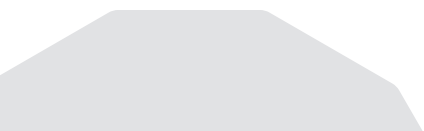




Paragon Banking Group PLC

2020 Annual Report and Accounts



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 statements can be identified by the fact that they do not relate strictly to historical or current facts. They use words such as 'anticipate', 'estimate', 'expect', 'intend', 'will', 'project', 'plan', 'believe', 'target' and other words and terms of similar meaning in connection with any discussion of future operating or financial performance. 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 other than in accordance with its legal or regulatory obligations (including under the Market Abuse Regulation, UK Listing Rules and the Disclosure Guidance and Transparency Rules of the Financial Conduct Authority).

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 that could cause actual results or events to differ materially from those expressed or implied by the forward-looking statements. 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. As a result, you are cautioned not to place reliance on such forward-looking statements as a prediction of actual results or otherwise.

These factors include, but are not limited to: material impacts related to foreign exchange fluctuations; macro-economic activity; the impact of outbreaks, epidemics or pandemics, such as the Covid-19 pandemic and ongoing challenges and uncertainties posed by the Covid-19 pandemic for businesses and governments around the world; potential changes in future dividend policy; changes in government policy and regulation (including the monetary, interest rate and other policies of central banks and other regulatory authorities in the principal markets in which the Group operates and the consequences thereof (including, without limitation, actions taken as a result of the Covid-19 outbreak); actions by the Group's competitors; the UK's exit from the EU which may result in a prolonged period of uncertainty, unstable economic conditions and market volatility, including currency fluctuations; general changes in government policy that may significantly influence investor decisions; and other risks inherent to the industries in which the Group operates.

Nothing in this Annual Report should be construed as a profit forecast.



PARAGON IS A SPECIALIST BANKING GROUP

**We help individuals and small
businesses across the UK prosper
and grow with a range of savings
and specialist lending products.**



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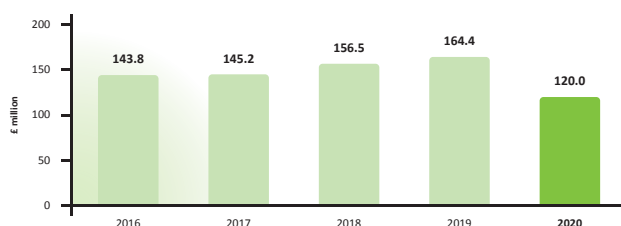
	2016	2017	2018	2019	2020
	£m	£m	£m	£m	£m
Underlying profit before taxation	143.8	145.2	156.5	164.4	120.0
Profit before taxation	143.2	144.8	181.5	159.0	118.4
Profit after taxation	116.0	117.2	145.8	127.4	91.3
Total loans to customers	10,737.5	11,124.1	12,127.8	12,186.1	12,631.4
Shareholders' funds	969.5	1,009.4	1,095.9	1,108.4	1,156.0
	2016	2017	2018	2019	2020
Return on tangible equity	12.9%	13.4%	16.1%	14.1%	9.7%
Earnings per share					
- basic	40.5p	43.1p	55.9p	49.4p	36.0p
- diluted	39.7p	41.9p	54.2p	48.2p	35.6p
Dividend per ordinary share	13.5p	15.7p	19.4p	21.2p	14.4p

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 54. The derivation of underlying profit before taxation and other underlying measures is described in Appendix A.

Financial highlights

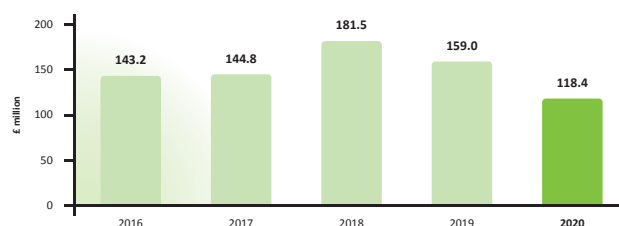
Underlying profit before tax

£120.0 million 27.0% lower (2019: £164.4 million)



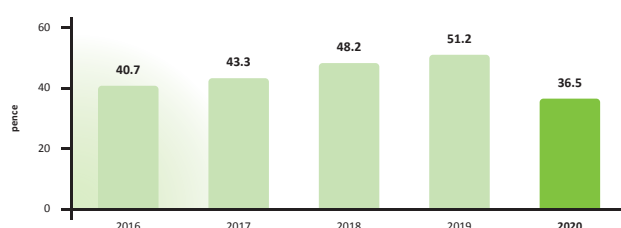
Profit before tax

£118.4 million 25.5% lower (2019: £159.0 million)



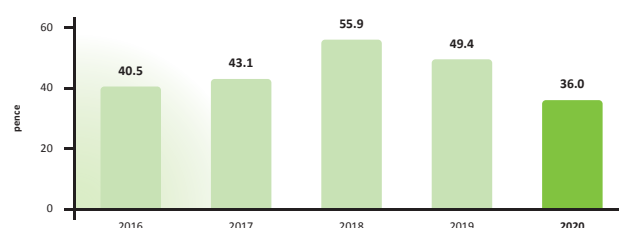
Underlying basic earnings per share

36.5 pence 28.7% lower (2019: 51.2 pence)



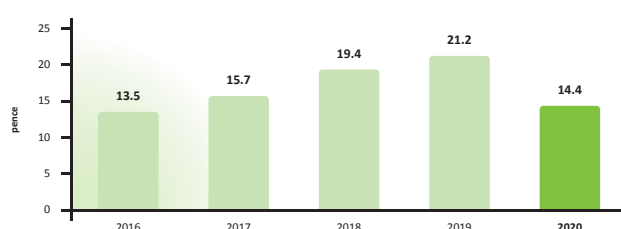
Basic earnings per share

36.0 pence 27.1% lower (2019: 49.4 pence)



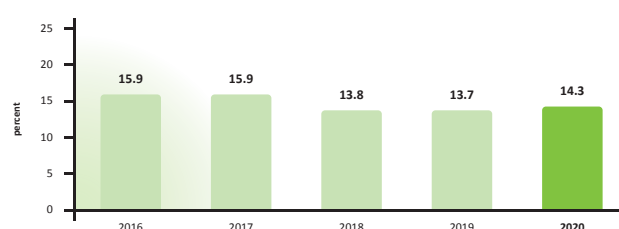
Dividend per share

14.4 pence 32.1% lower (2019: 21.2 pence)



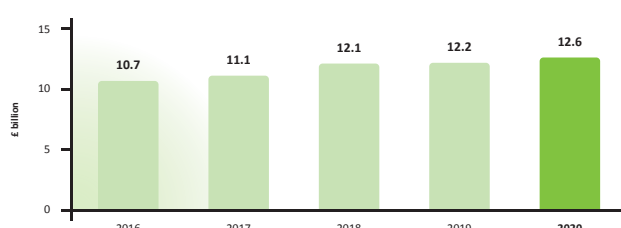
Capital - CET1 ratio

14.3% Remains strong (2019: 13.7%)



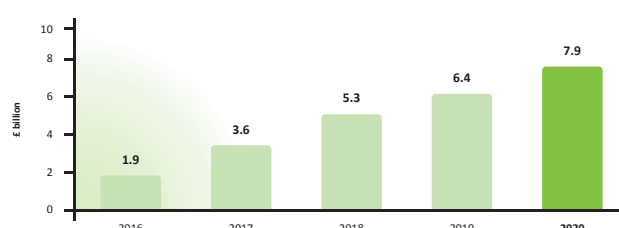
Total loans to customers

£12.6 billion 3.7% higher (2019: £12.2 billion)



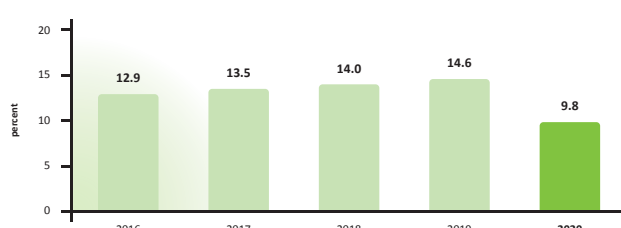
Retail deposits

£7.9 billion 22.9% higher (2019: £6.4 billion)



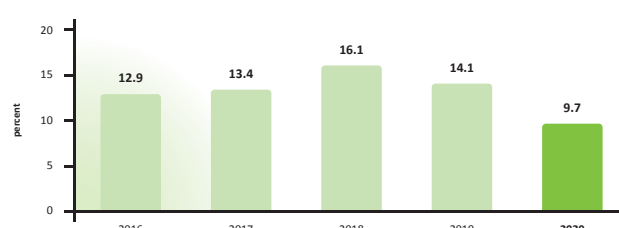
Underlying return on tangible equity

9.8% (2019: 14.6%)



Return on tangible equity

9.7% (2019: 14.1%)





EDI network

During 2020, Paragon formed its first Equality, Diversity and Inclusion Network to support all employees and encourage a diverse range of talent.



A. Strategic Report

The business and its performance in the year

- | | |
|------------|---|
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<i>Approval of the Strategic Report</i> |

The response to the pandemic has demonstrated the strength of the Group's proposition...

Fiona Clutterbuck
Chair of the Board



A1. Chair of the Board's introduction

Dear Shareholder

I find myself introducing my third report and accounts as Chair at the end of one of the most extraordinary years in the history of the Group, and indeed in the history of the UK corporate sector as a whole, and a year which demonstrated the fundamental resilience of the Group. I am very proud of the way in which the business responded to the Covid-19 pandemic, prioritising supporting our customers, protecting our people, preserving our capital and ensuring the ongoing future value of the business.

We have provided additional information in this report to help you understand the impact of Covid-19 on the Group's operations and financial results. I hope you find this report useful in understanding our business and the story of our year.

The business and its purpose

The business is managed through three lending divisions, Mortgage Lending, including buy-to-let, Commercial Lending and Idem Capital, with each division offering a range of specialist lending propositions. These are principally funded through our retail deposit base, supplemented with wholesale and central bank borrowings.

During the year the divisions have continued to pursue the strategic aims we have shared previously, and while the pandemic has adversely affected advances in the short-term, the growth of our development finance business has continued strongly, while our core buy-to-let specialist landlord customer base has remained robust.

The response to the pandemic has demonstrated the strength of the Group's proposition and, notwithstanding the continuing economic uncertainties, we see significant opportunities for further development and investment in the year to come.

I was particularly pleased with the ability of the business to move over 90% of its people to homeworking within a week of the lockdown on 23 March 2020. We supported our customers through the provision of payment reliefs, maintaining service

levels across all business areas, preserving the availability of new lending, providing access to CBILS and BBLS and continuing to offer attractively priced deposits. This was a great demonstration of how we aim to fulfil our purpose – to support the ambitions of the people and the businesses of the UK by delivering specialist financial services.

We pride ourselves on our culture and I believe that the way in which our colleagues responded to the crisis has further highlighted how embedded that ethos is within the business and its people. During the year PwC carried out a review of the Group's culture and noted:

"There is strong collaboration across the leadership team, and a real sense of being part of a 'family'. This alignment means that the leadership work well together ... and role model the desired behaviours consistently."

It is these behaviours which allowed the Group to respond so effectively to the pandemic for the benefit of all our stakeholders.

The Group's business model and purpose are described more fully in Section A2

Results

The Group's new lending in the year was £2.0 billion, reduced from £2.5 billion in 2019 as a result of constrained volumes in the second half. The savings deposit base grew to £7.9 billion from £6.4 billion a year earlier at an improved funding cost and the Bank of England TFSME programme was accessed.

Margins were impacted during the second half as a result of the base rate cuts in March and the increase in expected loss provisions by £40.0 million saw underlying profit before tax reduce to £120.0 million from £164.4 million in 2019. Profit before tax on the statutory basis fell by 25.5% to £118.4 million, reflecting one off gains made in 2019.

Underlying earnings per share ('EPS') decreased to 36.5 pence (2019: 51.1 pence) and statutory EPS fell to 36.0 pence (2019: 49.4 pence). Underlying return on tangible equity was 9.8% (2019: 14.6%), 9.7% on the statutory basis (2019: 14.1%).

The Group's capital base has remained strong, with high levels of liquidity maintained through the year and regulatory Core Equity Tier 1 ('CET1') ratio increasing to 14.3% (2019: 13.7%).

The financial results and operational performance are reviewed in Section A3

Stakeholders

We take our responsibility to all our stakeholder groups very seriously and our response to Covid-19 during the year was designed to protect the interests of customers, employees and suppliers as well as preserving shareholder value. We acknowledge our duties as a corporate citizen. We did not access any government support schemes, no employees were placed on furlough and no redundancies were made as a result of the Covid-19 outbreak.

Climate change is one of the biggest challenges faced by the world today and we are therefore cognisant of the growing pressure from investors for more and better reporting on companies' responses to climate change and other environmental issues and I hope you will find the additional information we have provided helpful. This evidences the Group's response to climate change, which will continue to develop over time.

I have been deeply impressed by the energy and commitment shown by senior management, and, indeed, all of our colleagues, in response to the pandemic which resulted in considerable personal upheaval for many. A significant number needed to balance childcare and home-schooling commitments whilst working at home during the pandemic. I am pleased that the Group was able to support employees, in some cases changing working patterns or offering additional paid leave. I am very grateful to all of the Group's people for their hard work and dedication throughout the period.

Social responsibility issues are discussed in Section A6

Governance

This was the first year where the Company was operating under the 2018 edition of the UK Corporate Governance Code. We had put systems in place before the beginning of the year and were able to report our compliance with the new provisions.

As part of the new arrangements enhanced employee voice provisions were instituted and I was pleased to attend our People Forum during the year to hear directly from our colleagues. I was also able to meet with shareholders and investor groups over the year on governance matters and I continue to value their input; their perspective helps us determine our priorities for the future.

We also present, for the first time in these accounts, a detailed analysis of how the Board takes into account the impact of its decisions on all stakeholders. I hope you will find this useful.

During the year, John Heron and Peter Hartill stepped down from the Board and Finlay Williamson announced his intention to step down in December 2020. All of them have made significant contributions to the Group over the years and they leave with the grateful thanks of their colleagues, my fellow directors and myself. We will miss their wise counsel.

I am delighted to welcome Alison Morris, who joined the Board in the year and now chairs the Audit Committee and Peter Hill who joined the Board after the year end. Following these changes, I am pleased to say that female directors will comprise 37.5% of the Board.

The Covid-19 crisis has impacted the Group in many ways and required an increased time commitment from my board colleagues. I would like to pay tribute to them for the level of care, thought and commitment they brought to this task.

Corporate governance is discussed in Section B3

Risk

The Group continues to invest in developing and supporting its risk management systems. A thorough review of principal risk categories was adopted by the Board and climate change risk, reputational risk and model risk were separately identified as principal risks for the first time, reflecting their importance in the Group's future strategy.

A particular focus of risk management in the year was the operational changes introduced in response to Covid-19. It was a priority to ensure that there was no weakening of the risk management arrangements as a consequence of employees working from home and the resultant increase in cyber risk.

The Risk Management report is set out in Section B8

Shareholder returns

The actions taken to protect shareholder value and the strong capital position of the Group underpin the payment of a final dividend for the financial year. We decided not to pay an interim dividend, due to the difficulty in determining the long-term economic impact of the pandemic at that point in time, despite the strength of our capital ratios. Following significant capital stress testing the Board has concluded that a dividend for the year of 14.4 pence per share can be declared, subject to shareholder approval, giving a dividend cover of 2.5 times, broadly in line with policy. We thank our shareholders for their support in the year.

Conclusion

The Group has performed well through the Covid-19 crisis, demonstrating its operational robustness and its ability to respond rapidly to new developments, with new processes, systems and ways of working. All of this enabled us to support customers and business partners through this difficult time, strengthening relationships for the future.

The underlying fundamentals of the Group's business remain sound and despite the short-term economic uncertainties which remain as a result of Covid-19, I believe that the Group is well placed for the future.

Fiona Clutterbuck

Chair of the Board
3 December 2020

A2. Business model and strategy

Paragon at a glance

Paragon is a specialist banking group. We offer a range of savings products and provide finance for landlords, small businesses and property developers in the UK.

Listed on the London Stock Exchange, we are a FTSE 250 company, headquartered in Solihull, employing just under 1,400 people.

Since gaining our banking licence in 2014, our new lending is funded principally through an online personal savings operation. We have expanded our operations in buy-to-let and extended into a wide range of commercial lending markets, including asset and development finance. We also service a range of consumer loan portfolios through our subsidiary, Idem Capital.

Our history

Paragon began life as a specialist residential mortgage lender in 1985. A pioneer in buy-to-let lending, in 1995 we launched our first mortgage products for UK landlords in the growing Private Rented Sector ('PRS') achieving a 10% share in the buy-to-let market by 2006. After successfully navigating through the financial crisis in 2008, we returned to new lending in 2010, and in 2014 we embarked on an ambitious transformation to diversify our funding sources and enter new lending markets.

Paragon Bank was established in 2014 and over the next few years we began supporting UK businesses in a wide range of sectors, including asset finance and property development. Today we help more than 400,000 customers to achieve their ambitions.



Our values

We have a strong and unique culture underpinned by eight essential values, which we strive to exceed every day. These values underpin how we operate, what we stand for and how we work together to achieve our goals. We believe that living our values helps us succeed in fulfilling our purpose (see page 14).



Fairness

To work together to ensure fair outcomes for all our customers



Professionalism

To maintain the highest standards and deliver our products and services with care and accuracy



Integrity

To be honest and open in everything we do



Humour

To ensure we have fun while achieving success!



Commitment

To drive the business forward with determination and to do so with effort and enthusiasm



Creativity

To identify and create new business opportunities and apply creative and effective solutions to problems



Teamwork

To work in harmony and collectively towards the delivery of our overall objective



Respect

To treat people as individuals and listen to their views

Our operations

Paragon's operations are organised into three divisions and new lending is funded largely by retail deposits. These divisions are supported by the Group through the provision of capital and 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.

Mortgage Lending

We provide mortgage finance for UK landlords to support growth in the Private Rented Sector ('PRS'), giving people choice and flexibility in housing tenure.

See pages 20 and 21



Commercial Lending

We support UK small businesses operating across a range of sectors with finance to help them grow. This includes finance for property developers, motor finance and structured lending products for non-bank lenders.

See pages 22 to 25



Idem Capital

We acquire and service UK loan portfolios from other financial institutions.



Funding

Our principal source of funding for new lending is our range of savings products offered to UK savers. Other funding for lending is derived from the efficient use of Bank of England funding schemes, while securitisation continues to fund much of the legacy book and is used tactically. Central funding is provided through corporate and retail bonds.

See pages 18 and 19



Our business model

What is a specialist bank?

As a specialist bank, we focus on lending to customers in markets typically underserved by larger high street banks who require funding in specific areas. This approach requires us to be experts in these areas, 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.

We see specialisation as what makes us different, as our competitive advantage, and it runs through our business model and strategy.



How we add value

Our core strengths

Customer expertise

We have a deep understanding of our customers and their markets, designing products to meet their needs and continually striving to exceed their expectations.

600 million items of customer data analysed each month

Risk management

We lend conservatively, based on detailed credit assessments of the customer and underlying loan collateral, to minimise the risk of non-payment and portfolio losses.

Cost of risk 0.39%

Cost control

Distributing loan products principally via third party brokers, collecting savings deposits online and operating mainly from a centralised location means we run a cost efficient business.

Underlying cost:income ratio 43.0%

Our people

We are committed to helping all our employees reach their potential and recognise the importance of diversity, thereby maintaining a skilled and engaged workforce.

Gold Investors in People accreditation

Technology

We are utilising technology to improve productivity and access new markets, and are well placed to take advantage of digital changes to enter new markets.

New online portal for landlord customers launched in 2020

Management expertise

We have an experienced management team with a through-the-cycle track record.

Average length of service for the executive management team is 15 years

Culture

Eight core values underpin the way we do business and how we interact with our customers and other stakeholders, with a focus on treating customers fairly.

91% of employees feel Paragon has clear values¹

Strong financial foundations

We efficiently utilise capital and debt positions to maintain balance sheet strength.

CET1 14.3%

¹Investors in People report, 2019

Value created

This approach enables us to create value for all our stakeholders.

Shareholders

Creating long-term shareholder value through growing profits and dividends.

14.4p dividend per share

See page 40

Customers

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

+61 Net promoter score for savings account opening

See pages 19 and 21

Employees

Helping all our people develop their career and reach their potential.

Average training per employee in 2020: 4.2 days

(CIPD average 2.8-3.3 days)

See page 59

Society

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

£100,000 charity donation to tackle Covid-19 impact

See page 65

Environment

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

100% of electricity used by sites for which we are responsible was from renewable energy sources in 2020

See page 63

Our strategy

Helping our customers to achieve their ambitions is central to our success and this is what drives our purpose and our vision. We have a clear strategy to help us achieve our goals and we have eight important values that underpin our culture and the way we do business.

Our strategic framework

Our purpose

To support the ambitions of the people and businesses of the UK by delivering specialist financial services



Our vision

To become the UK's leading specialist bank by helping our customers achieve their ambitions and be an organisation of which our employees are proud



Our strategy

To focus on specialist customers, delivering long-term sustainable growth and shareholder returns through a low risk and robust model



Our strategic priorities

Five strategic priorities help us deliver our strategy (see page 15)



Our values

Eight values underpin our culture and the way we do business (see page 10)

Our strategic priorities



Diversification

As a diversified bank, we have a broad funding base and lend on diversified loan assets. We are continually developing our range of savings and lending products, in both existing and new markets, to grow our business and help us succeed in becoming the UK's leading specialist bank.



Specialisation

We operate in selective markets and focus on being experts in these often underserved areas. We lend to customers operating in specific sectors where our specialist knowledge and expertise can help them develop their businesses. We seek to build strong positions in our chosen markets and work closely with our customers to help them succeed.



Growth

To ensure we can deliver long-term sustainable growth for our shareholders and other stakeholders, we are continually seeking new opportunities. Growth both organically and through acquisition helps develop the business to enable long-term success.



Capital management

Strong levels of capital and liquidity provide solid foundations for our business. We aim to recycle capital to reinvest in the business and provide increasing returns for our shareholders.



Sustainability

Sustainability influences every aspect of our business. For Paragon, sustainability means reducing the impact that our operations have on the environment, ensuring we have a positive effect on our stakeholders and communities, and delivering sustainable lending through the products we offer and markets in which we operate.

Risks

We have identified a number of principal risks, arising from both the environment in which we operate and our business model, which could impact our ability to achieve our strategic priorities.

Capital

Insufficient capital to operate effectively and meet minimum requirements.

Liquidity and funding

Insufficient financial resources to enable us to meet our obligations as they fall due.

Market

Changes in the net value of, or net income arising from, our assets and liabilities from adverse movements in market prices.

Credit

Financial loss arising from a borrower or counterparty failing to meet their financial obligations.

Model

Making incorrect decisions based on the output of internal models.

Pension obligation

Our commitments under our defined benefit pension scheme are insufficient to meet our liabilities.

Reputational

Failing to meet the expectations and standards of our stakeholders.

Strategic

Changes to business model or environmental factors may lead to an inappropriate or obsolete strategy or strategic plan.

Climate change

Financial risks arising through climate change impacting the Group and our strategy.

Conduct

Poor behaviours or decision making leading to failure to achieve fair outcomes for customers.

Operational

Resulting from inadequate or failed internal procedures, people, systems or external events.

These risks and their mitigants are discussed in more detail in Section B8.

Our response to Covid-19

Paragon is a strong, resilient and diversified business and we were well placed to deal with the uncertainties that arose from the Covid-19 pandemic. Our operational response was swift and, in March 2020, we were able to quickly shift our focus from growth and diversification, to the implementation of well-developed contingency plans, reflecting our highly agile and flexible infrastructure, technology and people.

Our through-the-cycle experience, robust credit approach, experienced workforce and resilient systems have enabled us to navigate through the crisis and mitigate the impact on our business.

Our priorities during the outbreak of Covid-19 have been to support our customers and suppliers, protect our people, safeguard our capital base and preserve the long-term value of our business.

Supporting our customers and suppliers

The skills and experience of our specialist customer-facing teams helped us to understand the impact of Covid-19 on our customers and to support them with a range of payment relief options and recovery assistance across our portfolios.



