).</p>

3. Our application of materiality and an overview of the scope of our audit

Materiality for the Group financial statements as a whole was set at £7.6 million (2018: £6.5 million), determined with reference to a benchmark of Group profit before tax (of which it represents 4.8% (2018: 4.1%)).

Materiality for the Parent Company financial statements as a whole was set at £3.5 million (2018: £3.9 million), determined with reference to a benchmark of net assets, of which it represents 0.6% (2018: 0.6%).

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.38 million, in addition to other identified misstatements that warranted reporting on qualitative grounds.

The Group team performed the audit of the Group as if it was a single aggregated set of financial information. The audit was performed using the materiality levels set out above.

4. We have nothing to report on going concern

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or the Group or to cease their operations, and as they have concluded that the Company's and the Group's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over their ability to continue as a going concern for at least a year from the date of approval of the financial statements ('the going concern period').

Our responsibility is to conclude on the appropriateness of the Directors' conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Group and the Company will continue in operation.

In our evaluation of the Directors' conclusions, we considered the inherent risks to the Group's and Company's business model and analysed how those risks might affect the Group's and Company's financial resources or ability to continue operations over the going concern period. The risks that we considered most likely to adversely affect the Group's and Company's available financial resources over this period were:

- availability of funding and liquidity in the event of a market wide stress scenario including the impact of Brexit, and
- impact on regulatory capital requirements in the event of an economic slowdown or recession.

As these were risks that could potentially cast significant doubt on the Group's and the Company's ability to continue as a going concern, we considered sensitivities over the level of available financial resources indicated by the Group's financial forecasts taking account of reasonably possible (but not unrealistic) adverse effects that could arise from these risks individually and collectively and evaluated the achievability of the actions the Directors consider they would take to improve the position should the risks materialise.

Based on this work, we are required to report to you if:

- we have anything material to add or draw attention to in relation to the directors' statement in note 63(c) to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Group and Company's use of that basis for a period of at least twelve months from the date of approval of the financial statements; or
- the related statement under the Listing Rules is materially inconsistent with our audit knowledge.

We have nothing to report in these respects, and we did not identify going concern as a key audit matter.

5. We have nothing to report on the other information in the Annual Report

The directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Strategic Report and Directors' Report

Based solely on our work on the other information:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

Directors' Remuneration Report

In our opinion the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Disclosures of principal risks and longer-term viability

Based on the knowledge we acquired during our financial statements audit, we have nothing material to add or draw attention to in relation to:

- the directors' confirmation within 'Future prospects' section, that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency and liquidity;
- the Principal Risks disclosures describing these risks and explaining how they are being managed and mitigated; and
- the directors' explanation in the Viability Statement of how they have assessed the prospects of the Group, over what period they have done so and why they considered that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Under the Listing Rules we are required to review the Viability Statement. We have nothing to report in this respect.

Our work is limited to assessing these matters in the context of only the knowledge acquired during our financial statements audit. As we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made, the absence of anything to report on these statements is not a guarantee as to the Group's and Company's longer-term viability.

Corporate governance disclosures

We are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our financial statements audit and the directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy; or
- the section of the annual report describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee

We are required to report to you if the Corporate Governance Statement does not properly disclose a departure from the eleven provisions of the UK Corporate Governance Code specified by the Listing Rules for our review.

We have nothing to report in these respects.

6. We have nothing to report on the other matters on which we are required to report by exception

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
- the Parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out in section B9, the directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and Parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the Parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or other irregularities (see below), or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

Irregularities – ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience, through discussion with the Directors and other management (as required by auditing standards), and from inspection of the Group's regulatory correspondence and discussed with the Directors and other management the policies and procedures regarding compliance with laws and regulations. We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the Group is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies legislation, distributable profits legislation and taxation legislation) and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Group is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of the Group's license to operate. We identified the following areas as those most likely to have such an effect: regulatory capital and liquidity and certain aspects of company legislation recognising the financial and regulated nature of the Group's activities and its legal form. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any.

Through these procedures, we became aware of actual or suspected non-compliance and considered the effect as part of our procedures on the related financial statement items. The identified actual or suspected non-compliance was not sufficiently significant to our audit to result in our response being identified as a key audit matter.

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it. In addition, as with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

8. The purpose of our audit work and to whom we owe our responsibilities

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.

Simon Clark (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

One Snowhill

Snow Hill Queensway

Birmingham

B4 6GH

26 November 2019

The image features a dark grey background. A bright green diagonal stripe runs from the top right towards the bottom left. In the upper right area, the text "D." is written in a white, sans-serif font.

D.

THE ACCOUNTS

Showing the financial position, results and cash flows of the Group and the Company prepared in accordance with IFRS and UK law

D1	Primary Financial Statements	Page 160
	<i>D1.1 Consolidated Income Statement</i>	Page 160
	<i>D1.2 Consolidated Statement of Comprehensive Income</i>	Page 161
	<i>D1.3 Consolidated Balance Sheet</i>	Page 162
	<i>D1.4 Company Balance Sheet</i>	Page 163
	<i>D1.5 Consolidated Cash Flow Statement</i>	Page 164
	<i>D1.6 Company Cash Flow Statement</i>	Page 164
	<i>D1.7 Consolidated Statement of Movements in Equity</i>	Page 165
	<i>D1.8 Company Statement of Movements in Equity</i>	Page 166
D2	Notes to the Accounts	Page 167
	<i>D2.1 Notes To The Accounts - Analysis</i>	Page 167
	<i>D2.2 Notes To The Accounts - Capital and financial risk</i>	Page 233
	<i>D2.3 Notes To The Accounts - Basis of preparation</i>	Page 255

D1

Primary Financial Statements

D1.1 Consolidated Income Statement

For the year ended 30 September 2019

	Note	2019 IFRS 9 £m	2019 IFRS 9 £m	2018 IAS 39 £m	2018 IAS 39 £m
Interest receivable	4		505.7		451.9
Interest payable and similar charges	5		(227.3)		(197.3)
Net interest income			278.4		254.6
Other leasing income	6	18.3		16.3	
Related costs	6	(14.5)		(12.5)	
Net leasing income		3.8		3.8	
Gain on derecognition of financial assets	7	9.7		28.0	
Other income	8	15.4		15.5	
Other operating income			28.9		47.3
Total operating income			307.3		301.9
Operating expenses	9		(125.2)		(114.2)
Provisions for losses	23		(8.0)		(7.4)
Operating profit before fair value items			174.1		180.3
Fair value net gains / (losses)	14		(15.1)		1.2
Operating profit being profit on ordinary activities before taxation			159.0		181.5
Tax charge on profit on ordinary activities	15		(31.6)		(35.7)
Profit on ordinary activities after taxation for the financial year			127.4		145.8
	Note		2019		2018
Earnings per share					
- basic	17		49.4p		55.9p
- diluted	17		48.2p		54.2p

The results for the current and preceding years relate entirely to continuing operations.

D1.2 Consolidated Statement of Comprehensive Income

For the year ended 30 September 2019

	Note	2019 IFRS 9 £m	2019 IFRS 9 £m	2018 IAS 39 £m	2018 IAS 39 £m
Profit for the year			127.4		145.8
Other comprehensive income					
<i>Items that will not be reclassified subsequently to profit or loss</i>					
Actuarial (loss) / gain on pension scheme	41	(16.5)		8.9	
Tax thereon		2.4		(1.7)	
			(14.1)		7.2
<i>Items that may be reclassified subsequently to profit or loss</i>					
Cash flow hedge gains taken to equity	24	0.5		1.0	
Tax thereon		(0.1)		(0.2)	
Reclassification on derecognition	7	(0.9)		-	
Tax thereon		0.2		-	
			(0.3)		0.8
Other comprehensive income for the year net of tax			(14.4)		8.0
Total comprehensive income for the year			113.0		153.8

D1.3 Consolidated Balance Sheet

For the year ended 30 September 2019

	Note	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m	2017 IAS 39 £m
Assets					
Cash – central banks	18	816.4	895.9	895.9	615.0
Cash – retail banks	18	409.0	414.7	414.7	881.9
Short term investments	19	-	-	-	-
Loans to customers	20	12,250.3	12,076.5	12,103.7	11,115.4
Derivative financial assets	24	592.4	855.7	855.7	906.6
Sundry assets	25	92.8	19.0	19.0	12.7
Deferred tax assets	26	6.2	-	-	-
Property, plant and equipment	27	57.3	56.8	56.8	46.2
Intangible assets	28	171.1	169.3	169.3	104.4
Total assets		14,395.5	14,487.9	14,515.1	13,682.2
Liabilities					
Short term bank borrowings		1.0	1.1	1.1	0.6
Retail deposits	31	6,395.8	5,292.4	5,292.4	3,611.9
Derivative financial liabilities	24	80.5	4.7	4.7	7.1
Asset backed loan notes	32	4,419.4	5,554.7	5,554.7	6,475.8
Secured bank borrowings	33	787.5	935.6	935.6	1,306.0
Retail bond issuance	34	296.5	296.1	296.1	295.7
Corporate bond issuance	35	149.6	149.3	149.3	149.1
Central bank facilities	36	994.4	1,024.4	1,024.4	700.0
Sundry liabilities	37	112.7	114.4	114.4	74.6
Current tax liabilities	40	15.2	21.4	21.4	17.4
Deferred tax liabilities	26	-	0.8	5.6	4.8
Retirement benefit obligations	41	34.5	19.5	19.5	29.8
Total liabilities		13,287.1	13,414.4	13,419.2	12,672.8
Called up share capital	42	261.6	281.6	281.6	281.5
Reserves	43	887.3	895.9	918.3	811.0
Own shares	44	(40.5)	(104.0)	(104.0)	(83.1)
Total equity		1,108.4	1,073.5	1,095.9	1,009.4
Total liabilities and equity		14,395.5	14,487.9	14,515.1	13,682.2

Approved by the Board of Directors on 26 November 2019.
Signed of behalf of the Board of Directors

N S Terrington
Chief Executive

R J Woodman
Chief Financial Officer

D1.4 Company Balance Sheet

For the year ended 30 September 2019

	Note	2019 IFRS 9 £m	2018 IAS 39 £m	2017 IAS 39 £m
Assets				
Cash – retail banks	18	14.1	24.9	277.6
Sundry assets	25	107.3	217.0	40.1
Current tax assets	40	2.8	-	-
Property, plant and equipment	27	-	-	18.6
Investment in subsidiary undertakings	30	940.7	984.4	819.1
Total assets		1,064.9	1,226.3	1,155.4
Liabilities				
Retail bond issuance	34	296.5	296.1	295.7
Corporate bond issuance	35	149.6	149.3	149.1
Sundry liabilities	37	27.4	128.5	39.4
Deferred tax liabilities	26	1.6	1.8	1.8
Total liabilities		475.1	575.7	486.0
Called up share capital	42	261.6	281.6	281.5
Reserves	43	351.2	460.8	454.5
Own shares	44	(23.0)	(91.8)	(66.6)
Total equity		589.8	650.6	669.4
		1,064.9	1,226.3	1,155.4

Approved by the Board of Directors on 26 November 2019.
Signed on behalf of the Board of Directors

N S Terrington
Chief Executive

R J Woodman
Chief Financial Officer

D1.5 Consolidated Cash Flow Statement

For the year ended 30 September 2019

	Note	2019 £m	2018 £m
Net cash generated by operating activities	46	397.9	1,074.4
Net cash generated / (utilised) by investing activities	47	8.3	(282.8)
Net cash (utilised) by financing activities	48	(491.3)	(978.4)
Net (decrease) in cash and cash equivalents		(85.1)	(186.8)
Opening cash and cash equivalents		1,309.5	1,496.3
Closing cash and cash equivalents		1,224.4	1,309.5
Represented by balances within:			
Cash	18	1,225.4	1,310.6
Short-term bank borrowings		(1.0)	(1.1)
		1,224.4	1,309.5

D1.6 Company Cash Flow Statement

For the year ended 30 September 2019

	Note	2019 £m	2018 £m
Net cash generated / (utilised) by operating activities	46	170.9	(30.5)
Net cash (utilised) by investing activities	47	(105.1)	(154.3)
Net cash (utilised) by financing activities	48	(76.6)	(67.9)
Net (decrease) in cash and cash equivalents		(10.8)	(252.7)
Opening cash and cash equivalents		24.9	277.6
Closing cash and cash equivalents		14.1	24.9
Represented by balances within:			
Cash	18	14.1	24.9
Short-term bank borrowings		-	-
		14.1	24.9

D1.7 Consolidated Statement of Movements in Equity

For the year ended 30 September 2019 (IFRS 9)

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Cash flow hedging reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m
Transactions arising from								
Profit for the year	-	-	-	-	-	127.4	-	127.4
Other comprehensive income	-	-	-	-	(0.3)	(14.1)	-	(14.4)
Total comprehensive income	-	-	-	-	(0.3)	113.3	-	113.0
Transactions with owners								
Dividends paid (note 45)	-	-	-	-	-	(54.0)	-	(54.0)
Shares cancelled	(21.6)	-	21.6	-	-	(95.5)	95.5	-
Own shares purchased	-	-	-	-	-	-	(34.3)	(34.3)
Exercise of share awards	1.6	2.5	-	-	-	(2.5)	2.3	3.9
Charge for share based remuneration (note 10)	-	-	-	-	-	5.9	-	5.9
Tax on share based remuneration	-	-	-	-	-	0.4	-	0.4
Net movement in equity in the year	(20.0)	2.5	21.6	-	(0.3)	(32.4)	63.5	34.9
Opening equity								
As previously reported	281.6	65.8	28.7	(70.2)	3.3	890.7	(104.0)	1,095.9
Change of accounting policy (note 62)	-	-	-	-	-	(22.4)	-	(22.4)
As restated	281.6	65.8	28.7	(70.2)	3.3	868.3	(104.0)	1,073.5
Closing equity	261.6	68.3	50.3	(70.2)	3.0	835.9	(40.5)	1,108.4

For the year ended 30 September 2018 (IAS 39)

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Cash flow hedging reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m
Transactions arising from								
Profit for the year	-	-	-	-	-	145.8	-	145.8
Other comprehensive income	-	-	-	-	0.8	7.2	-	8.0
Total comprehensive income	-	-	-	-	0.8	153.0	-	153.8
Transactions with owners								
Dividends paid (note 45)	-	-	-	-	-	(43.1)	-	(43.1)
Shares cancelled	-	-	-	-	-	-	-	-
Own shares purchased	-	-	-	-	-	-	(31.4)	(31.4)
Exercise of share awards	0.1	0.3	-	-	-	(10.9)	10.5	-
Charge for share based remuneration (note 10)	-	-	-	-	-	6.1	-	6.1
Tax on share based remuneration	-	-	-	-	-	1.1	-	1.1
Net movement in equity in the year	0.1	0.3	-	-	0.8	106.2	(20.9)	86.5
Opening equity	281.5	65.5	28.7	(70.2)	2.5	784.5	(83.1)	1,009.4
Closing equity	281.6	65.8	28.7	(70.2)	3.3	890.7	(104.0)	1,095.9

D1.8 Company Statement of Movements in Equity

For the year ended 30 September 2019 (IFRS 9)

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m
Transactions arising from							
Profit for the year	-	-	-	-	9.9	-	9.9
Other comprehensive income	-	-	-	-	-	-	-
Total comprehensive income	-	-	-	-	9.9	-	9.9
Transactions with owners							
Dividends paid (note 45)	-	-	-	-	(54.0)	-	(54.0)
Shares cancelled	(21.6)	-	21.6	-	(95.5)	95.5	-
Own shares purchased	-	-	-	-	-	(26.7)	(26.7)
Exercise of share awards	1.6	2.5	-	-	-	-	4.1
Charge for share based remuneration (note 10)	-	-	-	-	5.9	-	5.9
Net movement in equity in the year	(20.0)	2.5	21.6	-	(133.7)	68.8	(60.8)
Opening equity	281.6	65.8	28.7	(23.7)	390.0	(91.8)	650.6
Closing equity	261.6	68.3	50.3	(23.7)	256.3	(23.0)	589.8

For the year ended 30 September 2018 (IAS 39)

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m
Transactions arising from							
Profit for the year	-	-	-	-	43.0	-	43.0
Other comprehensive income	-	-	-	-	-	-	-
Total comprehensive income	-	-	-	-	43.0	-	43.0
Transactions with owners							
Dividends paid (note 45)	-	-	-	-	(43.1)	-	(43.1)
Shares cancelled	-	-	-	-	-	-	-
Own shares purchased	-	-	-	-	-	(25.2)	(25.2)
Exercise of share awards	0.1	0.3	-	-	-	-	0.4
Charge for share based remuneration (note 10)	-	-	-	-	6.1	-	6.1
Net movement in equity in the year	0.1	0.3	-	-	6.0	(25.2)	(18.8)
Opening equity	281.5	65.5	28.7	(23.7)	384.0	(66.6)	669.4
Closing equity	281.6	65.8	28.7	(23.7)	390.0	(91.8)	650.6

Notes to the accounts

For the year ended 30 September 2019

1. GENERAL INFORMATION

Paragon Banking Group PLC is a company domiciled in the United Kingdom and incorporated in England and Wales under the Companies Act 2006 with company number 2336032. The address of the registered office is 51 Homer Road, Solihull, West Midlands, B91 3QJ. The nature of the Group's operations and its principal activities are set out in the Strategic Report in Section A2.

These financial statements are presented in pounds sterling, which is the currency of the economic environment in which the Group operates.

The remaining notes to the accounts are organised in to three sections:

- Analysis – providing further analysis and information on the amounts shown in the primary financial statements
- Capital and Financial Risk Management – providing information on the Group's management of operational and regulatory capital and its principal financial risks
- Basis of preparation – providing details of the Group's accounting policies and of how they have been applied in the preparation of the financial statements

D2.1 NOTES TO THE ACCOUNTS – ANALYSIS

For the year ended 30 September 2019

The notes set out below give more detailed analysis of the balances shown in the primary financial statements and further information on how they relate to the operations, results and financial position of the Group and the Company.

2. SEGMENTAL INFORMATION

The Group analyses its operations, both for internal management reporting and external financial reporting, on the basis of the markets from which its assets are generated. The segments used are described below:

- Mortgages, including the Group's buy-to-let, and owner-occupied first and second charge lending and related activities
- Commercial Lending, including the Group's equipment leasing activities, development finance, structured lending and other offerings targeted towards SME customers, together with its motor finance business
- Idem Capital, including loan assets acquired from third parties and legacy assets which share certain credit characteristics with them

Dedicated financing and administration costs of each of these businesses are allocated to the segment. Shared central costs are not allocated between segments, nor is income from central cash balances or the carrying costs of unallocated savings balances.

Gains on derecognition of financial assets have not been allocated to segment results, nor have the costs arising in the year ended 30 September 2018 from the Iceberg and Titlestone acquisitions of £2.2m as those are not directly related to customer facing activity.

Loans to customers and operating lease assets are allocated to segments as are dedicated securitisation funding arrangements and their related cross-currency basis swaps and cash balances.

Retail deposits and their related costs are allocated to the segments based on the utilisation of those deposits. Retail deposits raised in advance of lending are not allocated.

Other assets and liabilities are not allocated between segments.

All of the Group's operations are conducted in the UK, all revenues arise from external customers and there are no inter-segment revenues. No customer contributes more than 10% of the revenue of the Group.

Financial information about these business segments, prepared on the same basis as used in the consolidated accounts of the Group, is shown below.

Year ended 30 September 2019 (IFRS 9)

	Mortgages	Commercial Lending	Idem Capital	Unallocated items	Total Segments
	£m	£m	£m	£m	£m
Interest receivable	342.1	95.7	61.3	6.6	505.7
Interest payable	(164.3)	(30.7)	(7.0)	(25.3)	(227.3)
Net interest income	177.8	65.0	54.3	(18.7)	278.4
Other operating income	6.8	11.0	1.4	9.7	28.9
Total operating income	184.6	76.0	55.7	(9.0)	307.3
Direct costs	(15.7)	(25.0)	(7.9)	(76.6)	(125.2)
Provisions for losses	(1.0)	(7.2)	0.2	-	(8.0)
	167.9	43.8	48.0	(85.6)	174.1

Year ended 30 September 2018 (IAS 39)

	Mortgages	Commercial Lending	Idem Capital	Unallocated items	Total Segments
	£m	£m	£m	£m	£m
Interest receivable	299.1	50.1	97.9	4.8	451.9
Interest payable	(141.5)	(17.9)	(10.1)	(27.8)	(197.3)
Net interest income	157.6	32.2	87.8	(23.0)	254.6
Other operating income	7.6	10.9	0.7	28.1	47.3
Total operating income	165.2	43.1	88.5	5.1	301.9
Direct costs	(14.9)	(21.2)	(10.4)	(67.7)	(114.2)
Provisions for losses	(5.5)	(2.0)	0.1	-	(7.4)
	144.8	19.9	78.2	(62.6)	180.3

The segmental profits disclosed above reconcile to the group results as shown below.

	2019	2018
	£m	£m
Results shown above	174.1	180.3
Fair value items	(15.1)	1.2
Operating profit	159.0	181.5

The assets and liabilities attributable to each of the segments at 30 September 2019, 1 October 2018 and 30 September 2018 on the basis described above were:

	Note	Mortgages £m	Commercial Lending £m	Idem Capital £m	Total Segments £m
30 September 2019 (IFRS 9)					
Segment assets					
Loans to customers	20	10,344.1	1,452.1	389.9	12,186.1
Operating lease assets	27	-	36.3	-	36.3
Cross-currency basis swaps	24	582.7	-	-	582.7
Securitisation cash	18	353.1	-	-	353.1
		11,279.9	1,488.4	389.9	13,158.2
Segment liabilities					
Allocated deposits		5,367.2	1,822.5	303.1	7,492.8
Securitisation funding		5,206.9	-	-	5,206.9
		10,574.1	1,822.5	303.1	12,699.7

	Note	Mortgages £m	Commercial Lending £m	Idem Capital £m	Total Segments £m
1 October 2018 (IFRS 9)					
Segment assets					
Loans to customers	20	10,449.5	1,131.3	519.8	12,100.6
Operating lease assets	27	-	35.4	-	35.4
Cross-currency basis swaps	24	829.7	-	-	829.7
Securitisation cash	18	319.0	-	19.8	338.8
		11,598.2	1,166.7	539.6	13,304.5
Segment liabilities					
Allocated deposits		4,702.4	1,443.5	411.0	6,556.9
Securitisation funding		6,457.2	-	33.1	6,490.3
		11,159.6	1,443.5	444.1	13,047.2

	Note	Mortgages £m	Commercial Lending £m	Idem Capital £m	Total Segments £m
30 September 2018 (IAS 39)					
Segment assets					
Loans to customers	20	10,473.5	1,133.2	521.1	12,127.8
Operating lease assets	27	-	35.4	-	35.4
Cross-currency basis swaps	24	829.7	-	-	829.7
Securitisation cash	18	319.0	-	19.8	338.8
		11,622.2	1,168.6	540.9	13,331.7
Segment liabilities					
Allocated deposits		4,702.4	1,443.5	411.0	6,556.9
Securitisation funding		6,457.2	-	33.1	6,490.3
		11,159.6	1,443.5	444.1	13,047.2

An analysis of the Group's financial assets by type and segment is shown in note 20. All of the assets shown above were located in the UK.

The additions to non-current assets, excluding financial assets, in the year which are included in segmental assets above are investments of £11.6m (2018: £19.3m) in assets held for leasing under operating leases, included in the Commercial Lending segment. No other fixed asset additions were allocated to segments.

The segmental assets and liabilities may be reconciled to the consolidated balance sheet as shown below.

	2019	2018	2018
	IFRS 9	IFRS 9	IAS 39
	£m	£m	£m
Total segment assets	13,158.2	13,304.5	13,331.7
Unallocated assets			
Central cash and investments	872.3	971.8	971.8
Unallocated derivatives	9.7	26.0	26.0
Operational property, plant and equipment	21.0	21.4	21.4
Intangible assets	171.1	169.3	169.3
Other	163.2	(5.1)	(5.1)
Total assets	14,395.5	14,487.9	14,515.1

	2019	2018	2018
	IFRS 9	IFRS 9	IAS 39
	£m	£m	£m
Total segment liabilities	12,699.7	13,047.2	13,047.2
Unallocated liabilities			
Unallocated retail deposits	(1,100.9)	(1,260.3)	(1,260.3)
Derivative financial instruments	80.5	4.7	4.7
Central bank borrowings	1,441.5	1,470.9	1,470.9
Tax liabilities	15.2	22.2	27.0
Retirement benefit obligations	34.5	19.5	19.5
Other	116.6	110.2	110.2
Total liabilities	13,287.1	13,414.4	13,419.2

3. REVENUE

	Note	2019	2018
		IFRS 9	IAS 39
		£m	£m
Interest receivable	4	505.7	451.9
Operating lease income	6	18.3	16.3
Gain on disposal of financial assets	7	9.7	28.0
Other income	8	15.4	15.5
Total revenue		549.1	511.7

Arising from:

Mortgages	348.9	306.7
Commercial Lending	121.2	73.5
Idem Capital	62.7	98.6
Total revenue from segments	532.8	478.8
Unallocated revenue	16.3	32.9
Total revenue	549.1	511.7

4. INTEREST RECEIVABLE

	2019 IFRS 9 £m	2018 IAS 39 £m
<i>Interest receivable in respect of</i>		
Loan accounts	449.3	408.9
Finance leases	44.5	34.4
Factoring income	3.1	2.2
Interest on loans to customers	496.9	445.5
Other interest receivable	8.8	6.4
Total interest on financial assets	505.7	451.9

The above interest arises from:

	2019 IFRS 9 £m	2018 IAS 39 £m
Financial assets held at amortised cost	461.2	417.5
Finance leases	44.5	34.4
	505.7	451.9

In 2018, under the requirements of IAS 39, interest receivable on loans to customers included £2.3m charged on accounts where an impairment provision had been made.

5. INTEREST PAYABLE AND SIMILAR CHARGES

	Note	2019 £m	2018 £m
On retail deposits		114.2	83.1
On asset backed loan notes		63.4	60.3
On bank loans and overdrafts		9.6	16.5
On corporate bonds		10.9	10.9
On retail bonds		18.6	18.6
On central bank facilities		8.0	5.2
Total interest on financial liabilities		224.7	194.6
On pension scheme deficit	41	0.5	0.8
Discounting on contingent consideration	38	0.5	0.5
Other finance costs		1.6	1.4
		227.3	197.3

All interest payable on financial liabilities relates to financial liabilities held at amortised cost.

6. NET OPERATING LEASE INCOME

	Note	2019 £m	2018 £m
Income			
Operating lease rentals		14.0	11.4
Maintenance income		4.3	4.9
Total operating lease income		18.3	16.3
Costs			
Depreciation of lease assets	27	(7.6)	(5.9)
Maintenance salaries	10	(1.9)	(1.5)
Other maintenance costs		(5.0)	(5.1)
Total operating lease costs		(14.5)	(12.5)
Net operating lease income		3.8	3.8

7. GAIN ON DISPOSAL OF FINANCIAL ASSETS

During the year, on 26 June 2019, the Group disposed of its residual interest in the Paragon Mortgages (No. 12) PLC securitisation transaction for a cash payment, in order to optimise capital usage. This participation, which exposed the Group to materially all of the credit risk in the securitised assets and entitled it to any net yield from these assets, was determined to give the Group control of the entity, as defined by IFRS 10. On disposal of the participation, this control ceased and hence the assets and the related external funding were derecognised.

The assets and liabilities derecognised in this transaction are set out below.

	£m
Cash	37.7
Loans to customers	695.8
Derivative financial assets	93.6
Other financial assets	-
	827.1
Asset backed loan notes	784.1
Tax liabilities	1.9
Other financial liabilities	1.7
	787.7
Net assets derecognised	39.4
Cash consideration received	49.8
Net assets derecognised	(39.4)
Transaction costs	(0.7)
Net gain on derecognition	9.7

The cash flow hedge relationship, including the derivatives and asset backed loan notes ceased on their derecognition and consequently an amount of £0.9m, less related tax of £0.2m, was recycled to profit and loss, and is included in other comprehensive income.

During the year ended 30 September 2018, the Group realised a gain of £28.0m on the disposal of second charge mortgages and unsecured consumer loans held in its Idem Capital division. The loans were originally acquired from various third parties as part of a number of portfolio purchases over time.

8. OTHER INCOME

	2019 £m	2018 £m
Loan account fee income	7.2	9.0
Broker commissions	2.2	2.1
Third party servicing	5.0	3.4
Other income	1.0	1.0
	15.4	15.5

All loan account fee income arises from financial assets held at amortised cost.

9. OPERATING EXPENSES

	Note	2019 £m	2018 £m
Employment costs	10	79.3	73.3
Auditor remuneration	13	1.8	1.6
Amortisation of intangible assets	28	2.4	2.1
Depreciation of operational assets	27	1.5	1.9
Operating lease rentals payable	51	2.9	2.2
Other administrative costs		37.3	33.1
		125.2	114.2

10. EMPLOYEES

The average number of persons (including directors) employed by the Group during the year was 1,365 (2018: 1,349). The number of employees at the end of the year was 1,368 (2018: 1,367).

Costs incurred during the year in respect of these employees were:

	2019 £m	2019 £m	2018 £m	2018 £m
Share based remuneration	5.9		6.1	
Other wages and salaries	62.6		57.2	
Total wages and salaries		68.5		63.3
National Insurance on share based remuneration	1.0		1.2	
Other social security costs	7.7		6.6	
Total social security costs		8.7		7.8
Defined benefit pension cost	1.9		1.8	
Other pension costs	2.1		1.9	
Total pension costs		4.0		3.7
Total employment costs		81.2		74.8

Of which

Included in operating expenses (note 9)	79.3	73.3
Included in maintenance costs (note 6)	1.9	1.5
	81.2	74.8

Details of the pension schemes operated by the Group are given in note 41. The Company has no employees. Details of the directors' remuneration are given in note 11.

11. KEY MANAGEMENT REMUNERATION

The remuneration of the directors, who are the key management personnel of the Group and the Company, is set out below in aggregate in accordance with IAS 24 – ‘Related Party Transactions’. Further information about the remuneration of individual directors is provided in the Annual Report on Remuneration in Section B6.2.2.

	2019 £m	2019 £m	2018 £m	2018 £m
Salaries and fees	1.8		1.9	
Cash amount of bonus	1.5		1.5	
Social security costs	0.5		0.5	
Short-term employee benefits		3.8		3.9
Post-employment benefits		0.5		0.5
IFRS 2 cost in respect of directors	2.1		2.2	
National Insurance thereon	0.4		0.5	
Share based payment		2.5		2.7
		6.8		7.1

Post-employment benefits shown above are shown as ‘pension allowance’ in Section B6.2.2. Costs in respect of share awards shown in the Annual Report on Remuneration are determined on a different basis to the IFRS 2 charge shown above.

Social security costs paid in respect of directors are required to be included in this note by IAS 24, but do not fall within the scope of the disclosures in the Directors’ Remuneration Report.

12. SHARE BASED REMUNERATION

During the year, the Group had various share based payment arrangements with employees. They are accounted for by the Group and the Company as shown below.

The effect of the share based payment arrangements on the Group’s profit is shown in note 10.

Further details of share based payment arrangements are given in the Annual Report on Remuneration in Section B6.2.2.

A summary of the number of share awards outstanding under each scheme at 30 September 2019 and at 30 September 2018 is set out below.

	Number 2019	Number 2018
(a) Sharesave Plan	2,558,569	3,265,788
(b) Performance Share Plan	4,762,886	4,297,809
(c) Company Share Option Plan	730,816	549,061
(d) Deferred Bonus Plan	774,046	496,762
(e) Restricted Stock Units	134,827	82,787
	8,961,144	8,692,207

(a) Sharesave plan

The Group operates an All Employee Share Option ("Sharesave") plan. Grants under this scheme vest, in the normal course, after the completion of the appropriate service period and subject to a savings requirement.

A reconciliation of movements in the number and weighted average exercise price of Sharesave options over £1 ordinary shares during the year ended 30 September 2019 and the year ended 30 September 2018 is shown below.

	2019 Number	2019 Weighted average exercise price p	2018 Number	2018 Weighted average exercise price p
Options outstanding				
At 1 October 2018	3,265,788	281.60	3,113,587	275.56
Granted in the year	1,147,016	360.16	464,112	408.80
Exercised or surrendered in the year	(1,606,849)	253.65	(107,235)	335.74
Lapsed during the year	(247,386)	361.53	(204,676)	307.04
At 30 September 2019	2,558,569	338.06	3,265,788	281.60
Options exercisable	119,846	249.44	21,966	345.68

The weighted average remaining contractual life of options outstanding at 30 September 2019 was 26.1 months (2018: 19.7 months). The weighted average market price at exercise for share options exercised in the year was 400.88p (2018: 492.50p).

Options are outstanding under the Sharesave plans to purchase ordinary shares as follows:

Grant date	Period exercisable	Exercise price	Number 2019	Number 2018
23/12/2013	01/02/2019 to 01/08/2019	276.32p	-	147,415
11/06/2015	01/08/2018 to 01/02/2019	345.68p	-	21,966
11/06/2015	01/08/2020 to 01/02/2021	345.68p	9,977	10,063
20/06/2016	01/08/2019 to 01/02/2020	249.44p	119,846	1,593,061
20/06/2016	01/08/2021 to 01/02/2022	249.44p	439,425	445,077
28/07/2017	01/09/2020 to 01/03/2021	341.76p	493,841	541,521
28/07/2017	01/09/2022 to 01/03/2023	341.76p	44,667	52,653
31/07/2018	01/09/2021 to 01/03/2022	408.80p	278,873	391,019
31/07/2018	01/09/2023 to 01/03/2024	408.80p	38,581	63,013
30/07/2019	01/09/2022 to 01/03/2023	360.16p	1,049,338	-
30/07/2019	01/09/2024 to 01/03/2025	360.16p	84,021	-
			2,558,569	3,265,788

An option holder has the legal right to a payment holiday of up to twelve months without forfeiting their rights. In such cases the exercise period would be deferred for an equivalent period of time and therefore options might be exercised later than the date shown above.

In the event of the death or redundancy of the employee options may be exercised early and the exercise period may also start or end later than stated above (options may be exercised up to twelve months after the decease of the holder).

The fair value of options granted is determined using a trinomial model. Details of the awards over £1 ordinary shares made in the year ended 30 September 2019 and the year ended 30 September 2018, are shown below.

Grant date	30/07/19	30/07/19	31/07/18	31/07/18
Number of awards granted	1,058,831	88,185	401,099	63,013
Market price at date of grant	422.0p	422.0p	498.0p	498.0p
Contractual life (years)	3.5	5.5	3.5	5.5
Fair value per share at date of grant (£)	0.51	0.53	1.00	0.91

Inputs to valuation model

Expected volatility	22.58%	26.44%	28.39%	26.47%
Expected life at grant date (years)	3.48	5.47	3.45	5.44
Risk-free interest rate	0.36%	0.40%	1.23%	1.39%
Expected dividend yield	4.95%	4.95%	3.31%	3.31%
Expected annual departures	5.00%	5.00%	5.00%	5.00%

The expected volatility of the share price used in determining the fair value for the three-year schemes is based on the annualised standard deviation of daily changes in price over the three years preceding the grant date. The five-year schemes use share price data for the preceding five years.

(b) Paragon Performance Share Plan ('PSP')

Awards under this plan comprise a right to acquire ordinary shares in the Company for nil or nominal payment and will vest on the third anniversary of their granting, to the extent that the applicable performance criteria have been satisfied, if the holder is still employed by the Group. The awards will lapse to the extent that the performance condition has not been satisfied on the third anniversary.

Awards are exercisable from the date on which the Remuneration Committee determines the extent to which the performance conditions have been satisfied to the day before the tenth anniversary of the grant date. Clawback provisions apply to awards granted under the PSP as detailed in the remuneration policy.

The conditional entitlements outstanding under this scheme at 30 September 2019 and 30 September 2018 were:

Grant date	Period exercisable	Number 2019	Number 2018
21/05/2009	21/05/2012 to 20/05/2019 †	-	15,000
04/01/2010	04/01/2013 to 03/01/2020 †	18,702	33,664
17/12/2010	17/12/2013 to 16/12/2020 †	12,424	12,424
21/12/2011	21/12/2014 to 20/12/2021 †	15,335	15,335
28/02/2013	28/02/2016 to 27/02/2023 †	6,981	8,824
10/12/2013	10/12/2016 to 09/12/2023 †	76,614	77,717
18/12/2014	18/12/2017 to 17/12/2024 †	233,550	243,297
22/12/2015	22/12/2018 to 21/12/2025 ‡	411,800	1,384,246
01/12/2016	01/12/2019 to 30/11/2026 §	1,339,409	1,342,051
08/12/2017	08/12/2020 to 07/12/2027 §	1,161,803	1,165,251
14/12/2018	14/12/2018 to 13/12/2028 ¶	1,486,268	-
		4,762,866	4,297,809

† These awards, which were conditional on the achievement of performance based criteria, have now vested.

‡ 50% of these awards were subject to a TSR test and 50% were subject to an EPS test. The TSR test compared the rank of the Company's TSR against a comparator group of companies comprising the constituents of the FTSE-250. 25% of the TSR-tested awards vest for median performance, increasing on a straight line basis to full vesting for upper quartile performance. The EPS test provided that 25% of EPS tested awards would vest where EPS growth was equal to the increase in the retail price index plus 3%, increasing on a straight line basis to full vesting for EPS growth equal to the increase in the retail price index plus 13% or more. For both tests the testing period was the three financial years commencing with the year of grant.

§ 50% of these awards are subject to a TSR test and 25% are subject to an EPS test as described at ‡ above, except that the comparator group for the TSR test is limited to a group of listed UK financial service entities rather than the entire FTSE-250. This group is determined at the point of each grant. In the EPS test, full vesting of the awards takes place if EPS growth is equal to the increase in the retail price index plus 7% or more.

The remaining 25% of these awards are subject to a risk performance condition which takes in to account factors deemed appropriate by the Remuneration Committee, who will ultimately decide the extent to which the risk condition has been satisfied.

Once the outcomes of these tests have been determined, the gross number of awards vesting will be reduced so that the gain to the recipient from the PSP and the CSOP described below is equal to the gain from the gross PSP vesting.

¶ 50% of these awards are subject to a TSR test, 25% to an EPS test and 25% to a risk based test, similar to those described as § above, except that EPS at the end of the test period is compared to an absolute target, rather than RPI.

On exercise, holders of awards granted in February 2013 and thereafter receive a payment equivalent to the dividends accruing on the vested shares during the vesting period.

The fair value of awards granted under the PSP is determined using a Monte Carlo simulation model, to take account of the effect of the market based condition. Details of the awards over £1 ordinary shares made in the year ended 30 September 2019 and the year ended 30 September 2018 are shown below:

Grant date	14/12/18	08/12/17
Number of awards granted	1,493,230	1,177,290
Market price at date of grant	401.00p	483.20p
Fair value per share at date of grant	307.32p	338.66p

Inputs to valuation model

Expected volatility	28.86%	28.25%
Risk-free interest rate	1.20%	0.94%

For all of the above grants the contractual life and expected life at grant date is three years and no departures are expected. The expected volatility is based on the annualised standard deviation of daily changes in price over the three years preceding the grant date.

The effect of the CSOPs is not allowed for in the IFRS 2 market values of the 2016, 2017 and 2018 grants.

(c) Company Share Option Plan ('CSOP')

The PSP includes a tax advantaged element under which CSOP options can be granted. The CSOPs may be exercised alongside their accompanying PSPs based upon the exercise price that was set at the grant date. Each member of staff may be granted up to a maximum total value of £30,000 of tax benefitted options.

A reconciliation of movements in the number and weighted average exercise price of CSOP options over £1 ordinary shares during the year ended 30 September 2019 and the year ended 30 September 2018 is shown below.

	2019 Number	2019 Weighted average exercise price p	2018 Number	2018 Weighted average exercise price p
Options outstanding				
At 1 October 2018	549,061	399.16	390,746	361.88
Granted in the year	191,543	396.04	179,722	477.76
Exercised or surrendered in the year	-	-	-	-
Lapsed during the year	(9,788)	410.72	(21,407)	378.59
At 30 September 2019	730,816	398.19	549,061	399.16
Options exercisable	-	-	-	-

The conditional entitlements outstanding under this scheme at 30 September 2019 and 30 September 2018 were:

Grant date	Period exercisable	Exercise price	Number 2019	Number 2018
01/12/2016	01/12/2019 to 30/11/2026 ◊	361.88p	370,445	372,426
08/12/2017	08/12/2020 to 07/12/2027 ◊	477.76p	174,049	176,635
14/12/2018	14/12/2021 to 13/12/2028 ◊	396.04p	186,322	-
			730,816	549,061

◊ 66.7% of these awards are subject to a TSR test and 33.3% are subject to an EPS test. These tests operate in the same manner and with the same conditions as those for the PSP grant of the same date.

To the extent that the CSOP awards vest, the vesting of the PSP award granted at the same time will be abated so that the overall gain to the grantee is the same as would be received on the related PSP award had the CSOP not been in place.

No separate fair value has been attributed to the CSOP options for IFRS 2 purposes as the IFRS 2 market values for the CSOP and PSP combined will equate to that calculated for the PSP without allowing for the CSOP. The benefit from the CSOP is in relation to the employees' tax position, which does not affect the IFRS 2 charge.

(d) Deferred Bonus awards

Awards under these plans comprise a right to acquire ordinary shares in the Company for nil or nominal payment. The conditional entitlements outstanding under these plans at 30 September 2019 and 30 September 2018 were:

Grant date	Period exercisable	Number 2019	Number 2018
10/12/2013	10/12/2016 to 09/12/2023	55,302	55,302
18/12/2014	18/12/2017 to 17/12/2024	79,853	99,102
22/12/2015	22/12/2018 to 21/12/2025	96,559	134,524
01/12/2016	01/12/2019 to 30/11/2026	105,318	105,318
08/12/2017	08/12/2020 to 07/12/2027	102,516	102,516
14/12/2018	14/12/2021 to 13/12/2028	334,498	-
		774,046	496,762

The Deferred Bonus shares can be exercised from the third anniversary of the award date until the day before the tenth anniversary of the date of grant.

The Deferred Bonus shares granted in December 2016 and thereafter accrue dividends only over the vesting period, unlike earlier grants which accrued dividends until the point of exercise. The fair value of Deferred Bonus awards issued in the year was determined using a Black-Scholes Merton model. Details of the awards over £1 ordinary shares made in the year ended 30 September 2019 and the year ended 30 September 2018 are shown below.

Grant date	14/12/18	08/12/17
Number of awards granted	334,498	102,516
Market price at date of grant	401.00p	483.20p
Fair value per share at date of grant	401.00p	483.20p

(e) Restricted Stock Units ('RSUs')

Since 2016, the Company has permitted certain employees to elect to receive RSU awards instead of PSP awards. RSU awards have vesting conditions based upon the grantee's personal performance (including a risk element) rather than conditions in the wider business. These conditions are determined to be met to the extent to which the Remuneration Committee deems that to be the case.

The conditional entitlements outstanding under this scheme at 30 September 2019 and 30 September 2018 were:

Grant date	Period exercisable	Number 2019	Number 2018
01/12/2016	01/12/2019 to 30/11/2026	60,115	60,115
08/12/2017	08/12/2020 to 07/12/2027	22,672	22,672
14/12/2018	14/12/2021 to 13/12/2028	52,040	-
		134,827	82,787

The fair value of RSU awards issued in the year was determined using a Black-Scholes Merton model. Details of the awards over £1 ordinary shares made in the year ended 30 September 2019 and the year ended 30 September 2018 are shown below.

Grant date	14/12/18	08/12/17
Number of awards granted	52,040	22,672
Market price at date of grant	401.00p	483.20p
Fair value per share at date of grant	401.00p	483.20p

13. AUDITOR REMUNERATION

The analysis of fees payable to the Company's auditors (KPMG LLP) and their associates, excluding irrecoverable VAT, required by the Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2008 is set out below. This analysis includes amounts charged to the profit and loss account or included within the issue costs of debt in respect of fees paid to the Group auditors and their associates.

	2019 £000	2018 £000
Audit fee of the company	462	445
Other services		
Audit of subsidiary undertakings pursuant to legislation	890	716
Total audit fees	1,352	1,161
Audit related assurance services		
Interim review	90	62
Other	22	20
Other assurance services	-	68
Total fees	1,464	1,311
Irrecoverable VAT	293	262
Total cost to the Group (note 9)	1,757	1,573

Fees paid to the auditors and their associates for non-audit services to the Company are not disclosed because the consolidated accounts of the Group are required to disclose such fees on a consolidated basis.

14. FAIR VALUE NET (LOSSES) / GAINS

	2019 £m	2018 £m
Ineffectiveness of fair value hedges (note 24)		
Portfolio hedges of interest rate risk		
Deposit hedge	(0.2)	0.2
Loan hedge	(6.3)	1.1
	(6.5)	1.3
Ineffectiveness of cash flow hedges	-	-
Other hedging movements	(5.8)	(0.5)
Net (losses) / gains on other derivatives	(2.8)	0.4
	(15.1)	1.2

The fair value net (loss) / gain represents the accounting volatility on derivative instruments which are matching risk exposure on an economic basis generated by the requirements of IAS 39. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting has not been adopted or is not achievable on certain items. The losses and gains are primarily due to timing differences in income recognition between the derivative instruments and the economically hedged assets and liabilities. Such differences will reverse over time and have no impact on the cash flows of the Group.

15. TAX CHARGE ON PROFIT ON ORDINARY ACTIVITIES

(a) Analysis of charge in the year

	2019 £m	2018 £m
Current tax		
UK Corporation Tax on profits of the period	36.3	38.0
Adjustment in respect of prior periods	(2.4)	(1.1)
Total current tax	33.9	36.9
Deferred tax	(2.3)	(1.2)
Tax charge on profit on ordinary activities	31.6	35.7

The standard rate of corporation tax applicable to the Group for the year ended 30 September 2018 was 19.0%, the rate in the year ended 30 September 2019 was 19.0%, the rate in the year ending 30 September 2020 is expected to be 18.0% and the rate in subsequent years is expected to be 17.0%, based on currently enacted legislation.

The Bank Corporation Tax Surcharge was introduced with effect from 1 January 2016. This subjects any taxable profits arising in the Group's banking subsidiary, Paragon Bank PLC (and no other Group entity), to an additional 8.0% of tax to the extent these profits exceed £25.0m. The effect of the surcharge shown in note (c) below.

(b) Deferred tax credit for the year

The deferred tax credit in the income statement comprises the following temporary differences:

	2019 £m	2018 £m
Accelerated tax depreciation	0.2	(0.9)
Retirement benefit obligations	0.3	0.3
Impairment and other provisions	(2.1)	(0.8)
Utilisation of tax losses	(0.2)	-
Other timing differences	(1.9)	(0.7)
Deferred tax (credit) for the year	(3.7)	(2.1)
Prior period adjustment	1.4	0.9
Deferred tax (credit) (note 26)	(2.3)	(1.2)

The expected impact on deferred tax balances of the changes in the rate of Corporation Tax to 19.0% and 17.0% described above was initially accounted when the changes in rate were substantively enacted.

(c) Factors affecting tax charge for the year

Accounting standards require companies to explain the difference between the effective rate of tax in the accounts and the 'applicable rate', generally the domestic rate of tax levied on corporate income in the jurisdiction in which the entity operates.

The Group operates wholly in the UK and all but a nominal amount of the Group's income arises in UK resident companies. Consequently, it is appropriate to use the prevailing UK corporation tax rate as the comparator to the effective tax rate. As noted in (b) above, the UK Corporation tax rate applicable to the Group for the year was 19.0% (2018: 19.0%).

The impact of the Banking Surcharge is shown as a difference between tax at this rate and the actual tax charge in the table below.

	2019 £m	2018 £m
Profit on ordinary activities before taxation	159.0	181.5
Profit on ordinary activities multiplied by the UK standard rate of corporation tax	30.2	34.5
Effects of:		
Permanent differences		
- Disallowable acquisition costs	-	0.3
- Income from structured entities	-	(0.6)
- Recurring disallowable expenditure and similar items	0.4	0.1
Mismatch in timing differences	0.3	0.5
Change in rate of taxation on deferred tax assets and liabilities	(0.6)	0.2
Bank Corporation Tax Surcharge	2.1	0.9
Tax losses created with no corresponding deferred tax asset recognised	0.1	-
Prior year (credit)	(0.9)	(0.2)
Tax charge for the year	31.6	35.7

The timing difference mismatch arises because tax relief for share based payments is given on a different basis from that on which the accounting charge for the provision of these awards is recognised under IFRS 2.

(d) Factors affecting future tax charges

Whilst practically all of the Group's profit is subject to UK corporation tax, its future effective tax rate is expected to be primarily driven by the proportion of its taxable profit subject to the Bank Surcharge.

The Group includes a leasing business in PAF. Whilst such businesses do not, in general, have significant permanent differences, the taxable profits in a given accounting period are usually significantly different from the accounting profits due to temporary differences. Consequently, the operation will have no material impact on the effective tax rate, but may have on the Group's tax payments.

At the balance sheet date there were no material tax uncertainties and no significant open matters with the UK tax authorities. The Group has no material exposure to any other tax jurisdiction.

As a wholly UK based business the Group does not expect to be significantly impacted by the OECD project on Base Erosion and Profit Shifting ('BEPS').

16. PROFIT ATTRIBUTABLE TO MEMBERS OF PARAGON BANKING GROUP PLC

The Company's profit after tax for the financial year amounted to £9.9m (2018: £43.0m). A separate income statement has not been prepared for the Company under the provisions of Section 408 of the Companies Act 2006.

The Company has no other items of comprehensive income for the years ended 30 September 2019 or 30 September 2018.

17. EARNINGS PER SHARE

Earnings per ordinary share is calculated as follows:

	2019	2018
Profit for the year (£m)	127.4	145.8
Basic weighted average number of ordinary shares ranking for dividend during the year (million)	257.6	260.8
Dilutive effect of the weighted average number of share options and incentive plans in issue during the year (million)	6.7	8.4
Diluted weighted average number of ordinary shares ranking for dividend during the year (million)	264.3	269.2
Earnings per ordinary share		
- basic	49.4p	55.9p
- diluted	48.2p	54.2p

18. CASH AND CASH EQUIVALENTS

	2019 £m	2018 £m	2017 £m
Deposits with the Bank of England	816.4	895.9	615.0
Balances with central banks	816.4	895.9	615.0
Deposits with other banks	409.0	393.1	758.8
Money Market Fund investments	-	21.6	123.1
Balances with other banks	409.0	414.7	881.9
Cash and cash equivalents	1,225.4	1,310.6	1,496.9

Only 'Free Cash' is unrestrictedly available for the Group's general purposes. Cash received in respect of loan assets funded through warehouse facilities and securitisations is not immediately available, due to the terms of those arrangements. This cash is shown as 'securitisation cash' below.

Balances with central banks form part of the liquidity buffer of Paragon Bank PLC and are therefore not available for the Group's general purposes. Free cash may also be deposited at the Bank of England.

Cash held by the Trustee of the Group's employee share ownership plan may only be used to invest in the shares of the Company, pursuant to the aims of that plan. This is shown as 'ESOP cash' below.

The total consolidated 'Cash and Cash Equivalents' balance may be analysed as shown below:

	2019 £m	2018 £m	2017 £m
Free cash	225.7	238.0	305.5
Securitisation cash	353.1	338.8	574.0
Liquidity buffer	646.4	724.9	615.0
ESOP cash	0.2	8.9	2.4
	1,225.4	1,310.6	1,496.9

The 'Cash and Cash Equivalents' amount of £14.1m (2018: £24.9m; 2017: £277.6m) shown in the Company balance sheet is included in 'Free Cash'. This amount includes £nil of Money Market Fund investments (2018: £150.0m, 2017: £119.5m)

'Cash and Cash Equivalents' includes current bank balances, money market placements and fixed rate sterling term deposits with London banks, and balances with the Bank of England.

Cash and cash equivalents are allocated to Stage 1 assets. The probabilities of default have been assessed to be so low as to require no significant impairment provision.

19. SHORT TERM INVESTMENTS

This amount represents fixed rate securities issued by the UK Government for which a liquid market exists, and which are held from time to time, as part of the liquidity requirement of Paragon Bank PLC.

No such securities were held at either 30 September 2019 or 30 September 2018, but the Group held this type of investment during the year.

20. LOANS TO CUSTOMERS

	Note	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m	2017 IAS 39 £m
Loan accounts	21	11,394.3	11,381.5	11,407.4	10,636.1
Finance lease receivables	22	791.8	719.1	720.4	488.0
Loans to customers		12,186.1	12,100.6	12,127.8	11,124.1
Fair value adjustments from portfolio hedging	24	64.2	(24.1)	(24.1)	(8.7)
		12,250.3	12,076.5	12,103.7	11,115.4

The Group's loans to customers at 30 September 2019, analysed between the segments described in note 2 are as follows:

	Mortgages £m	Commercial Lending £m	Idem Capital £m	Total £m
At 30 September 2019 (IFRS 9)				
First mortgages	10,172.5	-	-	10,172.5
Consumer loans	171.6	-	352.3	523.9
Motor finance	-	281.3	37.6	318.9
Asset finance	-	492.2	-	492.2
Development finance	-	506.5	-	506.5
Other loans	-	172.1	-	172.1
Loans to customers	10,344.1	1,452.1	389.9	12,186.1

At 1 October 2018 (IFRS 9)

First mortgages	10,308.3	-	-	10,308.3
Consumer loans	141.2	-	447.0	588.2
Motor finance	-	256.4	72.8	329.2
Asset finance	-	402.3	-	402.3
Development finance	-	352.9	-	352.9
Other commercial loans	-	119.7	-	119.7
Loans to customers	10,449.5	1,131.3	519.8	12,100.6

At 30 September 2018 (IAS 39)

First mortgages	10,332.2	-	-	10,332.2
Consumer loans	141.3	-	448.3	589.6
Motor finance	-	256.6	72.8	329.4
Asset finance	-	403.4	-	403.4
Development finance	-	352.8	-	352.8
Other loans	-	120.4	-	120.4
Loans to customers	10,473.5	1,133.2	521.1	12,127.8

The Group's purchased loan portfolios are analysed below.

	2019	2018	2018
	IFRS 9	IFRS 9	IAS 39
	£m	£m	£m
First mortgage loans	15.7	11.7	11.7
Consumer loans	275.4	352.0	352.5
Motor finance loans	37.6	72.8	72.8
	328.7	436.5	437.0

Information on the ERCs for first mortgages and consumer loans is given in note 57. All other loans above are internally generated or arise from acquired operations.

21. LOAN ACCOUNTS

Loan accounts at 30 September 2019, 1 October 2018, 30 September 2018 and 30 September 2017, which are all denominated and payable in sterling, were:

	2019	2018	2018	2017
	IFRS 9	IFRS 9	IAS 39	IAS 39
	£m	£m	£m	£m
First mortgage loans	10,172.5	10,308.3	10,332.2	9,855.5
Second charge mortgage loans	389.2	414.4	415.9	490.7
Other unsecured consumer loans	134.7	173.8	173.7	219.1
Development finance loans	506.5	352.9	352.8	42.3
Other secured commercial lending	125.9	72.8	72.9	17.5
Other commercial loans	65.5	59.3	59.9	11.0
	11,394.3	11,381.5	11,407.4	10,636.1

First mortgages are secured on residential property within the UK; second charge mortgage loans enjoy second charges on residential property.

Other secured commercial lending includes structured lending, aviation mortgages and invoice factoring.

Other commercial loans includes principally professions finance, discounted receivables and other short term commercial balances.

The amounts of the loan assets above pledged as collateral under the central bank facilities described in note 36 or under the external funding arrangements described in notes 32 and 33 are shown below. The table also shows assets prepositioned with the Bank of England for use in future drawings.

	First Mortgages £m	Consumer Finance £m	Other £m	Total £m
30 September 2019 (IFRS 9)				
In respect of:				
Asset backed loan notes	4,338.3	-	-	4,338.3
Warehouse facilities	948.1	-	-	948.1
Central bank facilities	1,734.4	-	-	1,734.4
Total pledged as collateral	7,020.8	-	-	7,020.8
Prepositioned with Bank of England	1,873.7	-	-	1,873.7
Other assets not pledged as collateral	1,278.0	523.9	697.9	2,499.8
	10,172.5	523.9	697.9	11,394.3

1 October 2018 (IFRS 9)

In respect of:				
Asset backed loan notes	5,037.8	40.4	-	5,078.2
Warehouse facilities	1,023.8	-	-	1,023.8
Central bank facilities	1,670.1	-	-	1,670.1
Total pledged as collateral	7,731.7	40.4	-	7,772.1
Prepositioned with Bank of England	1,171.0	-	-	1,171.0
Other assets not pledged as collateral	1,405.6	547.8	485.0	2,438.4
	10,308.3	588.2	485.0	11,381.5

30 September 2018 (IAS 39)

In respect of:				
Asset backed loan notes	5,052.2	40.8	-	5,093.0
Warehouse facilities	1,030.2	-	-	1,030.2
Central bank facilities	1,670.1	-	-	1,670.1
Total pledged as collateral	7,752.5	40.8	-	7,793.3
Prepositioned with Bank of England	1,171.1	-	-	1,171.1
Other assets not pledged as collateral	1,408.6	548.8	485.6	2,443.0
	10,332.2	589.6	485.6	11,407.4

22. FINANCE LEASE RECEIVABLES

The Group's finance leases can be analysed as shown below.

	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m	2017 IAS 39 £m
Motor finance	318.9	329.2	329.4	163.0
Asset finance	472.9	389.9	391.0	325.0
Carrying value	791.8	719.1	720.4	488.0

The minimum lease payments due under these loan agreements are:

	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m	2017 IAS 39 £m
Amounts receivable				
Within one year	292.9	258.5	259.5	174.9
Within two to five years	566.7	529.4	530.2	357.6
After five years	40.2	30.9	30.9	17.8
	897.8	818.8	820.6	550.3
Less: future finance income	(101.4)	(95.2)	(95.2)	(58.3)
Present value	798.4	723.6	725.4	492.0

The present values of those payments, net of provisions for impairment, carried in the accounts are:

	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m	2017 IAS 39 £m
Amounts receivable				
Within one year	255.8	225.5	226.4	151.9
Within two to five years	506.6	470.8	471.7	323.8
After five years	36.0	27.3	27.3	16.3
Present value	798.4	723.6	725.4	492.0
Allowance for uncollectible amounts	(6.6)	(4.5)	(5.0)	(4.0)
Carrying value	791.8	719.1	720.4	488.0

None of the Group's finance lease receivables were pledged as collateral for liabilities at 30 September 2019 or 30 September 2018.

23. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS

This note sets out information on the Group's impairment provisioning under IFRS 9 for the loans to customers balances set out in note 20, including both finance leases, accounted for under IAS 17, and loans held at amortised cost, accounted for under IFRS 9, as both groups of assets are subject to the IFRS 9 impairment requirements.

The disclosures are set out under the following headings:

- Basis of provision
- Impairments by stage and division
- Movements in impairment provision in the period
- Impairments charged to income
- Economic inputs to provision calculations
- Sensitivity analysis

Basis of provision

IFRS 9 requires that impairment is evaluated on an expected credit loss ('ECL') basis. ECLs are based on an assessment of the probability of default ('PD') and loss given default ('LGD'), discounted to give a net present value. The estimation of ECL should be unbiased and probability weighted, considering all reasonable and supportable information, including forward looking economic assumptions and a range of possible outcomes. Provision may be based on either twelve month or lifetime ECL, dependant on whether an account has experienced a significant increase in credit risk ('SICR').

Calculation of expected credit loss ('ECL')

For the majority of the Group's loan assets, the ECL is generated using statistical models applied to account data to generate PD and LGD components.

PD on both a twelve month and lifetime basis is estimated based on statistical models for the Group's most significant asset classes. The PD calculation is a function of current asset performance, customer information and future economic assumptions. The structure of the models was derived through analysis of correlation in historic data, which identified which current and historical customer attributes and external economic variables were predictive of future loss. PD measures are calculated for the full contractual lives of loans with the models deriving probabilities that, at a given future date, a loan will be in default, performing or closed. The Group utilised all reasonably available information in its possession for this exercise.

LGD for each account is derived by calculating a value for exposure at the point of default (which will include consideration of future interest, account charges and receipts) and reducing this for security values, net of likely costs of recovery. These calculations allow for the Group's potential case management activities. This evaluation includes the potential impact of economic conditions at the time of any future default or enforcement. The derivation of the significant assumptions used in these calculations is discussed below.

In certain asset classes a fully modelled approach is not possible. This is generally where there are few assets in the class, where there is insufficient historical data on which to base an analysis or where certain measures, such as days past due are not useful (e.g. where the loan agreement does not require regular payments of pre-determined amounts). In these cases, which represent a small proportion of the total portfolio, alternative approaches are adopted. These rely on internal credit monitoring practices and professional credit judgement.

Notwithstanding the mechanical procedures discussed above, the Group will always consider whether the process generates sufficient provision for particular loans, especially large exposures, and will provide additional amounts as appropriate.

Significant Increase in Credit Risk ('SICR')

Under IFRS 9, SICR is not defined solely by account performance, but on the basis of the customer's overall credit position, and this evaluation should include consideration of external data. The Group's aim is to define SICR to correspond, as closely as possible, to that population of accounts which are subject to enhanced administrative and monitoring procedures operationally. The Group assesses SICR in its modelled portfolios primarily on the basis of the relative difference in an account's lifetime PD between origination and the reporting date. The levels of difference required to qualify as an SICR may differ between portfolios and will depend, to some extent, on the level of risk originally perceived and are monitored on an ongoing basis to ensure that this calibrates with actual experience.

It should be noted that the use of the current PD, which includes external factors such as credit bureau data, means that all relevant information in the Group's hands concerning the customers present credit position is included in the evaluation, as well as the impact of future economic expectations.

For non-modelled portfolios, the SICR assessment is based on the credit monitoring position of the account in question and for all portfolios a number of qualitative indicators which provide evidence of SICR have been considered.

In all cases accounts which are more than one month in arrears, where this is a meaningful measure, are considered to have an SICR. However, in certain loan portfolios, regular monthly payments of pre-set amounts are not required and hence this criterion cannot be used.

The Group uses arrears multiples as a proxy for days past due, as this measure is commonly used in its arrears reporting. A loan will generally be one month in arrears from the point it is one day past due until it is thirty days past due.

Definitions of default

As the IFRS 9 definition of ECL is based on PD, default must be defined for this purpose. The Group's definitions of default for its various portfolios are aligned to its internal operational procedures and the regulatory definitions of default used internally. In particular, the Group's receiver of rent cases are defined as defaulted for modelling purposes as the behaviour of the case after that point is significantly influenced by internal management decisions.

IFRS 9 provides a rebuttable presumption that an account is in default when it is ninety days overdue and this was used as the basis of the Group's definition. A combination of qualitative and quantitative measures were used in developing the definitions. These include account management activities and internal statuses.

Credit Impaired loans

IFRS 9 defines a credit impaired account as one where an account has suffered one or more events which has had a detrimental effect on future cash flows. It is thus a backward-looking definition, rather than one based on future expectations.

Credit impaired assets are identified either through quantitative measures or by operational status. Designations of accounts for regulatory capital purposes are also taken into account. Assets may also be assigned to Stage 3 if they are identified as credit impaired as a result of management review processes.

All loans which are in the process of enforcement, from the point where this becomes the administration strategy, are classified as credit impaired.

During the year the Group revised certain of its default definitions for regulatory purposes. Where appropriate, IFRS 9 definitions have been amended to harmonise with the new definition and hence the staging at 1 October 2018 set out below differs from that presented in the Group's transition report.

As a result of this harmonisation all default cases are considered to be credit impaired, including all receiver of rent cases and all cases with at least one payment more than ninety days overdue, even where such cases are being managed in the expectation of realising all of the carrying balance. In order to provide better information for users, additional analysis of credit impaired accounts has been presented below distinguishing between receiver of rent account, accounts subject to realisation / enforcement procedures and long term managed accounts, all of which are treated as credit impaired.

IFRS 9 Staging

IFRS 9 calculations and related disclosures require loan assets to be divided into three stages, with accounts which were credit impaired on initial recognition representing a fourth class.

The three classes comprise: those where there has been no SICR since advance or acquisition (Stage 1); those where there has been a SICR (Stage 2); and loans which are impaired (Stage 3).

- On initial recognition, and for assets where there has not been an SICR, provisions will be made in respect of losses resulting from the level of credit default events expected in the twelve months following the balance sheet date
- Where a loan has experienced an SICR, whether or not the loan is considered to be credit impaired, provisions will be made based on the ECLs over the full life of the loan
- For credit impaired assets, provisions will also be made on the basis of lifetime ECLs

For assets which were 'Purchased or Originated as Credit Impaired' ('POCI') accounts (i.e. considered as credit impaired at the point of first recognition), such as certain of the Group's acquired assets in Idem Capital, the carrying valuation is based on expected cash flows discounted by the EIR determined at the point of acquisition.

Impairments by stage

An analysis of the Group's loan portfolios between the stages defined above is set out below.

	Stage 1 £m	Stage 2* £m	Stage 3* £m	POCI £m	Total £m
30 September 2019					
Gross loan book					
Mortgages	9,847.7	378.2	129.3	15.7	10,370.9
Commercial Lending	1,376.7	64.6	8.2	13.3	1,462.8
Idem Capital	158.2	15.7	30.4	190.0	394.3
Total	11,382.6	458.5	167.9	219.0	12,228.0
Impairment provision					
Mortgages	(0.4)	(2.0)	(24.4)	-	(26.8)
Commercial Lending	(5.4)	(1.3)	(4.0)	-	(10.7)
Idem Capital	(0.2)	(0.4)	(3.8)	-	(4.4)
Total	(6.0)	(3.7)	(32.2)	-	(41.9)
Net loan book					
Mortgages	9,847.3	376.2	104.9	15.7	10,344.1
Commercial Lending	1,371.3	63.3	4.2	13.3	1,452.1
Idem Capital	158.0	15.3	26.6	190.0	389.9
Total	11,376.6	454.8	135.7	219.0	12,186.1
Coverage ratio					
Mortgages	-	0.53%	18.87%	-	0.26%
Commercial Lending	0.39%	2.01%	48.78%	-	0.73%
Idem Capital	0.13%	2.55%	12.50%	-	1.12%
Total	0.05%	0.81%	19.18%	-	0.34%

	Stage 1 £m	Stage 2* £m	Stage 3* £m	POCI £m	Total £m
1 October 2018					
Gross loan book					
Mortgages	9,961.6	369.9	142.4	11.7	10,485.6
Commercial Lending	1,106.4	8.2	5.8	17.5	1,137.9
Idem Capital	206.1	19.7	40.0	265.5	531.3
Total	11,274.1	397.8	188.2	294.7	12,154.8
Impairment provision					
Mortgages	(0.3)	(1.7)	(34.1)	-	(36.1)
Commercial Lending	(4.2)	(0.4)	(2.0)	-	(6.6)
Idem Capital	(0.4)	(0.5)	(10.6)	-	(11.5)
Total	(4.9)	(2.6)	(46.7)	-	(54.2)
Net loan book					
Mortgages	9,961.3	368.2	108.3	11.7	10,449.5
Commercial Lending	1,102.2	7.8	3.8	17.5	1,131.3
Idem Capital	205.7	19.2	29.4	265.5	519.8
Total	11,269.2	395.2	141.5	294.7	12,100.6
Coverage ratio					
Mortgages	-	0.46%	23.95%	-	0.34%
Commercial Lending	0.38%	4.88%	34.48%	-	0.58%
Idem Capital	0.19%	2.54%	26.50%	-	2.16%
Total	0.04%	0.65%	24.81%	-	0.45%

* Stage 2 and 3 balances are analysed in more detail below.

Finance leases included above, analysed by staging, were:

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
30 September 2019					
Gross loan book	734.2	21.0	5.7	37.5	798.4
Impairment provision	(3.2)	(0.7)	(2.7)	-	(6.6)
Net loan book	731.0	20.3	3.0	37.5	791.8
1 October 2018					
Gross loan book	637.5	8.2	5.1	72.8	723.6
Impairment provision	(2.6)	(0.3)	(1.6)	-	(4.5)
Net loan book	634.9	7.9	3.5	72.8	719.1

In terms of the Group's credit management processes, Stage 1 cases will fall within the appropriate customer servicing functions and Stage 2 cases will be subject to account management arrangements. Stage 3 cases will include both those subject to recovery or similar processes and those which, though being managed on a long-term basis, are included with defaulted accounts for regulatory purposes. However, these broad categorisations may vary between different product types.

POCI balances included in the Commercial Lending segment arise principally from acquired businesses, where those assets were identified as credit impaired at the point of acquisition when the acquired portfolios as a whole were evaluated.

Idem Capital loans include acquired consumer and motor finance loans together with legacy (originated pre-2010) second charge mortgage and unsecured consumer loans. Legacy assets and acquired loans which were performing on acquisition are included in the staging analysis above. Acquired portfolios which were largely non-performing at acquisition, and which were purchased at a deep discount to face value are shown as POCI assets above. Although no provision is shown above for such assets, the effect of the discount on purchase is included in the gross value ensuring that the carrying value is substantially less than the current balances due from customers and the level of cover is considerable.

Analysis of Stage 2 loans

The table below analyses the accounts in Stage 2 between those not more than one month in arrears where an SICR has nonetheless been identified from other information and accounts more than one month in arrears, which are automatically deemed to have an SICR.

Coverage for Stage 2 cases remains broadly similar year-on-year in both the Mortgages and Idem Capital divisions. Within the Commercial Lending division, the '<1 month' total in 2019 includes increased balances from the maturing structured lending and development finance portfolios, where security levels are high and hence provision requirements are generally lower than for other businesses within the division. The '>1 month <=3 months' total in Commercial Lending includes very few cases and hence the coverage ratio may vary depending on the cases currently in progress.

	< 1 month arrears £m	> 1 <= 3 months arrears £m	Total £m
30 September 2019			
Gross loan book			
Mortgages	336.3	41.9	378.2
Commercial Lending	57.2	7.4	64.6
Idem Capital	7.7	8.0	15.7
Total	401.2	57.3	458.5
Impairment provision			
Mortgages	(1.3)	(0.7)	(2.0)
Commercial Lending	(1.0)	(0.3)	(1.3)
Idem Capital	(0.2)	(0.2)	(0.4)
Total	(2.5)	(1.2)	(3.7)
Net loan book			
Mortgages	335.0	41.2	376.2
Commercial Lending	56.2	7.1	63.3
Idem Capital	7.5	7.8	15.3
Total	398.7	56.1	454.8
Coverage ratio			
Mortgages	0.39%	1.67%	0.53%
Commercial Lending	1.75%	4.05%	2.01%
Idem Capital	2.60%	2.50%	2.55%
Total	0.62%	2.09%	0.81%

	< 1 month arrears £m	> 1 <= 3 months arrears £m	Total £m
1 October 2018			
Gross loan book			
Mortgages	306.3	63.6	369.9
Commercial Lending	4.0	4.2	8.2
Idem Capital	8.8	10.9	19.7
Total	319.1	78.7	397.8
Impairment provision			
Mortgages	(0.8)	(0.9)	(1.7)
Commercial Lending	(0.1)	(0.3)	(0.4)
Idem Capital	(0.2)	(0.3)	(0.5)
Total	(1.1)	(1.5)	(2.6)
Net loan book			
Mortgages	305.5	62.7	368.2
Commercial Lending	3.9	3.9	7.8
Idem Capital	8.6	10.6	19.2
Total	318.0	77.2	395.2
Coverage ratio			
Mortgages	0.26%	1.42%	0.46%
Commercial Lending	2.50%	7.14%	4.88%
Idem Capital	2.27%	2.75%	2.54%
Total	0.34%	1.91%	0.65%

Analysis of Stage 3 loans

The table below analyses the accounts in Stage 3 between accounts in the process of enforcement or where full recovery is considered unlikely ('Realisations' in the table), loans being managed on a long term basis where full recovery is possible but which are considered in default for regulatory purposes and buy-to-let mortgages where a receiver of rent ('RoR') has been appointed by the Group to manage the property on the customer's behalf. RoR accounts in Stage 3 may be fully up-to-date with full recovery possible. These accounts are included in Stage 3 as they are classified as defaulted for regulatory purposes.

Coverage for Stage 3 Mortgages has reduced over the year as a number of heavily provided legacy receiver of rent cases have been resolved, as discussed further below. The coverage ratio for Commercial Lending is subject to large fluctuations, as the number and absolute value of Stage 3 cases are relatively low and hence the specific details of individual cases will influence the ratio. In Idem Capital, the principal impact on the values shown below was a major operational review of legacy balances during the year which resulted in a change in the collection strategy and a consequent writing off of a large proportion of the balances shown at 1 October 2018.

	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m
30 September 2019				
Gross loan book				
Mortgages	8.3	106.3	14.7	129.3
Commercial Lending	1.7	-	6.5	8.2
Idem Capital	26.0	-	4.4	30.4
Total	36.0	106.3	25.6	167.9
Impairment provision				
Mortgages	(0.4)	(19.3)	(4.7)	(24.4)
Commercial Lending	(0.5)	-	(3.5)	(4.0)
Idem Capital	(1.9)	-	(1.9)	(3.8)
Total	(2.8)	(19.3)	(10.1)	(32.2)
Net loan book				
Mortgages	7.9	87.0	10.0	104.9
Commercial Lending	1.2	-	3.0	4.2
Idem Capital	24.1	-	2.5	26.6
Total	33.2	87.0	15.5	135.7
Coverage ratio				
Mortgages	4.82%	18.16%	31.97%	18.87%
Commercial Lending	29.41%	-	53.85%	48.78%
Idem Capital	7.31%	-	43.18%	12.50%
Total	7.78%	18.16%	39.45%	19.18%

	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m
1 October 2018				
Gross loan book				
Mortgages	5.0	116.3	21.1	142.4
Commercial Lending	1.1	-	4.7	5.8
Idem Capital	29.0	-	11.0	40.0
Total	35.1	116.3	36.8	188.2
Impairment provision				
Mortgages	-	(26.8)	(7.3)	(34.1)
Commercial Lending	(0.4)	-	(1.6)	(2.0)
Idem Capital	(1.7)	-	(8.9)	(10.6)
Total	(2.1)	(26.8)	(17.8)	(46.7)
Net loan book				
Mortgages	5.0	89.5	13.8	108.3
Commercial Lending	0.7	-	3.1	3.8
Idem Capital	27.3	-	2.1	29.4
Total	33.0	89.5	19.0	141.5
Coverage ratio				
Mortgages	-	23.04%	34.60%	23.95%
Commercial Lending	36.36%	-	34.04%	34.48%
Idem Capital	5.86%	-	80.91%	26.50%
Total	5.98%	23.04%	48.37%	24.81%

The security values available to reduce exposure at default in the calculation shown above for stage 3 accounts are set out below. The estimated value of the security represents, for each account, the lesser of the valuation estimate and the exposure at default in the Central scenario. Security values are based on the most recent valuation of the relevant asset held by the Group, indexed or depreciated as appropriate.

	2019	2018
	IFRS 9	IFRS 9
	£m	£m
First mortgages	65.7	69.6
Second mortgages	14.0	17.4
Asset finance	2.2	1.0
Motor finance	1.0	0.9
	82.9	88.9

The RoR managed accounts are being managed to ensure the optimal resolution for landlords, tenants and lenders and this long-term, stable situation underpinned their treatment as not impaired under IAS 39, but the existence of the RoR arrangement causes the accounts to be treated as defaulted for regulatory purposes. The Group's RoR arrangements are described in more detail below.