Customers representing 21% of loan balances were given a payment deferral of some sort. Of those, almost 95% had recovered sufficiently by 31 October 2020 and no longer need support



We introduced a programme of customer engagement surveys and data collection to ensure that optimal approaches to customers' individual situations are identified



We continued to apply the skills and experience of our in-house surveying team throughout the period



The flexibility of our workforce meant we could create pools of employees so that high volume areas could be addressed, with resource being moved around the Group



We offered payment holidays to our mortgage customers to help them provide security for their tenants and we provided funding to our SME customers by gaining accreditation to the UK Government's Coronavirus Business Interruption Loans Scheme ('CBILS') and Bounce Back Loans Scheme ('BBLs').

These measures required rapid developments in IT systems and procedures delivered using agile techniques and on an accelerated timescale. Our systems were adapted to record such reliefs and ensure they did not impact on our customers' credit agency records.



Protect our people

Our 1,400 people are central to the success of our business. Keeping them safe has been our main priority and enabled us to maintain operational stability throughout this period.

By 31 March 2020, more than 90% of our people were working from home, supported by IT upgrades and expanded use of technology across the business. We adopted a flexible approach to working patterns and introduced policies focussing on the morale and wellbeing of employees, providing extensive communication and enhanced management.

Around 10% of our employees continued to travel to work to deliver essential services to our customers which could not be carried out from home. To keep them safe, we implemented strict social distancing, together with additional measures to promote good hygiene practices.

We introduced regular employee wellbeing surveys to help us understand how our people were coping and to highlight where extra support is needed. Our intranet site features a host of wellbeing information and our internal wellbeing team provides confidential support and advice to employees across the Group.



0 employees have been placed on furlough schemes and no redundancies have been necessary

60% increase in communication activity on our intranet

94% of employees believe Paragon has been considerate of employee wellbeing when making decisions that affect the workforce and **84%** of employees are satisfied or very satisfied with the support available¹

Safeguard our capital base

Paragon entered this period with a strong capital base and significant liquidity, and our capital position has since been strengthened with liquidity access remaining good.

The volume of retail deposits in our savings operation has continued to grow, enhanced by the launch of a flexible ISA product, which proved successful in the spring 2020 ISA season.

No interim dividend was declared which helped retain resources to support our customers and continue to deliver growth, protecting our long-term financial position.

We completed our first fully retained securitisation, containing £760 million of prime buy-to-let fixed rate mortgage assets.

We have strong levels of capital and liquidity and are well placed to develop our core businesses as well as make the most of any potential opportunities that may arise in future...

Nigel Terrington,
Chief Executive

Preserving the long-term value of the business

Building a long-term sustainable business is central to our strategy, and we have continued to take steps to ensure we are in a strong position to continue to grow lending volumes in our chosen markets when customer confidence returns.

> Our historic credit focus and operational resilience have enabled us to continue to lend across our divisions and maintain functionality across all customer-facing and support areas

> We have continued to invest in projects to make improvements in our systems and technology

> We have instigated engagement programmes with our customers and maintained operational performance with minimal impact on customer service

> We have maintained our prudent approach to lending, focus on risk and disciplined underwriting

An important part of our response to Covid-19 has been changes to our risk profile. See Section B8 for more details.

¹Employee survey, June 2020

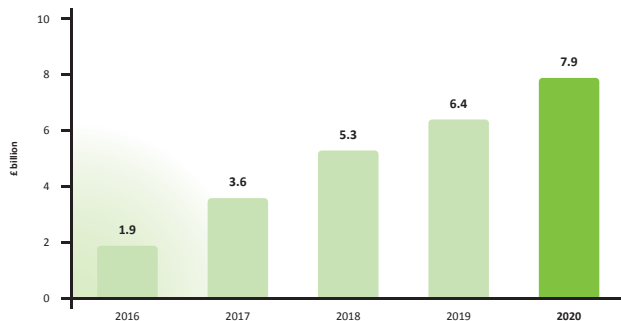
In focus: Savings



There is no doubt we've seen a seismic shift in the savings market this year, which has brought both challenges and opportunities. Our savings business has proved nimble, adaptive and resilient to rapid market fluctuations, which has allowed us to secure strong growth...

Michael Helsby, Strategic Development Director

Our principal source of funding for new lending is our range of savings products offered to UK savers. The savings arm entered its sixth year in 2020 and the total volume of retail deposits has continued to grow and now stands at £7.9 billion.



Products

We offer simple and straightforward products at competitive rates. This ranges from fixed term products to easy access, including notice and defined access products and ISAs.

The majority of deposits are sourced through our own website and through aggregator platforms, however during the year we expanded our services to be available through an increased number of digital banks and wealth management platforms, including Monzo, Revolut and Hargreaves Lansdown.

We also launched postal access across all of our fixed rate products.

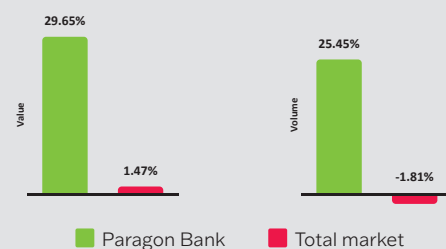


ISA innovation

In November 2019, Paragon became one of few financial providers to offer a Lifetime ISA product, helping to engage with a new demographic of savers by predominantly appealing to 18-39 year old first time buyers. We also launched Wallet and Flexible ISA features across our portfolio during the year which allow savers to split their yearly ISA allowance across a range of ISAs held with Paragon.

45% year-on-year increase in ISA applications during March and April

Growth in ISA applications



Source: CACI, January – September 2020

Market

The UK household savings market is estimated at £1.29 trillion.

The Bank of England base rate declines triggered a reduction in saving rates offered across the market, with rates sinking to an historical low in the first months of the pandemic.

The climate of financial uncertainty brought on by the pandemic also had a profound impact on household deposits and created a divided picture in the UK savings market. Whilst many households were at a financial disadvantage due to Covid-19, others were able to supplement their savings, aided by reduced opportunities for consumer spending.

As a result, deposits soared during the first few months of the pandemic, although this then started to plateau as lockdown measures started to lift.



Between March and June 2020, household savings deposits increased by nearly £43 billion, compared to an increase of £18 billion in the same period in 2019¹



Customers

In order to monitor customer satisfaction and identify areas for improvement, we regularly ask customers why they choose to save with us. We survey our savers at two stages of the customer journey: when they open a new account and at the maturity of a product.

New customers

+61 Net promoter score for savings account opening²

75% of new customers reported being very satisfied with the customer service that they received, with **86%** finding the account opening process easy or very easy.

Amongst new customers, **93%** chose Paragon because we offered the highest rate of interest, however the FSCS guarantee, online access and the easy application process were also cited as popular reasons.

Overall, **88%** of new customers would consider taking another savings account with Paragon.

Very quick and easy process to transfer my ISA from another provider. Everything done online which was important to me and the whole thing was done and in my Paragon account within a week. Excellent service - very pleased

Customer feedback

187,000
direct savings customers, an increase of 14.3% on last year

£29,000
average deposit for direct customers

Existing customers

85% of customers were satisfied with the customer service they had received when their fixed rate product matured. **90%** of fixed rate product customers would take out another savings account with Paragon in the future.

+50 Net promoter score for customers with maturing products³

We also display customer feedback sourced through the independent service rating Feefo on our website. Our average Feefo customer rating stands at **4.3/5**, which is based on more than **1,100 reviews** during the last 12 months.

feefo

¹Source: Bank of England ²Net Promoter Score of +61 for new savings account opening process based on an online survey of 3,311 savings customers between 1 October 2019 and 30 September 2020 (total respondents to this survey were 3,438). ³Net promoter score +50 for maturity accounts where fixed rate period ended based on an online survey of 2,972 savings customers between 1 October 2019 and 30 September 2020 (total respondents to this survey were 3,044).

In focus: Buy-to-let mortgages



With projected strong population and household formation growth across the UK, demand for good quality privately rented homes will become more pronounced in the coming years. Professional, larger-scale landlords have a greater propensity to invest in new property and it will be these portfolio landlords who will deliver the majority of new stock in the sector. Paragon's focus on this landlord customer group means we are well placed to meet this future demand, helping to provide homes for millions of people...

Richard Rowntree, Managing Director, Mortgages

We offer buy-to-let mortgage finance for landlords operating in the UK's Private Rented Sector ('PRS').

We were one of the first lenders to pioneer buy-to-let lending and, since 1996, we have originated £23.8 billion of buy-to-let accounts. During this time, we have built an unrivalled level of expertise in the market, becoming a leading authority on the sector and a principal source of engagement for regulators and government.

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 through corporate structures.

3.1%

share of all new buy-to-let mortgages in the UK

77,000+

buy-to-let loan accounts

£10.6 billion

buy-to-let loan assets

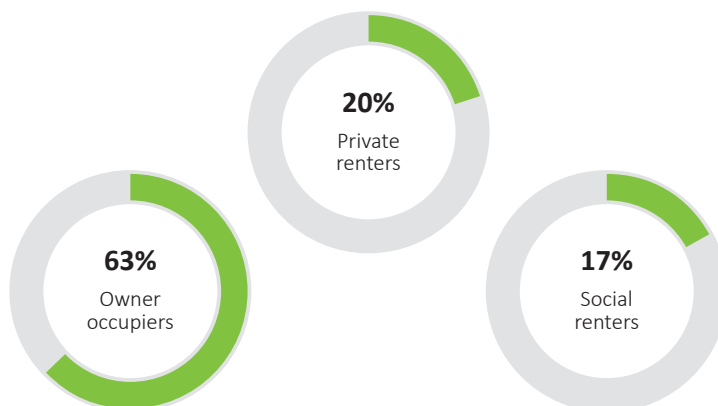
Market

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.

The UK's PRS has more than doubled in size since 2000. Today, in England, it comprises 4.6 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.

Housing tenure

The PRS makes up 20% of the English housing market¹



¹MHCLG English Housing Survey 2018-2019

Market trends

- > UK buy-to-let mortgage lending totalled £42 billion in 2019, including 72,000 loans for new house purchase, providing much needed new homes into the Private Rented Sector¹
- > Tenant demand has increased in most UK regions strongly during 2020 – ARLA Propertymark data shows that prospective tenants rose to the highest on record during the month of October 2020
- > Landlords have supported tenants throughout the pandemic – nearly half have put rent relief measures in place²

Market outlook

- > Despite strong historic growth in the PRS, Knight Frank forecasts further sectoral growth of 10% between 2020 and 2024
- > The number of households in England is expected to grow from 23.2 million today to 24.8 million by 2028 and 26.3 million by 2038, with much of the increase attributable to single person households, a group which has a greater propensity to rent³
- > Professional landlords have a greater propensity to invest in new homes – 26% of landlords with 6 or more properties say they will acquire new PRS property compared to 6% of those with one property²
- > The Build to Rent ('BTR') sector is growing, but not at scale to satisfy forecast levels of tenant demand – 167,853 BTR homes complete, in construction or planning phase at the end of Q2 2020 according to the British Property Federation

Customers

We focus on specialist landlords with large portfolios - 59% of Paragon landlords own four or more properties and 36% list their lettings business as their main occupation. Nearly three quarters (72%) have more than 10 years' experience as a landlord, and many have a long standing, valued relationship with Paragon⁴. In Q3 2020 a typical portfolio:



was worth around **£2.4 million⁵**



consisted of 15.3 properties **valued at an average of £154,000 each⁵**



generated an **annual income of £7,499** per property⁵



achieved a gross rental income of **£113,219 per annum⁵**



74% of Paragon landlords said they were happy /very happy with the service they received⁶

The service I have received over the years has been exemplary...

Landlord customer, February 2020⁶

Even in this difficult time with businesses locked down you performed really well and made the whole process easy...

Landlord customer, April 2020⁶



Support during Covid-19

To help our landlord customers during Covid-19 we introduced mortgage payment holidays and other forms of relief. This enabled our customers to offer security and support to their tenants. We have kept in regular contact with our landlords throughout the pandemic, conducting three sentiment surveys between April and September. Well over half of landlord customers (58%) rated Paragon's response to the coronavirus crisis as Excellent/Good compared with other lenders' responses. This figure increased to 77% amongst customers who arranged a mortgage payment deferral⁴.

68%

of mortgage intermediaries rated Paragon's service during the pandemic as better than other lenders⁷

¹UK Finance ²BVA-BDRC Landlord panel Q2 2020 ³ONS ⁴Landlord sentiment surveys April, May, September 2020 combined base 872 ⁵BVA-BDRC Landlord panel Q4 2019 - Q3 2020 ⁶Customer satisfaction survey feedback from 924 landlord customers 1 October 2019 – 30 September 2020 ⁷Telephone survey of 392 intermediaries April – September 2020

In focus: SME lending



We have been working closely with all of our customers to support them through this period and have remained open for business. As well as joining the UK Government's lending schemes, we are staying in close contact with our customers to discuss how the pandemic is affecting them and what support they need...

John Phillipou, Managing Director, SME lending

Paragon entered the SME finance market in 2015 with the acquisition of Five Arrows Leasing Group and we have continued to expand our offering to small businesses over the last five years with the acquisition of the asset finance broker Premier Asset Finance in 2016 and Iceberg in 2018.

We provide a range of finance solutions for SMEs covering a wide array of sectors, including agriculture, aviation, construction, business equipment, manufacturing, vehicle, technology and electric vehicles. Our expert SME lending teams have deep and specialist knowledge, not only in finance but also in the asset categories within which they operate.

We offer a range of finance types to fund assets including hire purchase, finance leases, operating leases and commercial loans. We also offer refinancing solutions.



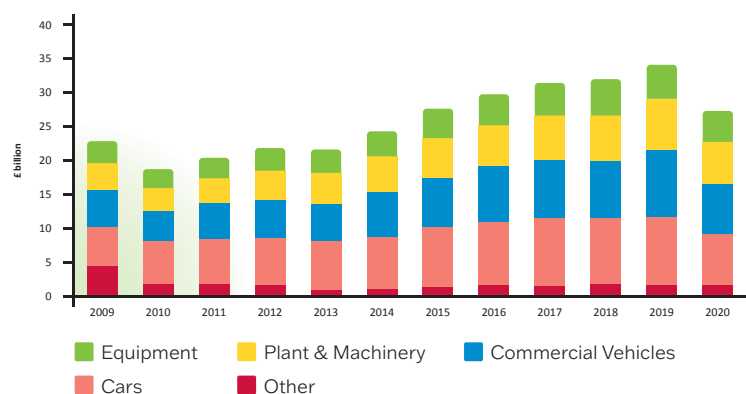
Market

The SME lending market is 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 rate of new work in commercial industries such as construction
- Government regulations and trading restrictions, particularly for sectors such as agriculture
- Advances in technology and SME growth
- Environmental concerns and the drive towards fuel efficiency

UK asset finance originations



Source: FLA

Market trends

- > The asset finance market declined by 11% in September 2020 compared with the same month in 2019¹
- > The plant and machinery finance sector saw a fall in new business of 19% in the 12 months to September 2020, compared to the same period in 2019¹
- > The car finance sector reported growth in new business of 3% in September 2020 compared with the same month in 2019. Over the same period, the commercial vehicle finance and business equipment sectors reported falls in new business of 2% and 4% respectively¹

Market outlook

- > In the motor finance market, the number of new car registrations is expected to grow by 28.3% in 2021¹
- > New customs regulations and changes to tariffs following the Brexit transition period are expected to impact supply chains for both the construction and agriculture sectors, in addition to the wider UK economy
- > 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 vehicles²

Customers

To help our business customers during Covid-19, we gained accreditation to offer government-backed Coronavirus Business Interruption Loans and Bounce Back Loans.

£25.9 million
Total CBILS and BBLS lending

37% of customers offered additional support
including flexibility with payment arrangements (typically in the form of an interest-only period) and access to BBLS and CBILS

Broker research drives new digital solution

During 2020, we undertook research with our brokers to gain a clear understanding of their current end-to-end digital experience and their future expectations, in order to subsequently improve the experience for the end customer.

The results highlighted a desire for simplicity, accuracy and speed across the digital journey, in addition to the need for lenders to offer an end-to-end digital solution.

As a result of this research, Paragon is in the process of developing a digital solution that is based on the needs of both brokers and SME business owners. This continued insight enables us to be forward-looking and innovative, developing new ways to best support our customers.

AdCo UK

Switching to manufacturing hand gel as a result of Covid-19

The support has enabled AdCo to help those in need and the funding has also assisted us in sustaining staffing levels without the need for furloughing. It's always a pleasure to work with the Paragon team. They are efficient, friendly and knowledgeable and they provide the right support for their client's needs...

Stuart Climpson, Director at AdCo UK Ltd

Milton Farms

Renewables
(AD generator)

Over the years we have built up a friendship with Paragon, who provide us not only with competitive rates but sound professional advice, all under a relaxed atmosphere. Paragon is able to respond at short notice which gives us flexibility in the marketplace...

Edward Morris, Milton Farms

¹FLA, November 2020 ²Accenture, 2019

In focus: Development finance



Throughout the difficult period during the height of coronavirus, Paragon's development finance team honoured all of the facilities we approved pre-lockdown as well as continuing to support new and existing projects throughout. As a result, we have seen some excellent opportunities across the last three months...

Robert Orr, Managing Director of Development Finance

Our development finance business provides competitive and flexible financing solutions targeted at experienced SME property developers. We started to offer finance to property developers in 2016 and the acquisition of Titlestone in 2018 accelerated progress in this area.

We support developers with a successful track record who are delivering an attractive product, correctly priced in the right locations. Our highly experienced team is based in London, as well as in locations across the Midlands, the North West and the North, offering tailored funding solutions to our clients.



Products

We focus on residential development loans, accounting for 98% of business written in 2020, and support experienced developers involved in multi-unit residential, new build, conversion or refurbishment projects. We provide loans up to £30 million and we lend up to 65% of the gross development value ('GDV').

We also provide:

£4.8 million average facility



Bridging finance

Access to short-term funding when securing the acquisition is the priority



Pre-planning finance

Working with developers to help fund sites that have not yet gained full planning permission



Student accommodation development finance

Helping experienced developers build quality student accommodation with good letting potential



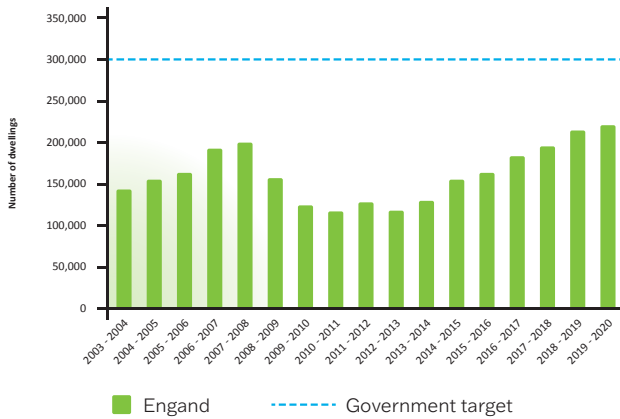
Marketing period loans

Funding for the marketing period once a development reaches completion

Market

The UK property market and rate of housebuilding drive the opportunities for development finance. The general economic conditions within the UK influence activity in the residential development sector, alongside interest rates, lifestyle choices, government targets for new homes and help to buy schemes.

New homes completed



Source: MHCLG - House building: permanent dwellings completed

Customers

75% of sites remained open during lockdown and all sites fully open by mid-June

Only 15.6% of the portfolio needed additional support at the peak of the pandemic (September 2020: 0%)



£15.5m funding for The General, Bristol

The Paragon team listened to our requirements and were able to quickly structure a great deal that matched our operational needs...

Tim Sargeant, owner of City and Country

Market trends

Demand for new homes in the UK continues to grow due to population expansion and forecast household formation. The UK Government has set a target of 300,000 new homes per year, yet housebuilding activity currently falls below that - 178,300 homes were completed in 2019, with 151,750 started

To accelerate the number of new homes being constructed, the UK Government has launched proposed planning reforms, including automatic planning permission on land designated for growth. Nearly half of SME housing developers cited planning issues as restricting their ability to build new homes

Consumer demand is driving the growth of three and four bedroom homes, which accounted for three in every four homes completed in England in the past year. The proportion of completed flats fell to its lowest level for 20 years at 15%

Covid-19 impacted developers' ability to operate during the second quarter of the calendar year. Between March and June almost 40,000 fewer homes were built in England and Wales as a result of Covid-19

37% of SME developers are concerned about the impact of restricted mortgage availability and what this will mean for prospective househunters (Federation of Master Builders Housebuilder survey)



£3.5m funding for Brick House, Romford

The project was made much easier by Paragon's great Relationship Manager, who thoroughly understood our needs as developers and was able to provide excellent support throughout all stages of the development as it progressed. Paragon is a trusted partner...

Daren Burney, Managing Director of Burney Essex Ltd

Sustainability

Sustainability is central to our long-term success. It influences every aspect of our business, from the markets we enter and the products we offer, to the support we give our customers and the culture that we cultivate at Paragon. We have a responsibility to use our influence and our resources wisely and we work diligently to support the communities in which we operate and the environment upon which we all depend.

Helping customers

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 are committed to ensuring good outcomes and fair treatment for all customers across the Group.



7/10 landlords rated Paragon's Covid-19 support as good or excellent. See page 21.



We expanded our Insight team to augment our customer understanding. Not only do we measure customer satisfaction, **we also work to identify what customers value most** so that we can further improve our products and service.



Offering the right **support to vulnerable customers** is essential and we work hard to identify and support those who need extra care, particularly during Covid-19.



Working better

Working better means building a strong and inclusive team with shared values and a commitment to helping our customers achieve their ambitions. We gauge success using a range of metrics and continuously challenge ourselves towards higher achievement.



The Investors in People framework helps us assess how well we lead and support our people. Gold accreditation and Champion status highlight our success.



Our wide-ranging development programme helps employees grow their capability and achieve their potential.



Employees enjoy comprehensive wellbeing support to boost physical, emotional and financial wellbeing.



We are a signatory to HM Treasury's Women in Finance Charter, part of an external mentoring programme, led by the 30% Club and delivered by Women Ahead, and work with The Women's Association to increase the visibility of women in the workplace.



Our newly formed Equality, Diversity and Inclusivity Network is designed to support all employees and champion ideas to make Paragon an even more inclusive workplace.



Caring for the environment

We support the UK's ambition to reduce greenhouse gas emissions to net zero by 2050. We are taking steps to quantify and manage climate-related financial risks associated with our lending and to develop products which will support our strategic aim for sustainable finance.



Working together, we now have an urgent need to measure and protect against the impact of irreversible climate change...

Richard Woodman
Chief Financial Officer

Lending sustainably



Climate change and risk

This year, the Board adopted climate change as a principal risk, ensuring we consider climate issues, alongside capital and liquidity, when making decisions and planning for the future.



Promoting sustainable finance

SFS, who provide vehicle leasing for local authorities, hosted a Low Carbon Emissions Awareness Day to highlight the crucial considerations and challenges for clients in delivering low emission vehicle projects.

Operational impact



100% renewable energy used at owned sites

Key performance indicators highlight our success in reducing Paragon's operational impact on the environment. Our Green Charter, environment policy, risk management and procurement approach provide a framework for continuous improvement.

Supporting communities

We aim to be an energetic and valuable contributor to the communities in which we operate, and we are actively involved in a wide range of volunteering and charity partnerships.

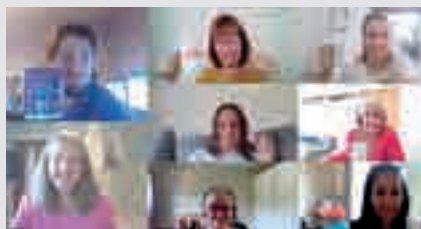


**WE ARE
MACMILLAN.
CANCER SUPPORT**



Employee volunteer scheme

Employees are encouraged to take an annual volunteer day to help at one of a range of community projects focussed on reducing poverty and improving education.



Charity of the year

Employees selected Macmillan Cancer Support as their charity partnership for 2020, raising in excess of £30,000 through events including Move for Macmillan and Paragon's Biggest Coffee Morning.



Covid-19

In May, Paragon made a £100,000 donation to tackle the impact of Covid-19, split between the NHS, Solihull Change into Action, Age UK and Macmillan.



Paragon's business model has been built upon strong financial and operational resilience, through-the-cycle sustainability and crucially, adaptability...

A3. Chief Executive's review

Introduction

2020 has been an eventful, challenging and unprecedented year. It started with the run-in to the Brexit Withdrawal Agreement and the general election. The strength of the economy in the first few months of the year was brought to an abrupt halt with the emergence of the Covid-19 pandemic and lockdown. The consequences have been far-reaching for the economy, society and the political landscape and it will change forever how we work, how we live, how we buy and sell goods and services, and how we interact.