Idem Capital balances with over three months arrears comprise principally second charge mortgage accounts originated over ten years ago which have been over three months in arrears for some time. These accounts are generally making regular payments and have significant levels of equity in the underlying property which reduces the required provision to the value shown above. It is expected that a high proportion of these accounts will eventually redeem naturally, either on the sale of the property or by the satisfaction of the amount due through instalment payments.

Buy-to-let receiver of rent cases (Stage 3)

Where a buy-to-let mortgage customer in England or Wales falls into arrears on their account the Group has the power to appoint a receiver of rent under the Law of Property Act. The receiver will then manage the property on behalf of the customer, collecting rents and remitting them to make payments on the account. While the receiver has the power to sell the property, in many cases they will operate it as a buy-to-let on at least a short to medium term basis, potentially longer, depending on the individual circumstances of the case. This causes less disruption to the tenants and may result in the mortgage account returning to performing status and the property being handed back to the customer.

The following table analyses the number and gross carrying value of RoR managed accounts shown above by the date of the receivers' appointment, illustrating this position.

	30 September 2019		1 October 2018	
	No.	£m	No.	£m
Managed accounts				
<i>Appointment date</i>				
2010 and earlier	402	70.5	464	83.0
2011 to 2013	86	17.3	107	21.8
2014 to 2016	31	4.5	40	5.9
2016 and later	84	14.0	44	5.6
Total managed accounts	603	106.3	655	116.3
Accounts in the process of realisation	80	11.9	115	16.9
	683	118.2	770	133.2

Receiver of rent accounts in the process of realisation at the period end are included under that heading.

Movements in impairment provision by stage

The movements in the impairment provision calculated under IFRS 9, analysed by business segments, are set out below.

	Mortgages	Commercial Lending	Idem Capital	Total
	£m	£m	£m	£m
At transition – 1 October 2018	36.1	6.6	11.5	54.2
Provided in period	1.2	7.2	0.3	8.7
Amounts written off	(6.5)	(3.1)	(7.4)	(17.0)
Assets derecognised	(4.0)	-	-	(4.0)
At 30 September 2019	26.8	10.7	4.4	41.9

Accounts are considered to be written off for accounting purposes if a balance remains once standard enforcement processes have been completed, subject to any amount retained in respect of expected salvage receipts. This has no effect on the net carrying value, only on the amounts reported as gross loan balances and accumulated impairment provisions.

At 30 September 2019 enforceable contractual balances of £9.0m were outstanding on non-POCI assets written off in the period. This will exclude those accounts where a full and final settlement was agreed and those where the contractual terms do not permit any further action. Enforceable balances will be kept under review for operational purposes but no amounts will be recognised in respect of such accounts unless further cash is received or there is a strong expectation that it will be.

A more detailed analysis of these movements by IFRS 9 stage on a consolidated basis for the year ended 30 September 2019 is set out below.

	Stage 1	Stage 2	Stage 3	POCI	Total
	£m	£m	£m	£m	£m
Loss allowance at 1 October 2018	4.9	2.6	46.7	-	54.2
New assets originated or purchased	4.4	-	-	-	4.4
Changes in loss allowance					
Transfer to stage 1	0.5	(0.5)	-	-	-
Transfer to stage 2	(0.3)	0.4	(0.1)	-	-
Transfer to stage 3	(0.5)	(0.4)	0.9	-	-
Changes due to credit risk	(3.1)	3.0	5.2	-	5.1
Write offs	-	-	(17.0)	-	(17.0)
Assets derecognised	(0.1)	(1.7)	(2.2)	-	(4.0)
Changes in models/parameters	0.2	0.3	(1.3)	-	(0.8)
Loss allowance at 30 September 2019	6.0	3.7	32.2	-	41.9

The principal factors generating the reduction in the loss allowance in the period are the derecognition of the PM12 assets, shown above as 'assets derecognised', a major account review exercise relating to unsecured legacy assets, resulting in the cessation of collection on a large number of accounts and a write off of £5.8m, and realisations on RoR cases where provisions of £7.3m were utilised.

The movements in the Loans to Customers balances in respect of which these loss allowances have been made are set out below.

	Stage 1	Stage 2	Stage 3	POCI	Total
	£m	£m	£m	£m	£m
Balances at 1 October 2018	11,274.1	397.8	188.2	294.7	12,154.8
New assets originated or purchased	2,443.2	-	-	4.1	2,447.3
Changes in staging					
Transfer to stage 1	100.8	(97.5)	(3.3)	-	-
Transfer to stage 2	(240.0)	243.4	(3.4)	-	-
Transfer to stage 3	(27.1)	(18.6)	45.7	-	-
Redemptions and repayments	(1,586.1)	(30.0)	(29.6)	(110.1)	(1,755.8)
Goodwill adjustment (note 66)	-	-	-	(2.7)	(2.7)
Assets derecognised	(636.8)	(39.4)	(14.1)	(14.7)	(705.0)
Write offs	-	-	(17.0)	-	(17.0)
Other changes	54.5	2.8	1.4	47.7	106.4
Balance at 30 September 2019	11,382.6	458.5	167.9	219.0	12,228.0
Loss allowance	(6.0)	(3.7)	(32.2)	-	(41.9)
Carrying value	11,376.6	454.8	135.7	219.0	12,186.1

Other changes includes interest and similar charges

Impairments charged to income

The amounts charged to the profit and loss account in the period are analysed as follows

	Mortgages	Commercial Lending	Idem Capital	2019 IFRS 9	2018 IAS 39
	£m	£m	£m	£m	£m
Provided in period	1.2	7.2	0.3	8.7	9.1
Recovery of written off amounts	(0.2)	-	(0.5)	(0.7)	(1.7)
	1.0	7.2	(0.2)	8.0	7.4
Of which					
Loan accounts	1.0	2.8	(0.2)	3.6	5.6
Finance leases	-	4.4	-	4.4	1.8
	1.0	7.2	(0.2)	8.0	7.4

Economic impacts

Impairment provision under IFRS 9 is calculated on a forward-looking ECL basis, based on expected economic conditions in multiple internally coherent scenarios. The Group uses four distinct economic scenarios chosen to represent the range of possible outcomes and allow for the impact of economic asymmetry in the calculations.

As the Group does not have an internal economics function, in developing its economic scenarios it considers analysis from reputable external sources to form a general market consensus which informs its central scenario. These sources include forecasts produced by the Office of Budget Responsibility ('OBR') and the PRA as well as private sector economic research bodies.

The outlook in the central scenario at 30 September 2019 is broadly similar to that a year earlier, although both the forecast level of bank rates and consumer lending growth are reduced, reflecting a more pessimistic economic outlook. However, the house price growth forecast over the five year period is a little stronger.

The central scenario is the economic forecast used within the Group for planning purposes and represents its expectation of the most likely outcome. The upside and downside scenarios are less likely variants developed from this base case. The final scenario represents a protracted slump and is derived from the Bank of England's annual stress testing scenarios. Each scenario comprises a number of economic parameters and while models for different portfolios may not use all of the variables, the set, as a whole, is defined for the Group and must be consistent.

The Group defines its upside and downside scenarios by reference to the central scenario. It is therefore necessary for management to consider the relative weightings that should apply to each of these scenarios when ECLs are calculated. At 30 September 2019, the directors considered the movements already reflected in the scenarios and the levels of uncertainty in the UK political and economic climate more generally and concluded that, while the central scenario still provided an appropriate basis for planning purposes, the downside risks had increased over the twelve months. The directors therefore determined that the weighting attributed to the downside scenario should be increased, and that to the upside scenario reduced.

The economic variables comprising each scenario, and their projected average rates of increase (or decrease) for the first five years of the forecast period are set out below.

30 September 2019

	Central scenario	Upside scenario	Downside scenario	Severe downside scenario
Weighting applied	40%	20%	35%	5%
Economic driver				
Gross Domestic Product ('GDP') (increase)	1.7%	2.2%	1.0%	(0.1)%
House Price Index ('HPI') (increase)	3.3%	5.5%	(0.1)%	(5.3)%
Bank Base Rate ('BBR')	0.8%	1.9%	0.5%	0.0%
Consumer Price Inflation ('CPI')	2.1%	1.8%	2.5%	3.1%
Unemployment (rate)	3.9%	3.5%	5.6%	8.0%
Secured lending (annual change)	3.6%	4.2%	2.7%	1.4%
Consumer credit (annual change)	6.1%	7.6%	3.8%	0.3%

	Central scenario	Upside scenario	Downside scenario	Severe downside scenario
Weighting applied	40%	30%	25%	5%
Economic driver				
Gross Domestic Product ('GDP') (increase)	1.6%	2.0%	0.9%	(0.1)%
House Price Index ('HPI') (increase)	3.0%	5.1%	(0.3)%	(5.2)%
Bank Base Rate ('BBR')	1.2%	1.7%	0.7%	0.0%
Consumer Price Inflation ('CPI')	2.1%	1.8%	2.6%	3.3%
Unemployment (rate)	3.9%	3.6%	5.7%	8.3%
Secured lending (annual change)	3.2%	3.6%	2.5%	1.5%
Consumer credit (annual change)	8.6%	10.5%	5.3%	0.6%

Sensitivity

The calculation of impairment provision under IFRS 9 is subject to a variety of uncertainties arising from assumptions, forecasts and expectations about future events and conditions. To illustrate the impact of these uncertainties, sensitivity calculations have been performed for some of the most significant.

Economic conditions

If the weightings of the economic scenarios were altered to weight the upside scenario at 10%, the central scenario at 40%, the downside scenario at 45% and the severe downside at 5%, the effect would be to increase buy-to-let provisions, the most significant part of the impairment provision, by £0.9m, from £26.5m to £27.4m.

Significant increase in credit risk

The most important driver of SICR is relative PD. If all PDs were increased by 10%, loans with a gross value of £25.8m would transfer from stage 1 to stage 2, and the total provision would increase by £0.6m from the effects of higher expected losses and the impact of providing for expected lifetime losses, rather than 12-month losses on the additional stage 2 cases.

Value of security

The principal assumptions impacting on loss given default are the estimated security values. If the rate of growth in house prices assumed by the model were halved, ignoring any PD effects, then the provision for the Group's first and second mortgages assets under the central scenario would increase by £5.5m.

Receiver of rent

The majority of receiver of rent cases, which are included in stage 3, are managed long-term and therefore their assumed realisation date has an important impact on the provision calculation. If the assumed rate of realisations was increased by 20%, the impairment provision in the central scenario would increase by £0.7m.

Superseded disclosures

Further information relating to comparative disclosures under IAS 39 which are no longer relevant under IFRS 9 is included in note 54(c).

24. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

Introduction

The Group uses derivative financial instruments such as interest rate swaps for risk management purposes only. Each such derivative contract is entered into for economic hedging purposes to manage a particular identified risk (as described in notes 56 to 60) and any gains or losses arising are incidental to this objective. No trading in derivative financial instruments is undertaken.

Hedge accounting is applied where appropriate, though some derivatives, while forming part of an economic hedge relationship, do not qualify for this accounting treatment under the IAS 39 rules, particularly where the hedged risk relates to an off balance sheet item. In other cases, hedge accounting has not been adopted either because natural accounting offsets are expected or because complying with the IAS 39 hedge accounting rules would be particularly onerous.

The Group's hedging arrangements can be analysed between:

- Fair value hedges of portfolio interest rate risk, which are used to manage the interest rate risk inherent in fixed rate lending and deposit taking
- Cash flow hedges, which are used to manage the foreign exchange and interest rate risk inherent in its currency borrowings

An economic hedge of interest rate risk in fixed rate lending will also address pipeline exposures, where future lending at a given fixed rate is anticipated. However, such arrangements do not qualify as hedges for accounting purposes.

In addition, the Group utilises currency derivatives to hedge its exposure on the small amount of its lending denominated in foreign currencies.

The analysis below splits derivatives between those accounted for within portfolio fair value hedges, or as cash flow hedges and those which, despite representing an economic hedge, are not accounted for as hedges. There were no individual interest rate risk hedging arrangements in place either in the year ended 30 September 2019 or the preceding year.

	2019 Assets £m	2019 Liabilities £m	2018 Assets £m	2018 Liabilities £m
Derivatives in accounting hedge relationships				
<i>Fair value hedges</i>				
Interest rate swaps				
Fixed to floating	0.2	(78.3)	22.0	(1.1)
Floating to fixed	7.6	(0.2)	1.9	(3.4)
	7.8	(78.5)	23.9	(4.5)
<i>Cash flow hedges</i>				
Cross-currency basis swaps				
Dollar-sterling	274.6	-	424.6	-
Euro-sterling	308.1	-	405.1	-
	582.7	-	829.7	-
Total derivatives in hedge accounting relationships	590.5	(78.5)	853.6	(4.5)
Other derivatives				
Interest rate swaps	1.9	(2.0)	2.1	(0.2)
Currency futures	-	-	-	-
Total recognised derivative assets/(liabilities)	592.4	(80.5)	855.7	(4.7)

The credit risk inherent in the derivative financial assets shown above is discussed in note 57.

a) Fair value hedges

Background and hedging objectives

The Group's fair value hedges of portfolios of interest rate risk ('macro hedges') arise from its management of the interest rate risk inherent in its fixed rate lending and deposit taking activities. These activities would expose the Group to movement in market interest rates if not hedged.

This position arises naturally where fixed rate loans are funded with floating or variable rate borrowings, as in the Group's securitisation transactions, but may also arise where retail deposit funding is used. Where possible the Group takes advantage of natural hedging between fixed rate assets and deposits, but it is unlikely that a precise match for value and tenor of the instruments could be achieved leaving unmatched items on both sides. This is referred to as repricing risk and controlled within limits under the Group's interest rate risk management process, described in note 59. In order to manage these exposures, they are hedged with financial derivatives and form part of the Group's portfolio hedging arrangements. Repricing risk is monitored regularly to ensure mismatches or gaps remain within limits set by policy.

Responsibility to direct and oversee structural risk management has been delegated by the Board to ALCO. A hedging strategy is developed for each fixed product considering behavioural characteristics, such as whether a customer is likely to prepay before contractual maturity. This is reviewed from time to time with any changes agreed with ALCO.

In order to manage potential exposure to increases in interest rates it may be necessary to undertake pre-hedging of fixed rate assets in the pipeline. Interest rate swaps used to hedge pipeline loan exposures, which are not yet recognised on the balance sheet, can cause unmatched fair value costs or credits to arise until both sides of the hedge can be recognised within the interest rate portfolio hedging arrangement, generally a few months after the inception of the derivative contract.

In managing interest rate exposure, Treasury may use interest rate swaps, forward rate agreements, swaptions or interest rate caps and floors. However, interest rate swaps are the most generally used instruments.

This policy creates two macro hedges:

- The 'loan hedge' matching fixed rate buy-to-let mortgage assets with interest rate swaps to convert the interest receivable to a floating rate
- The 'deposit hedge' matching fixed rate deposits with interest rate swaps which operates in the opposite direction, converting the fixed rate interest payable to floating rate amounts

The Group is in the process of changing the principal sterling reference rate used in its interest rate risk management framework from LIBOR to SONIA.

Where fixed rate assets or liabilities have been hedged with interest rate swaps, these currently mostly reference three-month LIBOR. During the year, the Group entered into SONIA swaps to hedge fixed rate assets funded in PM26, a SONIA-linked securitisation transaction. As the Group transitions away from LIBOR it is expected that all new hedging will eventually reference SONIA. For existing swaps referencing LIBOR that have a maturity beyond December 2021 (the date LIBOR is expected to become unavailable), the Group is closely following developments. The International Swaps and Derivative Association ('ISDA'), the trade organisation for derivatives, are consulting in developing fall backs and revisions to documentation that counterparties can sign to transition to SONIA. The proposals are expected to be finalised by calendar year-end, with implementation in 2020.

The designation of the two macro hedges is updated, on a month by month basis, using software which compares the overall tenor, value and rate positions to match the expected fair value movement of the swaps with the expected interest rate risk related movement in the fair value of the relevant assets or liabilities over the designation period as closely as possible. The software applies regression analysis techniques to the potential impact of changes in expected interest rates over the designation period to maximise expected hedge effectiveness on a prospective basis. The value of the portfolio of loans or deposits selected is then designated, as a monetary amount of interest rate risk, as the hedged item, while the portfolio of swaps selected are designated as the hedging instruments.

Any swaps not selected in this process are disclosed as derivatives not in hedging relationships.

At the end of each designation period the Group will assess the effectiveness of each hedge retrospectively, based on fair value movements (relating to interest rate risk components only) which have actually occurred in the period. Movements are compared to pre-determined test thresholds, using regression techniques, to determine whether the hedge was effective in the period.

Ineffectiveness

The Group has identified the following possible sources of hedge ineffectiveness in its portfolio hedges of interest rate risk:

- The maturity profile of the hedging instruments may not exactly match that of the hedged items, particularly where hedged items settle early
- The use of derivatives as a hedge of interest rate risk additionally exposes the Group to the derivative counterparties' credit risk, which is not matched in the hedged item. This risk is minimised by transacting only with high quality counterparties and through collateralisation arrangements (as described in note 57).
- The use of different discounting curves in measuring fair value changes in the hedged items and hedging instruments
- Difference in the timing of interest payments on the hedged items and settlements on the hedging instruments

These sources of ineffectiveness are minimised by the portfolio matching process, which seeks to match the terms of the items as closely as possible.

In addition to the hedging ineffectiveness described above, group profit will also be affected by the fair value movements of interest rate swap agreements which were entered into as part of the Group's interest rate risk hedging strategy, but failed to find a match in the hedging portfolio.

Hedging Instruments

The hedging portfolios at 30 September 2019 and 30 September 2018 consist of a large number of sterling denominated swaps. Settlement on all swaps is generally quarterly where:

- One payment is calculated based on a fixed rate of interest and the nominal value of the swap
- An opposite payment is calculated based on the same nominal value but using a floating interest rate set at a fixed margin over a reference rate, LIBOR or SONIA

The Group pays fixed rate and receives floating when hedging exposures from fixed rate assets (in the loan hedge). Conversely, the Group pays floating rate and receives fixed rate when hedging fixed rate deposits, in the deposit hedge.

The principal terms of the hedging instruments are set out below, analysed between the two directions of the swap.

	2019		2018	
	Deposit Hedge	Loan Hedge	Deposit Hedge	Loan Hedge
Average fixed notional interest rate	0.83%	1.04%	0.75%	1.00%
Average notional margin over LIBOR	-	-	-	-
Average notional margin over SONIA	-	-	-	-
	£m	£m	£m	£m
Notional principal value				
LIBOR swaps	1,619.0	4,304.5	1,592.5	3,161.4
SONIA swaps	-	486.8	-	-
	1,619.0	4,791.3	1,592.5	3,161.4
Maturing				
Within one year	805.5	465.4	1,412.0	814.6
Between one and two years	449.5	595.2	80.5	218.8
Between two and five years	364.0	3,554.7	100.0	2,128.0
More than 5 years	-	176.0	-	-
	1,619.0	4,791.3	1,592.5	3,161.4
Fair value	7.5	(78.2)	(1.5)	20.9

The increased levels of hedging shown above arise from the growth in both the loan and deposit books. The changes in fair value are a result of moves in market implied interest rates compared to the rates on the fixed legs of the swaps.

Accounting impacts

Movements affecting the portfolio fair value hedges during the year are set out below.

	2019		2018	
	Deposit Hedge	Loan Hedge	Deposit Hedge	Loan Hedge
	£m	£m	£m	£m
Hedging instruments				
<i>Interest rate swaps</i>				
Included in derivative financial assets	7.6	0.2	1.9	22.0
Included in derivative financial liabilities	(0.1)	(78.4)	(3.4)	(1.1)
	7.5	(78.2)	(1.5)	20.9
Notional principal value	1,619.0	4,791.3	1,592.5	3,161.4
Change in fair value used in calculating hedge ineffectiveness	7.9	(98.5)	(0.4)	15.1
Hedged items				
<i>Fixed rate deposits</i>				
Monetary amount of risk relating to Retail Deposits	1,473.7	-	1,446.7	-
<i>Fixed rate loans</i>				
Monetary amount of risk relating to Loans to Customers	-	4,834.8	-	3,141.3
Accumulated amount of fair value hedge adjustments included on balance sheet (notes 20 and 31)*	(3.9)	64.2	4.2	(24.1)
Of which: amounts related to discontinued hedging relationships being amortised	-	(8.8)	-	(5.0)
Change in fair value used in recognising hedge ineffectiveness	(8.1)	92.2	0.6	(14.0)

Hedge ineffectiveness recognised

Included in fair value (losses) / gains in the profit and loss account	(0.2)	(6.3)	0.2	1.1
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* Under the IAS 39 rules relating to fair value hedge accounting for portfolios of interest rate risk, the change in the fair value of the hedged items attributable to the hedged risk is shown as 'fair value adjustments from portfolio hedging' next to the carrying value of the hedged assets or liabilities in the appropriate note.

b) Cash flow hedging

Background and hedging objectives

The Group has entered into cross-currency basis swap agreements which form part of its securitisation arrangements, providing an economic hedge against financial risks inherent in the deal structures, as described below. Such relationships have been designated as cash flow hedges for accounting purposes.

In any securitisation where asset backed floating rate notes ('FRNs') are issued in currency (US dollars or euros), a currency and interest rate mismatch between assets and liabilities would exist, exposing the securitisation and the Group to both foreign exchange and interest basis risk.

This would preclude such a deal from attaining a AAA rating for its senior debt. To address that issue, in each deal a bespoke cross-currency basis swap was written, with the swap being an asset or liability of the relevant SPV company.

The effect of these swaps is to translate the required currency payments, both principal and interest to sterling payments, based on a fixed rate of exchange. They also translate the reference rate of interest on the notes from a dollar LIBOR or EURIBOR basis to a sterling LIBOR basis. This effectively eliminates the foreign exchange and interest rate basis risks with respect to these instruments.

In order to achieve a AAA rating for the deal, the swaps must themselves be capable of this level of rating. Therefore, the deal conditions specify that only high quality counterparties may be used, and that where there is deterioration in credit quality of the counterparty, collateral must be posted. The collateral requirement is supervised by the independent third-party rating agencies.

Hedging instruments

Under these swap agreements

- The Group will make quarterly payments of principal and floating rate interest in sterling and receive equivalent amounts of principal and floating rate interest, in currency (either US Dollars or Euros), translated at an exchange rate fixed on inception
- Settlement of both the cross-currency basis swaps and the notes to which they relate takes place on the same date. The Group makes a single payment in sterling to the swap provider who will make the corresponding swap payment in currency to the external principal paying agent. The principal paying agent will use these funds immediately to make the payments required on the currency notes
- The nominal amount of the swaps is adjusted automatically, quarter by quarter, such that it always amortises in line with the quarterly payments of principal made on the currency notes (a 'balance guarantee' feature)
- Floating rate interest on the sterling (pay) leg of the swaps is set with reference to three-month sterling LIBOR, with floating rate interest on the currency (receive) legs set by reference to equivalent currency rates
- The payment and repricing dates are the same (to the day) for the swaps as for their underlying notes
- The swaps must remain in place for as long as the notes are outstanding

The principal terms of the hedging instruments (the cross-currency basis swaps) are summarised below.

	2019		2018	
	Swap currency		Swap currency	
	USD	EUR	USD	EUR
Average fixed exchange rate	2.0	1.5	1.9	1.5
Average margin over LIBOR on interest payable	0.24%	0.49%	0.25%	0.52%
Average margin over US dollar LIBOR / EURIBOR on interest receivable	0.19%	0.52%	0.21%	0.53%
Notional Principal value (£m)	447.5	1,007.4	897.3	1,320.6
Fair value (£m)	274.6	308.1	424.6	405.1
Average remaining term (years)	21	22	20	21

Although the average remaining contractual term is as shown above, the link between the notional principal of the swaps and the balance outstanding on the notes means that the life may, in practice, be much shorter.

The absolute value of these swaps is relatively large as the majority of the instruments date from before the 2008 credit crisis, when a major dislocation in rates occurred, creating significant market value in the instruments. However, economically, this is offset by the corresponding increase in the carrying value of the currency denominated notes. Legacy assets, those with inception dates in 2008 or earlier, account for £582.1 million of the cross-currency basis swap balance at 30 September 2019 (2018: £819.5m), with post-2010 assets representing only £0.6 million (2018: £10.2m).

The decrease in notional principal related to the PM12 disposal, where the hedging arrangement ceased on the derecognition of both the hedged FRNs and the hedging instruments (note 7), and note repayments in the period.

Sources of potential ineffectiveness

All cross-currency basis swap agreements have been designated as cash flow hedges in line with their economic effect and the critical terms, such as interest and exchange rates, pricing dates and principal balances of the designated hedging instruments exactly match those of the hedged currency denominated FRNs. This results in a critical terms match for IAS 39 purposes and hence no ineffectiveness could arise from sources other than credit risk.

In respect of credit risk the hedging instruments are partially collateralised, with additional collateral conditionally available, as described in note 57. This generates a small potential credit valuation adjustment associated with the derivative asset representing the credit risk of the receivable future cash flows that make up the derivative fair value. However, IAS 39 requires that Other Comprehensive Income ('OCI') is adjusted by the lower of the cumulative gain or loss on the derivative or the hedged item (as proxied by a hypothetical derivative). As the derivative bears credit risk of the counterparty (for the uncollateralised portion) it has a lower fair value than the hypothetical derivative. The result is that the full fair value of the derivative is taken to OCI as it is the lower of the two amounts and no ineffectiveness arises.

Accounting impacts

Movements affecting the cash flow hedge relationships in the year are set out below.

	2019		2018	
	Swap currency		Swap currency	
	USD	EUR	USD	EUR
Hedging Instruments				
<i>Cross-currency basis swaps</i>				
Included in derivative financial assets	274.6	308.1	424.6	405.1
Included in derivative financial liabilities	-	-	-	-
	274.6	308.1	424.6	405.1
Notional principal value	447.5	1,007.4	897.3	1,320.6
Change in fair value used in calculating hedge ineffectiveness	71.3	(21.2)	(55.7)	8.3
Hedged Items				
<i>Floating rate notes</i>				
Included in Asset Backed Loan Notes	447.5	1,007.4	897.3	1,320.6
Changes in fair value used in calculating hedge ineffectiveness	71.3	(21.2)	55.7	8.3
Cash flow hedging reserve (before tax)	0.8	2.8	0.9	3.1

The table below summarises the amounts which have affected total comprehensive income as a result of the cash flow hedges described above.

	2019	2018
	£m	£m
Change of value in hedging instrument recognised in cash flow hedge reserve		
US Dollars swaps	71.3	55.7
Euro swaps	(21.2)	8.3
	50.1	64.0
Amount reclassified from cash flow hedge reserve to profit, recognised as foreign exchange differences and interest on asset backed loan notes both included within interest payable		
US Dollars swaps	71.1	55.5
Euro swaps	(21.5)	7.5
	49.6	63.0
Net amount recognised in Other Comprehensive Income before tax	0.5	1.0

All amounts reclassified to profit have been transferred because the hedged item has affected profit or loss, or in the case of the PM12 FRNs, has been derecognised (note 7).

c) Derivatives not in a hedge accounting relationship

The Group's other derivatives comprise:

- Interest rate swaps which are economically part of the Group's portfolio hedging arrangements but failed to find a match in the hedge designation, including swaps hedging interest rate risk on the new lending pipeline
- Currency futures, economically hedging exposures on lending denominated in currency, where hedge accounting has not been adopted due to the size of the exposure

The principal terms of these derivatives are set out below.

Interest rate swaps

	2019		2018	
	Pay fixed	Pay floating	Pay fixed	Pay floating
Average fixed notional interest rate	0.75%	0.77%	0.92%	0.80%
Average notional margin over LIBOR	-	-	-	-
Average notional margin over SONIA	-	-	-	-
	£m	£m	£m	£m
Notional principal value				
LIBOR swaps	315.4	554.0	441.7	362.0
SONIA swaps	-	8.0	-	8.0
	315.4	562.0	441.7	370.0
Maturing				
Within one year	68.4	424.0	215.0	359.0
Between one and two years	43.5	95.0	32.2	11.0
Between two and five years	92.5	43.0	189.0	-
More than 5 years	111.0	-	5.5	-
	315.4	562.0	441.7	370.0
Fair value	1.9	(2.0)	1.4	0.5

Currency futures

	2019	2018
<i>US Dollar futures</i>		
Average future exchange rate	1.22	1.32
	£m	£m
Notional principal value	5.7	5.8
Maturing		
Within one year	5.7	5.8
Between one and two years	-	-
Between two and five years	-	-
	5.7	5.8
Fair value	-	-

25. SUNDRY ASSETS

(a) The Group

	Note	2019 £m	2018 £m	2017 £m
Current assets				
Accrued interest income		0.4	0.6	0.2
Trade receivables		3.6	2.2	4.2
CSA Assets		72.2	3.8	2.0
CRDs		11.4	6.2	1.6
Other receivables		2.7	2.5	1.7
Sundry financial assets	67	90.3	15.3	9.7
Prepayments		2.1	2.6	2.8
Other tax		0.4	1.1	0.2
		92.8	19.0	12.7

Cash ratio deposits ('CRDs') are non-interest-bearing deposits lodged with the Bank of England, based on the value of the Bank's eligible liabilities. These are required to comply with regulatory rules.

Credit Support Annex ('CSA') assets are deposits placed with highly rated banks to act as security for the Group's derivative financial liabilities.

Neither of these balances is accessible by the Group at the balance sheet date. Therefore, they are included in sundry assets rather than cash balances.

CRD, CSA and accrued interest are considered to be stage 1 assets for IFRS 9 impairment purposes. The probabilities of default of the obligor institutions (the Bank of England and major banks) has been assessed and is considered to be so low as to require no significant impairment provision.

(b) The Company

	2019 £m	2018 £m	2017 £m
Current assets			
Amounts owed by Group companies	106.6	216.3	40.1
Accrued interest income	0.7	0.7	-
	107.3	217.0	40.1

The amounts owed to the Company by other Group entities are considered to be stage 1 balances for IFRS 9 impairment purposes. The probability of default of the subsidiaries has been assessed in the context of the Group's overall funding and asset position, and is considered to be so low as to require no significant impairment provision.

26. DEFERRED TAX

(a) The Group

The movements in the net deferred tax asset / (liability) are as follows:

	Note	2019 £m	2018 £m	2017 £m
Net liability at 1 October 2018				
As previously reported		(5.6)	(4.8)	(2.0)
Change of accounting policy	62	5.0	-	-
Restated		(0.6)	(4.8)	(2.0)
Derecognition	7	1.8	-	-
Acquisitions	66	0.5	(0.3)	-
Income statement credit	15	2.3	1.2	2.8
Credit to equity		2.2	(1.7)	(5.6)
Net asset / (liability) at 30 September 2019		6.2	(5.6)	(4.8)

The net deferred tax asset for which provision has been made is analysed as follows:

	2019 £m	2018 £m	2017 £m
Accelerated tax depreciation	2.3	4.1	4.0
Retirement benefit obligations	5.9	3.7	5.7
Impairment and other provisions	(5.3)	(14.0)	(14.9)
Tax (losses)	0.4	0.2	0.2
Other timing differences	2.9	0.4	0.2
Net deferred tax asset / (liability)	6.2	(5.6)	(4.8)

As stated in note 15 legislation has been introduced to reduce the standard rate of UK corporation tax to 17.0% from 1 April 2020. The temporary differences have been provided at the rate prevailing when the Group anticipates the temporary difference to reverse. In the event that the temporary differences actually reverse in different periods, a credit or charge will arise in a future period to reflect the difference. The timing of reversal of temporary differences will be affected by both matters within the Group's control (e.g. the timing and nature of the refinancing of certain portfolios) and matters outside the Group's control (e.g. the level of redemptions of finance leases).

If temporary differences reverse within Paragon Bank PLC in a period in which it is subject to the banking surcharge, then the impact of the reversal will be at an effective tax rate that includes the banking surcharge to some extent.

In addition, the Group has tax losses of £2.3m (2018: £1.7m) in entities whose current taxable profits are insufficient to support the recognition of a deferred tax asset.

(b) The Company

The movements in the net deferred tax liability are as follows:

	2019 £m	2018 £m	2017 £m
Net liability at 1 October 2018	1.8	1.8	1.9
Income statement (credit)	(0.2)	-	(0.1)
Net liability at 30 September 2019	1.6	1.8	1.8

The net deferred tax liability for which provision has been made is analysed as follows:

	2019 £m	2018 £m	2017 £m
Other timing differences	1.6	1.8	1.8
Net deferred tax liability	1.6	1.8	1.8

27. PROPERTY, PLANT AND EQUIPMENT

(a) The Group

	Leased assets £m	Land and buildings £m	Plant and machinery £m	Total £m
Cost				
At 1 October 2017	30.0	22.8	10.9	63.7
Acquisitions	-	-	-	-
Additions	19.3	-	0.8	20.1
Disposals	(2.9)	-	(1.0)	(3.9)
At 30 September 2018	46.4	22.8	10.7	79.9
Acquisitions	-	-	-	-
Additions	11.6	-	1.1	12.7
Disposals	(5.3)	-	(1.2)	(6.5)
At 30 September 2019	52.7	22.8	10.6	86.1
Accumulated depreciation				
At 1 October 2017	6.6	3.0	7.9	17.5
Charge for the year	5.9	0.6	1.3	7.8
On disposals	(1.5)	-	(0.7)	(2.2)
At 30 September 2018	11.0	3.6	8.5	23.1
Charge for the year	7.6	0.5	1.0	9.1
On disposals	(2.2)	-	(1.2)	(3.4)
At 30 September 2019	16.4	4.1	8.3	28.8
Net book value				
At 30 September 2019	36.3	18.7	2.3	57.3
At 30 September 2018	35.4	19.2	2.2	56.8
At 30 September 2017	23.4	19.8	3.0	46.2

Plant and machinery shown above is used within the Group's business. Leased assets includes £25.6m in respect of assets leased under operating leases (2018: £25.7m) and £10.7m of assets available for hire (2018: £9.7m).

During the year ended 30 September 2018, the Group entered into a transaction with the Paragon Pension Plan, effectively granting a first charge over its freehold head office building as security for its agreed contributions under the recovery plan. The carrying value of the assets subject to this charge was £18.0m (2018: £18.3m).

	Land and buildings £m
Cost	
At 1 October 2017	19.9
Disposals	(19.9)
At 30 September 2018	-
Disposals	-
At 30 September 2019	-
Accumulated depreciation	
At 1 October 2017	1.3
Charge for the year	0.2
On disposals	(1.5)
At 30 September 2018	-
Charge for the year	-
On disposals	-
At 30 September 2019	-
Net book value	
At 30 September 2019	-
At 30 September 2018	-
At 30 September 2017	18.6

During the year ended 30 September 2018, the Group's head office building was transferred to a subsidiary entity as part of the arrangements to establish the effective charge described above.

28. INTANGIBLE ASSETS

	Goodwill (note 29) £m	Computer software £m	Other intangible assets £m	Total £m
Cost				
At 1 October 2017	104.1	7.9	9.2	121.2
Acquisitions (note 66)	64.1	-	1.4	65.5
Additions	-	1.5	-	1.5
At 30 September 2018	168.2	9.4	10.6	188.2
Acquisitions (note 66)	2.2	-	-	2.2
Additions	-	2.0	-	2.0
At 30 September 2019	170.4	11.4	10.6	192.4
Accumulated amortisation and impairment				
At 1 October 2017	6.0	5.9	4.9	16.8
Amortisation charge for the year	-	1.4	0.7	2.1
At 30 September 2018	6.0	7.3	5.6	18.9
Amortisation charge for the year	-	1.7	0.7	2.4
At 30 September 2019	6.0	9.0	6.3	21.3
Net book value				
At 30 September 2019	164.4	2.4	4.3	171.1
At 30 September 2018	162.2	2.1	5.0	169.3
At 30 September 2017	98.1	2.0	4.3	104.4

Other intangible assets comprise brands and the benefit of business networks recognised on the acquisition of businesses.

29. GOODWILL

The goodwill carried in the accounts is attributable to three cash generating units, which have not changed in the year. The balance is as analysed below:

	2019 £m	2018 £m
Asset finance	113.0	113.0
Development finance	49.8	47.6
TBMC	1.6	1.6
	164.4	162.2

(a) Asset finance

The goodwill carried in the accounts relating to the asset finance cash generating unit was recognised on the acquisitions of PAF and Premier in the year ended 30 September 2016 and Iceberg in the year ended 30 September 2018.

An impairment review undertaken at 30 September 2019 indicated that no write down was required.

The recoverable amount of the asset finance cash generating unit used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board covering a five-year period.

The key assumptions underlying the value in use calculation for the asset finance cash generating unit are:

- Level of business activity, based on management expectations. The forecast assumes a compound annual growth rate ('CAGR') for new business over the five-year period of 12.0%, compared with 12.5% in the year ended 30 September 2019. Cash flows beyond the five-year budget are extrapolated using a constant growth rate of 1.9% (2018: 2.2%) which does not exceed the long term average growth rates for the markets in which the business is active

Management have concluded that the levels of activity assumed for the purpose of this forecast are reasonable, based on past experience and the current economic environment

- Discount rate, which is based on third party estimates of the implied industry cost of capital. The pre-tax discount rate applied to the cash flow projection is 13.2% (2018: 13.4%)

As an illustration of the sensitivity of this impairment test to movements in the key assumptions, the Group has calculated that a 24.0% reduction in profit levels coupled with a 370 basis point increase in the pre-tax discount rate would eliminate the headroom in the projection.

In the testing carried out at 30 September 2018, a 12.6% reduction in profit levels coupled with a 185 basis point increase in the pre-tax discount rate would have that effect.

(b) Development finance

The goodwill carried in the accounts relating to the development finance cash generating unit was recognised on the acquisition of Titlestone for the year ended 30 September 2018 and amended in the current year as described in note 66.

An impairment review undertaken at 30 September 2019 indicated that no write down was required.

The recoverable amount of the development finance cash generating unit used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board covering a five-year period.

The key assumptions underlying the value in use calculation for the development finance cash generating unit are:

- Level of business activity, based on management expectations. The forecast assumes a CAGR for new commitments over the five-year period of 18.3%, compared with 47.8% in the year ended 30 September 2019. Cash flows beyond the five-year budget are extrapolated using a constant growth rate of 1.9% (2018: 2.2%) which does not exceed the long-term average growth rate for the UK economy

Management have concluded that the levels of activity assumed for the purpose of this forecast are reasonable, based on past experience and the current economic environment

- Discount rate, which is based on third party estimates of the implied industry cost of capital. The pre-tax discount rate applied to the cash flow projection is 13.2% (2018: 13.4%)

Management believes any reasonably possible change in the key assumptions above would not cause the recoverable amount of the development finance cash generating unit to fall below the balance sheet carrying value. This was also the case in the testing carried out at 30 September 2018.

(c) TBMC

The goodwill carried in the accounts relating to the TBMC cash generating unit was recognised on the acquisition of The Business Mortgage Company Limited and its subsidiaries ('TBMC') in December 2008 and impaired by £6.0m in 2009.

An impairment review was undertaken at 30 September 2019 which indicated no further impairment. The recoverable amount of TBMC used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board covering a five year period. The pre-tax discount rate applied to the cash flow projection is 4.74% (2018: 5.66%) and cash flows beyond the five year budget are extrapolated using a 1.6% (2018: 2.0%) growth rate, being the average long term growth rate in the UK economy over a twenty year period.

The key assumptions underlying the value in use calculation for the TBMC business are:

- Level of business activity, based on management expectations. Management have concluded that the levels of activity assumed for the purpose of this forecast are reasonable, based on past experience and the current economic environment
- Discount rate, which is based on market rates of interest plus a margin appropriate to the risk profile of the TBMC business as an investment

The directors believe that no reasonably possible change in any of the key assumptions above would cause the carrying value of the unit to exceed its recoverable amount.

30. INVESTMENT IN SUBSIDIARY UNDERTAKINGS

	Shares in group companies	Loans to group companies	Loans to ESOP Trusts	Total
	£m	£m	£m	£m
At 1 October 2017	759.4	46.3	13.4	819.1
Investments in subsidiaries	12.5	-	-	12.5
Loans advanced	-	200.0	6.5	206.5
Loans repaid	-	(46.3)	-	(46.3)
Provision movements	(1.2)	-	(6.2)	(7.4)
At 30 September 2018	770.7	200.0	13.7	984.4
Investments in subsidiaries	-	-	-	-
Capital distributions	(130.0)	-	-	(130.0)
Loans advanced	-	100.0	5.1	105.1
Loans repaid	-	-	-	-
Provision movements	(0.2)	-	(18.6)	(18.8)
At 30 September 2019	640.5	300.0	0.2	940.7

Investments in subsidiaries represent transactions between the Company and various of its subsidiaries.

During the year ended 30 September 2019, the Group carried out capital reductions in various non-trading subsidiaries. Dividends were paid, or capital was distributed to the parent and the investments above were written off as a result of the reduction in these entities' net assets.

During the year ended 30 September 2019 the Company received £44.3m in dividend income from its subsidiaries (2018: £62.0m) and £15.1m of interest on loans to Group companies (2018: £12.6m).

The Company's subsidiaries, and the nature of its interest in them, are shown in note 68.

31. RETAIL DEPOSITS

The Group's retail deposits, held by Paragon Bank PLC, were received from customers in the UK and are denominated in sterling. The deposits comprise principally term deposits and 120 day notice accounts. The method of interest calculation on these deposits is analysed as follows:

	2019	2018	2017
	£m	£m	£m
Fixed rate	4,154.4	3,643.1	2,675.9
Variable rates	2,237.5	1,653.5	939.5
	6,391.9	5,296.6	3,615.4

The weighted average interest rate on retail deposits at 30 September 2019, analysed by charging method, was:

	2019	2018	2017
	%	%	%
Fixed rate	2.02	1.94	1.89
Variable rates	1.43	1.36	1.21
All deposits	1.81	1.76	1.71

The contractual maturity of these deposits is analysed below.

	2019 £m	2018 £m	2017 £m
Amounts repayable			
In less than three months	466.6	256.8	211.4
In more than three months, but not more than one year	2,088.4	2,024.7	1,399.6
In more than one year, but not more than two years	1,158.0	1,010.6	770.0
In more than two years, but not more than five years	900.9	655.3	629.7
Total term deposits	4,613.9	3,947.4	3,010.7
Repayable on demand	1,778.0	1,349.2	604.7
	6,391.9	5,296.6	3,615.4
Fair value adjustments for portfolio hedging (note 24)	3.9	(4.2)	(3.5)
	6,395.8	5,292.4	3,611.9

32. ASSET BACKED LOAN NOTES

The Group's asset backed loan notes ('Notes') are secured on portfolios comprising variable and fixed rate mortgages or personal, retail and car loans. The maturity date of the Notes matches the maturity date of the underlying assets. The Notes can be prepaid in part from time to time, but such prepayments are limited to the net capital received from borrowers in respect of the underlying assets. There is no requirement for the Group to make good any shortfall on the Notes out of general funds. It is likely that a substantial proportion of the Notes will be repaid within five years.

For its public issues, the Group has an additional option to repay all of the Notes at an earlier date (the 'call date'), at their outstanding principal amount.

Interest is payable at a fixed margin above;

- The London Interbank Offered Rate ('LIBOR') on notes denominated in sterling, other than notes issued by Paragon Mortgages (No. 26) PLC
- The Sterling Overnight Interbank Average Rate ('SONIA') on notes denominated in sterling issued by Paragon Mortgages (No. 26) PLC
- The Euro Interbank Offered Rate ('EURIBOR') on notes denominated in euros
- The London Interbank Offered Rate ('US Dollar LIBOR') on notes denominated in US dollars

All payments in respect of the Notes are required to be made in the currency in which they are denominated.

All of the Notes are rated and publicly listed.

The notes outstanding at 30 September 2019 can be analysed as follows:

	2019 £m	2018 £m
Secured on first mortgage assets	4,419.4	5,521.6
Secured on other assets	-	33.1
	4,419.4	5,554.7

The Group publishes detailed information on the performance of all of its listed note issues on the Bond Investor Reporting section of its website at www.paragonbankinggroup.co.uk. A more detailed description of the securitisation structure under which these Notes are issued is given in note 58.

On 3 July 2019, a Group company, Paragon Mortgages (No. 26) PLC, issued £364.3m of sterling mortgage backed floating rate notes to external investors at par. All of the notes were class A notes, rated AAA by Fitch and Aaa by Moody's. The interest rate above SONIA on the notes was 1.05%. The proceeds were used to refinance existing short-term liabilities. The Group retained £273.9m of notes of various classes meaning that its investment represented 43.0% of the issued notes.

Notes in issue at 30 September 2019 and 30 September 2018, net of any held by the Group, were:

Issuer	Maturity date	Call date	Principal outstanding		Average interest margin	
			2019	2018	2019	2018
Sterling notes			£m	£m	%	%
Interest based on LIBOR						
Paragon Mortgages (No. 9) PLC	15/05/41	15/05/09	95.2	102.4	0.38	0.38
Paragon Mortgages (No. 10) PLC	15/06/41	15/12/09	155.7	169.5	0.52	0.50
Paragon Mortgages (No. 11) PLC	15/10/41	15/04/10	237.7	258.9	0.15	0.15
Paragon Mortgages (No. 12) PLC	15/11/38	15/08/10	-	100.4	-	0.41
Paragon Mortgages (No. 13) PLC	15/01/39	15/10/10	443.7	475.8	0.27	0.27
Paragon Mortgages (No. 14) PLC	15/09/39	15/03/11	423.8	466.1	0.23	0.23
Paragon Mortgages (No. 15) PLC	15/12/39	15/06/11	117.7	128.3	0.30	0.30
Paragon Mortgages (No. 21) PLC	15/06/42	15/12/18	-	55.2	-	1.13
Paragon Mortgages (No. 22) PLC	15/09/42	15/06/19	-	48.3	-	1.15
Paragon Mortgages (No. 23) PLC	15/01/43	15/10/19	34.5	55.9	1.84	1.56
Paragon Mortgages (No. 24) PLC	15/07/43	15/04/20	45.7	71.5	2.85	2.36
Paragon Mortgages (No. 25) PLC	15/05/50	15/05/23	423.6	435.3	0.72	0.71
First Flexible No. 5 PLC	01/06/34	01/07/09	-	50.3	-	0.99
First Flexible No. 6 PLC	01/12/35	01/03/08	47.7	52.5	1.27	1.27
First Flexible (No. 7) PLC	15/09/33	15/03/11	-	12.4	-	0.30
Paragon Secured Finance (No. 1) PLC	15/11/35	15/11/08	-	33.1	-	0.98
Interest based on SONIA						
Paragon Mortgages (No. 26) PLC	15/05/45	15/08/24	364.3	-	1.05	-
US dollar notes			\$m	\$m	%	%
Paragon Mortgages (No. 9) PLC	15/05/41	15/05/09	15.5	16.7	0.36	0.36
Paragon Mortgages (No. 12) PLC	15/11/38	15/08/10	-	743.8	-	0.24
Paragon Mortgages (No. 13) PLC	15/01/39	15/10/10	143.4	154.3	0.18	0.18
Paragon Mortgages (No. 14) PLC	15/09/39	15/03/11	166.1	185.3	0.20	0.20
Paragon Mortgages (No. 15) PLC	15/12/39	15/06/11	552.9	611.2	0.19	0.19
First Flexible No. 6 PLC	01/12/35	01/03/08	7.5	8.2	0.56	0.56
Euro notes			€m	€m	%	%
Paragon Mortgages (No. 9) PLC	15/05/41	15/05/09	147.7	158.9	0.56	0.56
Paragon Mortgages (No. 10) PLC	15/06/41	15/12/09	247.0	254.1	0.39	0.39
Paragon Mortgages (No. 11) PLC	15/10/41	15/04/10	196.1	213.6	0.54	0.54
Paragon Mortgages (No. 12) PLC	15/11/38	15/08/10	-	326.0	-	0.54
Paragon Mortgages (No. 13) PLC	15/01/39	15/10/10	285.9	303.8	0.42	0.42
Paragon Mortgages (No. 14) PLC	15/09/39	15/03/11	326.4	338.2	0.48	0.47
Paragon Mortgages (No. 15) PLC	15/12/39	15/06/11	248.9	254.5	0.72	0.71
Paragon Mortgages (No. 22) PLC	15/09/42	15/06/19	-	26.3	-	0.50
Paragon Mortgages (No. 23) PLC	15/01/43	15/10/19	2.2	14.1	0.70	0.70
Paragon Mortgages (No. 24) PLC	15/07/43	15/04/20	0.6	16.1	1.10	1.10
First Flexible No. 6 PLC	01/12/35	01/03/08	26.8	29.6	1.05	1.05

The details of the assets backing these securities are given in note 21.

During the year, the Group redeemed all of the outstanding notes of the following securitisations at par:

- Paragon Secured Finance (No. 1) PLC on 15 November 2018
- First Flexible (No. 5) PLC on 3 December 2018
- Paragon Mortgages (No. 21) PLC on 17 December 2018
- Paragon Mortgages (No. 22) PLC on 17 June 2019
- First Flexible (No. 7) PLC on 17 June 2019

The underlying assets were subsequently funded by other Group companies.

On 25 September 2019, notice was given of the Group's intention to redeem all of the outstanding notes of Paragon Mortgages (No. 23) PLC at par, and this took place on 15 October 2019, after the year end.

On 26 June 2019, the Group disposed of its beneficial interest in the Paragon Mortgages (No. 12) PLC securitisation as described in note 7. At that point, the FRN liabilities were derecognised by the Group, although the notes remain in issue.

33. BANK BORROWINGS

New first mortgage loans may be financed by a secured bank loan, referred to as a 'warehouse facility'. These facilities are drawn on the completion of a mortgage and repayment of the facilities is restricted to the principal cash received in respect of the funded mortgage. Loans originated in warehouse facilities are refinanced in the mortgage backed securitisation market when conditions are appropriate or through internal sales to access retail funding. More information on this process is given in note 58 and details of assets held within the warehouse facilities are given in note 21. Details of the Group's bank borrowings are set out below.

	2019			2018		
	Principal value	Maximum available facility	Carrying value	Principal value	Maximum available facility	Carrying value
	£m	£m	£m	£m	£m	£m
i) Paragon Second Funding	787.5	787.5	787.5	935.6	935.6	935.6
ii) Paragon Seventh Funding	-	200.0	-	-	-	-
	787.5	987.5	787.5	935.6	935.6	935.6

- i) The Paragon Second Funding warehouse was available for further drawings until 29 February 2008 at which point it converted automatically to a term loan and no further drawings were allowed. This loan is a sterling facility provided to Paragon Second Funding Limited by a consortium of banks and is secured on all the assets of Paragon Second Funding Limited, Paragon Car Finance (1) Limited and Paragon Personal Finance (1) Limited. Its final repayment date is 28 February 2050, but it is likely that substantial repayments will be made within the next five years. Interest on this loan is payable monthly in sterling at 0.675% above LIBOR (2018: 0.675% above LIBOR).
- ii) On 26 September 2015, a Group company, Paragon Seventh Funding Limited, entered into an additional £200.0m committed sterling facility with Bank of America Merrill Lynch International Limited. This facility was secured on all the assets of Paragon Seventh Funding Limited and was available for drawings and redrawings until 8 October 2017. This facility bore interest at a rate of three month LIBOR plus 1.30%. The facility was not renewed at the end of the commitment period and was repaid during the year ended 30 September 2018.

On 14 November 2018, a new £200.0m warehouse funding facility was agreed between Paragon Seventh Funding Limited and Bank of America Merrill Lynch. The facility is secured over all of the assets of Paragon Seventh Funding Limited, with a 12 month commitment period. Interest is payable at 0.95% over three month LIBOR.

The weighted average margin above LIBOR on bank borrowings at 30 September 2019 was 0.675% (2018: 0.675%).

34. RETAIL BONDS

On 11 February 2013 the Company inaugurated a £1,000.0m Euro Medium Term Note Programme under which it may issue retail bonds, or other notes, within a twelve-month period. The prospectus has been updated from time to time, most recently renewing the programme for a further twelve-month period on 15 July 2016, but may be further extended in the future.

The terms of issue for each tranche of notes are separately determined. These bonds are listed on the London Stock Exchange and have a fixed term, but are callable at the option of the Company. A summary of the retail bonds outstanding under this programme, shown with their principal values, is set out below.

Maturity date	Interest terms	Issue price	Currency	2019 £m	2018 £m
5 December 2020	6.000% p.a. fixed	par	GBP	60.0	60.0
30 January 2022	6.125% p.a. fixed	par	GBP	125.0	125.0
28 August 2024	6.000% p.a. fixed	par	GBP	112.5	112.5
				297.5	297.5

The notes are unsubordinated unsecured liabilities of the Company and the amount included in the accounts of the Group and the Company in respect of these bonds is £296.5m (2018: £296.1m).

35. CORPORATE BONDS

On 9 September 2016 the Company issued £150.0m of 7.25% Fixed Rate Reset Callable Subordinated Tier 2 Notes due 2026 at par to provide long term capital for the Group. These bonds bear interest at a fixed rate of 7.25% per annum until 9 September 2021, after which interest will be payable at a fixed rate which is 6.731% over the sterling 5-year mid-market swap rate at that time. These bonds are unsecured and subordinated to any other creditors of the Company. At issue the Notes were rated BB+ by Fitch and this rating was upgraded to BBB- in the year ended 30 September 2018.

The carrying value of these bonds in the accounts of the Group and the Company at 30 September 2019 was £149.6m (2018: £149.3m).

36. CENTRAL BANK FACILITIES

During the year, the Group has utilised facilities provided by the Bank of England including through its Sterling Monetary Framework. These facilities enable either funding or off-balance sheet liquidity to be provided to Paragon Bank on the security of designated pools of the Bank's first mortgage assets, with the amount available based on the value of the security given, subject to a haircut.

Drawings under the FLS are used to provide off balance sheet liquidity and form part of the Bank's HQLA. Fees are charged under the FLS at 0.25% of the market value of the liquidity drawn and are repayable in June 2020.

Drawings under the Indexed Long-Term Repo Scheme ('ILTR') have a maturity of six months and a rate of interest set in an auction process. At 30 September 2019 the average rate of interest on the Group's ILTR drawings was 0.90% (2018: 0.90%).

Drawings under the Term Funding Scheme ('TFS') have a maturity of four years and bear interest at bank base rate. The average remaining maturity of the Group's drawings is 22 months (2018: 34 months). As these drawings are provided at rates below those available commercially, by a government agency, they are accounted for under IAS 20. The TFS is no longer available for new drawings.

The amounts drawn under these facilities are set out below.

	2019 £m	2018 £m
TFS	944.4	944.4
ILTR	50.0	80.0
On balance sheet funding	994.4	1,024.4
FLS	109.0	108.7
Total central bank facilities	1,103.4	1,133.1

Further first mortgage assets of the Bank have been pre-positioned with the Bank of England for future use in such schemes. The assets pledged in support of these drawings are set out in note 21.

The balances arising from the TFS carried in the Group accounts are shown below.

	2019 £m	2018 £m
TFS at IAS 20 carrying value	930.5	923.5
Deferred government assistance	13.9	20.9
	944.4	944.4

37. SUNDRY LIABILITIES

(a) The Group

	2019 £m	2018 £m	2017 £m
Current liabilities			
Accrued interest	37.4	27.5	23.6
Trade creditors	0.9	2.7	3.5
CSA liabilities (note 57)	-	10.3	-
Other accruals	29.7	29.7	21.0
Sundry financial liabilities at amortised cost	68.0	70.2	48.1
Contingent consideration (note 38)	2.2	-	-
Sundry financial liabilities	70.2	70.2	48.1
Deferred income	1.3	0.9	1.1
Conduct (note 39)	-	-	0.5
Other taxation and social security	2.4	2.5	1.4
	73.9	73.6	51.1
Non-current liabilities			
Accrued interest	14.9	12.4	7.2
Other accruals	0.2	0.2	0.2
Sundry financial liabilities at amortised cost	15.1	12.6	7.4
Contingent consideration (note 38)	21.5	25.7	14.0
Sundry financial liabilities	36.6	38.3	21.4
Deferred income	2.2	2.5	2.1
	38.8	40.8	23.5
Total sundry financial liabilities at amortised cost	83.1	82.8	55.5
Total sundry financial liabilities at fair value	23.7	25.7	14.0
Total other sundry liabilities	5.9	5.9	5.1
Total sundry liabilities	112.7	114.4	74.6

(b) The Company

	2019 £m	2018 £m	2017 £m
Current liabilities			
Amounts owed to Group companies	23.8	125.7	36.5
Accrued interest	3.6	2.8	2.9
	27.4	128.5	39.4

All of the above balances represent financial liabilities carried at amortised cost.

38. CONTINGENT CONSIDERATION

The contingent consideration represents consideration payable in respect of corporate acquisitions which is dependent on the performance of the acquired businesses. Movements in the balance are set out below.

	2019 £m	2018 £m
At 1 October 2018	25.7	14.0
Acquisitions (note 66)	-	11.8
Payments	(2.5)	-
Revaluation of liability	-	(0.6)
Unwind of discounting (note 5)	0.5	0.5
At 30 September 2019 (note 37)	23.7	25.7

39. CONDUCT

The Group, as a participant in the financial services industry is exposed to a high level of regulatory supervision, which could in the event of conduct failures expose it to financial liabilities. The Group maintains a strong compliance and conduct culture supervised by the second line compliance function, to mitigate the risk, although it is impossible to eliminate it entirely.

Over recent years, in common with other financial services firms, the Group has followed guidance issued by the FCA in respect of redress to customers in respect of the miss-selling of payment protection insurance ('PPI'), though the sums involved have not been material.

The regulatory environment continues to develop, both in respect of PPI and other matters, through regulatory policies, legislative rules and court rulings, and while the Group's assessment is that it currently has no further potential liability for conduct issues, this is based on our current interpretation of requirements and hence further liabilities may arise as these develop over time.

40. CURRENT TAX LIABILITIES

Current tax in the Group and the Company represents UK corporation tax owed or recoverable.

41. RETIREMENT BENEFIT OBLIGATIONS

(a) Defined benefit plan - description

The Group operates a funded defined benefit pension scheme in the UK (the 'Plan'). The Plan assets are held in a separate fund, administered by a corporate trustee, to meet long-term pension liabilities to past and present employees. The Trustee of the Plan is required by law to act in the best interests of the Plan's beneficiaries and is responsible for the investment policy adopted in respect of the Plan's assets. The appointment of directors to the Trustee is determined by the Plan's trust documentation. The Group has a policy that one third of all directors of the Trustee should be nominated by active and pensioner members of the Plan.

Employees who are members of the Plan are entitled to receive a pension of 1/60 of their final basic annual salary for every year of eligible service (to a maximum of 2/3). Dependants of members of the Plan are eligible for a dependant's pension and the payment of a lump sum in the event of death in service.

The principal actuarial risks to which the Plan is exposed are:

- Investment risk** – The present value of the defined benefit liabilities is calculated using a discount rate set by reference to high quality corporate bond yields. If plan assets underperform corporate bonds, this will increase the deficit. The strategic allocation of assets under the Plan is currently weighted towards equity assets and diversified growth funds as its liability profile is relatively immature, and it is expected that these asset classes will, over the long term, outperform gilts and corporate bonds. In consultation with the Company, the Trustee keeps the allocation of the Plan's investments under review to manage this risk on a long-term basis.
- Interest risk** – A fall in corporate bond yields would reduce the discount rate used in valuing the Plan liabilities and increase the value of the Plan liabilities. The Plan assets would also be expected to increase, to the extent that bond assets are held, but this would not be expected to fully match the increase in liabilities, given the weighting towards equity assets and diversified growth funds noted above.
- Inflation risk** – Pensions in payment are increased annually in line with the Retail Price Index ('RPI') or the Consumer Price Index ('CPI') for Guaranteed Minimum Pensions built up since 1988. Pensions built up since 5 April 2006 are capped at 2.5% and pensions built up before 6 April 2006 are capped at 5%. For employees who have left the Company but have deferred pensions, these also revalue over the period to retirement predominantly in line with RPI. Therefore, an increase in inflation would also increase the value of the pension liabilities. The Plan assets would also be expected to increase, to the extent that they are linked to inflation, but this may not fully match the increase in liabilities.

- **Longevity risk** – The value of the Plan deficit is calculated by reference to the best estimate of the mortality rate among Plan members both during and after employment. An increase in the life expectancy of the members would increase the deficit in the Plan.
- **Salary risk** – The valuation of the Plan assumes a level of future salary increases based on a premium over the expected rate of inflation. Should the salaries of Plan members increase at a higher rate, then the deficit will be higher.

The risks relating to death in service payments are insured with an external insurance company.

As a result of the Plan having been closed to new entrants since February 2002, the service cost as a percentage of pensionable salaries is expected to increase as the average age of active members rises over time. However, the membership is expected to reduce so that the service cost in monetary terms will gradually reduce.

The most recent full actuarial valuation of the Plan's liabilities, obtained by the Trustee, was carried out at 31 March 2016, by Aon Hewitt, the Plan's independent actuary. This showed that the value of the Plan's liabilities on a buy-out basis in accordance with Section 224 of the Pensions Act 2004 was £214.0m, with a shortfall against the assets of £118.4m. A full actuarial valuation, as at 31 March 2019, is currently in progress and will be reflected in the 2020 Group accounts.

Following the 2016 actuarial valuation, the Trustee put in place a revised recovery plan. The Trustee's recovery plan aims to meet the statutory funding objective within six years and ten months from the date of valuation, that is by 31 January 2023. As part of this recovery plan, the Group entered into a Pension Funding Partnership ('PFP') transaction effectively granting the Plan a first charge over its head office building as security for payments under the plan (note 27). No amount is included in the Plan assets in respect of the building, which remains within the Group's Property, Plant and Equipment balance (note 27) but it provides the Plan with additional security in a stress event.

(b) Defined benefit plan – financial impact

For accounting purposes, the valuation at 31 March 2016 was updated to 30 September 2019 in accordance with the requirements of IAS 19 (revised) by Mercer, the Group's independent consulting actuary.

The major categories of assets in the Plan at 30 September 2019, 30 September 2018 and 30 September 2017 and their fair values were:

	2019	2018	2017
	£m	£m	£m
Cash	7.1	0.6	0.9
Equity instruments	60.7	61.8	58.7
Debt instruments	34.2	28.4	28.9
Real estate	10.8	10.7	9.8
Total fair value of Plan assets	112.8	101.5	98.3
Present value of Plan liabilities	(147.3)	(121.0)	(128.1)
(Deficit) in the Plan	(34.5)	(19.5)	(29.8)

At 30 September 2019 the Plan assets were invested in a diversified portfolio that consisted primarily of equity and debt investments. The majority of the equities held by the Plan are in developed markets. All investments of the Plan are in managed funds for which unit prices are quoted publicly by the fund managers, however they are not openly traded so are considered to be Level 2 financial instruments as defined by IFRS 13.

During October 2018, the High Court made a ruling in the Lloyds Banking Group Pension Scheme GMP (Guaranteed Minimum Pension) equalisation case, which effectively directs defined benefit pension schemes to change their rules to equalise the benefits of male and female members for the effects of GMPs for employees who were, at one time, contracted out of state schemes. The Court did not specify a single method which schemes should employ and hence the impact of this on the Plan will not be certain until the Trustee has determined which method should be adopted and detailed calculations have been performed to evaluate the impact, as the impact on members will vary from person to person.

The effect of this ruling has been accounted for in the accounts of the Group for the year ended 30 September 2019. The Group's present expectation is that the ruling will result in an additional charge to profit of £0.3m before tax and this amount has been included as 'past service cost' below. However, this estimate is based on a preliminary interpretation of the ruling and a high-level calculation and therefore the actual amount posted may vary due to the Trustee's response to the ruling, idiosyncratic impacts on individual members and the development of a wider legal and accounting consensus on the proper interpretation of the courts requirements as the ruling is studied in more detail.

The movement in the fair value of the Plan assets during the year was as follows:

	2019 £m	2018 £m
At 1 October 2018	101.5	98.3
Interest on Plan assets	3.0	2.6
Cash flows		
Contributions by Group	4.6	4.5
Contributions by Plan members	0.2	0.2
Benefits paid	(2.4)	(4.7)
Administration expenses paid	(0.7)	(0.5)
Remeasurement gain		
Return on Plan assets (excluding amounts included in interest)	6.6	1.1
At 30 September 2019	112.8	101.5

The actual return on Plan assets in the year ended 30 September 2019 was £9.6m (2018: £3.7m).

The movement in the present value of the Plan liabilities during the year was as follows:

	2019 £m	2018 £m
At 1 October 2018	121.0	128.1
Current service cost	1.6	1.8
Past service cost	0.3	-
Funding cost	3.5	3.4
Cash flows		
Contributions by Plan members	0.2	0.2
Benefits paid	(2.4)	(4.7)
Remeasurement loss / (gain)		
Arising from demographic assumptions	(1.4)	(1.8)
Arising from financial assumptions	24.5	(6.0)
Arising from experience adjustments	-	-
At 30 September 2019	147.3	121.0

The liabilities of the Plan are measured by discounting the best estimate of future cash flows to be paid out by the Plan using the Projected Unit method. This amount is reflected in the liability in the balance sheet. The Projected Unit method is an accrued benefits valuation method in which the Plan liabilities are calculated based on service up until the valuation date allowing for future salary growth until the date of retirement, withdrawal or death, as appropriate. The future service rate is then calculated as the contribution rate required to fund the service accruing over the next year again allowing for future salary growth. The major weighted average assumptions used by the actuary were (in nominal terms):

	30 September 2019	30 September 2018	30 September 2017
In determining net pension cost for the year			
Discount rate	2.95%	2.70%	2.40%
Rate of compensation increase	3.60%	3.60%	3.50%
Rate of price inflation	3.10%	3.10%	3.00%
Rate of increase of pensions	2.95%	2.90%	2.95%
In determining benefit obligations			
Discount rate	1.85%	2.95%	2.70%
Rate of compensation increase	3.20%	3.60%	3.60%
Rate of price inflation	2.70%	3.10%	3.10%
Rate of increase of pensions	2.65%	2.95%	2.90%
Further life expectancy at age 60			
Male member aged 60	28	28	29
Female member aged 60	29	29	30
Male member aged 40	30	30	30
Female member aged 40	31	31	32

The amounts charged in the consolidated income statement in respect of the Plan are:

	Note	2019 £m	2018 £m
Current service cost		1.6	1.8
Past service cost		0.3	-
Total service cost	10	1.9	1.8
Administration expenses		0.7	0.5
Included within operating expenses		2.6	2.3
Funding cost of Plan liabilities		3.5	3.4
Interest on Plan assets		(3.0)	(2.6)
Net interest expense	5	0.5	0.8
Components of defined benefit costs recognised in profit or loss		3.1	3.1

The amounts recognised in the consolidated statement of comprehensive income in respect of the Plan are:

	2019 £m	2018 £m
Return on Plan assets (excluding amounts included in interest)	6.6	1.1
Actuarial gains/(losses)		
Arising from demographic assumptions	1.4	1.8
Arising from financial assumptions	(24.5)	6.0
Arising from experience adjustments	-	-
Total actuarial (loss)/gain	(16.5)	8.9
Tax thereon	2.4	(1.7)
Net actuarial (loss)/gain	(14.1)	7.2

Of the remeasurement movements reflected above:

- The return on plan assets represents better than expected investment performance
- The change in demographic assumptions reflects the adoption of new mortality assumptions, using the most recent version of the tables adopted by the Trustee in the triennial valuation, which predict lower life expectancy among members than the previous versions
- The change in financial assumptions reflects principally the impact of increased inflation expectations on discount rates
- The discount rate assumptions reflect the announcement made by National Statistics in September 2019 regarding its future intention to rebase its definition of RPI

(c) Defined benefit plan – future cash flows

The sensitivity of the valuation of the defined benefit obligation to the principal assumptions disclosed above at 30 September 2019, calculating the obligation on the same basis as used in determining the IAS 19 value, is as follows:

Assumption	Increase in assumption	Impact on scheme liabilities
Discount rate	0.1% p.a.	(2.3)%
Rate of inflation*	0.1% p.a.	0.4%
Rate of salary growth	0.1% p.a.	2.3%
Rates of mortality	1 year of life expectancy	2.9%

* maintaining a 0.5% assumption for real salary growth

The sensitivity analysis presented above may not be representative of an actual future change in the defined benefit obligation as it is unlikely that changes in assumptions would occur in isolation as some of the assumptions will be correlated. There has been no change in the method of preparing the analysis from that adopted in previous years.

In conjunction with the Trustee, the Group has continued to conduct asset-liability reviews of the Plan. These studies are used to assist the Trustee and the Group to determine the optimal long-term asset allocation with regard to the structure of liabilities within the Plan. The results of the studies are used to assist the Trustee in managing the volatility in the underlying investment performance and risk of a significant increase in the scheme deficit by providing information used to determine the investment strategy of the Plan. There have been no changes in the processes by which the Plan manages its risks from previous periods.

The target asset allocations for the year ending 30 September 2020 are 60% growth assets (primarily equities), 30% bonds and 10% real estate.

The rate of employee contributions to the Plan is 5.0% of pensionable salaries. Since 1 April 2017, following the finalisation of the March 2016 valuation, the agreed rate of employer contributions has been 32.0% of gross salaries. Additional contributions of £2.5m per annum for deficit reduction, including amounts payable under the PFP, and £0.4m per annum in respect of costs, each payable monthly, were also agreed.

The present best estimate of the contributions to be made to the Plan by the Group in the year ending 30 September 2020 is £4.5m.

The average durations of the benefit obligations in the Plan at the year end are shown in the table below:

	2019 Years	2018 Years
Category of member		
Active members	25	24
Deferred pensioners	24	23
Current pensioners	16	15
All members	24	22

(d) Defined contribution arrangements

The Group sponsors a defined contribution (Worksave) pension scheme, open to all employees who are not members of the Plan. The Group successfully completed the auto-enrolment process mandated by the UK Government in November 2013, using this scheme.

The PAF business also sponsors a number of defined contribution pension plans and makes contributions to these schemes in respect of employees.

The assets of these schemes are not Group assets and are held separately from those of the Group, under the control of independent trustees. Contributions made by the Group to these schemes in the year ended 30 September 2019, which represent the total cost charged against income, were £2.1m (2018: £1.9m) (note 10).

42. CALLED-UP SHARE CAPITAL

The share capital of the Company consists of a single class of £1 ordinary shares.

Movements in the issued share capital in the year were:

	2019 Number	2018 Number
Ordinary shares		
At 1 October 2018	281,596,936	281,489,701
Shares issued	1,606,849	107,235
Shares cancelled	(21,630,434)	-
At 30 September 2019	261,573,351	281,596,936

During the year the Company issued 1,606,849 shares (2018: 107,235) to satisfy options granted under Sharesave schemes for a consideration of £4,075,843 (2018: £360,031).

On 31 July 2019, 21,630,434 shares held in treasury were cancelled by the Company.

43. RESERVES

(a) The Group

	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m	2017 IAS 39 £m
Share premium account	68.3	65.8	65.8	65.5
Capital redemption reserve	50.3	28.7	28.7	28.7
Merger reserve	(70.2)	(70.2)	(70.2)	(70.2)
Cash flow hedging reserve (note 24)	3.0	3.3	3.3	2.5
Profit and loss account	835.9	868.3	890.7	784.5
	887.3	895.9	918.3	811.0

(b) The Company

	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m	2017 IAS 39 £m
Share premium account	68.3	65.8	65.8	65.5
Capital redemption reserve	50.3	28.7	28.7	28.7
Merger reserve	(23.7)	(23.7)	(23.7)	(23.7)
Profit and loss account	256.3	390.0	390.0	384.0
	351.2	460.8	460.8	454.5

The merger reserve arose, due to the provisions of UK company law at the time, on a group restructuring on 12 May 1989 when the Company became the parent entity of the Group.

44. OWN SHARES

	The Group		The Company	
	2019	2018	2019	2018
	£m	£m	£m	£m
Treasury shares				
At 1 October 2018	91.8	66.6	91.8	66.6
Shares purchased	26.7	25.2	26.7	25.2
Shares cancelled	(95.5)	-	(95.5)	-
At 30 September 2019	23.0	91.8	23.0	91.8
ESOP shares				
At 1 October 2018	12.2	16.5	-	-
Shares purchased	7.6	6.2	-	-
Options exercised	(2.3)	(10.5)	-	-
At 30 September 2019	17.5	12.2	-	-
Balance at 30 September 2019	40.5	104.0	23.0	91.8
Balance at 1 October 2018	104.0	83.1	91.8	66.6

At 30 September 2019 the number of the Company's own shares held in treasury was 5,218,702 (2018: 20,800,284). These shares had a nominal value of £5,218,702 (2018: £20,800,284). These shares do not qualify for dividends.

The Employee Share Ownership Plan ('ESOP') shares are held in trust for the benefit of employees exercising their options under the Company's share option schemes and awards under the Paragon Performance Share Plan and Deferred Share Bonus Plan. The trustees' costs are included in the operating expenses of the Group.

At 30 September 2019, the trust held 3,912,516 ordinary shares (2018: 2,874,825) with a nominal value of £3,912,516 (2018: £2,874,825) and a market value of £18,873,977 (2018: £13,764,662). Options, or other share-based awards, were outstanding against all of these shares at 30 September 2019 (2018: all). The dividends on all of these shares have been waived (2018: all).

45. EQUITY DIVIDEND

Amounts recognised as distributions to equity shareholders in the Group and the Company in the period:

	2019	2018	2019	2018
	Per share	Per share	£m	£m
Equity dividends on ordinary shares				
Final dividend for the year ended 30 September 2018	13.9p	11.0p	35.9	28.9
Interim dividend for the year ended 30 September 2019	7.0p	5.5p	18.1	14.2
	20.9p	16.5p	54.0	43.1

Amounts paid and proposed in respect of the year:

	2019	2018	2019	2018
	Per share	Per share	£m	£m
Interim dividend for the year ended 30 September 2019	7.0p	5.5p	18.1	14.2
Proposed final dividend for the year ended 30 September 2019	14.2p	13.9p	35.8	35.8
	21.2p	19.4p	53.9	50.0

The proposed final dividend for the year ended 30 September 2019 will be paid on 17 February 2020, subject to approval at the Annual General Meeting, with a record date of 10 January 2020. The dividend will be recognised in the accounts when it is paid.

46. NET CASH FLOW FROM OPERATING ACTIVITIES

(a) The Group

	2019 £m	2018 £m
Profit before tax	159.0	181.5
Non-cash items included in profit and other adjustments:		
Depreciation of operating property, plant and equipment	1.5	1.9
Profit on disposal of operating property, plant and equipment	-	(0.2)
Amortisation of intangible assets	2.4	2.1
Foreign exchange movement on borrowings	(124.8)	(67.6)
Other non-cash movements on borrowings	3.6	6.0
Impairment losses on loans to customers	8.0	7.4
Charge for share based remuneration	5.9	6.1
Gain on derecognition	(9.7)	-
Derecognition of cash flow hedge	(0.9)	-
Net (increase) / decrease in operating assets:		
Operating lease assets	(0.9)	(12.0)
Loans to customers	(792.0)	(781.7)
Derivative financial instruments	169.7	50.9
Fair value of portfolio hedges	(88.3)	15.4
Other receivables	(73.8)	(6.1)
Net increase / (decrease) in operating liabilities:		
Retail deposits	1,095.3	1,681.2
Derivative financial instruments	75.8	(2.4)
Fair value of portfolio hedges	8.1	(0.7)
Other liabilities	(1.6)	24.6
Cash generated by operations	437.3	1,106.4
Income taxes (paid)	(39.4)	(32.0)
	397.9	1,074.4

Cash flows relating to plant and equipment held for leasing under operating leases are classified as operating cash flows.