Paragon's business model has been built upon strong financial and operational resilience, through-the-cycle sustainability and crucially, adaptability. All these elements have been tested this year. Whilst the year had started well at an operating level, with strong new business volumes and good momentum, the rapid onset of the crisis meant that our priorities had to be dramatically changed. The new focus was on protecting our people, supporting our customers, protecting our suppliers, preserving our capital and protecting the longer term franchise of the business.

Whilst our business model has been tested across much of 2020, I am pleased to say it has stood up to these tests. Paragon's focus will remain on reinforcing the fundamentals of our business, whilst looking for the opportunities that this new world order will invariably create.

Response to Covid-19

The business reacted swiftly to the onset of Covid-19. Within four days of the national lockdown, over 90% of our employees were working from home. Our technology has been resilient, and we maintained all our product and service offerings throughout, including during both lockdowns.

Customer support was central to our activities across all business lines. Temporary payment reliefs were provided to mortgage, consumer and SME lending customers impacted by Covid-19, the vast majority of whom have returned to full payment as the year progressed, with 97% of the customers granted payment reliefs fully up to date at 30 September 2020. We also participated in the UK Government's business lending schemes.

Paragon has always maintained a strong focus on prudential strength. Capital ratios have been robust throughout and by the year end, CET1 stood at 14.3%, up from 13.7% a year earlier, after allowing for a full-year dividend at policy levels. Liquidity levels have been strong, benefitting from increasing diversification of our funding sources and a prudent approach to maintaining high cash levels.

Paragon's prudent lending approach has also resulted in exemplary portfolio strength and measures were taken to protect against the economic consequences of the pandemic with a tighter lending risk appetite. The Group's portfolio is credit defensive, with 99% of the book secured and only 4% of the mortgage portfolio having a loan-to-value ratio greater than 80%.

Trading performance

New lending activities were disrupted during lockdown, particularly in mortgage lending where the housing market was effectively closed. Most of the impact was felt in the second half of the year, with new lending down approximately 20% on the first half. However, with improved levels of customer retention the loan book expanded by 3.7% year-on-year, and lending volumes remained robust despite the challenges presented by Covid-19.

In mortgage lending, a strong first half was tempered by the impact of lockdown, when the housing market was effectively closed for a two-month period. Landlord demand rebounded quickly in the summer months once the housing market reopened, with pent-up acquisition opportunities and the introduction of the Stamp Duty holiday contributing to a replenished pipeline.

Development finance benefitted from approximately 80% of sites remaining open through the lockdown and the long-term nature of the product, with phased lending commitments. However, SME lending felt a greater impact as customers sought to defer investment decisions or chose instead to draw under one of the UK Government's funding initiatives.

This disruption to lending has now largely played through the business, notwithstanding the effects of a second wave and a further lockdown. At the same time, we are tracking the emergence of the expected credit losses which we have already provided for. The pipelines across the key business lines have rebuilt to pre-Covid-19 levels and, in some cases, are close to record levels. This momentum bodes well for the coming year.

In March the Bank of England reduced base rates to just 10bp. For the Group this resulted in the repricing of assets ahead of liabilities generating a short-term impact to Net Interest Margin ('NIM') in the second half. This had substantially unwound by the year end and we expect the structural upward trajectory in margins witnessed in recent years to resume going forward.

Financial performance

The Group reported an operating profit of £120.0 million for the full-year, 30% below 2019, largely driven by the IFRS 9 impairment charge which rose by over 500% year-on-year to £48.3 million, and was taken in anticipation of the expected impacts of Covid-19. Given the extensive government support to the UK economy, which has now been extended for a further period, much of this impairment charge is unlikely to crystallise in the form of customer defaults and write offs in the near term. Nevertheless, our approach has been conservative, applying post-model adjustments to modelled expected loss outputs. These were based on our close understanding of the customer base and reflected the Group's economic forecasts, anticipating the potential impact on our loan portfolio of the inevitable real economic consequences of the pandemic. Notwithstanding this impact on profitability, the Group still delivered an underlying return on tangible equity of 9.8% (9.7% on a statutory basis).

The huge uncertainty in the early stages of the pandemic meant that the Board took the decision at the time of the half-year results not to pay a dividend. The Group's resilient performance, strong capital ratios and our assessment of the book under stress gives us sufficient confidence to declare a full-year dividend of 14.4 pence per share in line with the policy of maintaining dividend cover of 2.5 times.

Business model developments

Our operating capability was thoroughly tested this year and has proven its resilience and adaptability. The efficient switch to home working enabled many of our customers to receive high levels of support across the depths of the lockdown period through the provision of forbearance and participation in government-sponsored initiatives. The experiences of 2020 will have a far-reaching impact on banking generally and on how customer engagement is undertaken in the future.

Despite the challenging environment, we delivered a number of customer and introducer-facing systems across the year. Whilst there have been some delays to the roll-out of the change road map this year it is likely we will see an acceleration of the new technology plans as digitalisation and greater workforce location flexibility emerge.

Paragon is a data-focussed business. This background, together with strong credit-focussed governance structures, has supported our application for IRB accreditation. IRB would allow internal credit models, specific to the Group, to be used to determine capital requirements. The greater use of such models within the Group's decision-making and capital analysis will further enhance our risk management over time. The IRB application process can be a lengthy one and for Paragon it has begun with its buy-to-let mortgage portfolio, with a subsequent roll-out to the Group's other lending portfolios scheduled over the next few years.

The Group's savings platform has seen material growth during the year, at much improved pricing with stock rates falling from 1.81% at 30 September 2019 to 1.34% at 30 September 2020. Strong direct inflows have been supplemented by closer ties with third-party platforms providing further diversification to our funding strategy. We expect to build on this strategy by increasing the number of third-party relationships and further extensions of our product range.

Alongside retail savings we have continued to broaden our wholesale funding facilities, having accessed securitisation markets, expanded warehouse capacity and increased central bank funding through access to the Bank of England's TFSME scheme.

Diversification is as important for our liabilities as it is in our assets. Warehouse and securitisation funding now represents 27.4% of total liabilities compared to 95.6% in 2014.

People

The performance of our people has been exceptional during this challenging year. Supported by our technology team, the move to home working was delivered efficiently and quickly, with minimal business interruption.

Each of our operating businesses remained open for new business and to support customers throughout the year. The material increase in customer contact to put appropriate arrangements in place was delivered effectively and swiftly, demonstrating the adaptability of our people and processes.

A key priority of our strategic response to Covid-19 was the protection of our long-term franchise – I firmly believe the incredible performance of our various teams has enhanced this position across 2020.

The flexibility of our employee base also facilitated a rotation of certain roles from front-end underwriting to a more customer service focussed position. There has been greater flexibility applied to working patterns and a material focus on enhanced communications, morale and wellbeing. When surveyed, 94% of our employees believed the Group had been considerate of their wellbeing when making decisions affecting the workforce and 84% of our people were either satisfied or very satisfied with the support available for them.

Paragon has not used the Coronavirus Job Interruption (furlough) scheme, nor has it made any redundancies since the onset of Covid-19.

Sustainability

2020 was a fundamentally important year in the recognition of the significance of some of the non-financial aspects of our business. We have always ensured that a wide range of stakeholders' interests are considered and, where appropriate, factored into strategy and policy. We are now explaining more fully about what we do across a range of stakeholder communications.

Paragon recognises that sustainable development can only be delivered through an increased awareness of such impacts across the business, embedded in its culture and values. The Board is fully engaged with this project and during the year made a clear statement of its commitment by promoting climate change to a principal risk within the governance framework, ensuring that environmental sustainability is placed at the core of our business model.

Outlook

We have delivered on the objectives we set at the start of the pandemic to protect our people, support our customers and business partners, preserve capital and protect the longer term franchise of the business. As a consequence, we are a stronger business today than before the crisis.

Our business model has proven its resilience both financially and operationally. Capital ratios and liquidity are strong, the balance sheet is credit defensive and the franchises have been enhanced during this difficult period.

Covid-19 has cast a long and dark shadow on the people and businesses of the UK, but we are well placed to manage the uncertainty that will run into 2021 and beyond. We remain committed to supporting our customers, helping them navigate through this period and achieve their ambitions, and believe we are in a strong position to capitalise on the opportunities which will inevitably emerge as the UK recovers from this pandemic.

Nigel Terrington

Chief Executive Officer

3 December 2020

A4. Review of the year

A4.1 Lending

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 in the year		Net loan balances at the year end	
	2020	2019	2020	2019
	£m	£m	£m	£m
Mortgage Lending	1,259.7	1,568.6	10,819.5	10,344.1
Commercial Lending	790.8	968.0	1,514.8	1,452.1
Idem Capital	-	-	297.1	389.9
	2,050.5	2,536.6	12,631.4	12,186.1

The Group's loan book increased by 3.7% in the year, despite the restrictions in lending activity caused by the Covid-19 crisis which depressed new business volumes across the business in the second half of the financial year.

A4.1.1 Mortgage Lending

The Group's Mortgage Lending 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, the Group targets niche markets where its focus on detailed case-by-case underwriting and its robust and informed approach to property risk differentiate it from mass market and other specialist lenders. Its core products are buy-to-let residential property mortgages, targeted at specialist landlords (those who have four or more properties and / or operate through corporate structures).

Housing and mortgage market

During March 2020 the UK housing market began to be impacted by the Covid-19 crisis, with the increased levels of economic uncertainty impacting on house purchase decisions.

Government responses on lockdown and social distancing also placed practical limitations on the operation of the housing market. RICS reported in its April 2020 Residential Market Survey that levels of activity in the housing market were the weakest since the inception of the survey in 1999.

To help mitigate the impact of the national lockdown on homeowners and landlords, the UK Government introduced mortgage relief schemes, covering both owner-occupied and buy-to-let mortgages of residential property which lenders in the sector then had to put in place. These enabled customers to take payment holidays without this impacting on their credit history or score. These holidays were initially for three months, but subsequently extended to six months if required.

In November 2020, after the end of the year, the payment holiday regime was extended further to address the new wave of Covid-19 restrictions. Many of the Group's landlord customers will have been able to provide rent relief to their tenants as a result of these arrangements.

Activity in the mortgage market recovered in the final quarter of the financial year, following the end of the UK lockdown, which allowed physical valuations of properties to resume and house moves to take place.

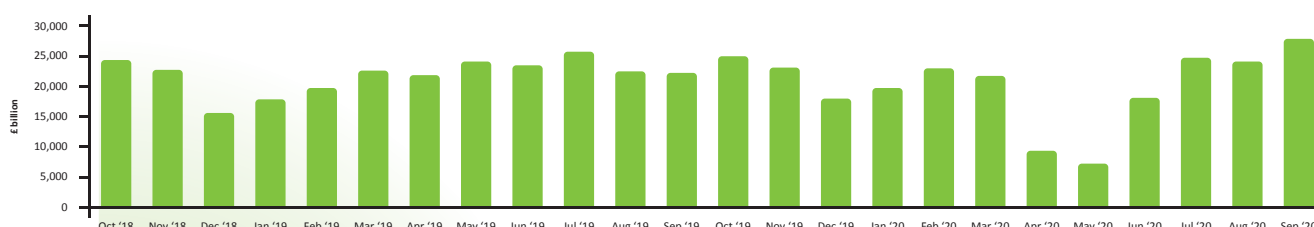
For most of the first half of the financial year the prospects for the UK housing market had appeared relatively positive, with economic uncertainty reduced by the UK general election in December 2019. This led to increasing transaction levels and upward pressure on house prices following a period of stagnation in the market. Market conditions for mortgage customers had remained benign, with low interest rates, arrears and possession levels.

This pattern is clearly shown in the Bank of England's data on mortgage approvals. The total approvals for the year ended 30 September 2020 of £242.3 billion reduced by 7.8% (2019: £262.9 billion), with most of the reduction attributable to the quarter ended June 2020 when mortgage approvals, at £34.8 billion, were half of the £69.5 billion recorded in the corresponding quarter of 2019.

House prices began to increase after the election, with the Nationwide Building Society reporting an average increase of 2.0% in the first six months of the financial year. The expected downward pressure on house prices following the onset of Covid-19 did not emerge. Rather than withdraw from the market, homeowners looked to improve their housing position, resulting in a structural shift in demand buoyed by the stamp duty holiday introduced by the UK Government. As a result, house prices increased by 5.0% over the financial year, benefitting the Group's security values. As the impact of the pandemic continues to emerge, significant uncertainty on the near and medium-term outlook will remain.

Mortgage approvals (Bank of England) (£billion)

1 October 2018 – 30 September 2020



The Private Rented Sector ('PRS') and the buy-to-let mortgage market

Specialist landlords form the largest part of the Group's target market. These are landlords with four or more rental properties who generally run their portfolio as a business and have a high level of personal day-to-day involvement. This approach has meant these specialist landlords have been better placed to address the challenges than other classes of mortgage customer.

The Group is amongst a small number of specialist lenders addressing this sector, which is underserved by many of the larger lenders. Non-bank lenders had a significant position in this market before the Covid-19 outbreak, but their funding issues have led to a restriction of the supply of credit from this source, providing opportunities for the Group.

Buy-to-let lending reflected the performance of the larger mortgage finance sector, with new advances of £38.2 billion in the year ended 30 September 2020 reported by UK Finance ('UKF'), compared to £41.8 billion in the same period in the previous year, a reduction of 8.6%, principally attributable to the performance in the June quarter. Refinancing of existing borrowings continued to represent the bulk of this activity, with 72.8% of new advances by value representing remortgages (2019: 71.3%).

Whilst Covid-19 restrictions meant that on-site property valuations could not be conducted during April and May 2020, restricting new business activity, the Group developed an enhanced desktop valuation process and introduced products with stricter than normal loan-to-value limits. These changes allowed lending to continue through the lockdown period, particularly in the larger remortgage market, ahead of the phased reintroduction of physical valuations in late May.

In common with other lenders in the market, the Group tightened policy on properties which it could accept as security, especially in the student lettings and complex property space. Market limitations on propositions have remained in place, to a greater or lesser extent, post lockdown, with the level of supply into the buy-to-let market such that lenders can be selective.

The lettings market remained stable through the early part of the period, with RICS reporting continuing supply issues and increasing tenant demand towards the end of the year, leading to an expectation of rent increases. The Covid-19 impact saw a short-term downward pressure on supply, demand and rents, but in its September survey RICS expected a generally upward trend for rents and there is some evidence that restricted volumes in the residential mortgage market have kept potential first time buyers in the rented sector.

Lending activity

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

	2020	2019
	£m	£m
Originated assets		
Specialist buy-to-let	1,119.0	1,315.1
Non-specialist buy-to-let	86.4	165.4
Total buy-to-let	1,205.4	1,480.5
Owner-occupied	0.3	11.9
Second charge	54.0	72.0
	1,259.7	1,564.4
Acquired assets	-	4.2
	1,259.7	1,568.6

Total mortgage originations in the Group reduced by 19.7% in the year. The major factor driving the reduction was the Covid-19 lockdown, and its impact on market activity over the summer months.

Buy-to-let

Specialist buy-to-let lending activity fell 14.9% when compared to 2019, principally as a result of the restricted market in the summer months, whereas non-specialist, or simple, buy-to-let lending fell by 47.8% as the Group tightened its focus on the specialist market. The new business pipeline, the loans passing through the underwriting process, was £868.1 million at the year end (2019: £911.7 million), showing business returning to more normal levels heading into the new financial year.

The Group sources the majority of its new buy-to-let lending through specialist intermediaries and it continues to invest to ensure the service offered to them is excellent. All the Group's significant intermediaries were able to stay in operation through the Covid-19 crisis. During the year the Group's regular surveys of its intermediaries showed 91% were satisfied with the ease of obtaining a response from the Group (2019: 84%), delivering a net promoter score at offer stage of +56 (2019: +60).

This result was achieved against the background of Covid-19, highlighting the value placed by the intermediary community on the Group's offering and on their relationship with the business. This relationship was enhanced by the Group's response to the Covid-19 crisis, with a survey of intermediaries finding that around 70% believed that its response was better than that of other lenders. Anecdotal evidence suggests that response times for brokers have generally been better than for other lenders in the market due to the proportion of the Group's employees who were able to remain active through the crisis.

The business is aware of the potential for climate change to impact on the mortgage business and seeks to mitigate risk through careful consideration of the properties on which it will lend. Since 2018 all properties accepted as security must have a minimum Energy Performance Certificate rating of E at the time of offer. The Group had EPC records for 85% of its mortgage book at 30 September 2020 with 98.1% of these covered by certificates of grade E and higher (on a scale of A to G). Such action by lenders will also lead to improvements in the housing stock in the PRS.

The Group also monitors the physical risks from climate change on its property exposure. As part of the underwriting process a property's flood risk is considered and less than 2.2% of our properties were situated within a medium or high flood risk zone (2019: 2.5%).

The business is also working with the Green Finance Institute to develop products which would encourage energy and carbon efficiency for the future.

Other 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.

Lending in the Group's second charge mortgage operation was in line with plan in the first half-year, however it was scaled back in the second half in response to Covid-19. Within the second charge mortgage market the Group targets only higher credit quality customers, rather than the lower-rated borrowers generally associated with this sector. This limits potential lending in this field but should provide more resilience in adverse economic conditions, as proved to be the case in the pandemic.

The Group continues to limit its exposure to first charge residential lending to owner-occupiers, given the pressure on market yields and a limited demand for products where its specialist approach adds value. The opportunities for the Group in this area principally relate to lending to the existing professional landlord customer base.

Performance

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

	30 September 2020	30 September 2019
	£m	£m
Post-2010 assets		
First charge buy-to-let	6,202.5	5,427.7
First charge owner-occupied	51.2	68.3
Second charge	182.6	171.6
	6,436.3	5,667.6
Legacy assets		
First charge buy-to-let	4,381.3	4,674.2
First charge owner-occupied	1.9	2.3
	10,819.5	10,344.1

At 30 September 2020, the Group's total net mortgage balance was 4.6% higher than at the start of the financial year, despite the impact of Covid-19 on advances and provisions. The balance on the post-2010 buy-to-let portfolio grew by 14.3% and it now represents 57.3% of the total (2019: 52.5%).

The annualised redemption rate on buy-to-let mortgage assets, at 6.6% (2019: 8.6%), has continued to reduce, driven partly by the slowing of the market due to Covid-19, partly as a result of continuing initiatives to encourage existing customers to remain with the Group and partly as a result of the increasing average length of fixed rate periods over recent years.

Arrears on the buy-to-let book decreased in the year to 0.15% (2019: 0.18%), although some arrears will inevitably have been suppressed by payment holidays. Arrears on post-2010 lending were at 0.03% (2019: 0.03%). These arrears remain very low compared to the national buy-to-let market, with UKF reporting arrears of 0.52% across the buy-to-let sector at 30 September 2020 (2019: 0.42%).

While just over 20% of the Group's buy-to-let customers took payment holidays when offered, less than 5% remained on payment holiday at the year end, with further reductions being seen in October and November. Customer surveys indicated the motivation for taking these holidays was, in many cases, precautionary, to ensure they were well positioned to deal with potential future tenant payment issues. The majority of respondents were also confident in their ability to resume payments after the end of the payment holiday period.

This strong performance reflects the Group's focus 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.

The Group is also confident that its robust approach to valuation and the loan-to-value coverage in its buy-to-let book, at 65.8% (2019: 67.4%) provides it with significant security in the face of the present economic stress. The levels of interest cover and stressed affordability in the portfolio suggest that its customers are also well placed to manage Covid-19 impacts on their businesses in the longer term.

Second charge arrears increased to 0.62% from 0.38% in the year, reflecting the increased seasoning and size of the portfolio. There were no arrears on post-2010 residential lending.

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. The Group's receiver of rent team worked with tenants through the Covid-19 lockdown to manage the rent position in a responsible manner. At the year end 623 properties were managed by a receiver on the customer's behalf, a reduction of 8.8% since 2019 (2019: 683 properties). Almost all these cases currently relate to pre-2010 lending, with cases being resolved on a long-term basis to ensure the best outcome for the Group, landlord and tenants.

Outlook

While the impact of Covid-19 means that the short-term macro-economic outlook for the Group and its landlord customers is difficult, the Group remains optimistic about its longer term prospects. The vast majority of customers remain committed to the PRS and their positive experiences of the Group through this period will have enhanced business relationships.

The funding of the PRS is vital to the housing infrastructure of the nation and that will ensure that the demand for the Group's products and services remains into the future.

A4.1.2 Commercial Lending

The Group's Commercial Lending division brings together various streams of predominantly asset-backed lending to, or through, commercial organisations and has been a major focus of growth over recent years.

The proposition is delivered through four key business lines;

- SME lending, providing leasing for business assets and unsecured cash flow lending for professional services firms, amongst other products
- Development finance, funding smaller, mostly residential, property development projects
- Structured lending, providing finance for niche non-bank lenders
- Motor finance, focussed on specialist parts of the sector

In each of its markets the division's competitors are small banks and non-bank 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 relies heavily on specialist teams to address the separate business lines, either sourced externally or developed internally.

The Group's strategy in this wider market is to target niches (either product types or customer groups) where its skill sets can be best applied, and its capital effectively deployed to optimise the relationship between growth, risk and return.

Given the nature of the assets financed, in the second half of the year Covid-19 resulted in a material number of customers requesting some form of payment relief and new advances being sharply reduced. However, the SME sector has been the focus of government support programmes and the Group was authorised to provide loans under the CBILS and BBLS initiatives, making advances under these programmes from June onwards.

As part of its strategy for the division the Group continues to enhance its operational functionality in this area, developing technological solutions both to enhance customer service and to assist in the procurement processes, enabling potential customers, or the brokers they use, to access appropriate finance.

The common themes of these diverse business lines are a deep understanding of their respective markets and customer needs, together with expertise in the valuation of any security, 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.

Work is ongoing to review the division's exposure to climate change risk. In development finance, the focus has been on determining the environmental impact of projects and the energy efficiency of the properties being constructed, whereas in motor finance the assessment has been on the fuel types and emissions of financed vehicles. Within SME lending, work is in progress to classify the sectors in which each of our clients operate with respect to their respective climate change sensitivities, while the potential for green financing solutions is being investigated.

Lending activity

During the first half of the year new business levels were strong across all business lines in the division. The Group's focus on widening the customer base and improving yields delivered both increased loan books and strong credit performance.

The onset of Covid-19 in March 2020 had a significant impact on volumes in the second half-year. The impact on customers' businesses, and the levels of uncertainty for those not directly impacted, reduced the appetite for new finance, while the practical issues of sourcing and delivering new assets in a lockdown situation also had an impact on the leasing business.

The Commercial Lending segment saw an 18.3% reduction in new advances compared to the previous year. While development finance continued to grow, though less strongly than planned (by 6.2%) activity in other areas was more materially reduced. The new lending activity in the segment during the year is set out below.

	2020	2019
	£m	£m
Development finance	385.3	362.9
SME lending	288.0	406.5
Structured lending	7.6	49.7
Motor finance	109.9	148.9
	790.8	968.0

The impact of this new business has been to increase the Group's overall Commercial Lending exposure by 4.3% in the year to £1,514.8 million (2019: £1,452.1 million).

SME lending

The SME lending business performed well through the first five months of the financial year, with the Group's customers regaining some level of confidence after the political uncertainties of 2019 and becoming more willing to enter into capital commitments. Advance levels in this period were strengthening and yields were being maintained.

The Covid-19 outbreak reduced new business activity from March, both as a result of customer unwillingness to enter into new commitments and, in the leasing business, as a result of the practical difficulties of sourcing and delivering large pieces of equipment, some internationally, in a global lockdown. Customers' access to other, cheaper funding sources through government sponsored relief schemes also reduced the scope for new business.

As a result of these impacts, new asset finance leasing volumes reduced by 42.5% compared to the comparative period in 2019, to £166.1 million (2019: £288.7 million). Investment in operating leases has also continued with £12.9 million of assets acquired in the period (2019: £11.6 million). Short-term lending to professional services firms, reduced significantly, by 32.9% to £79.1 million (2019: £117.8 million) as Covid-19 related tax deferrals from March meant that customers did not require to draw down in order to satisfy their liabilities. As a result, across all products, SME lending decreased by 29.2% to £288.0 million (2019: £406.5 million).

The Covid-19 crisis saw around 46% of the SME lending business's customers applying for some form of payment relief. Relief in this market is normally given as an interest only period, where the customer continues to make payments. The financial issue for many of the customers, particularly in sectors such as construction, was the inability to generate income from the financed assets during the lockdown period, creating a cash shortfall.