(b) The Company

	2019	2018
	£m	£m
Profit before tax	6.5	39.6
Non-cash items included in profit and other adjustments:		
Depreciation of property, plant and equipment	-	0.2
Non-cash movements on borrowings	0.7	0.6
Impairment provision / (release) on investments in subsidiaries	148.8	7.4
Charge for share based remuneration	5.9	6.1
Net decrease / (increase) in operating assets:		
Other receivables	109.7	(176.9)
Net (decrease) / increase in operating liabilities:		
Other liabilities	(101.1)	89.1
Cash generated / (utilised) by operations	170.5	(33.9)
Income taxes received	0.4	3.4
	170.9	(30.5)

47. NET CASH FLOW FROM INVESTING ACTIVITIES

	The Group		The Company	
	2019	2018	2019	2018
	£m	£m	£m	£m
Proceeds from sales of operating property, plant and equipment	-	0.5	-	18.4
Purchases of operating property, plant and equipment	(1.1)	(0.8)	-	-
Purchases of intangible assets	(2.0)	(1.5)	-	-
Movement in loans to subsidiary undertakings	-	-	(105.1)	(160.2)
Residual disposal (note 7)	11.4	-	-	-
Acquisitions (note 66)	-	(281.0)	-	-
Investment in subsidiary undertakings	-	-	-	(12.5)
Net cash generated / (utilised) by investing activities	8.3	(282.8)	(105.1)	(154.3)

48. NET CASH FLOW FROM FINANCING ACTIVITIES

	The Group		The Company	
	2019	2018	2019	2018
	£m	£m	£m	£m
Shares issued (note 42)	3.9	0.4	4.1	0.4
Dividends paid (note 45)	(54.0)	(43.1)	(54.0)	(43.1)
Issue of asset backed floating rate notes	362.5	432.5	-	-
Repayment of asset backed floating rate notes	(591.1)	(1,289.7)	-	-
Movement on central bank facilities	(30.0)	324.4	-	-
Movement on other bank facilities	(148.3)	(371.1)	-	-
Purchase of shares (note 44)	(34.3)	(31.8)	(26.7)	(25.2)
Net cash (utilised) by financing activities	(491.3)	(978.4)	(76.6)	(67.9)

49. RECONCILIATION OF NET DEBT

(a) The Group

	Cash flows			Non-cash movements			Closing debt
	Opening debt	Debt issued	Other	Acquisition / Derecognition	Foreign exchange	Other	
	£m	£m	£m	£m	£m	£m	£m
30 September 2019							
Asset backed loan notes	5,554.7	362.5	(591.1)	(784.1)	(124.8)	2.2	4,419.4
Bank borrowings	935.6	-	(148.3)	-	-	0.2	787.5
Corporate bonds	149.3	-	-	-	-	0.3	149.6
Retail bonds	296.1	-	-	-	-	0.4	296.5
Central bank borrowings	1,024.4	-	(30.0)	-	-	-	994.4
Bank overdrafts	1.1	-	(0.1)	-	-	-	1.0
Gross debt	7,961.2	362.5	(769.5)	(784.1)	(124.8)	3.1	6,648.4
Cash	(1,310.6)	(362.5)	447.7	-	-	-	(1,225.4)
Net debt	6,650.6	-	(321.8)	(784.1)	(124.8)	3.1	5,423.0
30 September 2018							
Asset backed loan notes	6,475.8	432.5	(1,289.7)	-	(67.6)	3.7	5,554.7
Bank borrowings	1,306.0	-	(371.1)	-	-	0.7	935.6
Corporate bonds	149.1	-	-	-	-	0.2	149.3
Retail bonds	295.7	-	-	-	-	0.4	296.1
Central bank borrowings	700.0	324.4	-	-	-	-	1,024.4
Bank overdrafts	0.6	-	0.5	-	-	-	1.1
Gross debt	8,927.2	756.9	(1,660.3)	-	(67.6)	5.0	7,961.2
Cash	(1,496.9)	(756.9)	1,224.1	(280.9)	-	-	(1,310.6)
Net debt	7,430.3	-	(436.2)	(280.9)	(67.6)	5.0	6,650.6

Non-cash movements arising from acquisition/derecognition in the year include the derecognition of PM12 asset backed loan notes on the derecognition of that securitisation (note 7).

Other non-cash changes shown above represent EIR adjustments relating to the spreading of initial costs of the facilities concerned.

(b) The Company

		Cash flows		Non-cash movements		
	Opening debt	Debt issued	Other	Foreign exchange	Other	Closing debt
	£m	£m	£m	£m	£m	£m
30 September 2019						
Corporate bonds	149.3	-	-	-	0.3	149.6
Retail bonds	296.1	-	-	-	0.4	296.5
Gross debt	445.4	-	-	-	0.7	446.1
Cash	(24.9)	-	10.8	-	-	(14.1)
Net debt	420.5	-	10.8	-	0.7	432.0
30 September 2018						
Corporate bonds	149.1	-	-	-	0.2	149.3
Retail bonds	295.7	-	-	-	0.4	296.1
Gross debt	444.8	-	-	-	0.6	445.4
Cash	(277.6)	-	252.7	-	-	(24.9)
Net debt	167.2	-	252.7	-	0.6	420.5

Other non-cash changes shown above represent EIR adjustments relating to the spreading of initial costs of the bonds.

50. UNCONSOLIDATED STRUCTURED ENTITIES

Following the Group's disposal of its residual interest in the Paragon Mortgages (No. 12) PLC securitisation (note 7), it ceased to consolidate the assets and liabilities of the entity. The external securitisation borrowings remain in place with their terms unchanged and the Group continues to act as administrator, for which it charges a fee. It has no other exposure to the profitability of the deal, no exposure to credit risk, other than on the recoverability of its quarterly fee, and no obligation to make further contribution to the entity.

Fee income from servicing arrangements since derecognition of £0.5m is included in third party servicing fees (note 8) and £0.3m is included in other debtors in respect of unpaid fees at the year end. Outstanding collection monies due to the structured entity of £0.4m are included in other creditors at 30 September 2019.

51. OPERATING LEASE ARRANGEMENTS

(a) As Lessor

The Group, through its asset finance business, leases assets under operating leases. In respect of certain of these assets, the Group also provides maintenance services to the lessee.

Assets subject to these arrangements are shown in note 27 and the income from these activities is shown in note 6.

The future minimum lease payments under these arrangements may be analysed as follows:

	The Group		The Company	
	2019 £m	2018 £m	2019 £m	2018 £m
Amounts falling due:				
Within one year	7.1	2.0	-	-
Between two and five years	12.7	7.2	-	-
After more than five years	0.5	0.6	-	-
	20.3	9.8	-	-

(b) As Lessee

	The Group		The Company	
	2019	2018	2019	2018
	£m	£m	£m	£m
Minimum lease payments under operating leases recognised in operating expenses for the year				
Office buildings	1.9	1.8	-	-
Motor vehicles	0.9	0.3	-	-
Office equipment	0.1	0.1	-	-
	2.9	2.2	-	-

At 30 September 2019 the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	The Group		The Company	
	2019	2018	2019	2018
	£m	£m	£m	£m
Amounts falling due:				
Within one year	3.2	2.6	-	-
Between two and five years	5.8	6.8	-	-
After more than five years	1.7	2.9	-	-
	10.7	12.3	-	-

Operating lease payments represent rents payable by the Group in respect of certain of its office premises and lease payments on company vehicles and equipment. The average term of the current building leases from inception or acquisition is 7 years (2018: 8 years) with rents subject to review every five years, while the average term of the vehicle leases and office equipment is 3 years (2018: 3 years).

52. RELATED PARTY TRANSACTIONS

(a) The Group

During the year certain of the non-executive directors of the Group were beneficially interested in savings deposits made with Paragon Bank, on the same terms as were available to members of the public. No such deposits were outstanding at the year end (2018: £250,000), and the maximum amount outstanding during the year was £250,000 (2018: £250,000).

Mr A K Fletcher, a non-executive director of the Company until 31 December 2018, is a director of Paragon Pension Plan Trustees Limited, which acts as the corporate trustee of the Plan. In respect of this appointment, he was paid £4,000 in the year ended 30 September 2019 by Paragon Finance PLC, the sponsoring company of the Plan up to the date of his resignation as a director of the Company (2018: £15,000).

The Plan is a related party of the Group. Transactions with the Plan are described in note 41.

The Group had no other transactions with related parties other than the key management compensation disclosed in note 11.

(b) The Company

During the year the parent company entered into transactions with its subsidiaries, which are related parties. Management services were provided to the Company by one of its subsidiaries and the Company granted awards to employees of subsidiary undertakings under the share based payment arrangements described in note 12.

Details of the Company's investments in subsidiaries and the income derived from them are shown in notes 30 and 68.

Outstanding current account balances with subsidiaries are shown in notes 25 and 37.

During the year the Company incurred interest costs of £1.6m in respect of borrowings from its subsidiaries (2018: £1.3m).

53. COUNTRY-BY-COUNTRY REPORTING

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 came into effect on 1 January 2014 and place certain reporting obligations on financial institutions that are within the scope of CRD IV. The objective of the country-by-country reporting requirements is to provide increased transparency regarding the source of the financial institution's income and the locations of its operations.

Paragon Banking Group PLC is a UK registered entity. Details of its subsidiaries are given in note 68 and the activities of the Group are described in Section A2.1.

The activities of the Group, described as required by the Regulations for the year ended 30 September 2019 were:

	United Kingdom £m
Year ended 30 September 2019	
Total operating income	307.3
Profit before tax	159.0
Corporation tax paid	39.4
Public subsidies received	-
Average number of full time equivalent employees	1,269

	United Kingdom £m
Year ended 30 September 2018	
Total operating income	301.9
Profit before tax	181.5
Corporation tax paid	32.0
Public subsidies received	-
Average number of full time equivalent employees	1,103

The Group's participation in Bank of England funding schemes is set out in note 36.

54. DISCLOSURES UNDER IAS 39

Certain disclosures made in respect of IAS 39 based amounts are not directly comparable to IFRS 9 disclosures, but still form part of the comparative financial information. To avoid confusion, these are presented below.

(a) Ageing of IAS 39 exposures (Note 57)

The payment status of the carrying balances of the Group's live loan assets, before provision for impairment, at 30 September 2018, split between those accounts considered as performing and those included in the population for impairment testing, is shown below. This disclosure is not required under IFRS 9, however comparative amounts are still required to be presented. Balances for immaterial asset classes are not shown. 'Asset finance loans' below includes other related loan balances. Fully provided non-live accounts are excluded from the tables below.

Days past due is not a relevant measure for the development finance, structured lending or invoice discounting businesses, due to their particular contractual arrangements.

First mortgages

	2018 £m
Not past due	10,211.1
Arrears less than 3 months	101.7
Performing accounts	10,312.8
Arrears 3 to 6 months	3.0
Arrears 6 to 12 months	2.2
Arrears over 12 months	5.7
Possessions and similar cases	22.1
Impairment population	33.0
Total gross balances	10,345.8
Impairment provision on live cases	(12.7)
Timing adjustments	(0.9)
Carrying balance	10,332.2

	Second charge mortgage loans	Motor finance loans	Asset finance loans	Total
	£m	£m	£m	£m
30 September 2018				
Not past due	350.7	310.8	388.6	1,050.1
Arrears less than 2 months	19.4	13.2	13.8	46.4
Performing accounts	370.1	324.0	402.4	1,096.5
Arrears 2 to 6 months	11.0	3.2	1.3	15.5
Arrears 6 to 9 months	4.1	0.9	0.7	5.7
Arrears 9 to 12 months	3.3	0.6	-	3.9
Arrears over 12 months	29.9	2.1	0.6	32.6
Specifically impaired asset finance cases	-	-	0.5	0.5
Impairment population	48.3	6.8	3.1	58.2
Total gross balances	418.4	330.8	405.5	1,154.7
Impairment provision on live cases	(1.5)	(1.7)	(1.7)	(4.9)
Timing adjustments	(1.0)	0.3	(0.4)	(1.1)
Carrying balance	415.9	329.4	403.4	1,148.7

Arrears in the tables above are based on the contractual payment status of the customers concerned. Where assets have been purchased by the Group, customers may already have been in arrears at the time of acquisition and an appropriate adjustment made to the consideration paid.

(b) Analysis of buy-to-let mortgages under IAS 39 (Note 57)

The Group's outstanding exposure to buy-to-let loans with an appointed receiver at 30 September 2018 calculated on the basis of IAS 39 is set out below. A different analysis, based on the IFRS 9 staging approach, has been presented in note 23, superseding this disclosure.

	2018 Gross £m	2018 Provision £m	2018 Net £m
Performing loans			
Let with less than 3 months arrears	106.6	(1.1)	105.5
Impaired loans			
Let with over 3 months arrears	5.9	(2.5)	3.4
Vacant or on sale	20.7	(6.4)	14.3
Impairment population	26.6	(8.9)	17.7
Total balances	133.2	(10.0)	123.2

(c) Security (Note 23)

The estimated value of the security held against those loans and receivables at 30 September 2018 which were considered to be impaired or past due under IAS 39, representing, for each such account, the lesser of the outstanding balance on the loan and the estimated valuation of the property was:

	2018 £m
First mortgage loans	23.1
Second charge mortgage loans	46.2
	69.3

Whilst on motor finance cases the Group has the benefit of the underlying vehicle as security on these loans, no account of this was taken in the allowance for uncollectible amounts in the Group's IAS 39 provision methodology.

For the Group's asset finance loans, estimated valuations of security assets for balances in arrears are undertaken as part of the credit management process. These exercises suggested that the security value of assets under finance leases which were past due or impaired at 30 September 2018 under IAS 39 was £16.4m.

(d) Movement in impairment provision (Note 23)

The following amounts in respect of impairment provisions under IAS 39, net of allowances for recoveries of written off assets, have been deducted from the appropriate assets in the balance sheet. This disclosure has been superseded under IFRS 9, but disclosures for comparator periods are still required.

	First mortgages	Other loans and receivables	Finance leases	Total
	£m	£m	£m	£m
At 1 October 2017	89.1	18.3	3.2	110.6
Amounts provided in the period	5.6	0.6	2.9	9.1
Amounts written off	(3.7)	(7.6)	(1.0)	(12.3)
At 30 September 2018	91.0	11.3	5.1	107.4

Of the above balances, the following provisions were held in respect of realised losses not charged off, which remain on the balance sheet and are provided for in full.

	First mortgages	Other loans and receivables	Finance leases	Total
	£m	£m	£m	£m
At 30 September 2018	78.2	-	0.9	79.1

The amounts charged to the profit and loss account, net of recoveries of previously provided amounts are set out below.

	First mortgages	Other loans and receivables	Finance leases	Total
	£m	£m	£m	£m
<i>Year ended 30 September 2018</i>				
Amounts provided in the year	5.6	0.6	2.9	9.1
Recovery of amounts previously provided	(0.1)	(0.5)	(1.1)	(1.7)
Net impairment for year	5.5	0.1	1.8	7.4

This impairment charge was analysed as set out below

	2018 £m
<i>Impairment of financial assets</i>	
First mortgage loans	5.5
Second charge mortgage loans	(0.5)
Finance lease receivables	1.8
Development finance loans	-
Other loans	0.6
	7.4

(e) Critical accounting estimates (note 65)

The following analysis was prepared at 30 September 2018 to illustrate the variability of the IAS 39 impairment provision. These were re-calculated by changing one factor in the calculation and keeping all others at their current levels. This exercise indicated that:

- Adopting a sale strategy for 5% of currently let buy-to-let properties with a receiver of rent in place would increase impairment provisions by £2.1m
- 5% of receiver of rent properties currently vacant or for sale becoming fully performing would reduce impairment provisions by £0.3m
- A 10% reduction in house prices would increase impairment provisions across the first mortgage assets by £1.7m, while a 10% increase would reduce these impairment provisions by £1.5m
- A reduction in cash flows from receiver of rent properties of 10% would increase impairment provisions by £0.1m

It should be noted that all of these changes would, in reality, be interrelated so examining them in isolation may not give reliable guidance as to future outcomes.

D2.2 NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK

For the year ended 30 September 2019

The notes below describe the processes and measurements which the Group and the Company use to manage their capital position and their exposure to financial risks including credit, liquidity, interest rate and foreign exchange risk. It should be noted that certain capital measures, which are presented to illustrate the Group's position, are not subject to audit. Where this is the case, the relevant disclosures are marked as such.

55. CAPITAL MANAGEMENT

The Group's objectives in managing capital are:

- To ensure that the Group has sufficient capital to meet its operational requirements and strategic objectives
- To safeguard the Group's ability to continue as a going concern, so that it can continue to provide returns to shareholders and benefits for other stakeholders
- To provide an adequate return to shareholders by pricing products and services commensurately with the level of risk
- To ensure that sufficient regulatory capital is available to meet any externally imposed requirements

The Group sets its target amount of capital in proportion to risk, availability, regulatory requirements and cost. The Group manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets, having particular regard to the relative costs and availability of debt and equity finance at any given time. In order to maintain or adjust the capital structure the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares, issue or redeem other capital instruments, such as retail or corporate bonds, or sell assets to reduce debt.

The Group is subject to regulatory capital rules imposed by the PRA on a consolidated basis as a group containing an authorised bank. This is discussed further below.

(a) Dividend policy

The Company is committed to a long-term sustainable dividend policy. Ordinarily, dividends will increase in line with earnings, subject to the requirements of the business and the availability of cash resources. The Board reviews the policy at least twice a year in advance of announcing its results, taking into account the Group's strategy, capital requirements, principal risks and the objective of enhancing shareholder value. In determining the level of dividend for any year, the Board expects to follow the dividend policy, but will also take into account the level of available retained earnings in the Company, its cash resources and the cash and capital requirements inherent in its business plans.

The distributable reserves of the Company comprise its profit and loss account balance (note 43) and, other than the requirement for the Bank to retain an appropriate level of capital, there are no restrictions preventing profits elsewhere in the Group from being distributed to the parent.

Since the year ended 30 September 2018, the Company has adopted a policy of paying out approximately 40% of its basic earnings per share as dividend (a dividend cover ratio of around 2.5 times), in the absence of any idiosyncratic factors which might make such a dividend inappropriate. This policy is reviewed by the Board at least annually. The Company considers it has access to sufficient cash resources to pay dividends at this level and that its distributable reserves are abundant for this purpose.

To provide greater transparency, the Company has also indicated that in future its interim dividend per share will normally be 50% of the previous final dividend, in the absence of any indicators which might make such a level of payment inappropriate. The interim dividend for the year ended 30 September 2019 was declared in accordance with the policy.

The most recent policy review, in November 2019, confirmed this policy but concluded that the size and nature of the non-cash fair value losses in the year, together with the gain arising on the derecognition of PM12, would support a higher pay-out ratio.

For the purposes of dividend policy, the Group defines dividend cover based on basic earnings per share, adjusted where considered appropriate, and dividend per share. This is the most common measure used by financial analysts.

The derivation of the dividend for the year, which is subject to approval at the forthcoming AGM is set out below.

	Note	2019	2018
Earnings per share (p)	17	49.4	55.9
Adjustment (p)		-	(7.3)
Adjusted earnings per share (p)		49.4	48.6
Dividend cover target (times)		2.33	2.50
Proposed dividend per share in respect of the year (p)	45	21.2	19.4

(b) Return on tangible equity ('RoTE')

RoTE is a measure of an entity's profitability used by investors. RoTE is defined by the Group by comparing the profit after tax for the year, adjusted for amortisation charged on intangible assets, to the average of the opening and closing equity positions, excluding intangible assets and goodwill.

It effectively reflects a return on equity as if all intangible assets are eliminated immediately against reserves. As this is similar to the approach used for the capital of financial institutions it is widely used in the sector.

The Group's consolidated RoTE for the year ended 30 September 2019 is derived as follows:

	Note	2019 IFRS 9 £m	2018 IAS 39 £m
Profit for the year after tax		127.4	145.8
Amortisation of intangible assets	28	2.4	2.1
Adjusted profit		129.8	147.9
Divided by			
Opening equity		1,073.5	1,009.4
Opening intangible assets	28	(169.3)	(104.4)
Opening tangible equity		904.2	905.0
Closing equity		1,108.4	1,095.9
Closing intangible assets	28	(171.1)	(169.3)
Closing tangible equity		937.3	926.6
Average tangible equity		920.7	915.8
Return on Tangible Equity		14.1%	16.1%

This table is not subject to audit

(c) Regulatory capital

The Group is subject to supervision by the PRA on a consolidated basis, as a group containing an authorised bank. As part of this supervision the regulator will issue an individual capital requirement setting an amount of regulatory capital, which the Group is required to hold relative to its total risk exposure in order to safeguard depositors from loss in the event of severe losses being incurred by the Group. This is defined by the international Basel III rules, set by the Basel Committee on Banking Supervision ('BCBS') and currently implemented in UK law by EU Regulation 575/2013, referred to as the Capital Requirements Regulation ('CRR').

The Group's regulatory capital is monitored by the Board, its Risk and Compliance Committee and the Asset and Liability Committee, who ensure that appropriate action is taken to ensure compliance with the regulator's requirements. The future regulatory capital requirement is also considered as part of the Group's forecasting and strategic planning process.

The introduction of IFRS 9 on 1 October 2018 impacted the Group's regulatory capital position. The principal impacts were:

- The reduction in reserves caused by increased provisions, net of associated future tax relief, reduces shareholders equity and hence regulatory capital
- The reduction in loans to customers generates a consequential reduction in risk weighted assets ('RWA'), the amount of which will vary by asset type
- Collectively assessed emergence provisions under IAS 39 qualified as tier 2 capital, with £4.9m being included in capital at 30 September 2018 in respect of such provisions. No such provisions are made under IFRS 9, therefore total capital is reduced

The Group has elected to take advantage of the transitional arrangements set out in Article 473a of the CRR, which allow the capital impact of expected credit losses to be phased in over a five-year period. The phase-in factors will allow for a 95% add back to CET1 capital and risk weighted assets in the financial year ended 30 September 2019, reducing to 85%, 70%, 50% and 25% for the financial years ending in 2020 to 2023, with full recognition of the impact on CET1 capital in the 2024 financial year. Where such relief is taken, firms are also required to disclose their capital positions calculated as if the relief were not available (the 'fully loaded' basis).

The capital position at 1 October 2018, immediately after transition, is set out in the notes below, marked 2018 IFRS 9.

The tables below demonstrate that at 30 September 2019 the Group's regulatory capital of £1,072.0m (2018: £1,044.8m) was comfortably in excess of the amounts required by the regulator, including £742.9m in respect of Pillar 1 and Pillar 2a capital (unaudited), which is comprised of fixed and variable elements. The CRR also requires firms to hold additional capital buffers, including a Capital Conservation Buffer of 2.5% of risk weighted assets (at 30 September 2019) (2018: 1.875%) and a Counter-Cyclical Buffer, currently 1.0% of risk weighted assets (2018: 0.5%). Firm specific buffers may also be required.

The Group's regulatory capital differs from its equity as certain adjustments are required by the regulator. A reconciliation of the Group's equity to its regulatory capital determined in accordance with CRD IV at 30 September 2019 is set out below.

	Note	30 September 2019 IFRS 9 £m	1 October 2018 IFRS 9 £m	30 September 2018 IAS 39 £m
Total equity		1,108.4	1,073.5	1,095.9
Deductions				
Proposed final dividend	45	(35.8)	(35.8)	(35.8)
IFRS 9 transitional relief	*	21.2	21.2	-
Intangible assets	28	(171.1)	(169.3)	(169.3)
Prudent valuation adjustments	‡	(0.7)	(0.9)	(0.9)
Common Equity Tier 1 ('CET1') capital		922.0	888.7	889.9
Other Tier 1 capital		-	-	-
Total Tier 1 capital		922.0	888.7	889.9
Corporate bond	35	150.0	150.0	150.0
Less: amortisation adjustment	†	-	-	-
		150.0	150.0	150.0
Collectively assessed credit impairment allowances	‡	-	-	4.9
Total Tier 2 capital		150.0	150.0	154.9
Total regulatory capital		1,072.0	1,038.7	1,044.8

* Firms are permitted to phase in the impact of IFRS 9 transition over a five-year period.

‡ For capital purposes, assets and liabilities held at fair value, such as the Group's derivatives, are required to be valued on a more conservative basis than the market value basis set out in IFRS 13. This difference is represented by the prudent valuation adjustment above, calculated using the 'Simplified Approach' set out in the CRR.

This was first included in the Group's regulatory capital position in the year and has been included in comparative amounts for consistency.

† When tier 2 capital instruments have less than five years to maturity the amount eligible as regulatory capital reduces by 20% per annum. No such adjustment is required in respect of the Corporate Bond issued in the year ended 30 September 2016, which matures in 2026.

‡ Under IFRS 9 there are no collectively assessed credit impairment allowances which are eligible as tier 2 capital.

The total exposure amount calculated under the CRD IV framework against which this capital is held, and the proportion of these assets it represents, are calculated as shown below.

	30 September 2019	1 October 2018	30 September 2018
	IFRS 9	IFRS 9	IAS 39
	£m	£m	£m
Credit risk			
Balance sheet assets	5,997.2	5,756.3	5,767.3
Off balance sheet	85.5	87.8	87.8
IFRS 9 transitional relief	10.5	10.5	-
Total credit risk	6,093.2	5,854.6	5,855.1
Operational risk	516.6	485.1	485.1
Market risk	-	-	-
Other	114.0	105.1	105.1
Total exposure amount	6,723.8	6,444.8	6,445.3
Solvency ratios	%	%	%
CET1	13.7	13.8	13.8
Total regulatory capital	15.9	16.2	16.2

This table is not subject to Audit

The CRD IV risk weightings for credit risk exposures are calculated using the Standardised Approach. The Basic Indicator Approach is used for operational risk.

On a fully loaded basis (excluding the effect of IFRS 9 transitional relief) the Group's capital ratios would be:

	30 September 2019	1 October 2018	30 September 2018
	IFRS 9	IFRS 9	IAS 39
	£m	£m	£m
CET1 Capital	922.0	888.7	889.9
Add back: IFRS 9 relief	(21.2)	(21.2)	-
Fully loaded CET1 Capital	900.8	867.5	889.9
TRC	1,072.0	1,038.7	1,044.8
Add back: IFRS 9 relief	(21.2)	(21.2)	-
Fully loaded TRC	1,050.8	1,017.5	1,044.8
Total risk exposure	6,723.8	6,444.8	6,445.3
Add back: IFRS 9 relief	(10.5)	(10.5)	-
Fully loaded TRE	6,713.3	6,434.3	6,445.3
Fully loaded Solvency ratios	%	%	%
CET1	13.4	13.5	13.8
Total regulatory capital	15.7	15.8	16.2

This table is not subject to audit

The total regulatory capital at 30 September 2019 on the fully loaded basis of £1,050.8m was in excess of the Pillar 1 & 2a requirement of £741.8m on the same basis (amounts not subject to audit).

The table below shows the calculation of the UK leverage ratio, based on the consolidated balance sheet assets adjusted as shown. The PRA has proposed a minimum UK leverage ratio of 3.25% for UK firms.

	Note	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m
Total balance sheet assets		14,395.5	14,487.9	14,515.1
Add: Credit fair value adjustments on loans to customers	20	-	24.1	24.1
Debit fair value adjustments on retail deposits	31	-	4.2	4.2
Adjusted balance sheet assets		14,395.5	14,516.2	14,543.4
Less: Derivative assets	24	(592.4)	(855.7)	(855.7)
Central bank deposits	18	(816.4)	(895.9)	(895.9)
CRDs	25	(11.4)	(6.2)	(6.2)
Accrued interest on sovereign exposures		(0.2)	(0.4)	(0.4)
On-balance sheet items		12,975.1	12,758.0	12,785.2
Less: Intangible assets	28	(171.1)	(169.3)	(169.3)
Total on balance sheet exposures		12,804.0	12,588.7	12,615.9
Derivative assets	24	592.4	855.7	855.7
Potential future exposure on derivatives		120.0	172.1	172.1
Total derivative exposures		712.4	1,027.8	1,027.8
Post offer pipeline at gross notional amount		903.4	817.7	817.7
Adjustment to convert to credit equivalent amounts		(739.2)	(569.2)	(569.2)
Off balance sheet items		164.2	248.5	248.5
Tier 1 capital		922.0	888.7	889.9
Total leverage exposure before IFRS 9 relief		13,680.6	13,865.0	13,892.2
IFRS 9 relief		25.8	25.8	-
Total leverage exposure		13,706.4	13,890.8	13,892.2
UK leverage ratio		6.7%	6.4%	6.4%

This table is not subject to audit

The fully loaded leverage ratio is calculated as follows

	30 September 2019 IFRS 9 £m	1 October 2018 IFRS 9 £m	30 September 2018 IAS 39 £m
Fully loaded Tier 1 capital	900.8	867.5	889.9
Total leverage exposure before IFRS 9 relief	13,680.6	13,865.0	13,892.2
Fully loaded UK leverage exposure	6.6%	6.3%	6.4%

This table is not subject to audit

The UK leverage ratio is prescribed by the PRA and differs from the leverage ratio defined by Basel and the CRR due to the exclusion of central bank balances from exposures.

The regulatory capital disclosures in these financial statements relate only to the consolidated position for the Group. Individual entities within the Group are also subject to supervision on a standalone basis. All such entities complied with the requirements to which they were subject during the year.

56. FINANCIAL RISK MANAGEMENT

The principal risks arising from the Group's exposure to financial instruments are credit risk, liquidity risk and market risk (particularly, interest rate risk and currency risk). These risks are discussed in notes 57 to 60 respectively. The Board has a Risk and Compliance Committee, consisting of the Chairman and the non-executive directors which is responsible for providing oversight and challenge to the Group's risk management arrangements. The Credit Committee and ALCO are executive sub-committees of the Risk and Compliance Committee which monitor performance against the risk appetites set by the Board and make recommendations for changes in risk appetite where appropriate. They also review and, where authorised to do so, agree or amend policies for managing each of these risks, which are summarised in the relevant note. The Corporate Governance Statement in Section B3 (which is not subject to audit) provides further detail on the operations of these committees.

The financial risk management policies have remained unchanged throughout the year and since the year end. The position discussed in notes 57 to 60 is materially similar to that existing throughout the year.

57. CREDIT RISK

The assets of the Group and the Company which are subject to credit risk are set out below:

	Note	The Group		The Company	
		2019	2018	2019	2018
		£m	£m	£m	£m
Financial assets at amortised cost					
Loans to customers	20	12,186.1	12,127.8	-	-
Trade receivables	25	3.6	2.2	-	-
Amounts owed by Group companies	25	-	-	106.6	216.3
Cash	18	1,225.4	1,310.6	14.1	24.9
CSA assets	25	72.2	3.8	-	-
CRDs	25	11.4	6.2	-	-
Accrued interest income	25	0.4	0.6	0.7	0.7
		13,499.1	13,451.2	121.4	241.9
Financial assets at fair value					
Derivative financial assets	24	592.4	855.7	-	-
Maximum exposure to credit risk		14,091.5	14,306.9	121.4	241.9

While this maximum exposure represents the potential loss which might have to be accounted for by the Group, the terms on which a significant proportion of the Group's loan assets are funded, described under Liquidity Risk in note 58, limit the amount of principal repayments on the Group's securitised and warehouse borrowings in cases of capital losses on assets, considerably reducing the effective shareholder value at risk.

All financial assets at amortised cost are subject to the requirements of IFRS 9 relating to impairment.

Further information on the Group's exposure to credit risk by asset type, including the credit quality of assets and any potential concentrations of credit risk, is set out below for:

- Loans to customers
- Cash balances (including CSA assets, CRDs and accrued interest)
- Trade receivables
- Derivative financial assets

Loans to customers

The Group's credit risk is primarily attributable to its loans to customers and its business objectives rely on maintaining a high-quality customer base and place strong emphasis on good credit management, both at the time of acquiring or underwriting a new loan, where strict lending criteria are applied, and throughout the loan's life.

Primary responsibility for the management of credit risk relating to lending activities across the Group lies with the Credit Committee. The Credit Committee is made up of senior employees, drawn from financial and risk functions independent of the underwriting process. It is chaired by the Chief Risk Officer. Its key responsibilities include setting and reviewing credit policy, controlling applicant quality, tracking account performance against targets, agreeing product criteria and lending guidelines and monitoring performance and trends.

The Group's underwriting philosophy is based on a combination of sophisticated individual credit assessment and the automated efficiencies of a scored decision making process. Information on each applicant is combined with data taken from a credit reference bureau to provide a complete credit picture of the applicant and the borrowing requested. Key information is validated through a combination of documentation and statistical data which collectively provides evidence of the applicant's ability and willingness to pay the amount contracted under the loan agreement. In assessing credit risk, even where the Group would have security on a proposed loan, an applicant's ability and propensity to repay the loan remain the principal factors in the decision to lend.

In considering whether to acquire pools of loan assets, the Group will undertake a due diligence exercise on the underlying loan accounts. Such assets are generally not fully performing and are offered at a discount to their current balance. The Group's procedures may include inspection of original loan documents, verification of security and the examination of the credit status of borrowers. Current and historic cash flow data will also be examined. The objective of the exercise is to establish, to a level of confidence similar to that provided by the underwriting process, that the assets will generate sufficient cash flows to recover the Group's investment and generate an appropriate return without exposing the Group to material operational or conduct risks.

This section sets out information relevant to assessing the credit risk inherent in the Group's loans to customers balances. It is set out in the following subsections:

- Types of lending and related security
- Overall credit grading
- Credit characteristics of particular portfolios
- Arrears performance
- Acquired assets

Types of lending

The Group's balance sheet loan assets at 30 September 2019 are analysed as follows:

	2019 IFRS 9		2018 IFRS 9		2018 IAS 39	
	£m	%	£m	%	£m	%
Buy-to-let mortgages	10,101.9	82.9%	10,227.4	84.5%	10,261.6	84.6%
Owner-occupied mortgages	70.6	0.6%	80.9	0.7%	70.6	0.6%
Total first charge residential mortgages	10,172.5	83.5%	10,308.3	85.2%	10,332.2	85.2%
Second charge mortgage loans	389.2	3.2%	414.4	3.4%	415.9	3.5%
Loans secured on residential property	10,561.7	86.7%	10,722.7	88.6%	10,748.1	88.7%
Development finance	506.5	4.1%	352.9	2.9%	352.8	2.9%
Loans secured on property	11,068.2	90.8%	11,075.6	91.5%	11,100.9	91.6%
Asset finance loans	472.9	3.9%	389.9	3.3%	391.0	3.2%
Motor finance loans	318.9	2.6%	329.2	2.7%	329.4	2.7%
Aircraft mortgages	19.3	0.2%	12.4	0.1%	12.4	0.1%
Structured lending	88.1	0.7%	38.7	0.3%	38.7	0.3%
Invoice finance	18.5	0.1%	21.7	0.2%	21.8	0.2%
Total secured loans	11,985.9	98.3%	11,867.5	98.1%	11,894.2	98.1%
Professions finance	46.2	0.4%	42.1	0.4%	42.6	0.4%
Other unsecured commercial loans	19.3	0.2%	17.2	0.1%	17.3	0.1%
Unsecured consumer loans	134.7	1.1%	173.8	1.4%	173.7	1.4%
Total loans to customers	12,186.1	100.0%	12,100.6	100.0%	12,127.8	100.0%

First and second charge mortgages are secured by charges over residential properties in England and Wales, or similar Scottish or Northern Irish securities.

Development finance loans are secured by a first charge (or similar Scottish security) over the development property and various charges over the build.

Asset finance loans and motor finance loans are effectively secured by the financed asset, while aircraft mortgages are secured by a charge on the aircraft funded.

Structured lending and invoice finance balances are effectively secured over the assets of the customer, with security enhanced by maintaining balances at a level less than the total amount of the security (the advance percentage).

Professions finance are generally short term unsecured loans made to firms of lawyers and accountants for working capital purposes.

Other unsecured consumer loans include unsecured loans either advanced by Group companies or acquired from their originators at a discount.

There are no significant concentrations of credit risk to individual counterparties due to the large number of customers included in the portfolios. All lending is to customers within the UK. The total gross carrying value of the Group's Loans to Customers due from customers with total portfolio exposures over £10.0m is analysed below by product type.

	2019 £m	2018 £m
Buy-to-let mortgages	149.7	211.9
Development finance	212.7	166.1
Structured lending	78.8	29.3
Asset finance	-	10.7
	441.2	418.0

The threshold of £10.0m is used internally for monitoring large exposures.

The fall in large buy-to-let exposures is principally a result of the derecognition of the PM12 assets (note 7) which included elements of several large portfolios.

Credit grading

An analysis of the Group's loans to customers by absolute level of credit risk at 30 September 2019 is set out below. The analysed amount represents gross carrying amount.

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
30 September 2019					
Very low risk	8,693.9	92.8	26.5	49.4	8,862.6
Low risk	1,267.2	77.5	6.7	26.5	1,377.9
Moderate risk	781.9	75.0	9.3	45.2	911.4
High risk	353.2	153.0	67.9	48.5	622.6
Very high risk	86.0	47.0	44.0	38.7	215.7
Not graded	200.4	13.2	13.5	10.7	237.8
Total gross carrying amount	11,382.6	458.5	167.9	219.0	12,228.0
Impairment	(6.0)	(3.7)	(32.2)	-	(41.9)
Total loans to customers	11,376.6	454.8	135.7	219.0	12,186.1

Gradings above are based on credit scorecards or internally assigned risk ratings as appropriate for the individual asset class. These measures are calibrated across product types and used internally to monitor the Group's overall credit risk profile against its risk appetite.

These gradings represent current credit quality on an absolute basis and this may result in assets in higher IFRS 9 stages with low risk grades, especially where a case qualifies through breaching, for example, an arrears threshold but is making regular payments. This will apply especially to stage 3 cases reported in note 23, other than those shown as 'realisations'.

Examples of these cases include fully up-to-date receiver of rent cases, customers who may be up to date on accounts with other lenders and accounts where the default on the Group's loan has yet to impact on external credit score.

A small proportion of the loan book (1.9%) is classed as 'not graded' above. This rating relates to loans that have been fully underwritten at origination but where the customer falls outside the automated assessment techniques used post-completion. This disclosure is expected to be developed further in future.

IFRS 7 does not require a comparative disclosure and it has been determined that the internal management information was insufficiently mature at 1 October 2018 to produce a reliable comparative.

Credit characteristics by portfolio

Loans secured on residential property

First mortgage loans have a contractual term of up to thirty years and second charge mortgage loans up to twenty five years. In all cases the borrower is entitled to settle the loan at any point and in most cases early settlement does take place. All borrowers on these accounts are required to make monthly payments.

An analysis of the indexed loan to value ratio ('LTV') for those loan accounts secured on residential property by value at 30 September 2019 is set out below. LTVs for second charge mortgages are calculated allowing for the interest of the first charge holder, based on the most recent first charge amount held by the Group, while for acquired accounts the effect of any discount on purchase is allowed for.

	2019 First mortgages %	2019 Second charge mortgages %	2018 First mortgages %	2018 Second charge mortgages %
Loan to value ratio				
Less than 70%	54.3	66.5	60.6	66.1
70% to 80%	36.2	18.5	29.7	17.4
80% to 90%	7.2	8.9	7.1	9.3
90% to 100%	0.6	2.7	0.8	3.5
Over 100%	1.7	3.4	1.8	3.7
	100.0	100.0	100.0	100.0
Average loan to value ratio	67.3	65.7	66.0	65.9
<i>of which</i>				
Buy-to-let	67.4		66.1	
Owner-occupied	53.2		51.3	

The regionally indexed LTVs shown above are affected by changes in house prices, with the Nationwide house price index, for the UK as a whole, registering an annual increase of 0.2% in the year ended 30 September 2019 (2018: 2.0%).

The increase in the LTV ratio for the owner-occupied accounts relates to the greater number of new lending accounts, which have higher LTV levels than legacy cases.

The geographical distribution of the Group's residential mortgage assets by gross carrying value is set out below.

	First Charge		Second Charge	
	2019 %	2018 %	2019 %	2018 %
East Anglia	3.2	3.0	3.3	3.5
East Midlands	5.3	5.2	6.3	6.5
Greater London	18.9	18.6	7.8	7.1
North	3.3	3.5	4.2	4.7
North West	10.1	10.2	8.0	8.5
South East	31.9	31.3	37.7	35.2
South West	8.9	9.2	7.9	8.0
West Midlands	5.1	4.8	7.6	8.0
Yorkshire and Humberside	8.6	9.4	6.2	6.7
Total England	95.3	95.2	89.0	88.2
Northern Ireland	0.1	0.1	1.9	2.1
Scotland	1.4	1.4	5.6	5.9
Wales	3.2	3.3	3.5	3.8
	100.0	100.0	100.0	100.0

Development finance

Development finance loans have an average term of 20 months (2018: 21 months). Settlement of principal and accrued interest takes place once the development is sold or refinanced following its completion and the customer is not normally required to make payments during the term of the loan. The loans are secured by a legal charge over the site and / or property together with other charges and warranties related to the build.

As customers are not required to make payments during the life of the loan, arrears and past due measures cannot be used to monitor credit risk. Instead, cases are monitored on an individual basis by management and Credit Risk. The average loan to gross development value ('LTGDV') ratio for the portfolio at year end, a measure of security cover, is analysed below.

	2019 By value %	2019 By number %	2018 By value %	2018 By number %
LTGDV				
50% or less	8.5	3.4	3.4	4.4
50% to 60%	18.2	15.5	18.9	22.8
60% to 65%	31.6	39.1	63.3	59.6
65% to 70%	32.3	32.4	7.1	9.6
70% to 75%	6.8	8.2	0.7	0.7
Over 75%	2.6	1.4	6.6	2.9
	100.0	100.0	100.0	100.0

The average LTGDV cover at the year end was 64.8% (2018: 63.2%).

The increase in LTGDV percentages over the year reflects the changing mix in the portfolio between those accounts originated using the initial cautious underwriting approach of the Group's in-house operation and those originated through the acquired operation. Following acquisition, risk appetites were adjusted to reflect the increased experience and maturity of the combined operation.

LTGDV is calculated by comparing the current expected end of term exposure with the latest estimate of the value of the completed development based on surveyors' reports.

At 30 September 2019 the development finance portfolio comprised 207 accounts (2018: 136) with a total carrying value of £506.5m (2018: £352.8m). Of these accounts only six were included in stage 2 at 30 September 2019 (2018 IFRS 9: none). In addition, three accounts acquired in the Titlestone purchase had been classified as POCI (2018: four). An allowance for these losses was made in the IFRS 3 fair value calculation.

The geographical distribution of the Group's development finance loans by gross carrying value is set out below.

	2019 %	2018 %
East Anglia	20.2	21.6
East Midlands	3.0	3.0
Greater London	20.9	28.5
North	1.0	0.7
North West	0.1	-
South East	30.8	23.0
South West	13.9	11.1
West Midlands	7.2	8.3
Yorkshire and Humberside	1.5	1.2
Total England	98.6	97.4
Northern Ireland	-	-
Scotland	1.4	2.6
Wales	-	-
	100.0	100.0

Asset finance and Motor finance

Asset and motor finance lending includes finance lease and hire purchase arrangements, which are accounted for as finance leases under IAS 17. The average contractual life of the asset finance loans was 56 months (2018: 52 months) while that of the motor finance loans was 57 months (2018: 55 months), but it is likely that a significant proportion of customers will choose to settle their obligations early.

Asset finance customers are generally small or medium sized businesses. The nature of the assets underlying the Group's asset finance lending by gross carrying value is set out below.

	2019 %	2018 %
Commercial vehicles	30.3	22.6
Construction plant	34.8	38.9
Technology	7.8	6.6
Manufacturing	6.1	5.2
Print and paper	4.8	7.1
Refuse disposal vehicles	5.2	6.7
Other vehicles	3.0	4.2
Agriculture	2.7	1.2
Other	5.3	7.5
	100.0	100.0

Motor finance loans are secured over cars, motorhomes and light commercial vehicles and represent exposure to consumers and small businesses.

Structured lending

The Group's structured lending division provides revolving loan facilities to support non-bank lending businesses. Loans are made to a Special Purpose Vehicle ('SPV') company controlled by the customer and effectively secured on the loans made by the SPV. Exposure is limited to a percentage of the underlying assets, providing a buffer against credit loss.

Summary details of the structured lending portfolio are set out below.

	2019	2018
Number of transactions	8	3
Total facilities (£m)	135.0	52.5
Carrying value (£m)	88.1	38.7

The maximum advance under these facilities was 80% of the underlying assets.

These accounts do not have a requirement to make regular payments, operating on revolving basis. The performance of each loan is monitored monthly on a case by case basis by the Group's Credit Risk function, assessing compliance with covenants relating to both the customer and the performance and composition of the asset pool. These assessments, which are reported to Credit Committee, are used to inform the assessment of expected credit loss under IFRS 9.

At 30 September 2019 there were no significant concerns regarding the credit performance of these facilities.

Unsecured consumer loans

Almost all of the Group's unsecured consumer loan assets are part of purchased debt portfolios where the consideration paid will have been based on the credit quality and performance of the loans at the point of the transaction. Collections on purchased accounts have been comfortably in excess of those implicit in the purchase prices.

Arrears performance

The number of accounts in arrears by asset class, based on the most commonly quoted definition of arrears for the type of asset, at 30 September 2019 and 30 September 2018, compared to the industry averages at those dates published by UK Finance ('UKF') and the FLA, was:

	2019 %	2018 %
First mortgages		
Accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	0.18	0.11
Buy-to-let accounts excluding receiver of rent cases	0.07	0.03
Owner-occupied accounts	2.44	3.15
UKF data for mortgage accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	0.42	0.42
Buy-to-let accounts excluding receiver of rent cases	0.37	0.38
Owner-occupied accounts	0.81	0.88
All mortgages	0.73	0.79
Second charge mortgage loans		
Accounts more than 2 months in arrears		
All accounts	14.08	13.64
Post-2010 originations	0.38	0.21
Legacy cases (Pre-2010 originations)	19.85	17.91
Purchased assets	16.05	14.81
FLA data for secured loans	8.70	9.40
Car loans		
Accounts more than 2 months in arrears	5.25	3.91
FLA data for point of sale hire purchase	2.70	2.50
Asset finance loans		
Accounts more than 2 months in arrears	0.43	0.78
FLA data for business lease / hire purchase loans	1.10	0.70

No published industry data for asset classes comparable to the Group's other books has been identified. Where revised data at 30 September 2018 has been published by the FLA or UKF, the comparative industry figures above have been amended.

Arrears information is not given for development finance, structured lending or invoice finance activities as the structure of the products means that such a measure is not relevant.

The Group calculates its headline arrears measure for buy-to-let mortgages, shown above, based on the numbers of accounts three months or more in arrears, including purchased Iden Capital assets, but excluding those cases in possession and receiver of rent cases designated for sale. This is consistent with the methodology used by UKF in compiling its statistics for the buy-to-let mortgage market as a whole.

The number of accounts in arrears will naturally be higher for legacy books, such as the Group's legacy second charge mortgages and residential first mortgages, than for comparable active ones, as performing accounts pay off their balances, leaving arrears accounts representing a greater proportion of the total.

The figures shown above for secured loans incorporate purchased portfolios which generally include a high proportion of cases in arrears at the time of purchase and where this level of performance is allowed for in the discount to current balance represented by the purchase price. However, this will lead to higher than average reported arrears.

Acquired assets

Almost all of the Group's unsecured consumer loan assets are part of purchased debt portfolios where the consideration paid will have been based on the credit quality and performance of the loans at the point of the transaction. The total amount of undiscounted ECL at initial recognition on POCI loans to customers initially recognised during the year ended 30 September 2019 was minimal due to the level of purchases.

Collections on purchased accounts have been comfortably in excess of those implicit in the purchase prices.

In the debt purchase industry, Estimated Remaining Collections ('ERCs') is commonly used as a measure of the value of a portfolio. This is defined as the sum of the undiscounted cash flows expected to be received over a specified future period. In the Group's view, this measure may be suitable for heavily discounted, unsecured, distressed portfolios, but is less applicable for the types of portfolio in which the Group has invested, where cash flows are higher on acquisition, loans may be secured on property and customers may not be in default. In such cases, the IFRS 9 amortised cost balance, at which these assets are carried in the Group balance sheet, provides a better indication of value.

However, to aid comparability, the 84 and 120 month ERC values for the Group's purchased consumer loan assets, are set out below. These are derived using the same models and assumptions used in the EIR calculations. ERCs are set out both for all purchased consumer portfolios and for those classified as POCI under IFRS 9.

	2019	2018	2017
	£m	£m	£m
All purchased consumer assets			
Carrying value	291.1	364.2	503.5
84 month ERC	342.3	434.9	608.9
120 month ERC	387.5	489.6	688.8
POCI assets only			
Carrying value	168.3	204.4	302.9
84 month ERC	214.1	269.9	317.2
120 month ERC	246.0	306.2	359.9

Amounts shown above are disclosed as loans to customers (note 20). They include first mortgages, second charge loans and unsecured consumer loans.

Further information relating to comparative information prepared under IAS 39 is included in note 54(a) and (b).

Cash balances

The credit risk inherent in the cash positions of the Group and the Company is controlled by ALCO, which determines with which institutions deposits may be placed with.

For cash deposits within the Group's securitisation structures, the scheme documents will set out criteria for allowable investments, including rating thresholds, which are monitored by the external trustees of each transaction.

The Group's cash balances are held in sterling at the Bank of England and at highly rated banks in current and call accounts. Cash is also invested in UK government securities and as short fixed term money market deposits. The Group has a Wholesale Credit Risk Policy including limits on large exposures to mitigate any concentration risk in respect of its investments.

The carrying value of the Group's and the Company's cash balances analysed by their long-term credit rating as determined by Fitch is set out below.

	2019 £m	2018 £m
The Group		
Cash with central banks rated:		
AA	816.4	895.9
Cash with retail banks rated:		
AA	-	81.3
AA-	230.5	171.5
A+	173.5	97.7
A	-	21.7
A-	5.0	-
BBB+	-	20.9
	409.0	393.1
Investments in money market funds rated:		
AAA	-	21.6
Total exposure	1,225.4	1,310.6

The Company

Cash with retail banks rated:

AAA	-	15.0
A+	9.1	9.9
BBB+	5.0	-
	14.1	24.9

CRDs share the central bank rating noted above while CSA assets, placed with retail banks, have similar ratings to those shown above.

Credit risk on all of these balances, and any interest accrued thereon, is considered to be minimal. These balances are considered as Stage 1 for IFRS 9 impairment purposes with a probability of default such that any provision required would be immaterial.

Trade debtors

The Group's trade debtors balance represents principally amounts outstanding on unpaid operating lease obligations in the asset finance business, where similar acceptance criteria to those used for finance lease cases apply.

Financial assets at fair value

The Group's financial assets held at fair value comprise solely derivative financial instruments used for hedging purposes (note 24)

In order to control credit risk relating to counterparties to the Group's derivative financial instruments, ALCO determines which counterparties the Group will deal with, establishes limits for each counterparty and monitors compliance with those limits. Such counterparties are typically highly rated banks and, for all derivative positions held within the Group's securitisation structures, must comply with criteria set out in the financing arrangements, which are monitored externally.

Where a derivative counterparty to the Group's cross-currency basis swaps fails to meet the required criteria, they are obliged under the terms of the instruments to provide a cash collateral deposit. These cash collateral deposits are held in escrow and not recognised as assets of the Group so do not form part of the Group's cash position.

The Group uses the International Swaps and Derivatives Association ('ISDA') Master Agreement for documenting certain derivative activity. For certain counterparties a Credit Support Annex ('CSA') has been executed in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between counterparties to mitigate the market contingent counterparty risk inherent in the outstanding positions. Collateral pledged to such counterparties by the Group is shown in note 25, while collateral pledged to the Group is shown in note 37.

The Group's exposure to credit risk in respect of the counterparties to its derivative financial assets, analysed by their long-term credit rating as determined by Fitch is set out below.

	2019 £m	2018 £m
Carrying value of derivative financial assets		
Counterparties rated		
AA	7.3	7.9
AA-	155.6	169.7
A+	388.8	5.4
A	5.5	630.2
A-	35.2	-
BBB+	-	42.5
Gross exposure (note 24)	592.4	855.7
Collateral amounts posted		
Cross-currency basis swap arrangements	64.1	67.5
CSA collateral amounts (note 37)	-	10.3
Total collateral	64.1	77.8
Net exposure	528.3	777.9

The increase in reported credit quality is due to upgrades in the year to the ratings of two of the Group's principal counterparties, Barclays and RBS.

58. LIQUIDITY RISK

Liquidity risk is the risk that the Group might be unable meet its liabilities as they fall due.

The Group's principal source of liquidity risk is from its retail deposit funding. Deposit balances raised are typically used to support lending activities where maturity is over a longer period than that of the deposits. This maturity transformation exposes the Group to liquidity risk.

Further liquidity risk arises:

- In the medium term from the Group's corporate and retail bonds which are used to support its general operations and from its participation in central bank funding schemes
- From the Group's derivatives portfolio which gives rise to liquidity risk due to the collateral requirements to cover adverse changes in valuation
- From the Group's participation in the SPVs where sufficient funding must be available

Liquidity is also required to provide capital support for new loans and working capital for the Group.

Where assets are funded by non-recourse arrangements, through the securitisation process, liquidity risk is effectively eliminated.

Set out below is a summary of the contractual cash flows expected to arise from the Group's financial liabilities, based on the earliest date at which repayment can be demanded.

	Amounts payable				Total
	In one year or less, or on demand	In more than one year, but not more than two years	In more than two years but not more than five years	In more than five years	
	£m	£m	£m	£m	£m
30 September 2019					
Retail deposits	4,418.0	1,210.1	982.4	-	6,610.5
Borrowings	89.9	794.6	551.8	171.8	1,608.1
Total non-derivative liabilities	4,507.9	2,004.7	1,534.2	171.8	8,218.6
Derivative liabilities	(0.1)	2.9	1.8	-	4.6
	4,507.8	2,007.6	1,536.0	171.8	8,223.2
30 September 2018					
Retail deposits	3,674.8	1,068.8	720.8	-	5,464.4
Borrowings	118.7	44.6	1,227.4	301.9	1,692.6
Total non-derivative liabilities	3,793.5	1,113.4	1,948.2	301.9	7,157.0
Derivative liabilities	(1.9)	4.7	22.6	(0.4)	25.0
	3,791.6	1,118.1	1,970.8	301.5	7,182.0

Non-recourse balances are payable only to the extent that funds are available, as described further below, and do not expose the Group to any material liquidity risk. They are therefore not included in the table above.

As the amounts set out above include all expected future cash flows, including principal and interest, they will not agree to amortised cost or fair value amounts reported in the balance sheet.

Further information on the liquidity exposure arising from the Group's retail deposits, securitisation and other borrowings is set out below.

The liquidity exposures of the Company arise only from its borrowings, and are set out below.

The responsibility for managing liquidity risk rests with ALCO which makes recommendations for the Group's liquidity policy for Board approval and uses detailed cash flow projections to ensure that an adequate level of liquidity is available at all times. The Group's liquidity position is managed on a day to day basis by the treasury function, under the supervision of ALCO.

Retail deposits

The Group's retail funding strategy is focussed on building a stable mix of deposit products. A high proportion of balances, 97.8% (2018: 97.9%), are protected by the Financial Services Compensation Scheme ('FSCS') which mitigates against the possibility of a retail run.

The cash outflows, including principal and estimated interest contractually required by the Group's retail deposit balances, analysed by the earliest date at which repayment can be demanded are set out below:

	2019 £m	2018 £m
Payable on demand	1,783.9	1,294.3
Payable in less than three months	482.7	281.9
Payable in less than one year but more than three months	2,151.4	2,098.6
Payable in less than one year or on demand	4,418.0	3,674.8
Payable in one to two years	1,210.1	1,068.8
Payable in two to five years	982.4	720.8
	6,610.5	5,464.4

In order to reduce the liquidity risk inherent in the Group's retail deposit balances, the PRA requires that the Bank, like other regulated banks, maintains a buffer of liquid assets to ensure it has sufficient available funds at all times to protect against unforeseen circumstances. The amount of this buffer is calculated using Individual Liquidity Guidance ('ILG') set by the PRA based on the Internal Liquidity Adequacy Assessment Process ('ILAAP') undertaken by the Bank. The ILAAP determines the liquid resources that must be maintained in the Bank to meet its Overall Liquidity Adequacy Requirement ('OLAR') and to ensure that it can meet its liabilities as they fall due. It is based on an analysis of its business as usual forecast cash requirements but also considers their predicted behaviour in stressed conditions.

At 30 September 2019 the liquidity buffer comprised the following on and off balance sheet assets. All of these assets are held within the Bank and are readily realisable.

	Note	2019 £m	2018 £m
Balances with central banks	18	646.4	724.9
Short-term investments	19	-	-
Total on balance sheet liquidity		646.4	724.9
FLS drawings	36	109.0	108.7
		755.4	833.6

The Bank manages its Liquidity Coverage Ratio ('LCR'), the level of its High Quality Liquid Assets ('HQLA') relative to its short term forecast net cash outflows. A minimum level of LCR, the Liquidity Coverage Requirement is set through regulation for all regulated financial institutions. As at 30 September 2019, the Bank's LCR was comfortably above the required minimum regulatory standard. The Bank also monitors its Net Stable Funding Ratio ('NSFR') which measures the stability of the funding profile in relation to the composition of its assets and off-balance sheet activities.

Liquidity is not regulated at Group level.

Borrowings

Set out below is the contractual maturity profile of the Group's and the Company's borrowings at 30 September 2019 and 30 September 2018 based on their carrying values. These are analysed between non-recourse (securitisation) and other funding, with the liquidity position arising principally from the other funding.

	Financial liabilities falling due:				Total
	In one year or less, or on demand	In more than one year, but not more than two years	In more than two years but not more than five years	In more than five years	
	£m	£m	£m	£m	£m
The Group					
30 September 2019					
Secured bank borrowings	-	-	-	787.5	787.5
Asset backed loan notes	-	-	-	4,419.4	4,419.4
Total non-recourse funding	-	-	-	5,206.9	5,206.9
Bank overdrafts	1.0	-	-	-	1.0
Retail bonds	-	59.9	236.6	-	296.5
Corporate bond	-	-	-	149.6	149.6
Central bank facilities	50.0	700.0	244.4	-	994.4
	51.0	759.9	481.0	5,356.5	6,648.4
30 September 2018					
Secured bank borrowings	-	-	-	935.6	935.6
Asset backed loan notes	-	-	-	5,554.7	5,554.7
Total non-recourse funding	-	-	-	6,490.3	6,490.3
Bank overdrafts	1.1	-	-	-	1.1
Retail bonds	-	-	184.3	111.8	296.1
Corporate bond	-	-	-	149.3	149.3
Central bank facilities	80.0	-	944.4	-	1,024.4
	81.1	-	1,128.7	6,751.4	7,961.2
The Company					
30 September 2019					
Retail bonds	-	59.9	236.6	-	296.5
Corporate bond	-	-	-	149.6	149.6
	-	59.9	236.6	149.6	446.1
30 September 2018					
Retail bonds	-	-	184.3	111.8	296.1
Corporate bond	-	-	-	149.3	149.3
	-	-	184.3	261.1	445.4

IFRS 7 requires the disclosure of future contractual cash flows (including interest) on these borrowings, and these are shown below.

Non-recourse funding

The Group has historically used securitisation as a principal source of funding, but currently only accesses this market on a strategic basis. In a securitisation an SPV company within the Group will issue asset backed loan notes ('Notes') secured on a pool of mortgage or other loan assets beneficially owned by the SPV in a public offer. The Notes have a maturity date later than the final repayment date for any asset in the pool, typically over thirty years from the issue date. The noteholders are entitled to receive repayment of the Note principal from principal funds generated by the loan assets from time to time, but their right to the repayment of principal is limited to the cash available in the SPV. Similarly, payment of accrued interest to the noteholders is limited to cash generated within the SPV. There is no requirement for any Group company other than the issuing SPV to make principal or interest payments in respect of the Notes. This matching of the maturities of the assets and the related funding substantially reduces the Group's exposure to liquidity risk. Details of Notes in issue are given in note 32 and the assets backing the Notes are shown in note 21.

In each case the Group provides funding to the SPV at inception, subordinated to the Notes, which means that the primary credit risk on the pool assets is retained within the Group. The Group receives the residual income generated by the assets. These factors mean that the risks and rewards of ownership of the assets remain with the Group, and hence the loans remain on the Group's balance sheet.

Cash received from time to time in each SPV is held until the next interest payment date when, following payment of principal, interest and the associated costs of the SPV, the remaining balances become available to the Group. Cash balances are also held within each SPV to provide credit enhancement for the particular securitisation, allowing interest and principal payments to be made even if some of the loans default. To provide further credit enhancement in certain SPVs, specific economic trigger events exist which cause additional cash to be retained in the SPV rather than being transferred to the Group. While the Group can, if it chooses, contribute additional cash to cover these requirements, it is under no obligation to do so. No such events occurred in the year ended 30 September 2019 or the year ended 30 September 2018. Whether any such events in any of the Group's other SPVs arise in the future will depend on the performance of the general economy and its impact on mortgage and loan arrears in each SPV. However, if all of the remaining trigger events occurred, a total of £55.8m of additional cash would be retained in the SPV companies (2018: £71.0m). The cash balances of the SPV companies are included within the restricted cash balances disclosed in note 18 as 'securitisation cash'.

Newly originated mortgage loans may be initially funded by a revolving loan facility or 'warehouse' from the point of their origination until their inclusion in a securitisation transaction or other refinancing. A warehouse may also be used to hold acquired loans or to refinance Group loans on a short-term basis. A warehouse company functions in a similar way to an SPV, except that funds are drawn down as advances are made or loans are sold in, repaid when loans are securitised or refinanced by an internal asset sale and may subsequently be redrawn up to the end of a commitment period. The Group's Paragon Second Funding facility was initiated as a warehouse, but is no longer available for new drawings.

Repayment of the principal amount of the facilities is not required unless amounts are realised from the secured assets either through repayment, securitisation or asset sales, even after the end of the period. There is no further recourse to other assets of the Group in respect of either interest or principal on the borrowings. The Group has reduced its available warehouse facilities in the period.

As with the SPVs, the Group provides subordinated funding to active warehouse companies and restricted cash balances are held within them. Contributions to the subordinated funding are made each time a drawing on the facility concerned is made. These amounts provide credit enhancement to the warehouse and cover certain fees. This funding is repaid when assets are securitised or refinanced by an internal asset sale. There were no active warehouse companies at 30 September 2019 or 30 September 2018.

Further details of the warehouse facilities are given in note 33 and details of the loan assets within the warehouses are given in note 21.

The final repayment date, for all of the securitisation borrowings and the Paragon Second Funding warehouse borrowing is more than five years from the balance sheet date, the earliest falling due in 2033 and the latest in 2050.

The equivalent sterling principal amount outstanding at 30 September 2019 under the SPV and warehouse arrangements, allowing for the effect of the cross-currency basis swaps, described under currency risk (note 60), which are net settled with the loan payments, was £4,706.1m (2018: £5,669.1m). The total sterling amount payable under these arrangements, were these principal amounts to remain outstanding until the final repayment date, would be £6,267.6m (2018: £8,874.2m). As the principal will, as discussed above, reduce as customers repay or redeem their accounts, the cash flow will be far less than this amount in practice.

Corporate debt

In February 2013, the Company initiated a Euro Medium Term Note issuance programme, with a maximum issuance of £1,000.0m. The Company had the ability to issue further notes under the programme and has issued three fixed rate bonds for a total of £297.5m, with interest rates ranging from 6.000% to 6.125% and maturities ranging from December 2020 to August 2024, the most recent issue of £112.5m being made in August 2015. This programme offers the Group opportunities to raise further working capital if needed.

The Group also issued £150.0m of tier 2 debt in September 2016 with an optional call date in September 2021 and a final maturity of September 2026.

The Group's ability to issue debt is supported by its credit rating issued by Fitch which was increased to BBB from BBB- in the year ended 30 September 2018 and confirmed in March 2019. It was, however, placed on negative watch, due to Brexit related concerns, in common with other UK bank issuance.

None of the Group's corporate or retail bond issuance falls due for payment earlier than 2020.

Central bank facilities

The Group has accessed term facilities under the central bank schemes described in note 36. The Group has prepositioned further assets with the Bank of England which can be used to release more funds for liquidity or other purposes. At 30 September 2019 the amount of drawings available in respect of prepositioned assets was £1,095.0m (2018: £703.2m).

Contractual cash flows

The total undiscounted amounts, inclusive of estimated interest, which would be payable in respect of the non-securitisation borrowings of the Group and the Company, should those balances remain outstanding until the contracted repayment date, or the earliest date on which repayment can be required, are set out below.

	Contingent consideration £m	Corporate bonds £m	Retail bonds £m	Central bank facilities £m	Total £m
a) The Group					
30 September 2019					
Payable in less than one year	5.7	10.9	18.0	55.3	89.9
Payable in one to two years	6.2	10.9	75.3	702.2	794.6
Payable in two to five years	12.7	32.6	261.6	244.9	551.8
Payable in over five years	-	171.8	-	-	171.8
	24.6	226.2	354.9	1,002.4	1,608.1

30 September 2018					
Payable in less than one year	2.5	10.9	18.0	87.3	118.7
Payable in one to two years	5.7	10.9	18.0	10.0	44.6
Payable in two to five years	18.9	32.6	217.6	958.3	1,227.4
Payable in over five years	-	182.6	119.3	-	301.9
	27.1	237.0	372.9	1,055.6	1,692.6

	Corporate bonds £m	Retail bonds £m	Total £m
b) The Company			
30 September 2019			
Payable in less than one year	10.9	18.0	28.9
Payable in one to two years	10.9	75.3	86.2
Payable in two to five years	32.6	261.6	294.2
Payable in over five years	171.8	-	171.8
	226.2	354.9	581.1

30 September 2018			
Payable in less than one year	10.9	18.0	28.9
Payable in one to two years	10.9	18.0	28.9
Payable in two to five years	32.6	217.6	250.2
Payable in over five years	182.6	119.3	301.9
	237.0	372.9	609.9

Amounts payable in respect of the 'other accruals' and 'trade creditors' shown in note 37 fall due within one year. The cash flows described above will include those for interest on borrowings accrued at 30 September 2019 disclosed in note 37.

The cash flows which are expected to arise from derivative contracts in place at the year end, estimating future floating rate payments and receipts on the basis of the yield curve at the balance sheet date are as follows:

	2019 Total cash outflow / (inflow) £m	2018 Total cash outflow / (inflow) £m
On derivative liabilities		
Payable in less than one year	(0.1)	(1.9)
Payable in one to two years	2.9	4.7
Payable in two to five years	1.8	22.6
Payable in over five years	-	(0.4)
	4.6	25.0
On derivative assets		
Payable in less than one year	(14.0)	(4.3)
Payable in one to two years	(20.8)	(1.2)
Payable in two to five years	(42.0)	0.2
Payable in over five years	(0.5)	-
	(77.3)	(5.3)
	(72.7)	19.7

59. INTEREST RATE RISK

Interest rate risk is the current or prospective risk to capital or earnings arising from adverse movements in interest rates. The Group's exposure to this risk is a natural consequence of its lending, deposit taking and other borrowing activities, as some of its financial assets and liabilities bear interest at rates which float with various market rates while others are fixed, either for a term or for their whole lives. Such risk is referred to as Interest Rate Risk in the Banking Book ('IRRBB'). The Group does not seek to generate income from taking interest rate risk and aims to minimise exposures that occur as a natural consequence of carrying out its normal business activities.

The principal market-set interest rate used by the Group is the London Interbank Offered Rate ('LIBOR') which is used to set rates for certain loan assets and borrowings. During the year, the Group issued its first debt with interest set by reference to the Sterling Overnight Index Average ('SONIA'), which is expected to be used more widely going forward.

The Group's risk management framework for IRRBB continues to evolve in line with updates in regulatory guidance on methods expected to be used by banks measuring, managing, monitoring and controlling such risks. The Group will continue to develop these processes as interpretation of these standards becomes clearer as they become more widely implemented.

IRRBB is managed through Board approved risk appetite limits and policies. The Group seeks to match the structure of assets and liabilities naturally where possible or by using appropriate financial instruments, such as interest rate swaps. Day to day management of interest rate risk is the responsibility of the Group's Treasury function, with control and oversight provided by ALCO.

IRRBB exposures

Risk exposure in the Group's operations might occur through:

- Gap or re-pricing risk. The risk created when interest rates on assets, liabilities and off-balance sheet items reprice at different times causing them to move by different amounts
- Basis risk. The risk arising where assets and liabilities re-price with reference to different reference interest rates, for example, rates set by the Group and market rates, such as Bank of England base rate, SONIA and LIBOR. Relative changes in the difference between the reference rates over time may impact earnings
- Option or prepayment risk. The risk that settlement of asset and liability balances at different times from those forecast due to economic conditions or customer behaviour may create a mismatch in future periods

Due to the maturity transformation inherent in the Group's business model, it is also exposed to the risk that the relationship between the rates affecting the shorter term funding balance and the rates affecting the longer term lending balance will have altered when the funding has to be refinanced.

The Group measures these risks through a combination of economic value and earnings-based measures considering prepayment risk:

- Economic Value ('EV') – a range of parallel and non-parallel interest rate stresses are applied to assess the change in market value from assets, liabilities and off-balance sheet items re-pricing at different times
- Net Interest Income ('NII') - impact on earnings from a range of interest rate stresses

Interest rate benchmarks such as LIBOR have been subject to increasing global regulatory scrutiny. In July 2017 the FCA announced that it was its intention that by the end of 2021 it would no longer compel banks to make submissions to the LIBOR setting process. As a result of this, LIBOR is expected to be discontinued and alternative reference rates are being developed. For LIBOR, the Bank of England's Working Group on Sterling Risk-Free Interest Rates recommended SONIA as that alternative. However, there remains significant uncertainty as to how the transition from LIBOR and other Interbank Offered Rates to alternative benchmarks will be managed across the banking industry.

LIBOR is used in setting interest rates on significant amounts of the Group's loan assets and borrowings and the Group has established an internal working group to identify the impact on the business and ensure an orderly transition from LIBOR to other reference rates.

The Group's use of financial derivatives for hedging interest rate risk is discussed further in note 24.

Interest rate sensitivity

To provide a broad indication of the Group's exposure to interest rate movements, the notional impact of a 1.0% change in UK interest rates on the equity of the Group at 30 September 2019, and the notional annualised impact of such a change on the operating profit of the Group, based on the year-end balance sheet have been calculated.

As a simplification this calculation assumes that all relevant UK interest rates move by the same amount in parallel and that all repricing takes place at the balance sheet date.

On this basis, a 1.0% increase in UK interest rates would reduce the Group's equity at 30 September 2019 by £1.1m (2018: £1.7m) and increase profit before tax by £10.1m (2018: increase by £19.8m).

This calculation allows only for the direct effects of any change in UK interest rates. In practice such a change might have wider economic consequences which would themselves potentially affect the Group's business and results.

Although certain of the Group's borrowings have interest rates dependent on US Dollar and Euro LIBOR rates, the effect of the cross-currency basis swaps is such that the Group's results have no material exposure to movements in these rates. The effects of independent 1.0% increases in US or Euro interest rates would be to increase the Group's equity by £0.4m (2018: £0.6m) and £1.1m (2018: £1.4m) respectively, however, in reality these movements would be mitigated by movements in UK interest rates and exchange rates.

It should be noted that these sensitivities are illustrative only, and much simplified from those used to manage IRRBB in practice.

The Company

All the borrowings of the Company have fixed interest rates. Its assets and liabilities with other group companies bear interest at floating rates based on LIBOR which reset within three months of the balance sheet date; all other balances in the Company balance sheet are non-interest bearing.

60. CURRENCY RISK

The Group has no appetite for material amounts of exposure to foreign currency movements and applies a hedging strategy for any material open positions through the use of spot or forward contracts or derivatives.

All of the Group's significant assets and liabilities are denominated in sterling with the exception of the asset backed loan notes denominated in US dollars and euros, which are described in note 32. Although IFRS 9 requires that they be accounted for as currency liabilities and valued at their spot rates, a condition of the issue of these notes was that bespoke interest rate and currency swaps ('cross-currency basis swaps') were put in place for the duration of the borrowing, having the effect of converting the liability to a LIBOR linked floating rate sterling borrowing eliminating currency risk for these exposures. The amount of this effective borrowing, i.e. the amount of the currency borrowing translated at the exchange rate on inception, is referred to as the 'equivalent sterling principal'.

The equivalent sterling principal amounts of notes in issue under the arrangements described above, and their carrying values at 30 September 2019 and 30 September 2018 are set out below:

	2019 Equivalent sterling principal £m	2019 Carrying value £m	2018 Equivalent sterling principal £m	2018 Carrying value £m
US dollar notes	447.5	721.6	897.3	1,321.8
Euro notes	1,007.4	1,314.1	1,320.5	1,724.5
	1,454.9	2,035.7	2,217.8	3,046.3

The asset finance business has a limited amount of lending denominated in US dollars and may contract to purchase assets for leasing in currency. These balances are hedged by the purchase of currency derivatives and/or appropriate currency balances.

As a result of these arrangements the Group has no material exposure to foreign currency risk, and no sensitivity analysis is presented for currency risk.

The Group's use of financial derivatives to manage currency risk is described further in note 24.

None of the assets or liabilities of the Company are denominated in foreign currencies.

D2.3 NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

For the year ended 30 September 2019

The notes set out below describe the accounting basis on which the Group and the Company prepare their accounts, the particular accounting policies adopted by the Group and the principal judgements and estimates which were required in the preparation of the financial statements.

They also include other information describing how the accounts have been prepared required by legislation and accounting standards.

61. BASIS OF PREPARATION

The financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted by the EU. In the financial years reported upon this means that, in the Group's circumstances, the financial statements accord also with International Financial Reporting Standards as approved by the International Accounting Standards Board.

The particular accounting policies adopted have been set out in note 63 and the critical accounting judgements and estimates which have been required in preparing these financial statements are described in note 64 and 65 respectively.

Adoption of new and revised reporting standards

In the preparation of these financial statements, the following accounting standards are being applied for the first time.

- IFRS 9 – 'Financial Instruments' (together with consequential changes to IFRS 7 - 'Financial Instruments: Disclosures')
- IFRS 15 – 'Revenue from Contracts with Customers'

The effect on the Group's and the Company's accounting of the adoption of these standards is discussed in note 62.

Comparability of information

IFRS 9 does not require that the balance sheet information at 30 September 2017 and 30 September 2018 and the profit and loss information for the years ended on these dates is restated on the adoption of the Standard. The information presented for those periods in these financial statements is derived in accordance with IAS 39 – 'Financial Instruments: Recognition and Measurement' ('IAS 39'), and therefore may not be directly comparable with the balance sheet at 30 September 2019 and the profit and loss account for the year then ended which are prepared under IFRS 9.

In order to aid users of the accounts additional comparative balance sheet amounts at 1 October 2018, immediately following transition, have been provided where relevant. These are marked as 2018 IFRS 9.

Standards not yet adopted

At the date of authorisation of these financial statements IFRS 16 – 'Leases', which has not been applied in these financial statements, was in issue but not yet effective.

Other standards and interpretations in issue but not effective do not address matters relevant to the Group's accounting and reporting.

IFRS 16

IFRS 16 will replace the standards currently governing the accounting for operating and finance leases and will come in to force with effect from the Group's financial statements for the year ending 30 September 2020. The Group has not early adopted IFRS 16 and will adopt IFRS 16 for the year ending 30 September 2020 using the modified retrospective approach.

Lessor accounting

The standard will address accounting by lessees and lessors, but the provisions for lessor accounting are little changed from those in IAS 17 and so the accounting for the Group's finance lease receivables will be largely unaffected.