In line with the approach taken on the mortgage book, extended payment holidays were offered to SME Lending customers, but these were taken up by a substantially smaller number than the initial three month reliefs and at the year end only 2.1% of accounts remained on a payment holiday.

The long-term impact of Covid-19 on customers is difficult to predict at this stage, particularly given that many may have received short-term relief in the form of CBILS or BBLS loans from their relationship banks, although feedback from the enhanced customer contact programme is encouraging.

The Group received authorisation to participate in the government-sponsored British Business Bank CBILS and BBLS schemes, providing funding to SMEs under a government guarantee. The Group has used this facility primarily to support its existing customers, completing £25.9 million of loans in the year, and anticipates making further advances, both to new and existing customers into the new financial year. The Group is working to support industry initiatives to establish a common collections framework for CBILS and BBLS, providing certainty to customers and hopes this can be established in the near future.

The Group has continued to focus on improving its operational procedures in this area, to deliver better customer service and enhance margins, focussing on people and processes and on improving the handling and use of data in the business to provide better targeting and analysis and to enhance customer experience. These developments continued to progress through the Covid-19 period, although they were delayed by the demands of the systems and process upgrades required for payment reliefs, CBILS and BBLS. The Group expects these investments to impact positively on efficiency and agility going forwards.

Lending activity into the new financial year will be dependent on the uncertain impact of the ongoing Covid-19 situation, with volumes likely to remain depressed in the short-term. The priority of the business will be to support its customer base through the crisis while working to enhance the proposition for the future.

Development finance

Activity levels in the Group's target market were healthy in the first half of the financial year, with increased enquiry levels and higher levels of new commitments, and prospects looking promising up to the end of February. At that point the onset of the Covid-19 pandemic impacted the market, with levels of lending in March being more subdued. However, demand in the second half of the year rebounded, to some extent, following the easing of the lockdown and this is reflected in longer term sentiment amongst the Group's customers which is less negative than might be expected.

New projects continued to commence throughout the second half of the year, while completed developments resulted in repayment of facilities. The Group remained active in the market throughout the year and this continuity of service was appreciated by our customers over the period.

The Group's target customer is a small-to-medium sized developer of UK residential property. The typical types of projects funded have an average development value of approximately £7 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 Home Counties, with 67.0% of balances at 30 September 2020 located in London and the South East, the Group's strategic objective is to lend more widely across the UK and this focus continued through the year. Central London property hot spots have been generally avoided.

The Group engages monitoring surveyors to review progress and costs on a regular basis through the build phase of each project, and these activities have generally continued through the Covid-19 period. The maximum level of closed sites during the crisis was 22%, but these were generally quickly reopened. 73% of sites remained active throughout the lockdown period. Many projects have been subject to some level of delay, principally due to access, labour or supply issues, but overall, the level of resilience in the customer base has been impressive.

While uncertainties around Covid-19 remain, prospects for the new financial year appear promising. Undrawn amounts on live facilities at 30 September 2020 of £380.9 million are expected to flow through to advances during the coming year, while the post-offer pipeline of £171.5 million is likely to be drawn down over a longer period, though the timing may be affected by ongoing Covid-19 restrictions. The Group is investing in the business, increasing resources to allow a greater variety of propositions and routes to market to be explored.

The underlying basis of the development finance proposition remains attractive, with positive market sentiment heading into the new financial year. The need for new housing will remain into the future and smaller developers have only a limited number of funding sources, which have reduced further through the Covid-19 crisis, with some non-bank lenders previously active in the sector suffering from limited lending capacity. The Group believes the business is well placed to support its developer customers during and after the pandemic.

Structured lending

The structured lending exposure has grown in the period by 7.7%, mostly as a result of additional drawings on extant facilities in the first half-year, although new facilities of £8.0 million came on stream during the year. These loans generally fund non-bank lenders, of various kinds, and as such facilities are carefully constructed to provide a buffer for the Group in the event of default in the ultimate customer population, with first loss cover of at least 20% in all cases. The impact of Covid-19 on each of the exposures varies with the nature of the underlying assets and the Group's experienced account managers have carefully monitored each of the facilities, maintaining a high level of contact with the counterparties.

Motor finance

The Group's strategy for motor finance is to target its offerings on those specialist propositions not typically addressed by mass-market lenders. After a positive first six months of the year, where completions increased while maintaining yield levels, business was sharply reduced in the second half due to the substantially reduced levels of activity seen in the automotive market throughout the Covid-19 crisis.

Performance

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

	30 September 2020	30 September 2019
	£m	£m
Asset leasing	478.0	492.2
Professions finance	22.3	46.2
CBILS and BBLS	25.2	-
Invoice finance	13.5	18.5
Unsecured business lending	15.0	19.3
Total SME lending	554.0	576.2
Development finance	609.0	506.5
Structured lending	94.9	88.1
Motor finance	256.9	281.3
	1,514.8	1,452.1

Credit quality in the development finance book has been good, and the overall performance of the projects has been in line with expectation allowing for the impact of Covid-19 on the timing of some projects. These accounts are monitored on a case-by-case basis by the Credit Risk function. At 30 September 2020 very few cases had been classified by the monitoring process as being likely to result in a loss, with a number of the problem cases acquired with the business resolved in the year.

While no Covid-19 specific credit concerns have been identified on individual development finance accounts, the Group recognises the potential impact of increased economic uncertainty, including the impact of the end of Stamp Duty relief on the property market, and execution risk on its portfolio. The average loan to gross development value for the portfolio at the year end, a measure of security cover, was 63.1% (2019: 64.8%), which gives the Group a substantial buffer if any project encounters problems.

Credit performance on the division's finance leasing portfolios remains stable, with arrears in asset leasing at 1.75% and motor finance at 1.76% (2019: 0.43% and 1.27% respectively). However, these measures may be distorted by the effect of payment holidays.

Take up of payment reliefs in SME lending was substantial, with 3,526 accounts given relief, representing almost half of the book, although only 326 of these required an extension. 2,899 (16.2%) of the Group's motor finance accounts were granted a payment holiday, with only 419 (2.3%) requiring an extension.

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 loan facilities.

Outlook

In the short-term the focus for growth in Commercial Lending will be in development finance, where the fundamentals of product, demand and service remain strong despite Covid-19. In the other business lines the priority will be on the careful management of the books and supporting customers through the ongoing crisis. The underlying long-term prospects for the division remain positive and the Group continues to invest in developing its activities for the future.

A4.1.3 Idem Capital

The Idem Capital segment contains the Group's acquired loan portfolios, together with its pre-2010 legacy consumer accounts. These include mostly second charge and unsecured consumer loans.

The division's strategic focus is on specialist loan portfolios which can augment the organic origination activities of the Group. In these portfolios, it can enhance value through leveraging the Group's originations and collections expertise, together with its access to a variety of retail and wholesale funding. It recognises that this model is essentially opportunistic and that the flow of such opportunities to the market may be sporadic. It carefully considers the capital requirements for any potential acquisition, particularly where asset types offered require relatively large amounts of capital to be held. It also considers the potential for conduct risk issues to arise in portfolios which may contain more vulnerable customers. Many of Idem Capital's customers have been under financial stress in the past and its processes aim to generate fair outcomes for all customers, recognising any vulnerabilities. In the present Covid-19 situation, that objective has an even greater focus.

Overall Idem Capital's success rests on understanding assets, strong analytics, advanced servicing capabilities and the efficient use of funding. All these attributes are vital in its management of the impact of Covid-19 on its customer base.

New business

While the UK loan portfolio purchase market remained active in the period up to the Covid-19 outbreak, and the Group participated in the majority of significant tender processes, there were few opportunities which were particularly appealing, either because of pricing, the nature of the assets or the capital which might have been required. Opportunities were even more limited in the post-Covid-19 environment, although some level of activity did remain in the market.

The Group only pursues transactions 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 portfolio acquisitions were completed (2019: none) although, as noted above, the division undertook a limited number of reviews of opportunities that were ultimately not progressed.

The main focus of the business in the year was the careful management of its existing books and ensuring that appropriate processes and systems are in place to address the Covid-19 outbreak with customers, many of whom were already identified as vulnerable.

Performance

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

	30 September 2020	30 September 2019
	£m	£m
Second charge mortgage loans	171.9	217.6
Unsecured consumer loans	109.7	134.7
Motor finance	15.5	37.6
	297.1	389.9

The reduction in balances is a result of collections from the brought forward loan portfolios, with receipts remaining relatively strong, despite the impact of Covid-19. The accounting balance was also reduced by £3.7 million at the half-year to allow for potential reductions in future cashflows due to Covid-19. 120 month Estimated Remaining Collections ('ERC') on acquired consumer assets fell to £313.7 million at 30 September 2020 (2019: £366.4 million) for the same reasons.

Collections from customers have, however, held up well in the year, despite the negative economic impacts of Covid-19, with instalment receipts remaining stable despite a temporary downturn in March. 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 18.8% (2019: 17.2%). These arrears levels remain higher than the average for the sector, but this reflects the seasoning of the balances, while the upward trend reflects the redemption of performing accounts. This book contains a significant number of accounts which are currently making full monthly payments but had missed payments at some point in the past, inflating the arrears rate. Average arrears for secured lending of 8.4% at 30 September 2020 were reported by the Finance and Leasing Association ('FLA') (2019: 8.7%).

Approximately 15.5% of the divisions secured accounts were granted initial payment holidays with 6.5% being granted extensions.

None of the live Idem Capital loan portfolios were regarded as materially underperforming at the year end, with strong overall cash generation, considering the impact of Covid-19. The Group monitors actual cash receipts from acquired portfolios against those forecast in the evaluation which informed the purchase price. Up to 30 September 2020 such collections were 109.8% of those forecast to that point (2019: 109.8%). The impact of Covid-19 on the long-term cash forecasts has not been significant.

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 Idem Capital loan book continues to provide strong cash flows and the Group's priority is to effectively manage this collection process while investigating potential portfolio investments which match its risk and reward requirements.

A4.2 Funding

The Group's funding strategy, built on diversification and sustainability, was both enhanced and tested in the period. New initiatives widened the footprint of the retail deposit operation, new forms of liquidity funding were introduced, and additional central bank funding schemes accessed.

This variety of funding options ensures that pricing and availability issues in any individual funding market can be mitigated, while, at the same time, maintaining the flexibility to fund strategic developments. In particular, it protects the Group from the effects of incidents such as the Covid-19 crisis. This saw capital market pricing seriously disrupted while emergency funding from the UK authorities was channelled principally through central bank lending to the UK banking sector.

Throughout the period the Group raised the majority of its new funding through the retail deposit market, where volumes proved robust throughout the Covid-19 crisis, as consumers' appetite for saving increased, either through economic anxiety or through reduced opportunities to spend. The Group's retail deposit balance grew by 22.9% in the year to £7,856.6 million (2019: £6,391.9 million), representing 55.8% of balance sheet funding.

The Group's funding at 30 September 2020 is summarised as follows:

	2020	2019	2018
	£m	£m	£m
Retail deposit balances	7,856.6	6,391.9	5,296.6
Securitised and warehouse funding	3,928.3	5,206.9	6,490.3
Central bank facilities	1,854.4	994.4	1,024.4
Tier 2 and retail bonds	446.6	446.1	445.4
Total on balance sheet funding	14,085.9	13,039.3	13,256.7
Off balance sheet central bank facilities	-	109.0	108.7
Other off balance sheet liquidity facilities	150.0	-	-
	14,235.9	13,148.3	13,365.4

The overall UK economic outlook has remained uncertain over the whole year, with the political instability of autumn 2019 followed in turn by the December general election and the Covid-19 crisis, while uncertainty over the final terms of any Brexit settlement continued through the year. All these factors affected market sentiment, generating considerable volatility.

In response, the Group maintained a conservative stance on liquidity throughout the year. £1,701.1 million of cash was available for liquidity and other purposes at the end of the period (2019: £872.1 million). The Group's contingent liquidity policy will be kept under review as the ultimate outcome of the Covid-19 crisis becomes clearer and longer term trends become more evident.

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 financial year ends since 2013, the outstanding funding balance by type.

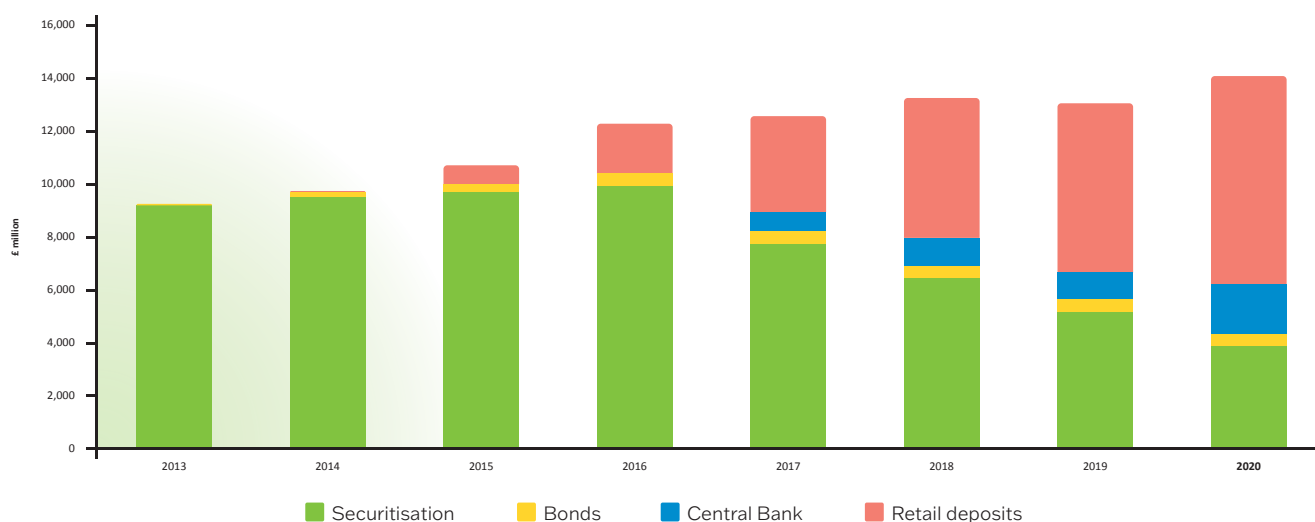
In the short-to-medium term, the Group's principal source of funding will remain retail deposits, which have performed well throughout the Covid-19 crisis to date. These will be supplemented by participation in TFSME, the Bank of England scheme to support lending into the UK economy, especially to SMEs. New public securitisations in the near-term are unlikely, with offerings in the short-term likely to be designed to create securities to support other borrowings.

LIBOR, which had been the principal sterling reference rate used by the Group, is due to be withdrawn by the end of 2021, with regulators confirming their commitment to this deadline, despite the Covid 19 crisis. All Group debt issuance since 2019 has been priced with reference to SONIA, the Sterling Overnight Index Average and, during the year, SONIA became the Group's principal reference rate for hedging operations.

However, much of the Group's outstanding debt issuance is priced by reference to LIBOR and other IBOR rates and the Group is actively participating in industry initiatives to determine the optimal treatment of such securities on the withdrawal of these rates. The Group also has a significant LIBOR-linked asset base, mostly relating to legacy mortgage assets, where it is participating in a Bank of England 'Tough Legacy Task Force' addressing the impact of transition on such products. This aims to ensure fair and consistent outcomes for customers with such exposures.

Funding by type (£m)

30 September 2013 – 2020



A4.2.1 Retail funding

Retail deposits provide the Group with a reliable, cost effective and scalable source of funding, and continued to remain so in the face of market disruption resulting from Covid-19. The Group offers customers a range of deposit options, offering competitive rates and value for money. This, combined with a strong customer service ethic and the protection provided to depositors by the Financial Services Compensation Scheme ('FSCS'), supports the Group in meeting its funding and margin requirements.

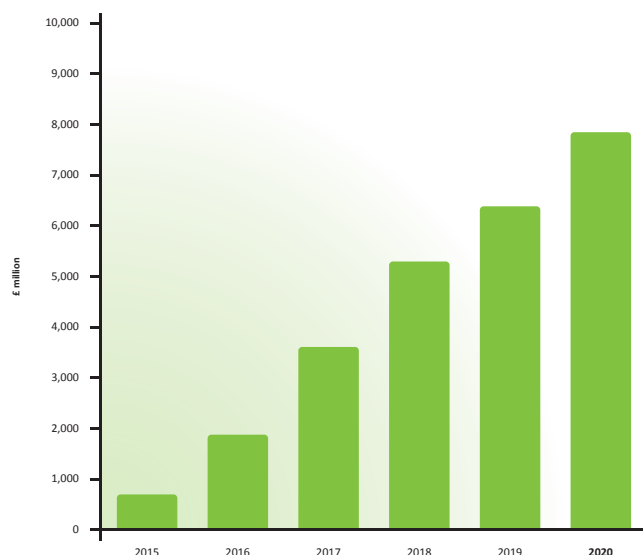
The volume of retail deposits has continued to grow during the period reaching £7,856.6 million at the year end, 22.9% higher than a year earlier (2019: £6,391.9 million). This has been achieved with a reduced funding cost, reflecting the improvements made to the Group's capacity and capability.

The Group's share of the overall UK savings market remains minimal, with household savings balances reported by the Bank of England increasing by 5.5% in the year to £1,287.9 billion (2019: £1,220.4 billion), although these deposits remain overwhelmingly with clearing banks and building societies.

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 - 2020



At 30 September 2020 the proportion of easy access deposits, which are repayable on demand, was 30.0% of the total deposit base, a little higher than its level at the beginning of the year (30 September 2019: 27.8%), and represented £2,359.6 million of the balance (2019: £1,778.0 million). This percentage is considered to be low compared to the rest of the banking sector and can be expected to rise going forward.

Savings accounts at the financial year end are analysed below.

	Average interest rate		Proportion of deposits	
	2020	2019	2020	2019
	%	%	%	%
Fixed rate deposits	1.69%	2.02%	63.3%	65.0%
Variable rate deposits	0.72%	1.43%	36.7%	35.0%
All balances	1.34%	1.81%	100.0%	100.0%

The average initial term of fixed rate deposits was 27 months (2018: 28 months). Market savings rates in the year have fallen substantially, with the Bank of England quoting average interest rates at 30 September 2020 for new 2-year fixed rate deposits at 0.48% (2019: 1.41%) and for instant access balances at 0.07% (2019: 0.42%). Some market disruption was created in the second half-year by the short-term pricing strategy adopted by NS&I, but the strength of the market meant that the Group was able to source its funding requirements throughout the period.

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. The Group also offers postal products, which tend to appeal to a different demographic to the online offering.

Growth in the deposit balance was enhanced by the launch of a flexible ISA product, which proved successful in the spring 2020 ISA season. Other enhancements to the product range are also being developed.

Offerings through third-party channels, including investment platforms and savings marketplaces operated by digital banks for their customers, provide access to further demographics and enhance the Group's ability to manage deposit inflows. The Group currently has four such relationships and is investing in people and systems to further develop this part of the business.

In customer feedback 88% 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 (2019: 89%). The net promoter score in the same survey was +61 (2019: +65).

When customers with maturing savings balances in the year were surveyed, 90% stated that they would 'probably' or 'definitely' consider taking out a replacement product with the Group (2019: 91%) with a net promoter score at maturity of +50, similar to the +53 recorded for the 2019 financial year.

Customers were also surveyed on the savings business's response to the Covid-19 crisis. 65% of the respondents felt that the Group's clarity of communications with customers had been good, while 99% of respondents said its response to the crisis was at least as good as other providers, including 17% who considered it to be better.

Given the benefits to customer and deposit retention of maintaining high service standards, these results give the Group great confidence in its market position. This is supported by continued success in industry awards. During the year, Paragon Bank won the 'Best Monthly Interest Provider' award in the 2020 Moneynet awards, the third year in a row it had received this accolade, and was named 'Best Multi-Channel Savings Provider' at the 2020 Savings Champion Awards.

The Group's outsourced deposit administration platform continues to perform well, and its service levels have not been significantly impacted by Covid-19 during the year. It provides a cost-effective, stable and scalable solution in the medium-to-long-term, and the Group has invested in its systems to manage the relationship.

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 operation will continue to expand the scope of its products, address wider demographics and explore new channels to market. The Group's broad product offering and the FSCS guarantee are likely to reduce the potential for any Covid-19 related economic downturn to impact liquidity and the Group's profiling of its target customers suggests they may be more resilient than average in such circumstances.

A4.2.2 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. The Group's 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 Covid-19 crisis.

Following the UK general election in December 2019 the performance of the capital markets strengthened during the early part of 2020, with increasing transaction volumes and improving margins for issuers. Demand in the markets remained high through the latter part of the year, however, the impact of Covid-19 and the availability of alternative funding sources made the markets unattractive for new public issuance.

Five mature securitisation transactions were refinanced during the year. These included three funding pre-2010 mortgages and two recent transactions which had reached their expected maturity dates and were paid down in accordance with market expectations. Notice was also given that two further legacy securitisations would be paid down after the year end. This will leave only two legacy transactions outstanding on the Group's balance sheet.

On 30 April 2020 the Group completed a fully retained securitisation transaction, Paragon Mortgages (No. 27) PLC, resulting in the issue of £735.8 million of rated notes to group companies. After the year end a further such transaction, Paragon Mortgages (No. 28) PLC issued £703.1 million of notes to group companies on 9 November 2020. These notes will be used as collateral in other funding transactions including central bank schemes.

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. The Group's £200.0 million facility with Bank of America Merrill Lynch was renewed in October 2019 and again in September 2020, when the commitment was increased to £400.0 million and the interest rate increased to LIBOR plus 1.05%.

During the period the Group also entered into a long / short repo transaction with a major UK bank. This provides £150.0 million of additional liquidity, based on retained securitisation notes, but does not appear on the Group's balance sheet, due to its contractual terms. This is the first such transaction the Group has undertaken, representing a further enhancement to its funding flexibility.

A4.2.3 Central bank facilities

During the year the Group has increased its use of central bank funding as the Bank of England channelled funds into the UK economy through the banking sector in order to support SMEs through the Covid-19 crisis.

The Group has been approved to participate in the SME Term Funding scheme ('TFSME') and had drawn £910.0 million by 30 September 2020. This scheme provides access to funding appropriate for the Group's operations with a four year term with interest payable at the bank base rate, using either mortgage assets or mortgage securities as collateral. This makes these borrowings readily accessible and cost effective for the Group.

Drawings under the Term Funding Scheme ('TFS') remain in place and provide £944.4 million of the Group's funding (2019: £944.4 million). These begin to fall due for repayment during the next financial year, with repayments allowed for in the Group's capital planning.

The Group also utilised the Indexed Long Term Repo scheme ('ILTR') for six-month borrowings, although no borrowings remained outstanding at the year end (2019: £50.0 million), and the Contingent Term Repo Facility ('CTRF') during the year. The Group's off balance sheet exposure under the Funding for Lending Scheme ('FLS') was settled in the year (2019: £109.0 million).

The Group has also pre-positioned mortgage loans and certain other assets with the Bank of England to act as collateral for future drawings on central bank funding lines, including the TFSME, if and when required, providing access to liquidity or funding of up to £684.0 million.

The Group will continue to access these facilities in future as part of its funding strategy, in accordance with the objectives of these schemes, where such borrowings are appropriate and cost effective.

A4.2.4 Funding outlook

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 28 to 33.

A4.3 Capital

The Group's capital policy aims to provide appropriate returns to shareholders, whilst maintaining prudent levels of capital to support its strategic objectives and protect the business and its customers in future years. The maintenance of strong regulatory capital and liquidity positions to safeguard its depositors is also a principal strategic objective, supported by detailed capital planning and stress testing procedures.

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 2020 AGM, which will be proposed for renewal at the forthcoming meeting.

A4.3.1 Dividends and distribution policy

The Group's stated distribution policy over recent years has been to distribute 40% of consolidated earnings to shareholders in ordinary circumstances, achieving a dividend cover ratio of approximately 2.5 times.

In normal years this would be achieved by the payment of an interim dividend following the announcement of the half-year results with a final dividend after the year end making up the balance. However, at the time of the half-year announcement the decision was taken, given the extreme levels of economic uncertainty due to Covid-19, to defer any discussion of dividend levels until after the end of the financial year and consequently no interim dividend was declared (2019: 7.0 pence).

Following the year end the Board considered the appropriateness of declaring a dividend for the year on the basis of the annual results and capital resources; customer and economic experience through the first six months of the Covid-19 crisis; updated business, capital and liquidity forecasts and stress tests; and the most recent economic forecasts. It also considered the most recent regulatory comments and views expressed by shareholder groups.