Lessee accounting

Accounting by lessees will change significantly, with a right of use asset recognised on the balance sheet for all leases, representing the right to use the underlying asset. This includes leases presently treated as operating leases and not recognised on the balance sheet. A corresponding liability arises representing the present value of future lease commitments.

The Group's present commitments under such leases are described in note 51(b). Additionally, the Group has undertaken an exercise to identify potential lease agreements arising from service contracts it holds.

The Group has made use of practical expedients within IFRS 16 when performing its initial impact assessment. These include the right to exclude contracts that have not previously been classified as leases before the implementation date, and the ability to exclude leases of low value and those with a short term. A discount rate based on a 5-year corporate bond rate has been used when performing the present value calculations.

This is expected to result in the recognition of a right of use ('ROU') asset of £9.0m and a corresponding liability of £9.0m. Comparative amounts will not be restated.

There is expected to be no immediate tax impact from transition and the Group's regulatory capital will be unaffected. Under IFRS 16, the amount charged to profit and loss will represent depreciation on the ROU asset and a finance charge on the liability instead of rents. While this is a change of classification, the overall effect on profit is likely to be insignificant. There is no impact on reported cash flows.

62. CHANGES IN ACCOUNTING STANDARDS

The Group is required to adopt IFRS 9 (and the consequent changes to IFRS 7) and IFRS 15 for the first time in preparing its financial statements for the year ended 30 September 2019.

IFRS 9 – Overview

IFRS 9 'Financial Instruments' replaces IAS 39 'Financial Instruments: Recognition and Measurement' ('IAS 39') and addresses the recognition, classification and measurement of financial assets and liabilities.

IFRS 9 – Classification

IFRS 9 changes the classification requirements for financial assets and liabilities. In order for financial assets to be carried at amortised cost under the new standard, they must be carried in a business model whose objective is to collect the contractual cash flows from the assets and where those cash flows comprise solely payments of principal and interest ('SPPI'). Further information on this judgement is given in note 64.

In accordance with the new rules:

- Cash balances and loans to customers (other than finance leases), which were classified as 'loans and receivables' under IAS 39 are classified as 'financial assets measured at amortised cost' under IFRS 9 and continue to be measured on the amortised cost basis
- Retail deposits and external borrowings, which were classified as 'other financial liabilities' under IAS 39 are classified as 'financial liabilities measured at amortised cost' and continue to be measured on the amortised cost basis
- Derivative financial assets and liabilities, which were carried at fair value under IAS 39 are classified as 'financial assets or liabilities at fair value through profit and loss' under IFRS 9 and continue to be measured on the same basis

The amortised cost and fair value measurement methodologies remain broadly the same in IFRS 9 as they were in IAS 39 and no measurement changes in the accounts of the Group or the Company have arisen as a result of these classification changes.

The Group's financial asset and financial liability balances measured in accordance with IFRS 9 and the preceding standard, IAS 39, at the transition date (1 October 2018) are set out below:

	Post-transition £m	Pre-transition £m
Financial Assets		
Cash – central banks	895.9	895.9
Cash – retail banks	414.7	414.7
Loans to customers	12,100.6	12,127.8
Derivative financial assets	855.7	855.7
Sundry financial assets	15.3	15.3
	14,282.2	14,309.4
Financial Liabilities		
Short-term bank borrowings	1.1	1.1
Retail deposits	5,296.6	5,296.6
Derivative financial liabilities	4.7	4.7
Asset backed loan notes	5,554.7	5,554.7
Secured bank borrowings	935.6	935.6
Retail bond issuance	296.1	296.1
Corporate bond issuance	149.3	149.3
Central bank facilities	1,024.4	1,024.4
Other financial liabilities	82.8	82.8
	13,345.3	13,345.3

The only changes arising from a change in measurement on transition to IFRS 9 relate to impairment provision on the Group's loans to customers. These are discussed further below.

The Company's financial asset and financial liability balances measured in accordance with IFRS 9 and the preceding standard, IAS 39, at the transition date (1 October 2018) are set out below:

	Post-transition £m	Pre-transition £m
Financial Assets		
Cash – retail banks	24.9	24.9
Balances owed by Group companies	216.3	216.3
Loans to Group companies	200.0	200.0
Sundry financial assets	0.7	0.7
	441.9	441.9
Financial Liabilities		
Retail bond issuance	296.1	296.1
Corporate bond issuance	149.3	149.3
Balances owed to Group companies	125.7	125.7
Sundry financial liabilities	2.8	2.8
	573.9	573.9

No measurement changes on transition to IFRS 9 arise in the accounts of the Company.

IFRS 9 – Impairment

IFRS 9 changes the basis of impairment provision for all financial assets from an incurred loss to an expected credit loss ('ECL') basis. Therefore, the provisioning is dependent on an assessment of the probability of future default and the loss which might be incurred at that time. This introduces significant additional areas of estimation to the accounting.

This introduces a number of new concepts and changes to the approach required by IAS 39. ECLs are based on an assessment of the probability of default ('PD') and loss given default ('LGD'), discounted to give a net present value. The estimation of ECL should be unbiased and probability weighted, considering all reasonable and supportable information, including forward looking economic assumptions and a range of possible outcomes. This has the effect of recognising losses on loans earlier than at present, as IAS 39 requires provisions to be made only at the point where a loss has actually occurred and there is objective evidence of credit impairment.

The Standard also requires that companies calculate impairment under a variety of differing economic scenarios and combine these on a weighted average basis to arrive at the final provision, rather than base calculations on a central forecast, as is generally the case under IAS 39.

IFRS 9 requires loan assets to be divided into three 'stages', with accounts which were credit impaired on initial recognition representing a fourth class.

The three classes comprise: those where there has been no Significant Increase in Credit Risk ('SICR') since advance or acquisition (Stage 1); those where there has been a SICR (Stage 2); and loans which are credit impaired (Stage 3). It is an important feature of the standard that SICR is not defined solely by the performance of the account, but also by other information available about the customer both internally and externally, such as credit bureau information.

- On initial recognition, and for assets where there has not been an SICR, provisions will be made in respect of losses resulting from the level of credit default events expected in the twelve months following the balance sheet date. These accounts would be largely unprovided for under IAS 39, although some cases with adverse qualitative indicators might have been addressed by a collective emergence provision. Such provisions under IAS 39 were designed to cover assets where a loss event had occurred before the reporting date, but this event had not yet affected performance
- Where a loan has experienced an SICR, whether or not the loan is considered to be credit impaired, provisions will be made based on the ECLs over the full life of the loan. This is likely to lead to an increase in provision in general, though the IAS 39 emergence provision would have also addressed some of this risk
- For credit impaired assets, provisions will be made on the basis of lifetime expected credit losses, taking account of forward-looking economic assumptions and a range of possible outcomes. Under IAS 39, provisions were based on the asset's carrying value and the present value of the estimated future cash flows. Despite IAS 39 not explicitly taking account of alternative economic scenarios, where loans had attracted a provision under IAS 39, the IFRS 9 provision on transition was, in most cases, broadly similar to the closing IAS 39 position

Credit impaired assets are identified either through quantitative measures or by operational status. In determining indicators of credit impairment regard is also taken of definitions used for regulatory capital purposes. Assets may also be assigned to Stage 3 if they are identified as credit impaired as a result of management review processes

- For assets which were purchased or originated as credit impaired ('POCI') accounts (i.e. considered as credit impaired at the point of first recognition), such as certain of the Group's acquired assets in Idem Capital, the required treatment is largely similar under IAS 39 and IFRS 9. This classification also includes credit impaired assets recognised in corporate acquisitions under IFRS 3. Purchased performing accounts are not classified as POCI, but are first recognised in Stage 1

Under IAS 39 the Group treated all loan accounts as live where they remained open on its administration system. IFRS 9 requires a firm to consider the prospect of future recovery in its write off approach and the Group has adopted a revised accounting policy for write offs following transition.

Accounts are now written off for accounting purposes when standard enforcement processes have been completed, subject to any amount retained in respect of expected salvage receipts. This change has no effect on the net carrying value, only on the amounts reported as gross loan balances and accumulated impairment provisions, but provides a more informative value for the coverage ratio.

All accounts which would have been written off for accounting purposes prior to the transition date under the new policy have been written off at transition. All of these cases were fully provided and therefore this has had no impact on reserves.

As disclosed in the transition report, the introduction of IFRS 9 resulted in an increase in the Group's impairment provision of £27.2m at the transition date, 1 October 2018. The impacts by business segment are set out below:

	IAS 39 £m	IFRS 9 £m	Change £m	Change %
Loans to customers				
Mortgages	10,473.5	10,449.5	(24.0)	(0.2) %
Commercial Lending	1,133.2	1,131.3	(1.9)	(0.2) %
Idem Capital	521.1	519.8	(1.3)	(0.2) %
Total	12,127.8	12,100.6	(27.2)	(0.2) %

The movement in impairment provisions in the Group's accounts between the balance disclosed under IAS 39 and the opening balance under IFRS 9 is set out below.

	£m
Loans to customers	
At 30 September 2018 under IAS 39	107.4
IFRS 9 transition adjustments	27.2
Change in write-off definition	(80.4)
At 1 October 2018 under IFRS 9	54.2

The reduction due to write off definitions is principally attributable to part redeemed loan balances which remained live on the administration systems of the Group and were therefore treated as live for accounting purposes. Under IFRS 9 these balances may be defined as written off, and the Group's IFRS 9 write off policy considers them to be so, as this provides users with a more useful measure of provision cover.

The increase in impairment on transition will be allowed as a deduction for the purposes of UK Corporation Tax under the Change in Accounting Practices Regulations. This is spread over the ten years following transition for loan assets and is allowable in the 2019 tax computations for finance leases. A deferred tax asset of £5.0m has been recognised on transition.

Cash balances, 'Trade receivables', and the sundry financial asset balances shown in note 25 are classified as financial assets accounted for at amortised cost and are therefore subject to the impairment provisions of IFRS 9. However, these assets are principally UK sovereign exposures (including exposures to the Bank of England) and exposures to highly rated banks. The ECLs on these counterparties are considered to be minimal. The value, tenor and potential for default of the other exposures is such that any potential IFRS 9 provision is insignificant.

Derivative financial assets are carried at fair value, which includes the consideration of credit risk, as they were under IAS 39.

The introduction of the IFRS 9 impairment regime had no impact on the financial assets of the Company.

IFRS 9 – Hedge accounting

The hedge accounting requirements of IFRS 9 do not specifically address portfolio fair value hedges of interest rate risk ('macro hedges') which IAS 39 deals with directly. A separate financial reporting standard is to be developed in this area. IFRS 9 allows the option to continue to apply the existing hedge accounting requirements of IAS 39 until this is implemented.

As the Group's hedging arrangements are either macro hedges, which are not specifically addressed by the new standard, or bespoke cash flow hedges, which would not be affected by the change of standard, the Group has decided to defer application of these rules until the full new hedge accounting regime is in place.

It thus continues to apply the hedge accounting requirements of IAS 39 and all hedging arrangements in place at 30 September 2018 continue to be recognised on 1 October 2018 after IFRS 9 transition.

However, the consequential changes to IFRS 7 (see below) do apply to these financial statements and the Group's disclosures in respect of hedge accounting and derivatives have been revised and expanded.

There are no hedge accounting arrangements in the accounts of the Company.

IFRS 7 – Disclosure

At the point of adoption of IFRS 9, entities are also required to adopt amendments to IFRS 7 – 'Financial Instruments: Disclosures' made by IFRS 9 in July 2014. The principal amendments affecting the Group's accounts are those concerning the reporting of impairment, taking account of the IFRS 9 measurement requirements for impairment, the reporting of credit risk and the reporting of hedging strategies and outcomes.

This has, therefore, required significant amendments to the disclosures presented as notes 57 (credit risk), 21 to 23 (loans and impairment) and 24 (derivatives and hedging) in these accounts compared to those presented for the year ended 30 September 2018. When new notes address impairment, no comparative amounts are required to be disclosed, but for other new requirements, comparative amounts under the new standard at 30 September 2018 are shown.

IFRS 15 – Impact

IFRS 15 governs the accounting for those of the Group's income streams which are not within the scope of either IFRS 9 or IAS 17 - 'Leases'. These comprise principally third-party servicing income, maintenance income on vehicle leasing, third party commission income and account fee income. The accounting for most of these flows is unchanged as the amounts are charged on an event-by-event basis.

There is a small balance sheet impact in the Group accounts from the accounting for maintenance agreements, decreasing reserves at 30 September 2018 by £0.2m. In view of the low level of impact comparative amounts have not been restated for this change.

The introduction of IFRS 15 had no impact on the accounts of the Company.

Summary

The overall impacts of the changes above on consolidated equity at 30 September 2018 are set out below.

	Note	£m	£m
Equity at 30 September 2018			1,095.9
IFRS 9			
Impairment	20	(27.2)	
Deferred tax thereon	26	5.0	
		(22.2)	
IFRS 15			
Maintenance income		(0.2)	
Total adjustments			(22.4)
Equity at 1 October 2018			1,073.5

All these amendments impacted retained earnings. None of these changes have any impact on the Group's cash flow reporting.

There were no impacts on the equity of the Company.

63. ACCOUNTING POLICIES

The particular policies applied by the Group in preparing these financial statements in accordance with the EU endorsed IFRS regime are described below.

As comparative financial information relating to the year ended 30 September 2018 and earlier periods has not been restated for IFRS 9, as permitted by that standard, the accounting policies applied differ to those used in the accounts for the year ended 30 September 2019. Where this is significant both policies are shown.

(a) Accounting convention

The financial statements have been prepared under the historical cost convention, except as required in the valuation of certain financial instruments which are carried at fair value.

(b) Basis of consolidation

The consolidated financial statements deal with the accounts of the Company and its subsidiaries made up to 30 September 2019. Subsidiaries comprise all those entities over which the Group has control, as defined by IFRS 10 – 'Consolidated Financial Statements'.

In addition to legal subsidiaries, where the Company owns shares in the entity, directly or indirectly, in accordance with IFRS 10, companies owned by charitable trusts into which loans originated by group companies were sold as part of its warehouse and securitisation funding arrangements, where the Group enjoys the benefits of ownership and which, therefore, it is considered to control, are treated as subsidiaries.

Similarly, trusts set up to hold shares in conjunction with the Group's employee share ownership arrangements are also treated as subsidiaries.

A full list of the Group's subsidiaries is set out in note 68, together with further information on the basis on which they are considered to be controlled by the Company. The results of businesses acquired are dealt with in the consolidated accounts from the date of acquisition.

(c) Going concern

The consolidated financial statements have been prepared on the going concern basis.

Accounting standards require the directors to assess the Group's ability to continue to adopt the going concern basis of accounting. In performing this assessment, the directors consider all available information about the future, the possible outcomes of events and changes in conditions and the realistically possible responses to such events and conditions that would be available to them, having regard to the 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' published by the Financial Reporting Council in September 2014.

In order to assess the appropriateness of the going concern basis the directors considered the Group's financial position, the cash flow requirements laid out in its forecasts, its access to funding, the assumptions underlying the forecasts and the potential risks affecting them.

After performing this assessment, the directors concluded that it was appropriate for them to continue to adopt the going concern basis in preparing the Annual Report and Accounts.

(d) Acquisitions and goodwill

Goodwill arising from the purchase of subsidiary undertakings, representing the excess of the fair value of the purchase consideration over the fair values of acquired assets, including intangible assets, is held on the balance sheet and reviewed annually to determine whether any impairment has occurred.

As permitted by IFRS 1, the Group has elected not to apply IFRS 3 – ‘Business Combinations’ to combinations taking place before its transition date to IFRS (1 October 2004). Therefore any goodwill which was written off to reserves under UK GAAP will not be charged or credited to the profit and loss account on any future disposal of the business to which it relates.

Contingent consideration arising on acquisitions is first recognised in the accounts at its fair value at the acquisition date and subsequently revalued at each accounting date until it falls due for payment or the final amount is otherwise determined.

(e) Cash and cash equivalents

Balances shown as cash and cash equivalents in the balance sheet comprise demand deposits and short-term deposits with banks with initial maturities of not more than 90 days.

(f) Short term investments

Short term investments are held as part of the liquidity requirement of Paragon Bank PLC. As such they are measured at their fair value which corresponds to their market value at the balance sheet date.

(g) Leases

Leases are accounted for as operating or finance leases in accordance with IAS 17 – ‘Leases’. A finance lease is deemed to be one which transfers substantially all of the risks and rewards of the ownership of the asset concerned. Any other lease is an operating lease.

Rental income and costs under operating leases are credited or charged to the profit and loss account on a straight line basis over the period of the leases.

(h) Loans to customers

Year ended 30 September 2019 under IFRS 9

Loans to customers includes assets accounted for as financial assets and finance leases. The Group assesses the classification and measurement of a financial asset based on the contractual cash flow characteristics of the asset and its business model for managing the asset. The Group has concluded that its business model for its customer loan assets is of the type defined as ‘Held to collect’ by IFRS 9 and the contractual terms of the asset should give rise to cash flows that are solely payments of principal and interest (‘SPPI’). Such loans are therefore accounted for on the amortised cost basis.

Loans advanced are valued at inception at the initial advance amount, which is the fair value at that time, inclusive of procurement fees paid to brokers or other business providers and less initial fees paid by the customer. Loans acquired from third parties are initially valued at the purchase consideration paid or payable. Thereafter, all loans to customers are valued at this initial amount less the cumulative amortisation calculated using the EIR method. The loan balances are then reduced where necessary by an impairment provision.

The EIR method spreads the expected net income arising from a loan over its expected life. The EIR is that rate of interest which, at inception, exactly discounts the future cash payments and receipts arising from the loan to the initial carrying amount.

Where financial assets are credit-impaired at initial recognition the EIR is calculated on the basis of expected future cash receipts allowing for the effect of credit risk. In other cases, the expected contractual cash flows are used.

Year ended 30 September 2018 under IAS 39

Loans to customers are considered to be ‘loans and receivables’ as defined by IAS 39 – ‘Financial Instruments: Recognition and Measurement’. They are therefore accounted for on the amortised cost basis.

Loans advanced are valued at inception at the initial advance amount, which is the fair value at that time, inclusive of procurement fees paid to brokers or other business providers and less initial fees paid by the customer. Loans acquired from third parties are initially valued at the purchase consideration paid or payable. Thereafter, all loans to customers are valued at this initial amount less the cumulative amortisation calculated using the EIR method. The loan balances are then reduced where necessary by a provision for balances which are considered to be impaired.

The EIR method spreads the expected net income arising from a loan over its expected life. The EIR is that rate of interest which, at inception, exactly discounts the future cash payments and receipts arising from the loan to the initial carrying amount.

(i) Finance lease receivables

Finance lease receivables are included within 'Loans to Customers' at the total amount receivable less interest not yet accrued, unamortised commissions and provision for impairment.

Income from finance lease contracts is governed by IAS 17 – 'Leases' and accounted for on the actuarial basis.

(j) Impairment of loans to customers

Year ended 30 September 2019 under IFRS 9

The carrying values of all loans to customers, whether accounted for under IFRS 9 or IAS 17, are reduced by an impairment provision based on their expected credit loss ('ECL'), determined in accordance with IFRS 9. These estimates are reviewed throughout the year and at each balance sheet date.

With the exception of POCI financial assets (which are discussed separately below), all assets are assessed to determine whether there has been a significant increase in credit risk ('SICR') since the point of first recognition (origination or acquisition). Assets are also reviewed to identify any which are 'Credit Impaired'. SICR and credit impairment are identified on the basis of pre-determined metrics including qualitative and quantitative factors relevant to each portfolio, with a management review to ensure appropriate allocation.

Assets which have not experienced an SICR are referred to as 'Stage 1' accounts, assets which have experienced an SICR but are not credit impaired are referred to as 'Stage 2' accounts, while credit impaired assets are referred to as 'Stage 3' accounts.

An impairment allowance is provided on an account by account basis:

- For Stage 1, at an amount equal to 12-month ECL, i.e. the total expected ECL that results from those default events that are possible within 12 months of the reporting date, weighted by the probability of those events occurring
- For Stage 2 and 3 accounts, at an amount equal to lifetime ECL, i.e. the total expected ECL that results from any future default events, weighted by the probability of those events occurring

In establishing an ECL allowance, the Group assesses its probability of default, loss given default and exposure at default for each reporting period, discounted to give a net present value. The estimates used in these assessments must be unbiased and take into account reasonable and supportable information including forward-looking economic inputs.

Within its buy-to-let portfolio the Group utilises a receiver of rent process, whereby the receiver stands between the landlord and tenant and will determine an appropriate strategy for dealing with any delinquency. This strategy may involve the immediate sale of any underlying security or the short or long term letting of the property to cover arrears and principal shortfalls. Such cases are automatically considered to have an SICR, but where a letting strategy is adopted by the receiver and a tenant is in place, arrears may be reduced or cleared. Properties in receivership are eventually either returned to their landlord owners or sold.

For loan portfolios acquired at a discount, the discounts take account of future expected impairments and such assets are treated as POCI. For these assets, the Group recognises all changes in future cash flows arising from changes in credit quality since initial recognition as a loss allowance with any changes recognised in profit or loss.

For financial accounting purposes, provisions for impairments of loans to customers are held in an impairment allowance account from the point at which they are first recognised. These balances are released to offset against the gross value of the loan when it is written off for accounting purposes. This occurs when standard enforcement processes have been completed, subject to any amount retained in respect of expected salvage receipts. Any further gains from post-write off salvage activity are reported as impairment gains.

Year ended 30 September 2018 under IAS 39

Loans and receivables are reviewed for indications of possible impairment throughout the year and at each balance sheet date in accordance with IAS 39. Where loans exhibit objective evidence of impairment (a 'loss event') the carrying value of the loans is reduced to the net present value of their expected future cash flows, including the value of the potential realisation of any security (net of sales costs) discounted at the original EIR.

Within its buy-to-let portfolio the Group utilises a receiver of rent process, whereby the receiver stands between the landlord and tenant and will determine an appropriate strategy for dealing with any delinquency. This strategy may involve the immediate sale of any underlying security or the short or long term letting of the property to cover arrears and principal shortfalls. Where a letting strategy is adopted by the receiver, a tenant is in place and arrears are reduced or cleared, the account will not necessarily attract an impairment provision. Properties in receivership are eventually either returned to their landlord owners or sold.

Loss events reflect both loans that display delinquency in contractual payments of principal or interest or, for buy-to-let loans in receivership but up to date at the balance sheet date, properties where the receiver adopts a sale strategy, where a shortfall may or may not arise.

In addition to loans where loss events are evident, loans are also assessed collectively, grouped by risk characteristics and account is taken of any impairment arising due to events which are believed to have taken place but have not been specifically identified at the balance sheet date. Collective impairment provisions are calculated for each key portfolio based on recent historical performance, with adjustments for expected changes in losses based on management's judgement. In the receiver of rent portfolio, collective provisions are also established for cases where the present strategy might not be sustainable.

For loan portfolios acquired at a discount, the discounts take account of future expected impairments. An impairment charge is only recognised in the income statement if the total receipts from an acquired portfolio are below the original purchase price. Changes to expected cash flows from acquired portfolios are reflected by discounting the future expected cash flows by the original effective interest rate, with any change from the prevailing carrying value being recognised in the income statement.

For financial accounting purposes provisions for impairments of loans to customers when first recognised in the income statement are held in an allowance account. These balances are released to offset against the gross value of the loan when it is written off to profit and loss on the administration system. After this point a salvage balance may be held in respect of any further recoveries expected on the loan.

(k) Amounts owed by or to group companies

In the accounts of the Company, balances owed by or to other group companies are carried at the current amount outstanding less any provision. Where balances owing between group companies fall within the definition of either financial assets or financial liabilities given in IAS 32 – ‘Financial Instruments: Presentation’ they are classified as assets or liabilities at amortised cost, as defined by IFRS 9.

(l) Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation.

Assets held for letting under operating leases are depreciated in equal annual instalments to their estimated residual value over the life of the related lease. This depreciation is deducted in arriving at net lease income and is shown in note 6.

The assets’ residual values and useful lives are reviewed by management and adjusted, if appropriate, at each balance sheet date.

Depreciation on operating assets is provided on cost in equal annual instalments over the lives of the assets. Land is not depreciated. The rates of depreciation are as follows:

Freehold premises	2% per annum
Short leasehold premises	over the term of the lease
Computer hardware	25% per annum
Furniture, fixtures and office equipment	15% per annum
Company motor vehicles	25% per annum

(m) Intangible assets

Intangible assets comprise purchased computer software and other intangible assets acquired in business combinations.

Purchased computer software is capitalised where it has a sufficiently enduring nature and is stated at cost less accumulated amortisation. Amortisation is provided in equal instalments at a rate of 25% per annum.

Other intangible assets acquired in business combinations include brands and business networks and are capitalised in accordance with the requirements of IFRS 3 – ‘Business Combinations’. Such assets are stated at attributed cost less accumulated amortisation. Amortisation is provided in equal instalments at a rate determined at the point of acquisition.

(n) Investments in subsidiaries

The Company’s investments in subsidiary undertakings are valued at cost less provision for impairment.

(o) Own shares

Shares in Paragon Banking Group PLC held in treasury or by the trustee of the Group’s employee share ownership plan are shown on the balance sheet as a deduction in arriving at total equity. Own shares are stated at cost.

(p) Retail deposits

Retail deposits are carried in the balance sheet on the amortised cost basis. The initial fair value recognised represents the cash amount received from the customer.

Interest payable to the customer is expensed to the income statement as interest payable over the deposit term on an EIR basis.

(q) Borrowings

Borrowings are carried in the balance sheet on the amortised cost basis. The initial value recognised includes the principal amount received less any discount on issue or costs of issuance.

Interest and all other costs of the funding are expensed to the income statement as interest payable over the term of the borrowing on an EIR basis.

(r) Central bank facilities

Where central bank facilities are provided at a below market rate of interest, and therefore fall within the definition of government assistance as defined by IAS 20 – 'Accounting for Government Grants and Disclosure of Government Assistance', the liability is initially recognised at the value of its expected cash flows discounted at a market rate of interest for a comparable commercial borrowing. Interest is recognised on this liability on an EIR basis, using the imputed market rate to determine the EIR.

The remaining amount of the advance is recognised as deferred government assistance and released to the profit and loss account through interest payable over the periods during which the arrangement affects profit.

(s) Derivative financial instruments

All derivative financial instruments are carried in the balance sheet at fair value, as assets where the value is positive or as liabilities where the value is negative. Fair value is based on market prices, where a market exists. If there is no active market, fair value is calculated using present value models which incorporate assumptions based on market conditions and are consistent with accepted economic methodologies for pricing financial instruments. Changes in the fair value of derivatives are recognised in the income statement, except where such amounts are permitted to be taken to equity as part of the accounting for a cash flow hedge.

(t) Hedging

IFRS 9 paragraph 7.2.21 permits an entity to elect, as a matter of accounting policy, to continue to apply the hedge accounting requirements of IAS 39 in place of those set out in Chapter 6 of IFRS 9. The Group has made this election and the accounting policy below has been determined in accordance with IAS 39.

For all hedges, the Group documents the relationship between the hedging instruments and the hedged items at inception, as well as its risk management strategy and objectives for undertaking the transaction. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the hedging arrangements put in place are considered to be 'highly effective' as defined by IAS 39.

For a fair value hedge, as long as the hedging relationship is deemed 'highly effective' and meets the hedging requirements of IAS 39, any gain or loss on the hedging instrument recognised in income can be offset against the fair value loss or gain arising from the hedged item for the hedged risk. For macro hedges (hedges of interest rate risk for a portfolio of loan assets or retail deposit liabilities) this fair value adjustment is disclosed in the balance sheet alongside the hedged item, for other hedges the adjustment is made to the carrying value of the hedged asset or liability. Only the net ineffectiveness of the hedge is charged or credited to income. Where a fair value hedge relationship is terminated, or deemed ineffective, the fair value adjustment is amortised over the remaining term of the underlying item.

Where a derivative is used to hedge the variability of cash flows of an asset or liability, it may be designated as a cash flow hedge so long as this relationship meets the hedging requirements of IAS 39. For such an instrument, the effective portion of the change in the fair value of the derivative is taken initially to equity, with the ineffective part taken to profit or loss. The amount taken to equity is released to the income statement at the same time as the hedged item affects the income statement. Where a cash flow hedge relationship is terminated, or deemed ineffective, the amount taken to equity will remain there until the hedged transaction occurs, or is no longer expected to take place.

(u) Taxation

The charge for taxation represents the expected UK corporation tax (including the Bank Corporation Tax Surcharge where applicable) and other income taxes arising from the Group's profit for the year. This consists of the current tax which will be shown in tax returns for the year and tax deferred because of temporary differences. This, in general, represents the tax impact of items recorded in the current year but which will impact tax returns for periods other than the one in which they are included in the financial statements.

The Group will hold a provision for any uncertain tax positions at the balance sheet date based on a global assessment of the expected amount that will ultimately be payable.

Tax relating to items taken directly to equity is also taken directly to equity.

(v) Deferred taxation

Deferred taxation is provided in full on temporary differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Deferred tax assets are recognised to the extent that it is regarded as probable that they will be recovered. As required by IAS 12 – 'Income Taxes', deferred tax assets and liabilities are not discounted to take account of the expected timing of realisation.

(w) Retirement benefit obligations

The expected cost of providing pensions within the funded defined benefit scheme, determined on the basis of annual valuations by professionally qualified actuaries using the projected unit method, is charged to the income statement. Actuarial gains and losses are recognised in full in the period in which they occur and do not form part of the result for the period, being recognised in the Statement of Comprehensive Income.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation, as reduced by the fair value of scheme assets at the balance sheet date.

The expected financing cost of the deficit, as estimated at the beginning of the period, is recognised in the result for the period within interest payable. Any variances against the estimated amount in the year form part of the actuarial gain or loss.

The charge to the income statement for providing pensions under defined contribution pension schemes is equal to the contributions payable to such schemes for the year.

(x) Revenue

The revenue of the Group comprises interest receivable and similar charges, operating lease income and other income. The accounting policy for the recognition of each element of revenue is described separately within these accounting policies.

(y) Other income

Other income, which is accounted for in accordance with IFRS 15, includes:

- Event-based administration fees charged to borrowers (other than the initial fees included in amortised cost), which are credited when the related service is performed
- Fees charged to third parties for account administration services, which are credited as those services are performed
- Commissions receivable on the sale of insurances, as agent of the third-party insurer, which are taken to profit at the point at which the Group becomes unconditionally entitled to the income
- Maintenance income charged as part of the Group's contract hire arrangements, which is recognised as the services are provided. Costs of these services are deducted in other income
- Broker fees receivable on the arrangement of loans funded by third parties, on an agency basis, which are taken to profit at the point of completion of the related loan

(z) Share based payments

In accordance with IFRS 2 – 'Share-based Payments', the fair value at the date of grant of awards to be made in respect of options and shares granted under the terms of the Group's various share-based employee incentive arrangements is charged to the profit and loss account over the period between the date of grant and the vesting date.

National Insurance on share based payments is accrued over the vesting period, based on the share price at the balance sheet date.

Where the allowable cost of share based awards for tax purposes is greater than the cost determined in accordance with IFRS 2, the tax effect of the excess is taken to reserves.

(aa) Dividends

In accordance with IAS 10 – 'Events after the balance sheet date', dividends payable on ordinary shares are recognised in equity once they are appropriately authorised and are no longer at the discretion of the Company. Dividends declared after the balance sheet date, but before the authorisation of the financial statements remain within shareholders' funds.

However, such dividends are deducted from regulatory capital from the point at which they are announced, and capital disclosures are prepared on this basis.

(bb) Foreign currency

Foreign currency transactions, assets and liabilities are accounted for in accordance with IAS 21 – 'The Effects of Changes in Foreign Exchange Rates'. The functional currency of the Company and all of the other entities in the Group is the pound sterling. Transactions which are not denominated in sterling are translated into sterling at the spot rate of exchange on the date of transaction. Monetary assets and liabilities which are not denominated in sterling are translated at the closing rate on the balance sheet date.

Gains and losses on retranslation are included in interest payable or interest receivable depending on whether the underlying instrument is an asset or a liability, except where deferred in equity in accordance with the cash flow hedging provisions of IAS 39.

(cc) Segmental reporting

The accounting policies of the segments are the same as those described above for the Group as a whole. Interest payable by each segment includes directly attributable funding and the allocated cost of retail deposit funds utilised. Costs attributed to each segment represent the direct costs incurred by the segment operations.

64. CRITICAL ACCOUNTING JUDGEMENTS

The most significant judgements which the directors have made in the application of the accounting policies set out in note 63 relate to:

(a) Significant Increase in Credit Risk ('SICR')

Under IFRS 9, the directors are required to assess where a credit obligation has suffered a Significant Increase in Credit Risk ('SICR'). The directors' assessment is based primarily on changes in the calculated probability of default, but also includes consideration of other qualitative indicators and the adoption of the backstop assumption in the Standard that all cases which are more than 30 days overdue have an SICR, for account types where days overdue is an appropriate measure.

If additional accounts were determined to have an SICR, these balances would attract additional impairment provision and the overall provision charge would be higher.

More information on the definition of SICR adopted is given in note 23.

(b) Definition of default

In applying the impairment provisions of IFRS 9, the directors have used models to derive the probabilities of default. In order to derive and apply such models, it is required to define 'default' for this purpose. The Group's definition of default is aligned to its internal operational procedures. IFRS 9 provides a rebuttable presumption of default when an account is 90 days overdue and this was used as the starting point for this exercise. Other factors include account management activities such as appointment of a receiver or enforcement procedures.

A combination of qualitative and quantitative measures was considered in developing the definition of default.

If a different definition of default had been adopted the expected loss amounts derived might differ from those shown in the accounts.

More information on the Group's definition of default adopted is given in note 23.

(c) Classification of financial assets

The classification of financial assets under IFRS 9 is based on two factors:

- The company's 'business model' – how the it intends to generate cash and profit from the assets; and
- The nature of the contractual cash flows inherent in the assets

Financial assets are classified as held at amortised cost, at fair value through other comprehensive income, or at fair value through profit and loss.

For an asset to be held at amortised cost, the cash flows received from it must comprise solely payments of principal and interest ('SPPI'). In effect, this restricts this classification to 'normal' lending activities, excluding arrangements where the lender may have a contingent return or profit share from the activities funded. The Group has considered its products and concluded that, as standard lending products, they fall within the SPPI criteria.

This is because all of the Group's lending arrangements involve the advancing of amounts to customers, either as loans or finance lease products and the receipt of repayments of principal and charges, where those charges are calculated based on the amount loaned. There are no 'success fee' or other compensation arrangements not linked to the loan principal.

The use of amortised cost accounting is also restricted to assets which a company holds within a business model whose object is to collect cash flows arising from them, rather than seek to profit by disposing of them (a 'Held to Collect' model). The Group's strategy is to hold loan assets until they are repaid or written off. Loan disposals are rare, and the Group does not manage its assets in order to generate profits on sale. On this basis, it has categorised its business model as Held to Collect.

Therefore, the Group has classified its customer loan assets as carried at amortised cost.

(d) Derecognition of financial assets and liabilities

On 26 June 2019, the Group disposed of its residual interest in the Paragon Mortgages (No. 12) PLC securitisation transaction. In order to determine whether the financial assets and liabilities of the SPV should be derecognised at that point, a management judgement is required. Following a review of the terms of the sale transaction, it was concluded that the Group was no longer significantly exposed to the risks and rewards in relation to the cash flows arising from the scheme, and hence the criteria for derecognition were met. More information on this transaction is given in note 7.

65. CRITICAL ACCOUNTING ESTIMATES

Certain of the balances reported in the financial statements are based wholly or in part on estimates or assumptions made by the directors. There is, therefore, a potential risk that they may be subject to change in future periods. The most significant of these are:

(a) Impairment losses on loans to customers

Impairment losses on loans are calculated based on statistical models, applied to the present status, performance and management strategy for the loans concerned which are used to determine each loan's PD and LGD.

Internal information used will include number of months arrears, qualitative information, such as possession by a first charge holder on a second charge mortgage or where a buy-to-let case is under the control of a receiver of rent, the receiver's present and likely future strategy for the property (e.g. keeping current tenants in place, refurbish and relet, immediate sale etc).

External information used includes customer specific data, such as credit bureau information, as well as more general economic data.

Key internal assumptions in the models relate to estimates of future cash flows from customers' accounts, their timing and, for secured accounts, the expected proceeds from the realisation of the property or other charged assets. These cash flows will include payments received from the customer, and, for buy-to-let cases where a receiver of rent is appointed, rental receipts from tenants, after allowing for void periods and running costs. These key assumptions are based on observed data from historical patterns and are updated regularly based on new data as it becomes available.

In addition, the directors consider how appropriate past trends and patterns might be in the current economic situation and make any adjustments they believe are necessary to reflect current and expected conditions.

The accuracy of the impairment calculations would therefore be affected by unexpected changes to the economic situation, variances between the models used and the actual results, or assumptions which differ from the actual outcomes. In particular, if the impact of economic factors, such as employment levels on customers is worse than is implicit in the model then the number of accounts requiring provision might be greater than suggested by the model, while falls in house prices, over and above any assumed by the model might increase the provision required in respect of accounts currently provided. Similarly, if the account management approach assumed in the modelling cannot be adopted the provision required may be different.

In order to provide forward looking economic inputs to the modelling of the ECL, the Group must derive a set of scenarios which are internally coherent. The Group addresses these requirements using four distinct economic scenarios chosen to represent the range of possible outcomes.

The variables are used for two purposes in the IFRS 9 calculations:

- They are applied as inputs in the models which generate PD values, where those found by statistical analysis to have the most predictive value are used
- They are used as part of the calculation where the variable has a direct impact on the expected loss calculation, such as the house price index

The economic variables will also inform assumptions about the Group's approach to account management given a particular scenario.

These assumptions are set out in note 23 where the sensitivity of the Group's modelling to them is also discussed.

(b) Effective interest rates

In order to determine the EIR applicable to loans and borrowings an estimate must be made of the expected life of each asset or liability and hence the cash flows relating thereto, including those relating to early redemption charges. For purchased loan accounts this will involve estimating the likely future credit performance of the accounts at the time of acquisition. These estimates are based on historical data and reviewed regularly. For purchased accounts historical data obtained from the vendor will be examined. The accuracy of the EIR applied would therefore be compromised by any differences between actual repayment profiles and those predicted, which in turn would depend directly or indirectly (in the case of borrowings) on customer behaviour.

To illustrate this, the amortised cost values were recalculated by changing one factor in the EIR calculation and keeping all others at their current levels. This exercise indicated that:

- A reduction of the assumed average lives of loans secured on residential property by three months would reduce balance sheet assets by £7.2m (2018: £4.0m), while an increase of the assumed asset lives of such assets by three months would increase balance sheet assets by £6.0m (2018: £4.0m)
- An increase of 50% in the number of five year fixed rate buy-to-let loan assets assumed to redeem before the end of the fixed rate period, generating additional early redemption charges, would increase balance sheet assets by £4.2m
- A reduction (or increase) in estimated cash flows from purchased loan assets of 5% would reduce (or increase) balance sheet assets by £12.5m (2018: £10.3m)

As any of these changes would, in reality, be accompanied by movements in other factors, actual outcomes may differ from these estimates.

(c) Impairment of goodwill

The carrying value of goodwill recognised on acquisitions is verified by use of an impairment test based on the projected cash flows for the cash generating unit, based on management forecasts and other assumptions described in note 29, including a discount factor.

The accuracy of this impairment calculation would therefore be compromised by any differences between these forecasts and the levels of business activity that the cash generating unit is able to achieve in practice. This test will also be affected by the accuracy of the discount factor used.

The sensitivity of the impairment test to reasonably possible movements in these assumptions is discussed in note 29.

(d) Retirement benefits

The present value of the retirement benefit obligation is derived from an actuarial calculation which rests on a number of assumptions relating to inflation, long-term return on investments and mortality. These are listed in note 41. Where actual conditions differ from those assumed the ultimate value of the obligation would be different.

Information on the sensitivity of the valuation to the various assumptions is given in note 41.

66. ACQUISITIONS

On 3 July 2018 the group acquired the entire share capital of Titlestone Property Finance Limited together with a portfolio of loans held by companies related to it (together 'Titlestone'). IFRS disclosures in respect of this acquisition were presented on a provisional basis in note 15 to the group accounts for the year ended 30 September 2018.

During the year ended 30 September 2019, the circumstances, performance and security value of certain of the Titlestone loans were reviewed in more detail, providing further information on the value of those assets at the acquisition date. As a result of this exercise, the initial values of those loans were reduced by £2.7m with a corresponding change in the related deferred tax balances of £0.5m. Consequently, the goodwill balance was increased by £2.2m (note 29).

67. FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The Group's financial assets and financial liabilities are valued on one of two bases, defined by IFRS 9:

- Financial assets and liabilities carried at fair value through profit and loss ('FVTPL')
- Financial assets and liabilities carried at amortised cost

IFRS 7 – 'Financial Instruments: Disclosures' requires that where assets are measured at fair value these measurements should be classified using the fair value hierarchy set out in IFRS 13 – 'Fair Value Measurement'. This hierarchy reflects the inputs used, and defines three levels.

- Level 1 measurements are unadjusted market prices
- Level 2 measurements are derived from directly or indirectly observable data, such as market prices or rates
- Level 3 measurements rely on significant inputs which are not derived from observable data

As quoted prices are not available for level 2 and 3 measurements, the valuation is derived from cash flow models based, where possible, on independently sourced parameters. The accuracy of the calculation would therefore be affected by unexpected market movements or other variances in the operation of the models or the assumptions used.

The Group had no financial assets or liabilities in the year ended 30 September 2019 or the year ended 30 September 2018 carried at fair value and valued using level 3 measurements, other than contingent consideration amounts (note 38).

The Group has not reclassified any of its measurements during the year.

The methods by which fair value is established for each class of financial assets and liabilities are set out below.

a) Assets and liabilities carried at fair value

The following table summarises the Group's financial assets and liabilities which are carried at fair value.

	Note	2019 £m	2018 £m
Financial assets			
Derivative financial assets	24	592.4	855.7
Short term investments	19	-	-
		592.4	855.7
Financial liabilities			
Derivative financial assets	24	80.5	4.7
Contingent consideration	38	23.7	25.7
		104.2	30.4

All of these financial assets and financial liabilities are required to be carried at fair value by IFRS 9, and the introduction of the new standard has had no impact on their classification, valuation basis or valuations.

The Company has no financial assets or liabilities carried at fair value.

Derivative financial assets and liabilities

Derivative financial instruments are stated at their fair values in the accounts. The Group uses a number of techniques to determine the fair values of its derivative assets and liabilities, for which observable prices in active markets are not available. These are principally present value calculations based on estimated future cash flows arising from the instruments, discounted using a risk adjusted interest rate.

The principal inputs to these valuation models are LIBOR and SONIA benchmark interest rates for the currencies in which the instruments are denominated, being sterling, euros and dollars. The cross-currency basis swaps have a notional principal related to the outstanding currency borrowings and therefore the estimated rate of repayment of these notes also affects the valuation of the swaps. However, variability in this input does not have a significant impact on the valuation, compared to other inputs.

In order to determine the fair values, the management applies valuation adjustments to observed data where that data would not fully reflect the attributes of the instrument being valued, such as particular contractual features or the identity of the counterparty. The management reviews the models used on an ongoing basis to ensure that the valuations produced are reasonable and reflect all relevant factors. These valuations are based on market information and they are therefore classified as level 2 measurements. Details of these assets are given in note 24.

Short term investments

The short-term investments described in note 19 are freely traded securities for which a market price quotation is available and are classified as level 1 measurements.

Contingent consideration

The value of the contingent consideration balances shown in note 38 are required to be stated at fair value in the accounts. These amounts are valued based on the expected outcomes of the performance tests set out in the respective sale and purchase agreements, discounted as appropriate. The most significant inputs to these valuations are the Group's forecasts on future activity relating to business generated by operational units acquired, business derived as a result of the vendor's contacts or other goodwill and any other new business flows which are or might be attributable to the acquisition agreement, which are drawn from the overall Group forecasting model. As such, these are classified as unobservable inputs and the valuations classified as level 3 measurements.

b) Assets and liabilities carried at amortised cost

The fair values for financial assets and financial liabilities held at amortised cost, determined in accordance with the methodologies set out below are summarised below.

	Note	2019 Carrying amount £m	2019 Fair value £m	2018 IFRS 9 Carrying Amount £m	2018 IAS 39 Carrying amount £m	2018 Fair value £m
The Group						
Financial assets						
Cash	18	1,225.4	1,225.4	1,310.6	1,310.6	1,310.6
Loans to customers	20	12,186.1	12,370.1	12,100.6	12,127.8	12,222.9
Sundry financial assets	25	90.3	90.3	15.3	15.3	15.3
		13,501.8	13,685.8	13,426.5	13,453.7	13,548.8
Financial liabilities						
Short term bank borrowings		1.0	1.0	1.1	1.1	1.1
Asset backed loan notes		4,419.4	4,419.4	5,554.7	5,554.7	5,554.7
Secured bank borrowings		787.5	787.5	935.6	935.6	935.6
Retail deposits	31	6,391.9	6,408.9	5,296.6	5,296.6	5,301.7
Corporate and retail bonds		446.1	474.9	445.4	445.4	478.3
Other financial liabilities	37	83.1	83.1	82.8	82.8	82.8
		12,129.0	12,174.8	12,316.2	12,316.2	12,354.2
The Company						
Financial assets						
Cash	18	14.1	14.1	24.9	24.9	24.9
Loans to group companies	25	106.6	106.6	216.3	216.3	216.3
Sundry financial assets	25	0.7	0.7	0.7	0.7	0.7
		121.4	121.4	241.9	241.9	241.9
Financial liabilities						
Corporate and retail bonds		446.1	474.9	445.4	445.4	478.3
Amounts owed to group companies	37	23.8	23.8	125.7	125.7	125.7
Other financial liabilities	37	3.6	3.6	2.8	2.8	2.8
		473.5	502.3	573.9	573.9	606.8

The fair values of retail deposits and Corporate and retail bonds shown above will include amounts for the related accrued interest.

Cash, bank loans and securitisation borrowings

The fair values of cash and cash equivalents, bank loans and overdrafts and asset backed loan notes, which are carried at amortised cost are considered to be not materially different from their book values. In arriving at that conclusion market inputs have been considered but because all the assets mature within three months of the year end and the interest rates charged on financial liabilities reset to market rates on a quarterly basis, little difference arises. This also applies to the parent company's loans to its subsidiaries.

While the Group's asset backed loan notes are listed, the quoted prices for an individual note may not be indicative of the fair value of the issue as a whole, due to the specialised nature of the market in such instruments and the limited number of investors participating in it.

As these valuation exercises are not wholly market based, they are considered to be level 2 measurements.

Loans to customers

To assess the likely fair value of the Group's loan assets in the absence of a liquid market, the directors have considered the estimated cash flows expected to arise from the Group's investments in its loans to customers based on a mixture of market based inputs, such as rates and pricing and non-market based inputs such as redemption rates. Given the mixture of observable and non-observable inputs these are considered to be level 3 measurements.

Corporate debt

The Group's retail and corporate bonds are listed on the London Stock Exchange and there is presently a reasonably liquid market in the instruments. It is therefore appropriate to consider that the market price of these borrowings constitutes a fair value. As this valuation is based on a market price, it is considered to be a level 1 measurement.

Retail deposits

To assess the likely fair value of the Group's retail deposit liabilities, the directors have considered the estimated cash flows expected to arise based on a mixture of market based inputs, such as rates and pricing and non-market based inputs such as withdrawal rates. Given the mixture of observable and non-observable inputs, these are considered to be level 3 measurements.

Sundry assets and liabilities

Fair values of financial assets and liabilities disclosed as sundry assets and sundry liabilities are not considered to be materially different to their carrying values.

These assets and liabilities are of relatively low value and may be settled at their carrying value at the balance sheet date or shortly thereafter.

68. DETAILS OF SUBSIDIARY UNDERTAKINGS

Subsidiary undertakings of the Group at 30 September 2019, where the share capital is held within the Group are shown below. The holdings shown are those held within the Group. The shareholdings of the Company in the direct subsidiaries listed below are the same as those held by the Group, except that:

- For the shareholdings marked * the Company holds only 74% of the share capital
- For the shareholdings marked † the Company holds only 66.7% of the share capital

In these cases, the remainder is held by other group companies.

The issued share capital of all subsidiaries consists of ordinary share capital, except those companies marked §, which have additional preference share capital held within the Group.

Company	Holding	Principal activity
Direct subsidiaries of Paragon Banking Group PLC		
Paragon Car Finance Limited	100%	Vehicle finance
Idem Capital Holdings Limited	100%	Intermediate holding company
Moorgate Servicing Limited	100%	Intermediate holding company
Paragon Bank PLC	100%	Deposit taking, residential mortgages and loan and vehicle finance
The Business Mortgage Company Limited	100%	Mortgage broker
Paragon Fourth Funding Limited	100%	Residential mortgages
Paragon Mortgages (No. 9) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 10) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 11) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 12) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 13) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 14) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 15) PLC	100% *	Residential mortgages
Paragon Secured Finance (No. 1) PLC	100%	Loan finance
First Flexible (No. 7) PLC	100% *	Residential mortgages
Colonial Finance (UK) Limited	100%	Non-trading
Earlswood Finance Limited	100% *	Non-trading
Herbert (1) PLC	100%	Non-trading
Herbert (2) PLC	100%	Non-trading
Herbert (4) PLC	100%	Non-trading
Herbert (5) PLC	100%	Non-trading
Herbert (6) PLC	100%	Non-trading
Herbert (7) PLC	100%	Non-trading
Herbert (8) PLC	100%	Non-trading
Herbert (9) PLC	100%	Non-trading
Herbert (10) PLC	100%	Non-trading
Idem Luxembourg (No. 4) †	100%	Non-trading
Idem Luxembourg (No. 9) †	100%	Non-trading
Paragon Car Finance (1) Limited	100%	Non-trading
Paragon Dealer Finance Limited	100%	Non-trading
Paragon Loan Finance (No. 1) Limited	100% §	Non-trading
Paragon Loan Finance (No. 2) Limited	100% §	Non-trading
Paragon Mortgages (No. 5) PLC	100%	Non-trading
Paragon Pension Investments GP Limited	100%	Non-trading
Paragon Pension Plan Trustees Limited	100%	Non-trading
Paragon Personal Finance (1) Limited	100%	Non-trading
Paragon Third Funding Limited	100%	Non-trading
Paragon Vehicle Contracts Limited	100%	Non-trading
Plymouth Funding Limited	100%	Non-trading

Company	Holding	Principal activity
Direct subsidiaries of Paragon Banking Group PLC		
Paragon Loan Finance (No. 3) Limited	100%	Non-trading
Townend Farm (Easington) Management Company Limited	100%	Non-trading
Universal Credit Limited	100%	Non-trading
Yorkshire Freeholds Limited	100%	Non-trading
Yorkshire Leaseholds Limited	100%	Non-trading
Direct and indirect subsidiaries of Paragon Bank PLC		
Paragon Finance PLC	100%	Residential mortgages and asset administration
Mortgage Trust Limited	100%	Residential mortgages
Paragon Mortgages Limited	100%	Residential mortgages
Paragon Mortgages (2010) Limited	100%	Residential mortgages
First Flexible No. 6 PLC	100% §	Residential mortgages
Mortgage Trust Services PLC	100%	Residential mortgages and asset administration
Paragon Second Funding Limited	100%	Residential mortgages and loan and vehicle finance
Paragon Asset Finance Limited	100%	Holding company and portfolio administration
City Business Finance Limited	100%	Asset finance
Paragon Business Finance PLC	100%	Asset finance
Paragon Commercial Finance Limited	80%	Asset finance
Paragon Development Finance Limited	96.39%	Development Finance
Paragon Development Finance Services Limited	100%	Development Finance
Paragon Technology Finance Limited	100%	Asset finance
Premier Asset Finance Limited	100%	Asset finance broker
PBAF Acquisitions Limited	100%	Residential mortgages and loan finance
PBAF (No. 1) Limited	100%	Intermediate holding company
Specialist Fleet Services Limited	100%	Asset finance and contract hire
Collett Transport Services Limited	100%	Non-trading
Fineline Holdings Limited	100%	Non-trading
Fineline Media Finance Limited	100%	Non-trading
Homer Management Limited	100%	Non-trading
Lease Portfolio Management Limited	100%	Non-trading
Paragon Options PLC	100%	Non-trading
State Securities Holdings Limited	100%	Non-trading
State Security Limited	100%	Non-trading
Direct and indirect subsidiaries of Idem Capital Holdings Limited		
Moorgate Loan Servicing Limited	100%	Asset administration
Idem (No. 3) Limited	100%	Asset investment
Idem Capital Securities Limited	100%	Asset investment
Paragon Personal Finance Limited	100%	Consumer loan finance
Other indirect subsidiary undertakings		
Redbrick Survey and Valuation Limited	100%	Surveyors and property consulting
Buy to Let Direct Limited	100%	Non-trading
TBMC Group Limited	100%	Non-trading
The Business Mortgage Company Services Limited	100%	Non-trading

The financial year end of all of the Group's subsidiary companies is 30 September. They are all registered in England and Wales and operate in the UK except:

- Those entities marked ‡ which are registered in the Grand Duchy of Luxembourg
- Paragon Pension Investments GP Limited, which is registered in Scotland and operates in the UK

20% of the equity of Paragon Commercial Finance Limited is subject to a call option agreed as part of the acquisition of the company by PAF. No material minority interest attaches to this holding. 3.61% of the nominal value of the share capital of Paragon Development Finance Limited relates to shares subjects to put and call options issued pursuant to long-term incentive plans. No material minority interest attaches to this holding.

As part of the Group's financing arrangements certain mortgage and consumer loans originated by Paragon Mortgages (2010) Limited and Mortgage Trust Limited or acquired by Idem Capital Securities Limited have been sold to special purpose entity companies, which had raised non-recourse finance to fund these purchases. The shares of these companies are ultimately beneficially owned through independent trusts, but they are considered to be controlled by the Group, as defined by IFRS 10, due to the Group's exposures to the variable returns from the assets of each entity and its ability to direct their activities, within the constraints imposed by the lending documents. Hence, they are considered to be subsidiaries of the Group.

The principal companies party to these arrangements at 30 September 2019 comprise:

Company	Principal activity
First Flexible No. 5 PLC	Residential mortgages
Paragon Fifth Funding Limited	Residential mortgages
Paragon Sixth Funding Limited	Residential mortgages
Paragon Seventh Funding Limited	Residential mortgages
Paragon Mortgages (No. 18) Holdings Limited	Holding company
Paragon Mortgages (No. 18) PLC	Residential mortgages
Paragon Mortgages (No. 19) Holdings Limited	Holding company
Paragon Mortgages (No. 19) PLC	Residential mortgages
Paragon Mortgages (No. 20) Holdings Limited	Holding company
Paragon Mortgages (No. 20) PLC	Residential mortgages
Paragon Mortgages (No. 21) Holdings Limited	Holding company
Paragon Mortgages (No. 21) PLC	Residential mortgages
Paragon Mortgages (No. 22) Holdings Limited	Holding company
Paragon Mortgages (No. 22) PLC	Residential mortgages
Paragon Mortgages (No. 23) Holdings Limited	Holding company
Paragon Mortgages (No. 23) PLC	Residential mortgages
Paragon Mortgages (No. 24) Holdings Limited	Holding company
Paragon Mortgages (No. 24) PLC	Residential mortgages
Paragon Mortgages (No. 25) Holdings Limited	Holding company
Paragon Mortgages (No. 25) PLC	Residential mortgages
Paragon Mortgages (No. 26) Holdings Limited	Holding company
Paragon Mortgages (No. 26) PLC	Residential mortgages
Arianty Holdings Limited	Holding company
Arianty No. 1 Limited	Non-trading

All of these companies are registered and operate in the UK.

Earlswood Finance (No. 3) Limited, a company limited by guarantee, is registered in England and Wales and operates in the UK. It is included in the consolidation as it is ultimately controlled by the parent company.

The Group accounts include the results of two Jersey companies, which are ultimately beneficially owned by a charitable trust, but are considered to be controlled by the Group, using the definition contained in IFRS 10 'Consolidated Financial Statements'. These companies, Idem Jersey (No. 1) Limited and Idem Jersey (No. 2) Limited are registered in the Bailiwick of Jersey and operate in the UK.

The share capital of Idem Jersey (No. 1) Limited is divided into A shares and B shares. All of the 600 B shares are held by Group companies, 100 by the parent company and 500 by other Group companies.

The Paragon Pension Partnership LP is a limited partnership established under Scots law, in which control is vested in members which are Group companies. It is therefore considered to be a subsidiary entity. The outside member is the Group's Pension Plan and the Plan's rights to income from the partnership are set out in the partnership agreement. Therefore, no minority interest arises. The partnership is registered in Scotland and operates in the UK.

The registered office of each of the entities listed in this note is the same as that of the Company (note 1), except that:

- The registered office of The Business Mortgage Company Limited, Buy to Let Direct Limited, TBMC Group Limited, and The Business Mortgage Company Services Limited is Greenmeadow House, 2 Village Way, Greenmeadow Springs Business Park, Cardiff, CF15 7NE
- The registered office of State Security Limited is Burlington House, Botleigh Grange Office Campus, Grange Drive, Hedge End, Southampton, SO30 2AF
- The registered office of the Scottish companies is Citypoint, 65 Haymarket Terrace, Edinburgh, EH12 5HD
- The office of the Luxembourg entities is 8-10, Avenue de la Gare, L-1610 Luxembourg
- The registered office of the Jersey companies is IFC 5, St Helier, Jersey, JE1 1ST

All of the entities listed above are included in the consolidated accounts of the Group.

The following legal subsidiaries of the Group are currently in liquidation. They do not form part of the consolidation as they are considered to be controlled by the liquidator.

Company	Holding	Principal activity
Direct subsidiaries of Paragon Banking Group PLC		
SPV Securities Limited	100%	Non-trading
Paragon Mortgages (No. 7) PLC	100%	Non-trading
Paragon Mortgages (No. 8) PLC	100%	Non-trading
Paragon Mortgages (No. 16) PLC	100%	Non-trading
Paragon Mortgages (No. 17) PLC	100%	Non-trading
Paragon Personal and Auto Finance (No. 3) PLC	100%	Non-trading
Collateralised Mortgage Securities (No. 12) PLC	100%	Non-trading
Finance for People (No. 3) Limited	100%	Non-trading
Finance for People (No. 4) PLC	100% §	Non-trading
Homeloans (No. 4) PLC	100% §	Non-trading
Mortgage Funding Corporation PLC	100%	Non-trading
NHL Second Funding Corporation Limited	100%	Non-trading
NHL Third Funding Corporation Limited	100%	Non-trading
Paragon Mortgages (No. 1) PLC	100% §	Non-trading
Paragon Mortgages (No. 2) PLC	100% §	Non-trading
Paragon Mortgages (No. 4) PLC	100%	Non-trading
Redbrick Real Estate Services Limited	100%	Non-trading
Indirect subsidiaries		
Idem First Finance Limited	100%	Non-trading
Idem Capital Limited	100%	Non-trading

The issued share capital of all subsidiaries consists of ordinary share capital, except those companies marked § which have additional preference share capital held within the Group.

The companies previously controlled by the Group which had been party to the types of financing arrangements described above at 30 September 2019 and which were in liquidation at that date comprise:

Company	Principal activity
First Flexible No. 4 PLC	Non-trading
Arianty Services Limited	Non-trading
First Flexible No. 1 Limited	Non-trading
First Flexible No. 2 Limited	Non-trading
First Flexible No. 3 Limited	Non-trading

Homeloans (No. 7) LLP and Homeloans (No. 8) LLP are limited liability partnerships, established under English law, in which all of the members are Group companies. They are currently in liquidation. Both are registered in England and Wales and operate in the UK.

A dark grey, almost black, abstract shape occupies the left and center of the frame. A bright green diagonal stripe runs from the top right towards the bottom left, passing behind the dark shape. On the right side of the dark shape, the letters 'E.' are written in a white, clean, sans-serif font. The 'E' is composed of three horizontal bars and a vertical stem, with a small square dot following it.

E.

APPENDICES TO THE ANNUAL REPORT

Additional financial information supporting amounts shown in the Strategic
Report (Section A), but not forming part of the Statutory Accounts

Appendices to the annual report

A. UNDERLYING RESULTS

The Group reports underlying profit excluding fair value accounting adjustments arising from its hedging arrangements and certain one-off items of income and costs relating to asset sales and acquisitions.

The fair value adjustments arise principally as a result of market interest rate movements, outside the Groups control. They are profit neutral over time and are not included in operating profit for management reporting purposes. They are also disregarded by many external analysts.

Transactions relating to acquisition and disposals include the direct transaction costs of the 2018 acquisitions, the additional net funding costs of deposits built up over time to satisfy consideration on those acquisitions and the break costs of the Idem Capital facility, in addition to the gains recognised.

The transactions relating to the asset disposals and acquisitions do not form part of the day-to-day activities of the Group and, therefore, their removal provides greater clarity on the Group's operational performance.

This definition of 'underlying' has been chosen following consideration of the needs of investors and analysts following the Group's shares, and because management feel it better represents the underlying economic performance of the Group's business.

	2019 £m	2018 £m	2018 £m
Profit on ordinary activities before tax	159.0		181.5
Less: Gain on disposal of financial assets	(9.7)		(28.0)
Add back: Acquisition related funding costs included in net interest		0.7	
Add back: Overhead costs related to acquisition related funding		0.2	
Add back: Transaction costs		1.3	
Add back: Acquisition related costs	-		2.2
Add back: Facility break costs	-		1.2
Add back: Other one-off costs	-		0.8
Add back: Fair value adjustments	15.1		(1.2)
Underlying profit	164.4		156.5

Underlying basic earnings per share, calculated on the basis of underlying profit, charged at the overall effective tax rate, is derived as follows.

	2019 £m	2018 £m
Underlying profit	164.4	156.5
Tax at effective rate (note 15)	(32.7)	(30.8)
Underlying earnings	131.7	125.7
Basic weighted average number of shares (note 17)	257.6	260.8
Underlying earnings per share	51.1p	48.2p

Underlying return on tangible equity is derived using underlying earnings calculated on the same basis.

	2019 £m	2018 £m
Underlying earnings	131.7	125.7
Amortisation of intangible assets (note 9)	2.4	2.1
Adjusted underlying earnings	134.1	127.8
Average tangible equity (note 55(b))	920.7	915.8
Underlying RoTE	14.6%	14.0%

B. INCOME STATEMENT RATIOS

The average net interest margin is calculated as follows:

Year ended 30 September 2019 (IFRS 9)

	Note	Mortgages £m	Commercial Lending £m	Idem Capital £m	Total £m
Opening loans to customers	20	10,449.5	1,131.3	519.8	12,100.6
Closing loans to customers	20	10,344.1	1,452.1	389.9	12,186.1
Average loans to customers		10,396.8	1,291.8	454.8	12,143.4
Net interest		177.8	65.0	54.3	278.4
NIM		1.71%	5.03%	11.94%	2.29%
Impairment provision	23	1.0	7.2	(0.2)	8.0
Cost of risk		0.01%	0.56%	(0.04)%	0.07%

Year ended 30 September 2018 (IAS 39)

	Note	Mortgages £m	Commercial Lending £m	Idem Capital £m	Total £m
Opening loans to customers		9,953.9	558.8	611.4	11,124.1
Closing loans to customers	20	10,473.5	1,133.2	521.1	12,127.8
Average loans to customers		10,213.7	846.0	566.3	11,626.0
Net interest		157.6	32.2	87.8	254.6
NIM		1.54%	3.81%	15.50%	2.19%
Impairment provision	23	5.5	2.0	(0.1)	7.4
Cost of risk		0.05%	0.24%	(0.02)%	0.06%

Net interest margin on an underlying basis is derived as shown below

	2019 £m	2018 £m
Net interest (as above)	278.4	254.6
One off items related to interest		
Acquisition funding costs	-	0.7
Facility break costs	-	1.2
Underlying net interest	278.4	256.5
Average loans to customers (as above)	12,143.4	11,626.0
Underlying net interest margin	2.29%	2.21%

C. COST:INCOME RATIO

Cost:income ratio is derived as follows:

	Note	2019 £m	2018 £m
Cost – operating expenses	9	125.2	114.2
Total operating income		307.3	301.9
Cost / Income		40.7%	37.8%

Underlying cost:income ratio is derived as follows:

	2019 £m	2018 £m
Cost – as above	125.2	114.2
Acquisition costs expensed	-	(1.5)
Other one-off costs	-	(0.8)
Adjusted cost	125.2	111.9
Income – as above	307.3	301.9
Gain on disposal of financial asset	(9.7)	(28.0)
Acquisition net funding costs	-	0.7
Facility break costs	-	1.2
Adjusted income	297.6	275.8
Underlying cost:income ratio	42.1%	40.6%

D. NET ASSET VALUE

	Note	2019	2018
Total equity (£m)		1,108.4	1,095.9
Outstanding issued shares (m)	42	261.6	281.6
Treasury shares (m)	44	(5.2)	(20.8)
Shares held by ESOP schemes (m)	44	(3.9)	(2.9)
		252.5	257.9
Net asset value per £1 ordinary share		£4.39	£4.25
Tangible equity (£m)	55	937.3	926.6
Tangible net asset value per £1 ordinary share		£3.71	£3.59

A large, dark gray, stylized letter 'F' is the central focus. A bright green diagonal stripe runs from the top right corner towards the bottom left, passing behind the 'F'. The background is a solid dark gray.

F.

USEFUL INFORMATION

Information which may be helpful to shareholders and other users of the Annual Report and Accounts

F1	Glossary <i>A summary of abbreviations used in the Annual Report and Accounts</i>	Page 284
F2	Shareholder Information <i>Information about dividends, meetings and managing shareholdings</i>	Page 286
F3	Other Public Reporting <i>Current and future public reporting information for the Group</i>	Page 288
F4	Contacts <i>Names and addresses of the Group's advisers</i>	Page 290

F1

Glossary

AGM	Annual General Meeting	ESOP	Employee Share Ownership Plan
ALCO	Asset and Liability Committee	ESOS	Energy Savings and Opportunities Scheme
AT1	Additional Tier 1	EU	European Union
ARLA	ARLA Propertymark	EURIBOR	Euro Interbank Offered Rate
B2B	Business-to-Business	EV	Economic Value
B2C	Business-to-Consumer	FCA	Financial Conduct Authority
BBR	Bank Base Rate	FLA	Finance and Leasing Association
BCBS	Basel Committee on Banking Supervision	FLS	Funding for Lending Scheme
BEIS	Department for Business, Energy and Industrial Strategy	FOS	Financial Ombudsman Service
BEPS	Base Erosion and Profit Shifting	FRC	Financial Reporting Council
BS 18001	British Standard 18001:2007, 'Occupational Health and Safety Management Systems'	FRN	Floating Rate Note
CAGR	Compound Annual Growth Rate	FSC	Forest Stewardship Council
CCC	Compliance and Conduct Committee	FSCS	Financial Services Compensation Scheme
CCoB	Capital Conservation Buffer	FVTPL	Fair Value Through Profit and Loss
CCyB	Counter-Cyclical Buffer	GDP	Gross Domestic Product
CEO	Chief Executive Officer	GDPR	General Data Protection Regulation
CET1	Core Equity Tier 1	GHG	Greenhouse Gases
CFO	Chief Financial Officer	GMP	Guaranteed Minimum Pension
CGU	Cash Generating Unit	HA	Hampton-Alexander
CIIA	Chartered Institute of Internal Audit	HMRC	Her Majesty's Revenue and Customs
CIPD	Chartered Institute of Personnel and Development	HPI	House Price Index
CMI	Chartered Management Institute	HQLA	High Quality Liquid Assets
CML	Council of Mortgage Lenders	IAS	International Accounting Standard(s)
CO₂	Carbon Dioxide	IASB	International Accounting Standards Board
Compliance Plan	Compliance Monitoring Plan	ICAAP	Internal Capital Adequacy Assessment Process
CPI	Consumer Price Index	IFRS	International Financial Reporting Standard(s)
CRD IV	The Current EU Capital Requirements Regulation and Directive regime	IIP	Investors in People
CRDs	Cash Ratio Deposits	ILAAP	Internal Liquidity Adequacy Assessment Process
CRO	Chief Risk Officer	ILG	Individual Liquidity Guidance
CRR	Capital Requirements Regulation EU Regulation 575/2013	ILTR	Indexed Long Term Repo Scheme
CSA	Credit Support Annex	IMLA	Intermediary Mortgage Lenders Association
CSOP	Company Share Option Plan	IRB	Internal Ratings Based
DEFRA	Department for Environment, Food and Rural Affairs	IRRBB	Interest Rate Risk in the Banking Book
Deloitte	Deloitte LLP	ISA	Individual Savings Account
DSBP	Deferred Share Bonus Plan	ISDA	International Swaps and Derivatives Association
EBA	European Banking Authority	ISO14001:2015	International Organization for Standardization 14001:2015, 'Environmental Management Systems'
ECL	Expected Credit Loss	ISO27001:2005	International Organization for Standardization 27001:2005, 'Information Security Management Systems'
EIR	Effective Interest Rate	ISO45001:2018	International Organization for Standardization 45001:2018, 'Management Systems of Occupational Health and Safety'
EPS	Earnings per Share	KPMG	KPMG LLP, the Group's auditor
EQA	External Quality Assessment		
ERC	Estimated Remaining Collections		

LCR	Liquidity Coverage Ratio
LGD	Loss Given Default
LIBOR	London Interbank Offered Rate
Ltd	Limited (company)
LTGDV	Loan to Gross Development Value
LTIP	Long-term Incentive Plan
LTV	Loan to Value
M&A	Mergers and Acquisitions
MHCLG	Ministry of Housing, Communities and Local Government
MRC	Model Risk Committee
NI	National Insurance
NII	Net Interest Income
NIM	Net Interest Margin
Notes	Asset backed loan notes
NPS	Net Promoter Score
NSFR	Net Stable Funding Ratio
OBR	Office of Budget Responsibility
OCI	Other Comprehensive Income
OFGEM	Office of Gas and Electricity Markets
OHSMS	Occupational Health and Safety Management System
OLAR	Overall Liquidity Adequacy Requirement
ORC	Operational Risk Committee
PAF	Paragon Asset Finance
PAYE	Pay As You Earn
PD	Probability of Default
PFP	Pension Funding Partnership
PIDA	Public Interest Disclosure Act 1998
PIEs	Public Interest Entities
PLC	Public Limited Company
PM12	Paragon Mortgages (No.12) PLC
PM26	Paragon Mortgages (No.26) PLC
POCI	Purchased or Originated Credit Impaired (assets)
PPI	Payment Protection Insurance
PRA	Prudential Regulation Authority (of the Bank of England)
Premier	Premier Asset Finance Limited
PRS	Private Rented Sector
PSD2	Second Payment Services Directive
PSP	Performance Share Plan
PwC	PricewaterhouseCoopers
RBS	Royal Bank of Scotland
RICS	Royal Institution of Chartered Surveyors
RIDDOR	Reporting of Incidents, Disease and Dangerous Occurrences Regulation 2013

RoR	Receiver of Rent
RoTE	Return on Tangible Equity
ROU	Right of Use
RPI	Retail Price Index
RP	Recovery Plan
RSUs	Restricted Stock Units
RWA	Risk Weighted Assets
SA	Standardised Approach
Schedule 7	Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008
SFS	Specialist Fleet Service
SICR	Significant Increase in Credit Risk
Sharesave	All Employee Share Option scheme
SME	Small and/or Medium-sized Enterprise(s)
SMCR	Senior Managers and Certification Regime
SONIA	Sterling Overnight Interbank Average Rate
SPPI	Solely Payments of Principal and Interest
SPV	Special Purpose Vehicle company
The 2016 Code	UK Corporate Governance Code (2016 version)
The 2018 Code	UK Corporate Governance Code (2018 version)
TBMC	The Business Mortgage Company
TFS	Term Funding Scheme
The Act	The Companies Act 2006
The Articles	The Articles of Association of the Company
The Bank	Paragon Bank PLC
The Company	Paragon Banking Group PLC
The Group	The Company and all of its subsidiary undertakings
The Order	The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014
The Plan	The Paragon Pension Plan
TRC	Total Regulatory Capital
TPF	Titlestone Property Finance Limited
TSR	Total Shareholder Return
UK	United Kingdom
UKF	UK Finance
US	United States of America
US Dollar LIBOR	The London Interbank Offered Rate on balances denominated in US dollars
VAT	Value Added Tax
WEEE	Waste Electrical and Electronic Equipment

F2

Shareholder information

Want more information or help?

The Company's share register is maintained by our Registrars, Computershare, who you should contact directly if you have questions about your shareholding or wish to update your address details.

Computershare Investor Services PLC
The Pavilions
Bridgwater Road
Bristol BS99 6ZZ

Telephone: 0370 707 1244*

and outside the UK +44 (0)370 707 1244

Online: www.investorcentre.co.uk

*Calls are charged at the standard geographic rate and will vary by provider. Calls outside the UK will be charged at the applicable international rate. Lines are open 8:30am to 5:30pm, Monday to Friday, excluding UK public holidays.

Electronic communications

You can view and manage your shareholding online by registering with Computershare's Investor Centre Service. To register:

- Visit www.computershare.com
- Go to 'Manage my shareholdings'
- Register using your Shareholder Reference Number and your postcode

We actively encourage our shareholders to receive communications via email and view documents electronically on our website, including our Annual Report and Accounts, as this has significant environmental and cost benefits. Should you wish to receive electronic documents please contact Computershare by telephone or online.

Website

You can find further useful information on our website, www.paragonbankinggroup.co.uk, including:

- Regular updates about our business
- Comprehensive share price information
- Financial results and reports
- Historic dividend dates and amounts

Shareholder fraud warning

Shareholders are advised to be very wary of any suspicious or unsolicited advice or offers, whether over the telephone, through the post or by email. If you receive any such unsolicited communication please check the company or person contacting you is properly authorised by the Financial Conduct Authority ('FCA') before getting involved. You can check at www.fca.org.uk/consumers/protect-yourself and can report calls from unauthorised firms to the FCA by calling 0800 111 6768.

Duplicate documents and communications

If you receive more than one copy of shareholder documents, it is likely that you have multiple accounts on the share register, perhaps with a slightly different name or address. To combine your shareholdings, please contact Computershare and provide your Shareholder Reference Numbers.

Financial calendar

January 2020

Trading update

July / August 2020

Trading update

20 May 2020

Half year results

November 2020

Full year results

Dividend calendar

9 January 2020

Ex-dividend date for 2019 final dividend

2 July 2020

Ex-dividend date for 2020 interim dividend

10 January 2020

Record date for 2019 final dividend

3 July 2020

Record date for 2020 interim dividend

17 February 2020

Payment date for 2020 final dividend

24 July 2020

Payment date for 2020 interim dividend

Annual General Meeting

13 February 2020

To be held at 9:00am at the offices of UBS AG London Branch, 5 Broadgate, London EC2M 2QS

F3

Other public reporting

In addition to its annual financial reporting the Group has published, or will publish, the following documents in respect of the year ended 30 September 2019, as required by legislation or regulation, relating to the Group or its constituent entities.

- Pillar III disclosures required by Part 8 of the CRR
- Tax Strategy Statement
- Modern Slavery Statement
- Gender pay gap information

These documents are made available on the Group's website at www.paragonbankinggroup.co.uk.

All of these statements are required to be published annually. In addition, for the year ended 30 September 2019, the Group has had to publish bi-annual statements on supplier payments under the Reporting on Payment Practices and Performance Regulations 2017. It also made its third report against its Women in Finance charter commitments in September 2019.

All of this reporting will be continued in the financial year ending 30 September 2020.

F4

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