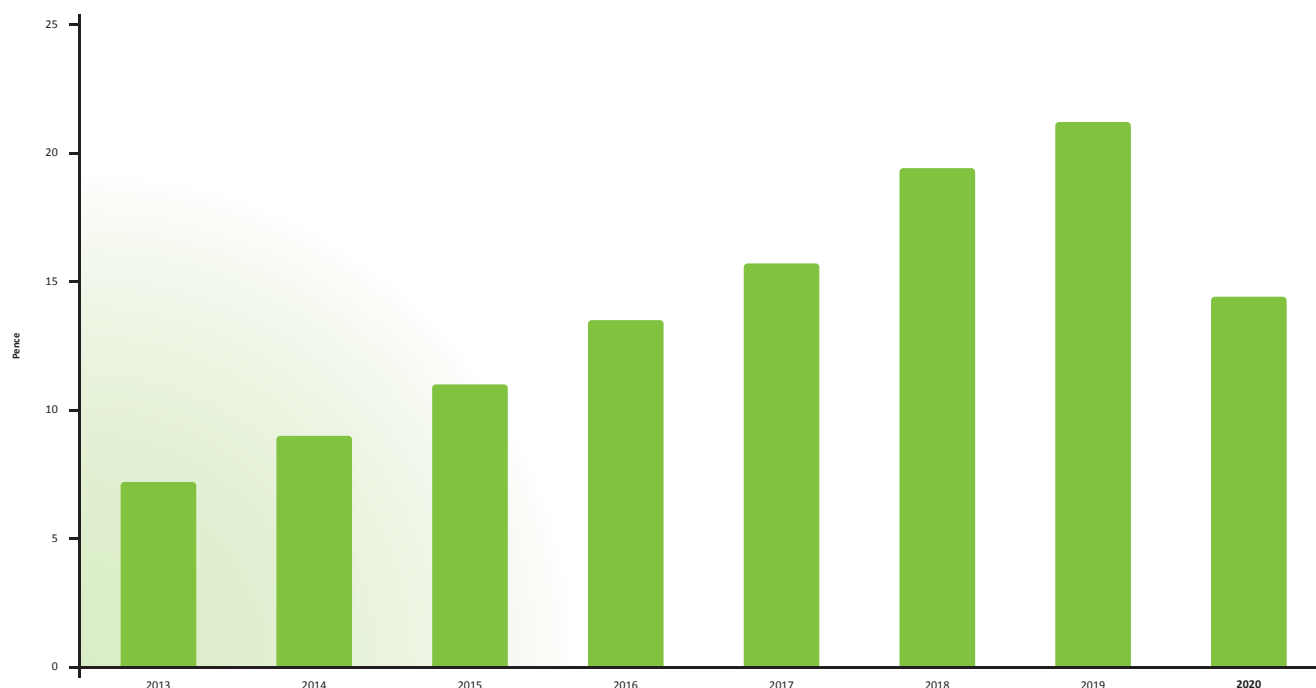
In determining the level of dividend for the year, the Board has considered the dividend policy, together with the Group's strategy, capital requirements, principal risks, the level of available retained earnings in the Company, its cash resources and the objective of enhancing shareholder value.

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 24 February 2021, a dividend for the year of 14.4 pence for 2020 (2019: final dividend of 14.2p per share, total dividend of 21.2p per share). This dividend would be in line with the stated policy, giving a dividend cover of 2.50 times (2019: 2.33 times), with the reduction in amount from the previous year corresponding largely to the reduction in group earnings.

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 - 2020



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

The Board also affirmed the existing dividend policy going forward, subject to an assessment of prevailing conditions at the time, but noted that, due to paying the full 2020 dividend as a final dividend, any interim dividend declared for 2021 would not necessarily bear the normal relation to the preceding final distribution.

A4.3.2 Regulatory capital

The Group is subject to supervision by the Prudential Regulation Authority ('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, currently implemented through the EU Capital Requirements Regulation and Directive regime ('CRD IV'). This capital, which includes elements determined based on the Group's total risk exposure together with fixed elements, is held in order to safeguard depositors in the event of severe losses being incurred by the Group.

As a matter of strategy, the Group maintains strong capital and leverage ratios, its principal capital measures being set out below. It was granted transitional relief on the adoption of IFRS 9, with the impact on capital of additional impairments being phased in over a five-year period, with only 15.0% of the effect being recognised in this, the second year (2019: 5.0%). However, firms are also required to disclose capital measures as if the relief has not been given (referred to as the 'fully loaded' basis).

During the year, as part of a package of measures to mitigate the economic impacts of Covid-19, regulators increased the scope of this IFRS 9 relief to additionally defer impairment provisions made in the current year. This has widened the gap between the basic and fully loaded bases.

	Basic		Fully loaded	
	2020	2019	2020	2019
	£m	£m	£m	£m
CET1 capital	991.2	922.0	948.9	900.8
Total Regulatory Capital ('TRC')	1,141.2	1,072.0	1,098.9	1,050.8
Pillar 1 + 2A capital requirement	749.6	742.9	745.3	741.8

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.

The Group's trading performance, including the deferral of bonuses, has led to the increase in capital shown above, with the basic measure, discounting IFRS 9 impairment charges, growing faster than the fully loaded measure. However, the amount of headroom over the Pillar 1 + 2A requirement, even on the fully loaded basis which allows for IFRS 9 provisioning, is significant.

Available 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. While the CCoB remained at 2.5%, its long-term rate, throughout the year, the CCyB was cut from 1.0% to zero during the period as a regulatory response to the pandemic. However, it was also announced that the long-term normal rate of the CCyB in the UK would be 2.0%. CET1 capital required to cover these buffers therefore reduced to £173.7 million at the year end on the regulatory basis (2019: £235.3 million). Further buffers may be set by the PRA on a firm-by-firm basis but may not be disclosed.

The Total Capital Requirement for the Group (Pillar 1 and Pillar 2A) must be met with at least 56% Common Equity Tier 1 ('CET1') capital, and can include no more than 44% Additional Tier 1 ('AT1') capital and no more than 25% Tier 2 capital. Other capital requirements, including the CRD IV buffers, must be satisfied with CET1 capital.

The Group's capital ratios are set out below.

	Basic		Fully loaded	
	2020	2019	2020	2019
CET1 ratio	14.3%	13.7%	13.7%	13.4%
Total capital ratio	16.4%	15.9%	15.9%	15.7%
UK leverage ratio	7.1%	6.7%	6.8%	6.6%

Capital ratios have strengthened on the fully loaded basis, even allowing for the payment of the proposed dividend, and are considerably stronger on the basic regulatory basis due to the reliefs described above.

As a result of the Covid-19 situation, the Basel Committee on Banking Supervision has deferred the implementation date of its revisions to the Basel III framework which were to take effect on 1 January 2022 to 1 January 2023, subject to those revisions being enacted in the relevant jurisdiction (expected to be CRD VI / CRR III in the EU framework). This means that changes which would have potentially increased the Group's Total Risk Exposure ('TRE') calculated under the standardised approach will be delayed.

The first stage of the Group's application for the accreditation of its Internal Ratings Based ('IRB') approach to credit risk for capital adequacy purposes was submitted to the PRA in March 2020. This phase of the application covers the Group's buy-to-let mortgage assets and considerable work has taken place to reach this stage. Models have been built and tested, governance frameworks enhanced, and IRB outputs are now being regularly considered internally. Work on this project has continued to progress throughout the second half of the year.

A4.3.3 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 the Liquidity Coverage Ratio ('LCR') and Net Stable Funding Ratio ('NSFR').

The monthly average LCR for the year was 173.7% compared to 143.7% during 2019, reflecting the steps taken to enhance liquidity in response to the Covid-19 situation. The year end NSFR stood at 114.7%, in line with the 115.0% reported at 30 September 2019.

A4.3.4 Capital outlook

The maintenance of strong capital and liquidity positions has been a central part of the Group's strategic thinking over many years, leaving it well placed to deal with stresses. Actions taken during the year, including the passing of the interim dividend and the deferral of senior management bonuses in shares, have maintained the strength of that position.

While the short-term regulatory capital reliefs put in place by regulators in response to Covid-19 are welcome, the Group considers itself to be well capitalised, even on a fully loaded basis.

This position is built upon strong businesses, careful management and a flexible funding base. Regular reviews of capital requirements by the Board form part of the planning and strategic development process, considering the level and form of capital demanded by current business, regulatory and economic conditions and future developments as well as the Group's strategic objectives.

This is designed to deliver a future capital position which is prudent and sustainable, even under stress, protecting the viability of the Group's business, for the benefit of all its stakeholders.

A4.4 Financial results

The impacts from Covid-19 and the associated policy response have been included in the reported outcomes for 2020. These impacts include slower customer demand in the second half, a material reduction in interest rates which had an initially adverse effect on net interest margins and higher expected levels of loan impairments. Under IFRS 9, impairments are charged on an expected loss basis.

A4.4.1 Consolidated results

Underlying operating profit for 2020 was 27.0% below 2019's level at £120.0 million (2019: £164.4 million) (Appendix A). On a statutory basis profit was reduced by 25.5% to £118.4 million (2019: £159.0 million). The single largest contributor to this reduction came from the charge for loan impairments, which was 503.8% higher than in 2019.

Consolidated results

For the year ended 30 September 2020

	2020	2019
	£m	£m
Interest receivable	491.7	505.7
Interest payable and similar charges	(213.6)	(227.3)
Net interest income	278.1	278.4
Net leasing income	3.0	3.8
Gain on derecognition of financial assets	-	9.7
Other income	14.0	15.4
Total operating income	295.1	307.3
Operating expenses	(126.8)	(125.2)
Provisions for losses	(48.3)	(8.0)
	120.0	174.1
Fair value net (losses) / gains	(1.6)	(15.1)
Operating profit being profit on ordinary activities before taxation	118.4	159.0
Tax charge on profit on ordinary activities	(27.1)	(31.6)
Profit on ordinary activities after taxation	91.3	127.4
	2020	2019
Dividend – rate per share for the year	14.4p	21.2p
Basic earnings per share	36.0p	49.4p
Diluted earnings per share	35.6p	48.2p

Income

Net interest income was broadly unchanged when compared to 2019 at £278.1 million (2019: £278.4 million). Within this figure, average loan balances rose by 2.2% and the Group's net interest margin ('NIM') fell by 5 basis points to 224 basis points.

The reduction in base rates to just 10 basis points generated a short-term reduction in the Group's NIM, with the reduction applying to both the investment rate earned on the Group's cash investments and also to variable rate loans, where the full reduction in rates was passed on to customers. Funding deposit costs have also reduced in the second half, but initially at a slower pace. After reporting 229 basis points of NIM at the first six months of the year, margins reduced for much of the second half but had recovered most of the lost ground by the year end.

With slower levels of new business growth in 2020, the effect of the amortisation of the Idem Capital portfolio had a greater effect on the mix of yields in the loan book and hence on reported net interest margins. The Idem-specific net interest margin fell to 7.60% for 2020 (2019: 11.94%), reflecting a combination of continued reductions in the loan book, changes in the mix of products and lower future cash flow expectations. The largest element of this cash flow re-estimate was a result of a detailed review on the basis of the Covid-19 economic outlook, where £3.7 million was written off, reversing income taken in previous years.

Net interest margin for the Group excluding Idem increased from 1.92% in 2019 to 2.09% in 2020. This reflects structural change in the loan book, with new buy-to-let and commercial loans carrying higher margins than the legacy buy-to-let portfolio. The scale of change in this ratio (+17 basis points) was lower than the +39 basis points reported for 2019 as a result of the base rate changes reported above.

The progression of the Group's NIM, including and excluding the Idem Capital division, over the past five years is set out below.

	Total	Excluding Idem Capital
	Basis points	Basis points
Year ended 30 September		
2020	224	209
2019	229	192
2018	219	153
2017	213	141
2016	215	139

Other operating income was £17.0 million for the six months, compared with £19.2 million reported in 2019. This reduction reflected lower account fee income, which is attributable to the changing profile of the portfolio, and reduced levels of broking income in the year.

Costs

Operating expenses were 1.3% above their 2019 level at £126.8 million (2019: £125.2 million). The Group had been anticipating a higher rate of increase than this, but Covid-19 served to delay the implementation of certain projects, with these costs now expected to be incurred during 2021 and 2022.

The cost base for the year does, however, reflect the Group's continued investment in IT infrastructure and operational resilience, an approach which has helped support its response to the Covid-19 pandemic. An updated broker portal for the Mortgage Lending division and new treasury systems came on stream during the early part of the year and developments continued, even during the lockdown period, with enhancements to the SME lending customer experience a particular focus.

While staff numbers remained stable and all employees remained on full pay throughout the Covid-19 crisis, savings arose from lower senior management cash bonuses and share-based remuneration charges. The accounting effect of the deferral in shares of 100% of the executive bonuses and large proportions of other senior management bonuses is to remove these costs from the 2020 cost base, instead spreading them over future periods.

The Group outsources its savings deposit administration, the costs of which relate to the size and activity levels of the savings portfolio rather than being linked to general cost inflation. As the Group refocuses its funding model to have a greater retail deposit weighting, operating costs will therefore tend to grow at rates above the general inflation rate. Savings related overheads grew by £1.6 million in the year.

The progress of the Group's cost income ratio over the last five year is set out below.

	Underlying %	Statutory %
Year ended 30 September		
2020	43.0	43.0
2019	42.1	40.7
2018	40.6	37.8
2017	40.5	40.5
2016	37.9	37.9

Impairment provisions

Impairment charges totalled £48.3 million for 2020 compared to £8.0 million during 2019. The major factors driving this increase were the impact of Covid-19 on expected customer behaviour and the impact of lower projected asset values in the event of default. Up to the point of the impact of Covid-19 on the UK in March, the Group's provision data was largely positive, with charges remaining in line with expectations. However, from the half-year onwards the Group factored the potential impact of Covid-19 into its consideration of expected credit losses. While IFRS 9 is intended to provide for expected future losses, the unprecedented and unexpected nature of the Covid-19 crisis resulted in a sharp increase in provisions to reflect the fundamental change in economic outlook.

In addition to applying a more severe suite of economic projections to the Group's IFRS 9 impairment models, the year end analysis also takes explicit account of payment holidays granted to customers during the year, together with

adjusting for the lagging effect government policy has had, and potentially continues to have, on observable impairment. Careful consideration was also given to the extent to which the Group's base models, derived on the basis of historic data, can accurately predict behaviour in these unprecedented circumstances.

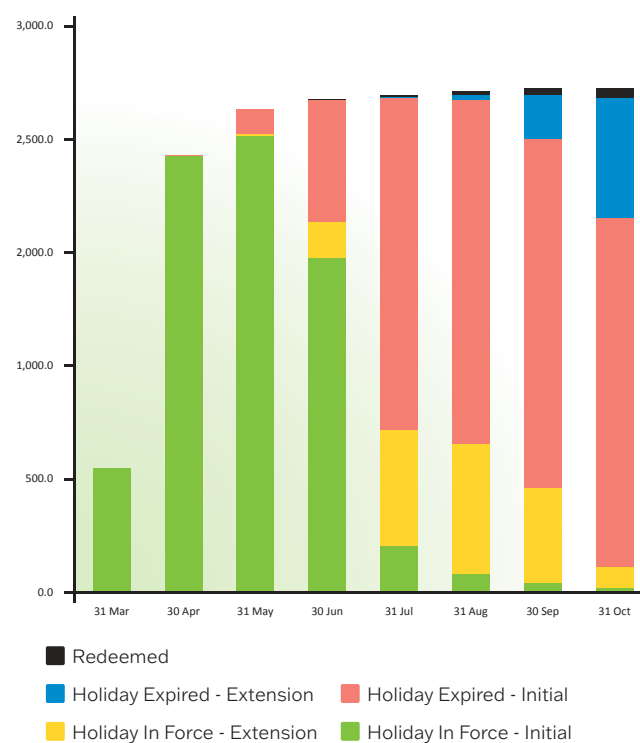
The impairment calculations generate £62.0 million of the £81.8 million total balance sheet provision, with the balancing £19.8 million being post model adjustments ('PMAs') based on management's judgement of the effects of lagging and payment reliefs.

Payment holidays

Over £2.6 billion of customer balances were granted Covid-19 payment reliefs at some point during the year, with some of these holidays extended beyond the year end.

The table below shows how this position developed throughout 2020, including October 2020's results, which gives the most up-to-date view on the flows.

Payment holidays



Month End	Relief in force		Relief expired		Redeemed	Total
	Initial	Extension	Initial	Extension		
	£m	£m	£m	£m	£m	£m
March	658.2	-	0.2	-	0.3	658.7
April	2,306.9	-	2.4	-	0.6	2,309.9
May	2,414.7	7.3	130.3	-	1.4	2,553.7
June	1,767.6	190.6	642.9	1.3	3.3	2,605.7
July	245.7	619.4	1,752.6	9.6	9.2	2,636.5
August	94.4	688.0	1,825.3	23.2	21.8	2,652.7
September	46.1	506.0	1,843.7	230.2	33.3	2,659.3
October	24.1	111.5	1,844.8	638.7	49.1	2,668.2

	Currently business as usual			Between relief and BAU	Current relief	
	No relief	Single relief only	Extended relief		Extended	Original
	£ billion	£ billion	£ billion	£ billion	£ billion	£ billion
Balance	10.20	1.84	0.62	0.03	0.11	0.03
Proportion	79.5%	14.4%	4.8%	0.2%	0.9%	0.2%
% with arrears deterioration	0.9%	1.5%	6.8%	10.0%	2.8%	1.7%
% with arrears improvement	3.0%	1.1%	7.8%	1.5%	3.5%	2.8%

Payment holiday status (2 November 2020)

The position at 31 October 2020 is summarised in the table above, which analyses the values of accounts by payment relief status and which also highlights, for each of those groups, the relative change between the October 2020 arrears position and the 29 February 2020, pre-Covid-19 position. Cases where the payment holiday has ended, but no payment is yet due are shown separately.

Whilst almost 95% (by value) of accounts which had been granted relief have since returned to a fully paying status, there has been materially more arrears volatility amongst those loans where extensions were granted, both worsening and improving. This generally increased level of volatility for the portfolio has resulted in management increasing the probability of default for this population above the levels suggested by the underlying models, but this increase is only considered significant in respect of accounts that have taken a payment holiday extension. Such accounts have been transferred from Stage 1 to Stage 2 for impairment purposes.

Multiple economic scenario summary and outputs

The Group creates four macro-economic scenarios to underpin its IFRS 9 impairment modelling, and business forecasting. These comprise a base case position, an upside, a downside and a severe case. Covid-19 has had a material impact on the most recent iteration of these forecasts when compared to the Group's 2019 economic outlook for the same periods. The year-on-year differences in a selection of the variables defining these scenarios are set out below on a weighted average basis.

The forecast economic assumptions within each scenario, and the weightings applied are set out in more detail in note 19 to the accounts.

<i>Scenarios used at 30 September 2019</i>						
	Weighted scenario outcome at					
	2019	2020	2021	2022	2023	2024
GDP (indexed to Sep 2019)	100.0	101.0	102.8	106.4	108.3	110.3
House prices (indexed to Sep 2019)	100.0	100.9	103.0	106.8	111.4	116.2
Unemployment rate (absolute value)	3.8%	4.5%	4.6%	4.5%	4.4%	4.2%

<i>Scenarios used at 30 September 2020</i>						
	Weighted scenario outcome at					
	2019	2020	2021	2022	2023	2024
GDP (indexed to Sep 2019)	100.0	94.5	99.5	102.3	104.6	108.3
House prices (indexed to Sep 2019)	100.0	105.0	97.6	96.0	102.0	106.1
Unemployment rate (absolute value)	3.8%	4.8%	7.0%	5.8%	5.1%	4.4%

<i>Change</i>					
	Weighted scenario change				
	2020	2021	2022	2023	2024
GDP (indexed to Sep 2019)	(6.5)	(3.3)	(4.1)	(3.7)	(4.0)
House Prices (indexed to Sep 2019)	4.1	(5.4)	(10.8)	(12.9)	(14.2)
Unemployment rate (absolute value)	+0.3%	+2.4%	+1.3%	+1.0%	+0.9%

These economic assumptions are principal inputs to the Group's IFRS 9 models. The probability of default profiles arising from the models have, in turn, been re-phased to reflect the impacts of policy reactions to Covid-19, essentially incorporating a lag in the profile. Intervention by the UK Government has suppressed enforcement action by lenders, while recorded arrears performance and market credit data is currently not fully representative of underlying credit quality due to the payment relief rules.

The lag applied by the Group ensures that the consequences of the GDP reduction experienced since the half-year are still adequately reflected in the model output, where, thus far, the impairments that would normally be expected to arise from such changes are yet to emerge.

Impairment cover ratios and trends

The combination of harsher economic forecasts and the approach to assessing payment reliefs have led to materially higher provisions and cover ratios, as set out below.

	30 Sep 2019	31 Mar 2020	30 Sep 2020
	£m	£m	£m
Calculated provision	41.9	42.7	62.0
Overlay	-	24.0	-
PMAs (for payment relief and lagged effects)	-	-	19.8
Total	41.9	66.7	81.8
Cover ratio	0.34%	0.53%	0.64%

Fair value movements

The material reductions in both spot and forward rates during 2020 have resulted in a fair value charge of £1.6 million for the year arising from the Group's hedging activities. This compares to a charge of £15.1 million during 2019. The fair value movements reflect non-cash items and revert to zero over the lives of the instruments involved.

Tax

The effective tax rate applied to the Group's profits in 2020 has increased from 19.9% in 2019 to 22.9% during 2020. While the standard tax rate applying to the Group remained at 19.0%, the proportion of Group profits arising in Paragon Bank and consequently attracting the banking surcharge, increased. This caused the surcharge amount to increase by £1.9m, equivalent to an increase of 190 basis points on the tax rate.

The reduction in UK corporation tax rates to 17.0% which had been previously legislated for, and hence accounted for, was reversed in the year, with the impact of this on the Group's deferred tax balances affecting the year's charge.

The Group remained up-to-date with all payments of national and local taxes throughout the Covid-19 period.

Results

As noted above, there were no one-off gains or losses included in the 2020 result, whereas 2019 benefitted from a £9.7 million gain on the disposal of the Group's residual interest in one of its legacy securitisations. Profit before tax for the year was 25.5% lower than 2019's outturn at £118.4 million (2019: £159.0 million).

Basic earnings per share for 2020 were 36.0 pence (2019: 49.4 pence) and the diluted measure was 35.6 pence per share (2019: 48.2 pence), reflecting the fall in profit.

This result increased equity to £1,156.0 million (2019: £1,108.6 million), representing a tangible net asset value of £3.90 per share (2019: £3.71 per share) and a net asset value on the statutory basis of £4.57 per share (2019: £4.39 per share) (Appendix D).

A4.4.2 Assets and liabilities

Summary balance sheet

30 September 2020

	2020	2019	2018
	£m	£m	£m
Investment in customer loans			
Mortgage Lending	10,819.5	10,344.1	10,449.5
Commercial Lending	1,514.8	1,452.1	1,131.3
Idem Capital	297.1	389.9	519.8
	12,631.4	12,186.1	12,100.6
Derivative financial assets	463.3	592.4	855.7
Cash	1,925.0	1,225.4	1,310.6
Intangible assets	170.1	171.1	169.3
Other assets	315.7	220.5	51.7
Total assets	15,505.5	14,395.5	14,487.9
Equity	1,156.0	1,108.6	1,073.5
Retail deposits	7,856.6	6,391.9	5,296.6
Other borrowings	6,229.7	6,648.4	7,961.2
Derivative financial assets	132.4	80.5	4.7
Pension deficit	20.4	34.5	19.5
Other liabilities	110.4	131.6	132.4
Total equity and liabilities	15,505.5	14,395.5	14,487.9

The Group's loan portfolio grew by 3.7% during 2020, with growth in each of its Mortgage Lending and Commercial Lending divisions and continued amortisation of balances in Idem Capital. More detail on these movements is given in section A4.1. This increase, together with the Group's liquidity and capital policy, determines its funding requirements and hence the level of its liabilities.

Funding structure and cash resources

The Group's funding increased by 8.0% during the year in response to the growth of the business and a cautious outlook on funding and liquidity. The proportion represented by retail deposits increased to 55.8% in accordance with the Group's long-term funding strategy (2019: 49.0%). The cautious approach to liquidity and capital resulted in the increased cash balance, which increased by £699.6 million in the period. Movements in funding balances are discussed in more detail in section A4.2.

Derivatives

Movements in derivative financial assets principally relate to the retirement of certain of the Group's currency denominated floating rate notes and their related hedging instruments in the period. These swaps decreased by £137.4 million over the year. These movements do not impact the Group's results.

Derivative assets and liabilities used for interest rate hedging increased by £6.6 million and £51.5 million respectively, as a result of interest rate movements. These were largely offset by a £45.5 million increase in the hedging adjustment on loans to customers, included in sundry assets above, and a £4.5 million increase in the adjustment on retail deposits, included in sundry liabilities.

Pension obligations

The IAS 19 valuation of the Group's defined benefit pension scheme deficit reduced by £14.1 million in the period, less than the £20.0 million additional cash contribution made by the Group in the year. Market implied gilt yields, which are used to value future liabilities, reduced by less in the year than bond yields, which are used to estimate the discount rates applied to them, and hence the discounted value of the liability increased. The deficit at 30 September 2020 stood at £20.4 million (2019: £34.5 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 30 September 2020 was estimated at £9.7 million, a reduction of £19.5 million in the period (2019: £29.2 million), representing a 93.9% funding level (2019: 80.0%).

Other assets and liabilities

Sundry assets have increased since 30 September 2019 by £95.2 million. This increase was driven principally by movements in swap rates which generated the £45.5 million movement in fair value hedging referred to above and required a £31.3 million increase in CSA collateral deposits as a result of the increased value of derivative liabilities. Other movements included the inclusion of a tax current debtor of £5.7 million, with payments on account in the year being greater than the calculated tax payable; an increase of £3.7 million in mandatory CRD deposits at the Bank of England, which are calculated based on the size of the Group's deposit base; and the recognition of £7.0 million of right-of-use assets on the adoption of IFRS 16 (note 61).

Within sundry liabilities, which reduced by £21.2 million, the absence of a current tax liability (2019: £15.2 million), as referred to above, and a reduction in accrued investment interest receivable as a result of reduced interest rates, are offset by the lease liability recognised on transition to IFRS 16.

A4.4.3 Segmental results

The underlying operating profits of the three segments described in the Lending Review in section A4.1 are detailed fully in note 2 and are summarised below.

	2020	2019
	£m	£m
Segmental profit		
Mortgage Lending	154.3	167.9
Commercial Lending	45.9	43.8
Idem Capital	19.6	48.0
	219.8	259.7
Gains on disposals	-	9.7
Unallocated central costs and other one-off items	(99.8)	(95.3)
	120.0	174.1

The Group's central administration and funding costs, principally the costs of service areas, establishment costs and bond interest have not been allocated.

Mortgage Lending

The Mortgage Lending division has maintained a strong position in its market throughout the year, increasing its average net loan balance by 1.8%, despite the impact of Covid-19 through the second half of the year. Average NIM improved by 9 basis points over the year as a result of business initiatives and the replacement of legacy assets with higher yielding accounts. This generated a 6.9% increase in net interest. However, the impact of the virus on loss expectations generated impairment charges for the year of £25.8 million (2019: £1.0 million), increasing the cost of risk to 0.24% (2019: 0.01%).

The impact of this increased provision saw segmental profit decrease by 8.1% to £154.3 million, from the previous year (2019: £167.9 million).

Commercial Lending

Segmental profit in Commercial Lending was £45.9 million in the period (2019: £43.8 million), an increase of 4.8% even after allowing for the impact of Covid-19 on provisions. This resulted from the 14.8% growth in average loan balances, year-on-year, principally attributable to the strength of growth in the development finance business.

Coupled with a strategic focus on yield which saw NIM in the segment increased by 50 basis points in the year, this growth generated a rise of 21.1% in total operating income in the segment. With the cost base broadly similar to the previous period, the increase in operating income was offset by the £14.5 million increase in provision arising from the worsening economic outlook reflected in the Group's IFRS 9 impairment scenarios.

Idem Capital

The result for the Idem Capital division continues to be driven by the rate of portfolio run-off, with no new deals completed in the year. The average loan balance reduced by 24.5% in the year while average NIM continued to reduce with high-yielding assets paying down more rapidly than lower yielding secured balances.

Unsecured consumer assets in the division are valued based on future expected cash flows. The reforecast of these balances in the light of Covid-19 generated a write-down of expected interest of £3.7 million, which has also impacted NIM in the segment. However actual performance in the last six months of the year has been encouraging.

This, together with the Covid-19 provisioning on the secured assets, impacted on segment profit, which fell to £19.6 million (2019: £48.0 million).

A4.5 Operations

The major factor impacting the Group's operational capabilities in the year was the Covid-19 pandemic, which affected all business areas. The achievement of the Group's objectives is heavily reliant on its people, business partners, suppliers, systems and governance structures, with a single framework covering all locations and operations. This framework has been successfully reconfigured in response to Covid-19.

The development of the Group's operations has continued despite the virus. Both before the outbreak of Covid-19 and during the pandemic, the Group has continued to invest in its infrastructure, particularly in customer and broker facing systems. The Group's planned change programme progressed throughout the year with minimal impact from the pandemic, delivering new technology and operational enhancements which will generate efficiencies and improve customer experiences.

A4.5.1 Covid-19 response

The Group's operational response to Covid-19 has focussed on enabling its businesses to continue operating as normally as possible whilst supporting its customers and protecting employees and other stakeholders. Operating in a key economic sector, it recognised the need for service levels to be preserved as far as possible and the difficulties in achieving that. The Group is proud of what has been achieved and is confident that it has in place the operational infrastructure to deliver the levels of customer service and employee safety required both during and after the pandemic.

The Group's operational functions faced three major challenges as a result of the Covid-19 situation:

- To develop processes and IT systems to deliver appropriate financial reliefs to customers, in line with the structures set out by the UK Government
- To enable working from home to be widely available amongst the workforce while preserving the Group's culture and retaining a strong compliance and cyber-security framework
- To develop the systems and procedures to offer the CBILS and BBLS products introduced across the financial services industry to support its customers

The UK Government announced the initial package of Covid-19 reliefs that it expected lenders to grant on 17 March 2020 and the Group was able to develop and put in place the necessary processes and systems before the first large batch of payments fell due on 31 March, 14 days later. This involved a significant amount of work by operational and IT staff to ensure that not only were the appropriate reliefs given, but also that they were

given in a way that would not adversely impact customers' credit records. Systems have continued to develop as reliefs have been extended and amended through the second half of the year.

Prior to the announcement of the UK lockdown the Group was already planning for that eventuality, with groups of employees trialling working from home while on-site social distancing was enhanced. Following the announcement, a programme was quickly put in place to convert as many people as possible to working from home, including customer service and contact centre employees. This involved both the transfer of significant amounts of IT equipment to employees' homes and also changes to the Group's networks and systems. These changes were required to enable remote working, while still retaining appropriate controls over data and system security as well as the levels of monitoring required by regulators, particularly in a contact centre environment.

The operation saw the conversion of around 1,000 previously office-based employees to home working. This involved the provision of desktop computers, screens and related IT equipment at 425 homes, an additional 50 users being provided with laptop computers, and additional equipment being provided to many other employees already equipped for home working.

By 31 March 2020, the Group had enabled 90% of employees to work from home on a sustained basis whilst maintaining service levels for all its customers. Almost all the Group's offices have been temporarily closed with employees identified as critical being retained in a handful of premises, mostly in roles which require the employees' physical presence, such as those maintaining council waste disposal vehicles funded by the Commercial Lending division. Other than these workshop personnel, almost all remaining on-site employees are based in the head office in Solihull.

At the year end most employees were still working from home and while plans had been made to bring some people back to the Group's offices, those plans were put on hold following the worsening of the Covid-19 situation in the autumn, with a large scale return to office working not expected before March 2021 at the earliest. The Group has not placed any employee on a furlough scheme, nor made any employee redundant following the Covid-19 outbreak, and has no current intention of doing so.

This approach has allowed the Group to provide operational capacity to support its customers, who may themselves be suffering from the effects of the Covid-19 crisis. Data relating to both the period of transition and the period since, with customer-facing employees mostly working from home, demonstrated no significant increase in complaint levels.

The protection of the health and wellbeing of the Group's employees has been a principal objective of its Covid-19 response. Increased hygiene products and more frequent cleaning routines were introduced across the Group's offices from February. Throughout March a coordinated approach was implemented to identify and protect the Group's most vulnerable employees, as defined by the UK Government, and these people were immediately sent home and subsequently, as described above, provided with the necessary IT infrastructure to work from home effectively. Social distancing, in line with UK government guidance was implemented across all open offices during March and this remains in place.

Ensuring regular engagement with employees working from home during the crisis has been an area of focus. Regular briefings by the CEO and senior team, delivered online, have spearheaded a coordinated and regular programme of communications for all employees, as well as specific communications for line managers. Additional learning opportunities have been provided to managers and employees addressing physical and emotional wellbeing with a focus on working from home effectively and managing teams remotely. Further support is provided by the Group's team of emotional wellbeing volunteers, set up in 2018, and all identified and trained with the assistance of the charity Mind.

In addition, quarterly engagement pulse surveys have monitored employees' overall physical and mental wellbeing, enabling the Group to respond quickly to any emerging needs. Fortnightly meetings with the Group's elected People Forum representatives, attended by senior management, as well as two members of the Board on one occasion during the pandemic, have provided a further source of feedback to ensure employees have been considered throughout the Group's response to the pandemic.

All activity is in line with the advice of the UK Government. In addition, an ongoing programme of development activity has taken place through the second half of this year. This is delivered through both learning and virtual group sessions and covers such topics as: effective use of Office 365 applications, including Microsoft Teams; the importance of communication; how to motivate and engage people; and delivering effective performance management whilst working remotely.

Overall, the Group is satisfied with its operational performance during the first six months of the Covid-19 crisis, which has justified its investment in contingency planning and operational resilience over recent years. It is proud of the response to the crisis by its people throughout the operation, without whom this could not have been achieved.

A4.5.2 Management and people

The Group employs just under 1,400 people, with the majority of employees being based at its Solihull head office. The Group is proud of its strong culture; our employees and leadership live by our values and we believe that this is one of our differentiators that makes us a great place to work.

During the period the Group commissioned an independent review of its culture from PwC which concluded that "there is a strong working relationship across the leadership team and consistent alignment on the firm's values and desired behaviours as it pertains to good customer outcomes".

Governance and management

The Group's business continuity governance processes were invoked once it became clear that the Covid-19 pandemic was likely to impact the UK. In addition to the governance provided by senior management, the Board increased its oversight with an additional series of director updates, issued by the Chair of the Board and the CEO, specifically discussing the impact of Covid-19 on the Group and its market. Ad hoc meetings of the Board and committees have also taken place. Board and committee meetings have been held remotely since March 2020. The impact of the pandemic on the Group's stakeholders, including its customers and employees, and the Group's response to it have been thoroughly communicated to the Board and discussed at board meetings.

Since 1 October 2019 the Company has been subject to the 2018 UK Corporate Governance Code (the 'Code'). This includes significant changes from the 2016 edition of the Code and work was undertaken during the year ended 30 September 2019 to ensure compliance with the Code. The enhancements made to the Group's governance arrangements in response to the Code are discussed further in section B of this annual report. The Company has complied with the principles of the Code during the year.

In January 2020 the Group and the Board offered their thanks and best wishes on his retirement to John Heron who was the Group's longest serving employee and Managing Director - Mortgages. John had been an executive director since 2003 and was instrumental in establishing and building both the Group's buy-to-let mortgage offering and the buy-to-let sector as a distinct part of the UK mortgage market.

Peter Hartill reached nine years' service on the Board in February 2020, and it had previously been announced that he intended to step down from the Board at that point. However, the Board announced in December 2019 that it considered Peter's independence, skills and experience allowed him to continue to make a very effective contribution as a non-executive director, Senior Independent Director and Audit Committee Chair and that it had therefore asked him to postpone his resignation. This was in order to ensure that the Board would not have to compromise on either the quality of candidate or a suitable transition period in finding a replacement for him.

In March 2020 Alison Morris was appointed to the Board and succeeded Peter as Chair of the Audit Committee, chairing her first meeting in September 2020. Alison is a chartered accountant and recently retired as a partner in PwC's Financial Services Assurance Practice. She joined PwC in 1982 and spent her entire career with the organisation in a range of internal and external audit roles across the Asset and Wealth Management practice and Banking and Capital Markets business unit.

A thorough handover from Peter to Alison took place over the summer and Peter stepped down from the Board on 30 September 2020. Peter retires from the Board with the thanks of the Chair and the Board for his commitment to the Group and his professionalism and dedication in the role of Audit Committee Chair and, latterly, Senior Independent Director.

Hugo Tudor replaced Peter as Senior Independent Director on 23 July 2020 and continues to chair the Remuneration Committee.

Following the year end, the Group announced the appointment of Peter Hill as a non-executive director, following a robust search and selection process. Peter was CEO of Leeds Building Society from 2011 until his retirement in 2019 and is currently a non-executive director of Pure Retirement Limited and chairman of its risk committee. He is also Chair of Mortgage Brain and brings with him a wealth of experience in financial services and a proven track record in risk oversight, gained during his executive and non-executive career.

Peter will become Chair of the Risk and Compliance Committee with effect from 31 December 2020 to allow for a managed and orderly transition from the current committee chair, Finlay Williamson, who has announced his intention to step down from the Board on 31 December 2020.

Finlay was appointed to the Board in 2017 and is Chair of the Risk and Compliance Committee and a member of the Audit Committee. Finlay will also be stepping down at the same time from the Board of Paragon Bank PLC, to which he was appointed in 2015. He leaves with the Board's thanks for the contribution he has made to embedding the Group's Risk Management Framework. He has brought humour, great experience and energy to his role and his input will be missed.

Following these changes, women will comprise 37.5% of the Board.

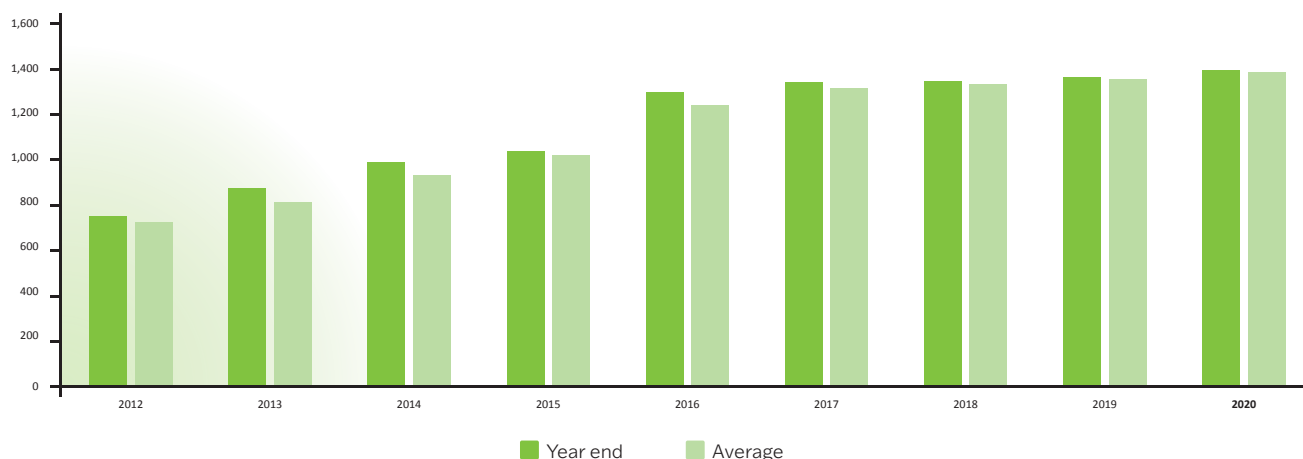
People and development

The Group continues to focus on maintaining an efficient and effective workforce, increasing employee numbers by 1.4% over the year. It maintains its accreditation from the UK Living Wage Foundation and minimum pay continues to meet the levels set by the Foundation.

Retention of employees continues to remain high, with the attrition rate of 10.4% continuing to track below the national average of 21.7%. These high levels of retention are further bolstered by 24.7% of employees achieving over 5 years' service, 13.3% achieving over 20 years with the Group and 4.5% achieving over 30 years' service.

Employee numbers

At 30 September and average for the year



Retaining this level of skill and knowledge within the Group has helped to navigate the challenges that remote working has presented during the Covid-19 pandemic and enabled operational challenges to be met, with employees redeployed to meet operational needs. The Group believes that these levels of retention are driven by a culture of continuing to provide employees with opportunities for personal development and career progression; 25% of the Group's vacancies during the year were filled internally.

The Group has continued to recruit and develop the best talent over the year; adapting how this is achieved through the Covid-19 pandemic. Most of the Group's employees were moved to work from home in the space of a week; new hires were virtually onboarded; and the provision of day-to-day training moved online. The Group has seen its employees pull together and demonstrate their resilience over the course of the year, with some employees temporarily moving into new roles to ensure operational needs are met and customer service standards maintained.

This year it has been more important than ever to continue to promote wellbeing and the Group's Wellbeing Network has organised numerous initiatives to support our people's mental and physical health.

The Group's senior leadership development programme has continued during the year. This is aimed at developing those identified as successors for the executive management team and their direct reports. During this year four members of this programme have secured promotions within the Group. Additionally, the Group continued its participation in the Women Ahead 30% Club cross-company mentoring scheme.

The Group has also continued to take on new apprentices during the period with 46 apprentices currently in place across various business functions. The Group's intern opportunities also continued to be successful, with interns undertaking placements in Finance and Treasury during the year and recruitment taking place over the summer despite the pandemic.

The Group rolled out its 'Leadership Blueprint' in October 2019. This personal development initiative is designed to build the capability of line managers and drive consistency in the way the Group manages its people. It focuses on developing the behaviours of line managers and leaders and measuring the impact that these improvements have on business outcomes.

The Group also focussed on the provision of professional qualifications training during the period, with an additional 37 employees commencing their Certificate in Mortgage Advice and Practice during the period, and other employees being supported in qualifications relevant to their specialism.

During the year the Group also complied with the FCA requirement for the Senior Managers and Certification Regime ('SMCR') to be extended to all regulated legal entities. People performing Senior Management Functions ('SMFs') for its solo regulated businesses (Paragon Finance PLC, Mortgage Trust Services PLC, The Business Mortgage Company Services Limited, Premier Asset Finance Limited, Paragon Technology Finance Limited and Paragon Commercial Finance Limited) have been identified and approved by the FCA.

Alison Morris, non-executive director, became the Group's Whistleblowing Champion this year and all members of the Whistleblowing Committee received training from Protect on how to develop robust whistleblowing arrangements and achieve a culture where employees feel able to raise concerns.

Equality and diversity

The Group continued to make progress with its Equality, Diversity and Inclusion strategy during the year. In January 2020 the Group enhanced its maternity provision, to 18 weeks leave at full pay from 6 weeks at 90%, to support the retention and career progression of female employees. The Group has continued its participation in the 'Women Ahead 30% Club' cross-company mentoring scheme, providing ten trained mentors to support female mentees from other companies, whilst nominating ten female mentees from the Group's workforce to receive external mentoring support at the same time. This is an annual programme and feedback from both mentors and mentees has been very positive. It is the Group's second year of involvement.

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 2020; unfortunately, the proportion of female senior managers fell to 33.9% during the period (2019: 35.9%). This reduction is primarily due to reporting line changes within the senior management population and plans are in place to ensure that the Group can achieve its 35% target by the January 2022 deadline.

At the time of setting its Women in Finance target, the Group set additional targets which it is making excellent progress towards. In particular:

- 50.1% of employees receiving management development / leadership training are female (compared to 42.7% in 2019)
- 24.3% of the workforce are on flexible working contracts (compared to 35.8% in 2019)
- 82% of flexible working available is on a part-time basis (compared to 65.9% in 2019)

The Group continues to monitor external developments and is confident that the practices and plans that are in place are aligned to best practice and reflect the recommendations made by the Hampton Alexander review.

The Group calculated its gender pay gap at April 2020. This calculation shows that median female pay in the Group was 36.9% less than the median male pay (2019: 33.9%). This is broadly in line with the results reported by other financial services companies and the 35.9% gap for the sector reported by the Office of National Statistics in their Annual Survey of Hours and Earnings ('ASHE') published in October 2020. 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 Group has begun to increase its focus on other diversity strands during the period; rolling out new recruitment technology to reduce the likelihood of unconscious bias in the early stages of candidate selection.

The Group is also in the process of rolling out an Equality, Diversity and Inclusion Network, an employee resource group which consists of people who are passionate about supporting the Group's target of becoming more inclusive for all employees. Richard Rowntree, Managing Director-Mortgages is the executive sponsor for the network and progress will be reported to the Nomination Committee.

A4.5.3 Environment and social

Climate change

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. Furthermore, the PRA released a 'Dear CEO' letter in July 2020 emphasising their expectations for firms to have fully embedded their approaches to managing climate related financial risks by the end of 2021.

The Group is developing an enhanced approach to identifying and managing the potential impacts of climate change in its business in order to meet these requirements.

In order to provide the appropriate governance, the Board has been engaged in the process for developing and accepting climate change as a principal risk. The Group has established a project and working group reporting to the Executive Risk Committee which is chaired by the CEO. The working group contains personnel from across the business to manage the broad scope of climate change. The working group's remit includes but is not limited to:

- Ensuring the financial risks from climate change are managed effectively following its allocation as a principal risk
- Keeping up-to-date with emerging best practice across the financial services industry

- Developing a clear understanding of how our current products impact the UK's progression to net zero by 2050
- Embedding climate change risk within established risk types such as operational risk and credit risk to ensure a consistent approach is taken across the business

The Group is also cooperating with several industry initiatives on climate change, including projects led by the Green Finance Institute to investigate how financing solutions can support increasing energy efficiency in the UK property sector.

Operationally the Group has taken the decision to move away from diesel vehicles in its company fleet in favour of electric or hybrid vehicles which will reduce greenhouse gas emissions as new cars join the fleet. The Group has also relaunched its cycle-to-work scheme.

More detail on the Group's response to climate change is included in section A6.4.

Charitable activity

As part of its response to Covid-19, and its ongoing commitment to the communities in which it operates, the Group has donated £100,000 to charities supporting people impacted by the pandemic. These included organisations supporting NHS staff, homeless people and elderly people. It has also recognised the difficulties faced by the employee charity committee in fundraising, with so many of the Group's people working off site, and pledged to double the amount raised by staff in the 'Move for Macmillan' challenge. This initiative both supported this year's company charity and promoted exercise and wellbeing amongst people working from home.

A4.5.4 Risk

The effective management of risk remains 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 focus of the Group's risk management has inevitably been heavily focussed on managing the impacts of Covid-19. The Group has responded effectively to the changes in risk profile arising from the impact of the pandemic.

The Group's risk management framework has provided a robust mechanism to ensure that new risks are promptly identified, assessed, managed and appropriately overseen from a risk governance perspective. As the pandemic unfolded a dedicated Risk Working Group ('RWG') reporting to the Crisis Management Team, was established to oversee all significant process and lending changes resulting from Covid-19, providing independent challenge and oversight, and ensured that all risk aspects were fully considered.

In particular, the RWG and the independent risk function have provided assurance over the following:

- New risks arising from the provision of CBILS and BBLS lending including process changes and underwriting decisions
- Changes to technology and infrastructure required to facilitate mass home working especially in the many customer-facing roles where this practice was new
- Revised credit policies and decisioning to reflect the challenges in applying existing lending criteria

- Implementation of payment holidays in accordance with regulatory initiatives together with other payment reliefs across all product lines
- Planning for a Covid-19 safe return to office-based working and the implications for the longer term workplace strategy

In addition to the challenges of Covid-19, the Group has continued to evolve and embed its risk management framework and in particular has focussed on:

- Anticipating the level of change in product design, funding and operations which will be required in preparation for the withdrawal of LIBOR in 2021
- Embedding operational resilience capabilities which have also been critical in handling the Covid-19 situation. This has included refinement of critical business services and tolerances and ensuring these considerations are embedded as part of day-to-day operations
- Addressing the impact of climate change on managing financial risks
- Developing advanced models and the overarching model risk framework to enhance credit risk management and support the Group's IRB application process
- Evolution and embedding of the Group's approach to managing the risks and oversight of its outsourced relationships and important suppliers
- Enhancing stress testing procedures to ensure the robustness of capital and liquidity positions
- Ensuring effective cyber-security controls and a robust data protection approach

The Group continues to review its exposure to emerging developments in the Brexit process once the transition period ends on 31 December 2020, given the remaining potential of no deal being agreed for the terms of exit. While the Group does not have operations outside the UK it has continued to review the capital, liquidity and operational implications of the stresses which might be caused by the process. The Board has monitored the position throughout the year and the Group considers itself well placed to address the challenges. However, the position remains uncertain and will continue to be subject to detailed monitoring given the imminent deadline.

The principal challenges in the risk environment faced by the Group during the year and moving forward into 2021 include:

- Management of those risks arising from changes introduced in response to Covid-19. As payment reliefs end and the wider economic impacts of the crisis are felt, there will be a need to ensure appropriate treatment of ongoing arrears and the ongoing position of affected customers. Key to this will be ensuring that the treatment of customers is fair and conduct principles remain at the forefront of all interactions
- Management of the transition from LIBOR to alternative benchmark rates given the commitment by the regulators to the transfer being fully completed by 31 December 2021
- Whilst Covid-19 has underlined the need to ensure the Group is fully resilient, the unprecedented crisis has identified a number of industry-wide issues which will need to be built into the resilience frameworks going forward. Further clarification on the broader industry approach is expected with the publication of a consultation paper in late 2020. The Group is committed to strengthening its operational resilience as a core priority in 2021

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 B8 of this annual report.

A4.5.5 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.

Since March 2020, the impact of Covid-19 has largely driven regulatory priorities and the Group continues to respond effectively to these ongoing challenges. Overall, the Covid-19 response has included reviewing the Group's arrangements to address an evolving situation, whilst maintaining clear focus on customers, staff and the marketplace. Across all product areas the Group continues to provide support and service to its customers.

In response to the economic shock from Covid-19, regulators have sought to alleviate some of the pressures on the banking sector. These regulatory responses include:

- 'Quick Fix' amendments to the CRR discussed in the capital section, A4.3, alleviating the short-term impact of Covid-19 on regulatory capital. These have been reviewed, and where relevant, incorporated into capital and corporate planning
- Guidance from accounting and financial services regulators on the application of IFRS 9 in the Covid-19 environment, including the treatment of payment reliefs and the need to pay regard to the impact of government support measures. These are discussed in Section A4.4.
- Guidance on payment deferrals by the FCA for mortgages, unsecured consumer credit and motor finance to enable customers suffering Covid-19 related financial difficulties to be supported without impact on their credit files. The Group has applied the guidance in full and has worked with customers to ensure they are supported throughout the deferral period, and affordable repayment arrangements are put in place following any such relief

In addition to requirements introduced in response to Covid-19, the following developments currently in progress are particularly relevant to the Group:

- Both the PRA and FCA have been active in ensuring an orderly transition from LIBOR to alternative benchmark measures, both in terms of the impact on financial markets and the impact on customers. A project has been established to oversee the Group's LIBOR transition plan to ensure the regulatory deadlines and requirements are met
- Due to Covid-19 the consultation period for proposed PRA and FCA operational resilience requirements was extended to 1 October 2020, with final rules expected to be published in early 2021. The FCA has also requested that firms comply with the EBA Guidelines on ICT and security risk, particularly focusing on business continuity. The business has reviewed the guidelines and confirmed its proportionate adherence to the requirements. A gap analysis of the Operational Resilience Consultation Paper has been completed, and a plan to ensure compliance within appropriate timeframes is in place

- The FCA published updated guidance on vulnerable customers this year, and HM Treasury has continued work on its proposed Breathing Space scheme. The Group has amended processes and updated procedures to reflect these changes, and to take account of temporary guidance for those experiencing financial difficulties linked to Covid-19
- The FCA has further developed its messaging on culture during 2019/20, broadening its focus from 'Tone at the Top', to a wider view of culture across firms. The FCA has cautioned firms against measuring culture too narrowly. Culture remains a key focus for the Board, senior management and throughout the business
- The PRA published a Policy Statement in July 2020 confirming its expectations of firms when managing the key prudential risks associated with asset encumbrance, specifically in the contexts of managing liquidity and funding risks, recovery planning and resolution. The Group has reviewed the Policy Statement and considers itself to be in a good position to meet these expectations and related PRA rules
- The PRA has confirmed that it expects firms to have fully embedded their approaches to managing climate-related financial risks by the end of 2021. To help firms understand the risks and opportunities that arise from climate change, and to provide support on how to integrate these risks into strategy and decision-making processes, the Climate Financial Risk Forum Guide was published in June 2020. The Group continues to develop its strategy in respect of climate change, in line with this guidance, to ensure it is well-positioned to address these emerging challenges
- The PRA is undertaking a consultation on proposed amendments to the Capital Requirements Directive ('CRD V'). CRD V builds on the existing CRD IV, introducing further measures covering capital, remuneration and governance. It also introduces a number of EU-specific measures designed to further harmonise micro and macroprudential supervision and to introduce greater proportionality in prudential requirements. Whilst the Group awaits the outcome of this consultation, it believes it will be well placed to meet the final requirements

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 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 end of the Brexit transition period on 31 December 2020. HM Treasury has extended the temporary transitional powers for the regulators until 31 March 2022. Regulatory obligations for firms will generally remain the same for that period.

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.

A5. 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, Chief Executive's review in Section A3 and review of the business in Section A4. The principal risks and uncertainties affecting the Group, and the steps taken to mitigate these risks are described in Section B8.5.

Section B8 of this annual report describes the Group's risk management system and the three lines of defence model which it is based upon.

Note 54 to the accounts includes an analysis of the Group's working and regulatory capital position and policies, while notes 55 to 58 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 judgements and estimates affecting the results and financial position disclosed in this annual report are discussed in notes 63 and 64.

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 Group makes extensive use of stress testing in compiling and reviewing its forecasts. This stress testing approach was reviewed in detail during the year as part of the annual Internal Capital Adequacy Assessment Process ('ICAAP') cycle, where testing considered the impact of a number of severe scenarios.

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.

In compiling the most recent forecast, for the period commencing 1 October 2020, particular attention was paid to the potential consequences of Covid-19 on the Group's operations, customers, funding and prospects, both in the short and longer term. This included consideration of a number of different scenarios with impacts of varying duration and severity. In common with the Group's approach to IFRS 9, the economics used in the forecasting process were updated in October in light of the continuing development of the Covid-19 crisis, based on updated external projections. Future business activity was reforecast reflecting the potential impacts of the pandemic on markets and products.

The forecast was based on the best available information at the time of its approval, but the uncertainties surrounding the potential ongoing impact of Covid-19 and the nature, duration and effectiveness of government and regulatory measures to address it, mean that accurate forecasting is a more complex task than in normal circumstances. Therefore, further scenario modelling was undertaken to evaluate the impact of adverse stresses of the forecast variables with the greatest impact.

The key stresses modelled in detail to evaluate the forecast were:

- An increase of 10% in buy-to-let volumes. This examined the impact of volumes on profitability and illustrated the extent to which capital resources and liquidity would be stretched due to the higher cash and capital requirements
- Higher funding costs – 20bps higher cost on all new savings deposits throughout. This scenario illustrates the impact of a significant margin squeeze on profitability and whether this would cause significant impacts on any capital, liquidity or encumbrance ratios
- An increase in impairment due to more Covid-19 disruption. This scenario models a significant short-term profitability stress and the consequent stress on capital
- A 10% reduction in development finance volumes. Development finance is the highest yielding product and this scenario illustrates the effect of product mix on contribution and other ratios
- A stress combining higher funding costs and more Covid-19 disruption, without reducing lending. Although it is not deemed likely that such a scenario would materialise, since severe stresses almost always result in lower lending volumes, the output from this stress provides a benchmark for a plausible worst-case position that impacts all aspects of business performance and ratios, in particular, capital

These stresses did not take account of management actions which might mitigate the impact of the adverse assumptions used. They were designed to demonstrate how such stresses would affect the Group's financing, capital and liquidity positions and highlight any areas which might impact the Group's going concern and viability assessments. Under all these scenarios, the Group had the ability to meet its obligations over the forecast horizon and maintain a surplus over its regulatory requirements for both capital and liquidity through normal balance sheet management activities.

A further, more material impairment stress was modelled, based on the Group's severe macroeconomic scenario. This, together with the outputs from the other stresses described, presents the Board with enough information to assess the Group's ability to continue on a going concern basis and ensure that there are enough management actions within their control to mitigate any plausible and foreseeable failure scenario.

The Group started the Covid-19 period with a strong capital surplus and has also built up a significant liquidity buffer during the second half of the year, as described below, to ensure that any significant outflows of deposits and / or reduced inflows from customer receipts can be managed. Overall, the forecasts, even under reasonable further levels of stress show the Group retaining sufficient equity, capital, cash and liquidity throughout the forecast period to satisfy its regulatory and operational requirements.

Risk assessment

During the year the Board discussed, reviewed and approved the amended principal risks identified for the Group. This process included debate and challenge regarding the most material areas for focus on an ongoing basis and resulted in the addition of principal risks in relation to strategic risk, climate change risk, reputational risk and model risk.

Each of these principal risks is considered on an ongoing basis at each Executive Risk Committee meeting and each meeting of the board-level Risk and Compliance Committee.

The work of the Risk and Compliance Committee, of which all directors are members or attendees included:

- 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

In addition, the directors held 'deep dive' sessions into key areas of risk focus; including the potential for (and impact of) negative interest rates, possible risk arising from a change of government, LIBOR transition, introduction of CBILS and BBLS and Covid-19 payment reliefs. The results of these exercises were fed back into the Group's risk management process.

Throughout the second half of the year, the directors received regular analysis and management information illustrating the impacts of Covid-19 on the Group and its risk profile. They considered this information, taking into consideration regulatory impacts, conduct risks in dealing with customer vulnerabilities arising from the pandemic, customer credit and the changes in the Group's operational processes. The results of these considerations fed into the Group's forecasting and risk assessment.

The potential impact of negative interest on the Group's operations and margins was a particular area of risk focus in the year. The directors also continued to monitor the potential impact of the UK Brexit process as the situation developed through the year.

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 B8.5 of the Risk Management Report.

Availability of funding and liquidity

The Group's retail deposits of £7,856.6 million (note 28), raised through Paragon Bank, are repayable within five years, with 71.9% of this balance (£5,650.2 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 2020 Paragon Bank held £1,637.1 million of balance sheet assets for liquidity purposes, in the form of central bank deposits (note 15). A further £150.0 million of liquidity was provided by an off balance sheet swap arrangement (note 57), bringing the total to £1,787.1 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 £684.0 million. Holdings of the Group's own externally rated mortgage backed loan notes can also be used to access the Bank of England's liquidity facilities or other funding arrangements. At 30 September 2020 the Group had £1,063.5 million of such notes available for use, of which £872.9 million were rated AAA.

The Group's securitisation funding structures, described in note 57, ensure that a significant proportion of its originated loan portfolio is match-funded, although this was reduced in the period by the retirement of five securitisation transactions. 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. While the Group has not accessed the public securitisation market in the year, the market has remained active throughout the Covid-19 crisis and remains a potential funding source.

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, of £60.0 million matures. The Group's TFS borrowings also start to mature in the coming financial year, with £700.0 million falling due within twelve months.

The Group's access to debt is enhanced by its corporate BBB rating, affirmed by Fitch Ratings in March 2020, and its status as an issuer is evidenced by the BB+ rating of its £150.0 million Tier 2 bond. It has regularly accessed the capital markets for warehouse funding and corporate and retail bonds over recent years and continues to be able to access these markets.

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

As described in note 54 the Group's capital base is subject to consolidated supervision by the PRA. Its capital at 30 September 2020 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 2020. 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 Sections A3 and A4
- 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 and forecasting processes
- 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 2020.

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.

A6. Citizenship and sustainability

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.

A6.1 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 A6. 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 A6.4
(b)	Employees	Section A6.3
(c)	Social matters	Section A6.5
(d)	Respect for human rights	Section A6.6
(e)	Anti-corruption and anti-bribery matters	Section A6.7

This section also includes the information on the directors engagement with employees required by schedule 7.11(1)(b) of the Act (in Section A6.3) and the information on business relationships required by schedule 7.11B(1) of the Act (in Section A6.7).

A6.2 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 ensuring good customer outcomes, preventing customer harm 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.

Complaints

There will be occasions where the Group does not get things right, and as a consequence this will give customers cause to complain. The effective resolution of complaints is a key focus, with all business areas following the FCA's Dispute Resolution Sourcebook ('DISP') to ensure consistent and fair customer outcomes.

Handling

The Group aims to resolve complaints at the first point of contact, where possible, 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 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, and the FLA. Where customers feel the need to appeal, the Group co-operates fully and promptly with any settlements and awards made by these parties.

Monitoring

The Group has established complaint reporting forums in all business areas, to enable the effective discussion of complaint volumes, trends and Root Cause Analysis. This ensures that all business lines effectively resolve customer complaints, and learn from the issues raised to address the causes of those complaints. The effectiveness of this activity is regularly assessed through independent first line outcomes testing to ensure ongoing agent competence in the identification and resolution of complaints ensuring the delivery of fair customer outcomes. The reporting of this activity flows to the Customer and Conduct Committee ('CCC'), ensuring complaint visibility goes right to the top of the organisation.

The number of complaint cases reported to FOS in the six months ended 31 December 2019 was 83, with an uphold rate of 48.2%. The number of cases reported in the six months ended 30 June 2020, including the first three full months of the Covid-19 crisis, was 40 with an uphold rate of 41.3%, below the FOS disclosure threshold.

Metrics on customer complaints are an important management information measure for the Board and form part of the determination of management bonuses and the vesting conditions for the share-based remuneration described in the Directors' Remuneration Report (Section B7).

A6.3 People

The Group employs just under 1,400 people with a variety of expertise and experience to ensure it is best placed to serve its customers and achieve its strategic priorities. The Group prides itself on its culture and how employees demonstrate its values every day. PwC's review of the Group's culture noted that:

"There is strong collaboration across the leadership team, and a real sense of being part of a 'family'. This alignment means that the leadership work well together, particularly when there are challenges/issues to resolve, and role model the desired behaviours consistently."

During the period employees have benefited from the introduction of new HR technology, with a digital self-service platform introduced in February 2020. This has improved the employee experience by creating process efficiencies such as online appraisals and also through new functionality, such as online expenses, introduced in April 2020.

Employment conditions

All of the Group's employees are based in the UK and it is committed 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 2020, employees on temporary or short-term contracts accounted for 1.5% of the workforce (2019: 2.1%) and no use was made of zero-hours contracts. The Group's annual employee turnover for the year was 10.4% (2019: 11.5%).

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.

Flexible working arrangements are in place for 24.3% of our employees, with 82% of these working part time. The Covid-19 pandemic has meant the Group has had to rethink what flexible working arrangements are available, both on a formal and informal basis.

A significant number of employees have needed to juggle childcare and home schooling commitments whilst working at home during the pandemic, and the Group has supported employees to change working hours or patterns, and in some circumstances also offered paid leave, to allow our employees to fulfil these commitments. This has meant that a far higher percentage of employees than reported have been able to work informally on a flexible basis, to some degree.

No employees were put on furlough or made redundant as a result of Covid-19 and no use was made of the UK Government's Coronavirus Job Retention Scheme. Where any employee was requested to 'shield' due to vulnerability and was unable to work from home, they did so on full pay.

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, the 'real Living Wage', 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 also ensure that any contractors used undertake to do so.

The Group has decided that, despite the impact of Covid-19, the increase in the real Living Wage announced by the Living Wage Foundation in November 2020 will be passed on to employees.

The Group runs a Worksave defined contribution pension scheme in line with UK legal requirements. During the year the Group increased its maximum contribution for each employee to 10% of salary, for those employees making a maximum contribution of 6%. It was gratifying that this both incentivised employees already in the scheme to increase their contributions and led to a greater uptake of the scheme as a whole, increasing the levels of saving for retirement amongst the workforce.

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 creating a culture where employees feel able to 'bring their whole self to work'. Creating an inclusive environment where this is possible will contribute to the success of the business but most importantly, it is quite simply the right thing to do.

The progress that has been made on gender diversity over recent years continued in this period, and additionally the focus has widened to consider how we can do more to attract, develop and retain employees from other under-represented groups.

As well as eLearning for all employees, the Group continues to combat unconscious bias through the use of recruitment technology that was introduced in 2019. The new recruitment technology anonymises applications before hiring managers see them, and therefore ensures applications from under-represented groups are given full and fair consideration.

The Group launched its Equality, Diversity and Inclusion ('EDI') Network in October 2020. The network is made up of employees from across the Group, selected through a formal application process, and aims to make the Group a more inclusive place to work. The progress on the initiatives the EDI Network undertakes will be reported to the Nomination Committee, as the board committee responsible for diversity issues.

The Group has set a target level of minority ethnic employees holding 10% of management grade positions, increasing from the current 2.2% (2019: 1.8%). Continued progress will be a key focus for the EDI Network and its support is an important step towards this.

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 is committed to provide all employees with access to the same training, development and job opportunities.

Every effort is 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. Ensuring that opportunities and progression within the Group are available to people with disabilities is an important part of its inclusivity and diversity strategy and will form a strand of the work of the EDI Network.

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 within the 'Sustainability' 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 proportion of female senior managers on this basis at 30 September 2020 was 33.9% (2019: 35.9%), unfortunately not maintaining our target position. This is largely due to changes to organisational structures that impact the classification of senior management. The Group is confident that it will meet its target over the coming year.

During the year the Group continued to monitor the levels of women taking up training opportunities, with particular initiatives focussed on female talent, as described below.

The Group has also extended the availability of maternity pay, so that employees now generally receive 18 weeks leave at full pay, rather than six weeks at 90% pay. It is hoped that this will help in the retention and career progression of women in the organisation.

Gender Pay

As required by legislation, the Group has calculated its gender pay gap as at April 2020. The results will be published on the government website and on the Group's own website and are summarised below.

	April 2020	April 2019
Median gender pay gap	36.9%	33.9%
Mean gender pay gap	40.7%	41.3%
Median bonus pay gap	2.5%	1.2%
Mean bonus pay gap	82.6%	76.9%

The median pay gap is broadly in line with the 35.9% median pay gap in the financial services sector reported by the Office of National Statistics ('ONS') in their Annual Survey of Hours and Earnings published in October 2020. The mean pay gap is somewhat higher than the 28.8% mean pay gap reported by the ONS, but this is attributable to the Group's limited representation of females in senior roles.

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 a small number of senior appointments, which, despite gender-balanced candidate pools being considered, have been filled by men. The Group remains 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 90.3% of female employees received a bonus (2019: 88.0% and 90.1%), 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 2.1% to 1,391 people (2019: 1,362). Information on the composition of the workforce at the year end is summarised below:

	2020 Females	2020 Males	2019 Females	2019 Males
Employees				
Number	735	656	711	651
Percentage	52.8%	47.2%	52.2%	47.8%
Management grade employees				
Number	119	190	115	210
Percentage	38.5%	61.5%	35.4%	64.6%
Senior managers				
Number	6	33	7	30
Percentage	15.4%	84.6%	18.9%	81.1%
Directors				
Number	3	6	2	7
Percentage	33.3%	66.7%	22.2%	77.8%

Of these employees, ethnic minority employees comprised 13.2% of the workforce (2019: 13.4%) and 1.8% of management grade employees (2019: 1.8%).

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 2020 the Group conducted its fourth annual diversity survey to obtain anonymous feedback from employees on their age, gender, ethnicity, sexual orientation, religious beliefs and disability. A response rate of 72% was received (2019: 67%) and, as expected, the survey illustrated that our workforce continues to be diverse. The results of the 2019 survey informed action plans that have been executed over this period. We also continue to monitor recruitment data relating to the provision of equal opportunities.

Health and wellbeing

The welfare of the Group's employees has never been so important and throughout the year it has been monitored regularly using employee surveys. The Group's Wellbeing network has been extremely active during the period, activities they have undertaken include; running internal communications campaigns on ways to adjust to remote working; launching a new wellbeing app that provides access to a wide range of resources; arranging virtual fitness classes for employees; and holding introductory wellbeing meetings with all employees who joined the Group during the pandemic.

An employee engagement survey had been planned for June 2020; in light of Covid-19 this was replaced by shorter, regular pulse checks (three took place between April and September) and a full employee engagement survey is now planned for early 2021. The latest employee check-in survey was completed by over 70% of employees and results indicated that 85% of employees were happy with communications from their line managers, and 86% were happy with communications from the Chief Executive, Nigel Terrington.

This sentiment is echoed by the Group's People Forum, who had the opportunity to speak to non-executive directors and provide feedback on how the Group has managed during the Covid-19 pandemic. The People Forum has been a valuable channel of engagement with employees during the year and has contributed to changes such as changing the supplier of our recognition awards and supported the introduction of new HR systems.

Training and development

Even throughout the Covid-19 pandemic, the Group has remained focussed on providing opportunities to develop all employees and on average, employees received 4.2 days training in the year (2019: 6.9 days). This continues to place the Group 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.

The Group created a new team focussed solely on technology-related training in 2019 and the benefits of this have been immeasurable during the Covid-19 crisis. The team were established to support the Group's digital agenda and drive for greater innovation, but throughout the pandemic they have been pivotal in supporting employees to adapt to remote working and maximise the use of the newly upgraded Microsoft Office suite of products. The learning and development team have also created virtual induction programmes for new joiners and adapted how customer facing employees are provided with the right training and support for their roles whilst working remotely.

Another area of focus for the Group's learning and development team during the period has been ensuring employees understand how to support the Group's most vulnerable customers. A bespoke training course has been created and all customer facing employees are expected to undertake this annually. The Group's operational training team has also ensured that all employees who have been seconded to meet increased volumes of customer queries throughout the pandemic were appropriately trained and inducted into their new roles.

All employees receive an appraisal at least annually; this year 99.3% of employees used the Group's new HR technology to log their performance review. The annual performance management and talent management processes not only support individual performance and personal development, but also help the Group to effectively manage rising talent and fulfil its succession planning objectives. The Group's Senior Leadership Development programme is one initiative that has supported the delivery against succession plans over the past year, with four members of the programme being promoted internally, including one promotion to the Executive Management team.

The Group has continued to focus on developing female talent during the year to support our Women in Finance Charter targets. Over 50% of employees receiving management development or leadership training are female compared to 42.7% in 2019, and the Group continues to be a member of the Women Ahead 30% Club cross-company mentoring scheme. Feedback from both mentors and mentees on the programme has been overwhelmingly positive and the third cohort of employees on the programme started this 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. The Group currently has 46 apprentices (3.3% of employees) registered under the levy scheme, utilising 41% 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.

There are currently 120 people completing professional qualifications across the Group, including 54 employees undertaking their CeMap mortgage qualification. Of these, 64% are female compared to 40% in 2019, contributing towards the Women in Finance agenda.

Recruitment

Headcount has continued to grow over the period, and whilst recruitment volumes reduced due to the pandemic, roles which were deemed critical, such as customer-facing positions and those needed to comply with regulatory requirements, continued to be offered. Over 50 new hires have been successfully onboarded remotely since March. New HR technology has also made the experience of joining the Group more efficient and a more engaging experience.

The Group also runs a successful 'refer a friend' scheme whereby employees receive a referral fee if an individual they refer for a role passes probation. This year 18 individuals were successfully recruited through this scheme (2019: 55), the reduction a function of the overall reduction in numbers of recruits.

Employees' involvement

The directors recognise the benefit of keeping employees informed of the progress of the business. The Group operates a People Forum, which meets regularly and is attended by employee representatives from each area of the business. The Forum 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.

During the period the Forum has been designated as the primary channel through which the Board receives information on the views of the workforce, either by attendance at the meetings or through the People Director who attends all Forum meetings and reports to ExCo and the Nomination Committee on matters raised.

During the period non-executive directors have attended several People Forum meetings and discussed topics such as pay, reward and the impact that the Covid-19 pandemic has had on the workforce and the business.

Executive directors provide biannual updates on business progress to the entire workforce, either in person or through recorded messages, with the frequency of such communications increased during the Covid-19 crisis.

To involve employees in the Group's performance, 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. In 2020 72% of employees signed up to take part in the most recent offer under the Sharesave scheme.

To reward employees for their contribution during the Covid-19 crisis, a one-off grant of shares worth £1,000, deferred for three years is to be made to all employees below senior management level. This will increase the extent to which employees can benefit from the Group's performance.

Health and Safety

Through to year end the Group has remained compliant with all applicable health and safety legal requirements and implemented best practice management standards across its businesses. This is combined with a commitment 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.

While the Group's primary source of health and safety related risk remains with the vehicle maintenance operations of Specialist Fleet Services Limited ('SFS') the significant focus for the vast majority of this year has been on mitigating the risk to our employees from Covid-19.

We began monitoring the epidemic in China in January 2020 and initiated an enhancement programme regarding all aspects of hygiene across all the Group's sites. On escalation to a pandemic and in line with the Government advice in March, we succeeded in transitioning 82.69% of our employees to home working prior to the 23 March lockdown, with the number rising over 90% shortly thereafter.

Where employees were transferred to working from home ('WFH'), workstation assessments have been carried out at critical intervals to ascertain that they have a healthy and safe environment with access to appropriate equipment.

For those who remained in the office, a Covid-19 secure configuration of premises was introduced to facilitate an increase in physical distancing. Building works at premises under direct control were only permitted where they were deemed as necessary to meet statutory requirements or were business critical. Risk assessments, procedures and documentation were reviewed to consider Covid-19 measures, and an e-learning module created and made available to all employees to provide awareness regarding the Covid-19 secure measures.

The offices that remained open continue to comply with all health and safety rules, with the number of fire marshals, first aiders and other qualified personnel continuing to be sufficient, this is regularly monitored based on the number of occupants. All temporarily vacated premises are monitored under current contractual arrangements to ensure they remain fit for occupation when the time arises.

Throughout the pandemic employee engagement has been a key factor. Field teams have carried out risk assessments, equipment has been issued for employee safety and enhanced processes have been implemented to permit public facing appointments as and when appropriate. Ongoing consultations are taking place as government guidance develops.

Employees 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 the Group's stated health and safety objectives, whether in the office or home based.

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').

The Group (excluding SFS) remains certified to ISO45001:2018 and its Occupational Health and Safety Management System ('OHSMS') is audited for compliance 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.

During the year, only 11 incidents were reported (2019: 19), all of a minor nature with no lost time. SFS have reported one incident, due to lost time, under the Reporting of Incidents, Disease and Dangerous Occurrences Regulations 2013 ('RIDDOR') (2019: 0)

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 2020 there were no prosecutions or any enforcement action from visits by the authorities for non-compliance in respect of health and safety matters.

A6.4 Environmental impact

The Group's environmental impacts can be considered under two headings, its operational (or internal) impacts and the impact of its lending activities – the external or downstream impacts. Until recently 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.

External Impact

Climate change is one of the biggest challenges faced by the world today. The UK Government confirmed its goal of net zero carbon by 2050 in November 2020 and the Group, and the rest of the financial services industry have a vital role to play in that project.

Alongside the widespread societal concerns, financial regulators have also increased their focus on climate change. The PRA has published a Policy Statement, setting out its expectations of the type of strategic approach it expects firms to adopt in managing the financial risks of climate change. The Group is in the process of completing a plan of work which adheres to the requirements set out. This plan also reflects subsequent statements by the PRA and will continue to be updated as the regulators develop their thinking.

Impacts of climate change

The use to which customers put the funds advanced to them by the Group gives rise to two related issues:

- Climate change and other environmental factors may, of themselves, increase financial risks. As an example, increased flooding risk might have an adverse impact on security asset valuations. These are the physical risks of climate change
- Regulatory and governmental pressure might be brought to bear on lenders, amongst other businesses, to reduce the environmental impacts of their product chains. Such regulation might impact on the ability to realise security or to continue business lines. These are the transitional risks

The Group uses these classifications to categorise the financial risks of climate change and is working to further embed the consideration of both forms of risk across all its lending. Risks in each of these categories may impact over the short (one to five year), medium (five to ten year) or long (over ten year) term.

The Group already considers these types of issues in its underwriting and credit risk processes to some extent. Examples of how the Mortgage Lending business manages its exposure to climate change effects, and seeks to promote environmentally positive behaviour by customers, are given in section A4.1.1.

Governance

During the year the Board has designated climate change as a principal risk within the Group's Risk Management Framework. This means information and measures on climate change risks are considered at board level and the Group's responses considered within the Board's overall strategy. The CFO has been designated as the director responsible for climate change matters.

A climate change working group has been established, working under the oversight of ERC. The working group reports to ERC and to the Board on a regular basis. The working group aims to embed Climate Change Risk into the Group's operational culture, recognising the potential impact on current and future business activities.

Risk management

Due to the nature of climate change and its wider consequences, climate change risk can impact across many of the Group's business areas. Work is underway to embed the consideration of climate change risk across the relevant risk sub-committees, initially focussing on the Credit and Operational Risk Committees.

Assessment of current environmental risks and forward-looking climate change risks are already factored into the Group's business. When assessing the appropriateness of a property as security on a buy-to-let mortgage, factors such as the energy performance certificate ('EPC') rating of the property, flood risk, risk of coastal erosion and ground stability are considered. It is essential for the Group to ensure that a property is, and remains, insurable.

As part of the climate change agenda, the Group intends to make enhanced use of the environmental data currently held on the mortgage book, and to expand on currently available information. Work is taking place to enable the collection of increased and more detailed environmental data as part of the valuation process. The Group can then use its core data analytics skills in developing the tools necessary to run longer term climate related scenarios, which run beyond normal planning horizons and consider various policy and environmental developments.

Similar activity is planned to ensure any other lending subsets which might be particularly exposed to physical or transitional climate change risk can be identified and monitored.

Quantifying our climate exposure

During the year the Group has made progress in assessing the potential financial impact of climate change on its buy-to-let mortgage book. This has been initially focussed on the physical risk posed by flooding. Analysis used granular postcode level data and indicated that only a small proportion of security properties were located within medium or high-risk zones.

The initial focus in the assessment of transitional risk has been on the energy efficiency of mortgaged properties, measured by their EPC grades. The UK Government has announced initiatives to improve energy efficiency and it is likely that policies based on EPC levels will be used to help the UK's transition and reduce its property stock's emissions, with a potentially adverse impact on the valuation of properties not meeting required standards.

The table below summarises the highlights of the preliminary climate risk assessment work performed to date across our mortgage lending exposure in England and Wales.

Indicator	Measure	2020	Coverage
EPC	Grading A to C	37.7%	85.0%
	Grading A to E	98.1%	85.0%
Flood risk	High risk properties	0.4%	99.0%
	High or medium risk properties	2.2%	99.0%

Flood risk above is based on exposure to flooding from rivers and seas only. In the underwriting process flood risk from other sources is also considered. Work is ongoing to incorporate these additional risks into the Group's risk metrics.

In the Group's SME Lending business, limited company customers have been broadly analysed by SIC codes to identify those operating in high carbon intensive industries. The results are set out below:

Indicator	Measure	2020	Coverage
Sector	Water, sewerage and waste	3.54%	100%
	Extractive industries	1.75%	100%
	Power generation	0.01%	100%
	Total carbon intensive industries	5.30%	100%

Measures addressing other risk elements including those in other business streams, eg classifications of business assets and motor vehicles financed by environmental impacts, and classification of development finance projects by environmental rating, are under development. These will be aligned to the UK's new Green Taxonomy recently announced at the Green Horizon Summit.

Future developments

In addition to the work currently in progress and described above, the Group's climate change strategy also includes:

- Developing climate change scenario analysis and embedding this in stress testing programmes, leveraging off Bank of England scenarios
- Further embedding climate change risk management across the business
- Enhancement of the business' understanding of the climate change impact of the Group's lending
- Continued engagement with external climate change initiatives. This includes involvement in industry initiatives, particularly through the Green Finance Institute
- Development of formal climate related risk appetites and a full suite of Key Risk Indicators and Key Performance Indicators

The Group will also be expected to report its climate change exposures in accordance with the recommendations of the Taskforce on Climate-related Financial Disclosure ('TCFD') which are being introduced into UK listing requirements from the financial year ending 30 September 2022. This reporting will be developed alongside the other initiatives.

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. The Group's environmental commitment is included within the Health, Safety and Environmental policy that is approved by the CEO and the People Director. Its environmental commitments are expressed in its Green Charter which is approved by the CEO and kept under regular review.

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

Risk management

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 by the second line Operational Risk function and the ORC.

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 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 submitted its ESOS compliance notification to the Environment Agency 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.

84.0% (2019: 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').

Across the year ending 30 September 2020, the Group increased the percentage of its total stationery and consumables expenditure going towards green products to 55.3% from 32.0% achieved in the previous period.

Environmental initiatives

All the general waste produced at the Group's principal sites was disposed through an approved waste contractor using Waste to Energy initiatives, resulting in no waste being disposed at landfill.

During a refurbishment of the external welfare area at the Group's head office building, bird boxes were installed within the treescapes to encourage wildlife to coexist with our employees. Further initiatives are under development to include beehives, and to roll out this initiative to other sites under the Group's direct control. Areas of land will be given over to wild space to encourage plant and animal species and improve biodiversity.

The Group's other environmental initiatives in the period include:

- Reducing the product range of office consumables to steer employees towards selecting more environmentally friendly products
- Moving to fortnightly stationery deliveries thereby reducing the carbon footprint of procurement activities
- Undertaking refurbishment work to the washroom facilities at the head office building employing touchless energy and resource saving technology. All construction wastes were segregated and disposed of responsibly by the contractor
- Modernising the key components of the Heating, Ventilation and Air Conditioning ('HVAC') systems at the head office site, reducing the Global Warming Potential ('GWP') of chiller plant used during the summer months.

The financial year ending 30 September 2021 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 £295.1 million (2019: £297.6 million excluding the £9.7 million gain on derecognition).

Greenhouse gas ('GHG') emissions

	2020 Tonnes CO ₂	2019 Tonnes CO ₂
Scope 1 (Direct emissions)		
Combustion of fuel:		
Operation of gas heating boilers	452	519
Petrol and diesel used by company cars	402	679
Operation of facilities:		
Air conditioning systems	33	24
	887	1,222
Scope 2 (Energy indirect emissions)		
Directly purchased electricity	697	995
Total scope 1 and 2	1,584	2,217
Normalised tonnes - scope 1 and 2 CO ₂ per £m income	5.4	7.5
Scope 3 (Other indirect emissions)		
Fuel and energy related activities not included in scope 1 or 2	325	542
Water consumption	12	14
Waste generated in operations	61	88
Total scope 3	398	644
Total scopes 1, 2 and 3	1,982	2,861
Normalised tonnes scope 1, 2 and 3 CO ₂ per £m income	6.7	9.6

CO₂ equivalent values above are calculated based on the BEIS / DEFRA guidelines published in June 2020. These guidelines showed a significant increase in the conversion factor for the Group's landfill waste, increasing from 99.8 kg CO₂ per tonne in the 2019 conversion tables to 458.2 kg CO₂ per tonne in the new edition. Given the magnitude of this change, the amount stated for 'waste generated in operations' for 2019 above has been restated using the 2020 conversion factor.

The amounts shown above for total scope 1 and scope 2 emissions are those required to be reported under the Companies Act (Directors Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018. Other scope 3 emissions not reported above are not considered to be significant.

The reduction in emissions in the year is principally driven by the Covid-19 crisis. The majority of emissions included above relate to the provision of heat, light and power to the Group's premises. Several office buildings were closed for long periods and the social distancing rules meant that the scope for business travel, for meetings, property surveys and other normal parts of the business process was sharply reduced for a significant part of the year.

Emissions attributable to employees working from home are not included within the scope of the regulations, at present.

It is unlikely that this performance would be repeated in a normal operating environment.

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, which is included in Scope 1 above and through business travel of employees, which is included in Scope 3. The amount of power used in the year ended 30 September 2020 is shown below.

	2020	2019	2018
	MWh	MWh	MWh
Renewable electricity	2,509.3	3,123.5	
Other electricity	478.2	768.1	
Electricity	2,987.5	3,891.6	4,107.5
Natural gas	2,450.9	2,817.1	3,547.6
Motor fuel	1,900.3	3,099.9	2,913.9
	7,338.7	9,808.6	10,569.0
Normalised MWh per £m income	24.9	33.0	38.6

Consumption levels have reduced significantly in the year, principally as a result of the closure of some of the Group's buildings for long periods, and the reduced utilisation of others.

Gas and electricity usage are based on consumption recorded on purchase invoices. Vehicle fuel usage is based upon expense claims and recorded mileage. Renewable energy is supplied through the grid with OFGEM accreditation received from the suppliers. No separate conversion factor is stated by BEIS / DEFRA for electricity from renewables and therefore the Group receives no benefit for this in the GHG emissions table 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 2020 was 11,950m³ (2019: 13,010m³), based upon consumption recorded on purchase invoices, a normalised amount of 40.5m³ per £m income (2019: 43.7m³ per £m income). The reduction in usage is a result of reduced

office occupancy offset by additional consumption generated by Covid-19 cleaning and hygiene guidance.

A water saving initiative remains in place which is intended to reduce long-term 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. The largest part of the Group's recycled outputs relates to waste paper.

All the Group's waste is either recycled, used in waste to energy initiatives or sent to landfill. Amounts of waste generated in the year ended 30 September 2020 together with the methods of disposal are shown below.

	2020	2019	2018
	Tonnes	Tonnes	Tonnes
Recycled	61	122	202
Waste to Energy Initiatives	29	-	-
Landfill	131	187	154
	221	309	356
Normalised tonnes per £m income	0.75	1.04	1.30

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

The reduction in waste generation is principally a result of lower occupancy of the Group's premises, with the amount of recycled paper generated being substantially reduced.

The Group's long-term strategy is to increase the proportion of waste which is either recycled or used in Waste to Energy initiatives.

A6.5 Social and community

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.

Industry initiatives

The Group is active within trade organisations in the UK, helping to formulate public policy and sharing experience on best practice to drive forward better financial provision. The Group has been particularly active in initiatives to enable the private rented sector to more effectively serve the UK housing market.

Membership of bodies such as UK Finance and the FLA enables the Group to be part of shaping the future of financial services provision to the benefit of the whole community. This year this has been enhanced by work done by the Mortgage Lending business with the Green Finance Institute on the potential for greening the buy-to-let mortgage market. In particular the business worked with the Coalition for Energy Efficient Buildings formed by the Institute.

The Group contributes to registered charities providing debt advice to support its vulnerable customers. Contributions of £1,110,000 (2019: £1,522,000) were made by the Group during the year to the work of the Foundation for Credit Counselling which operates the StepChange Debt Charity.

Supporting the community

The Group actively supports charity initiatives, focussing on organisations serving the communities in which it operates. Contributions made in the year totalled £157,800 (2019: £24,200).

Contributions were increased as part of the Group's response to Covid-19, with donations including; £50,000 to NHS charities to help frontline staff needing accommodation and food while caring for patients during the Covid-19 pandemic and to provide iPads to enable patients in isolation to keep in contact with their family and friends; a £20,000 donation to Change into Action which provides support to homeless people; and £10,000 to Age UK to support elderly people who are isolated and alone during the pandemic.

Other charities which benefitted from the Group's charitable donations include several local schools, sports clubs, hospitals and hospices, the Downs Syndrome Association, Get Set Girls, Great Ormond Street Hospital and Lupus UK, amongst others.

Before activities were stopped due to the pandemic, employees continued to make a difference to the local community in many ways, achieving 23.5 volunteering days. Activities have included:

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

The Group is in the process of identifying ways to continue volunteering activities remotely, such as career mentoring opportunities.

At Christmas 2019, food parcels were collected amongst the employees 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 2019, £28,700 was raised for Dementia UK, while in the first nine months of 2020, £26,500 has been raised for Macmillan through events such as Paragon's Biggest Coffee Morning, Move for Macmillan and employees taking part in sponsored events. Given the restrictions imposed on office-based fund-raising activities by working from home, this is an impressive achievement by the Committee and the Group's people.

Each year all employees are given the opportunity to nominate a charity 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 fourth 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 CFO 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:

	2020	2019
	£m	£m
Corporation tax	46.1	39.4
PAYE and NI	32.8	27.3
VAT	2.7	2.1
Stamp duty	-	0.1
Total national taxation	81.6	68.9
Business rates	1.4	1.4
	83.0	70.3

In response to the Covid-19 crisis the UK Government permitted companies to defer VAT payments due between 20 March 2020 and 30 June 2020. The Group did not take advantage of this concession and paid its liabilities in accordance with the statutory provisions.

A6.6 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 A6.3.

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.

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.

A6.7 Business practices

Business partners

The Group's business model relies on maintaining good relationships with its principal business partners, primarily financial intermediaries, such as mortgage brokers, and purchase ledger suppliers including those for establishment costs and professional services.

The Group is committed to the fair treatment of all suppliers. In return, we expect suppliers to help to deliver a high standard of service to our customers and act responsibly.

The Group introduced a Supplier Code of Conduct during the year, which sets out our overall approach to supplier engagement and corporate responsibility and, importantly, the standards of behaviour that we expect from our suppliers.

It includes the minimum standards we expect from suppliers and our conduct commitments and expectations around bribery and corruption, data protection and modern slavery. It also includes important information concerning our employment practices, health and safety, community and environmental matters.

The Group is a signatory to the UK's Prompt Payment Code, administered by the Chartered Institute of Credit Management and as such commits to paying invoices within 60 days, unless there is good reason for non-payment, and aims to make payment within 30 days where correct procedures are followed.

Anti-corruption

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 or accept bribes, nor will it condone the offering or receiving of bribes on its behalf. The Group will always 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 continues to conclude 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 twelfth safest in the Corruption Perceptions Index for 2019, out of 198 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 2020.

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. In the last year there have been no material changes in legislation or guidance in the UK.

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 (2019: none).

Anti-money laundering

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 Head of Financial Crime.

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.

Whistleblowing

A whistleblowing hotline, run by an independent third party, Protect, is available to staff who have concerns over any aspects of the Group's business practices. This is described further in Section B4.5.

A7. Approval of Strategic Report

Section A of this Annual Report comprises a Strategic Report for the Group. The information on how the directors have discharged their duties under s172 of the Companies Act 2006 included in Section B4.3 of the corporate governance report is also included in this strategic report by reference.

This Strategic Report 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.

Marius van Niekerk

Company Secretary

3 December 2020



Paragon has joined up with The Women's Association to increase the visibility of women in the workplace.



B. Corporate Governance

How the Group is run and how risk is managed

- | | |
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<i>An overview of governance in the year</i> |
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<i>How the Company complied with the Code in the year</i> |
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<i>The directors and the operation of the Board during the year</i> |
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<i>How the Group identifies and manages risk in its businesses</i> |
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<i>Statement of the responsibilities of the directors in relation to the preparation of the financial statements</i> |

We recognise that a robust governance structure and effective risk management framework are integral to delivering sustainable growth and shareholder returns...

Fiona Clutterbuck

Chair of the Board



B1. Chair's statement on corporate governance

Dear Shareholder

I am delighted to introduce the Company's corporate governance report, in what will be our first year reporting in compliance with the 2018 UK Corporate Governance Code ('the Code'). The Code was applicable to the Company with effect from 1 October 2019 and presented the Board with an opportunity to review and restructure our governance framework, which you can read about in Section B4. As a board we recognise that a robust governance structure and effective risk management framework are integral to delivering sustainable growth and shareholder returns. An overview of our activities as a board and a summary of the key financial, operational and strategic matters considered throughout the financial year is set out in Section B3.3.

Stakeholder engagement

This year the Board has specifically reviewed its duty to promote the success of the Group and the Company, whilst considering the broader implications for stakeholders. You can find out more about how our approach enables us to create value for all stakeholders in Section A2 of our Strategic Report.

I am particularly proud of our People Forum, which is currently made up of 22 employee members across six different locations who represent their colleagues from all business areas on a range of topics and concerns that are raised by employees during the year. The People Director updates the Nomination Committee on the outcome of these meetings and has developed a comprehensive action plan to ensure that the key themes captured are fed back into the Board's decision-making process and that these decisions are subsequently reported to all employees, via the People Forum.

Hugo Tudor and I attended a meeting of the People Forum in November 2019 where we focussed on executive remuneration and pay and reward more generally. In addition, Hugo and Graeme Yorston attended the People Forum in September 2020, where the progress made over the past year was reviewed, with a particular focus on the measures taken to manage the impact of Covid-19 on employees. The People Forum representatives commented that they appreciated this engagement and were pleased to hear from members of the Board and have the opportunity to provide direct feedback.

I have had the opportunity during the year, with some of my non-executive colleagues, to meet with representatives of the PRA. I found this a valuable opportunity to understand how the regulator views the Group and their priorities as a significant stakeholder in our business.

Our Remuneration Policy and Remuneration Report were approved at the AGM in February 2020, but each had a 'significant vote' against. We have continued to engage with shareholders to address their concerns and further details of this are given in the Directors' Remuneration Report in Section B7.1.

Culture

Our purpose, to support the ambitions of the people and businesses of the UK by delivering specialist financial services, is underpinned by our culture and values (which are set out in Section A2). During the year, as part of the 2019/20 Compliance Monitoring Plan, an external review focussed on assessing culture within the Group was conducted. I am delighted that this review highlighted the strong collaborative culture within Paragon, which was cited by many employees as their principal reason for staying with the Group. It is a clear differentiator from an employee engagement perspective and one the Group is looking to enhance further.

The review also highlighted areas we can continue to develop such as: more frequent employee engagement surveys, improved alignment of acquired businesses and a further promotion of our values. I am pleased to report that these activities are already well underway and, with as many as 90% of our employees working remotely during the Covid-19 lockdown, we have made a step change in utilising technology to encourage more frequent 'check-ins' via Microsoft Teams and promote increased levels of virtual learning. There has also been a strong focus on employee well-being throughout this challenging period.

Diversity and Inclusion

I made it very clear last year that one of my personal goals was to ensure that both the Board and Group are diverse and reflective of the communities in which we are based. I can confirm that the Board has met its target of at least a third female representation on the Board, in line with the Hampton-Alexander Review, following the appointment of Alison Morris to the Board in March 2020. This year also saw the launch of the Paragon Equality, Diversity and Inclusion network. The employee committee which will run the network was appointed following a two-stage interview process in August. Both the volume and quality of applications were very impressive. The network was formally launched to all employees in October 2020.

Board effectiveness

During 2019 the Board undertook its triennial externally facilitated board evaluation, carried out by Independent Board Evaluation. As a result, the Board developed a comprehensive action plan based on the outputs which included:

- Enhanced training for non-executive directors (Section B4.4)
- Enhanced use of non-executive directors' skills matrix in the recruitment process – further detail on this can be found in Section B4.4.
- Six-monthly training sessions delivered to the Board based on strategic priorities and market developments (Section B4.4)
- Greater visibility of non-financial issues (ie customer, employee and competition)
- Improved succession planning (Section B4).
- Several deep dives from the business, with greater access to senior management (see Section B3.3 for more detail)

Excellent progress was made in relation to all of these actions over the past year and we have recently completed our own annual internally-led assessment to ensure that we, as a board, continue to operate responsibly and effectively. Further detail on the 2020 evaluation actions and outputs can be found in section B4.4.

As mentioned above, Alison Morris joined the Board in March 2020, subsequently becoming Audit Committee Chair. Alison is a highly experienced audit specialist and her skills, expertise and capabilities are of great benefit to the Group. Peter Hill was appointed to the Board on 27 October 2020. He was previously CEO of Leeds Building Society from 2011 until his retirement in 2019, and brings with him a wealth of experience in financial services and a proven track record in risk oversight, gained during his executive and non-executive career.

The Group's AGM will be held on 24 February 2021 and I look forward to welcoming shareholders, subject to any restrictions which might still be in place as a result of the Covid-19 situation.

Fiona Clutterbuck

Chair of the Board
3 December 2020

B2. Corporate Governance Statement

The Board is committed to the principles of corporate governance contained in the UK Corporate Governance Code issued by the FRC in July 2018 ('the Code') and which is publicly available at www.frc.org.uk. Throughout the year ended 30 September 2020, the Company complied with the principles and provisions of the Code.

During the year under review, the Company adopted the 'comply and explain' approach under Provision 10 of the Code to extend a director's tenure to more than nine years for succession planning purposes and to ensure the appointment of a suitable replacement non-executive director, as set out below. In February 2020, Peter Hartill's length of service reached nine years. However, the Board and Nomination Committee considered Peter's re-appointment beyond nine years, and agreed that, due to his independence, skills and experience, Peter continued to make an effective contribution as a non-executive director and therefore agreed to extend Peter's tenure until a suitable replacement could be found and an appropriate hand-over had taken place. Peter stepped down from the Board with effect from 30 September 2020 following a successful handover of his duties as Chair of the Audit Committee to Alison Morris, who joined the Board in the year.

The Group's 2020 annual report is the first to be produced since our adoption of the new Code and the table below indicates the relevant sections of this report which describe how the Code's Principles have been applied.

Section 1: Board Leadership and Company Purpose	Section
A. The Company is led by an effective and entrepreneurial board, who promote the long-term sustainable success of the Company, generating shareholder value and contributing to wider society.	B3
B. The Company's purpose, values and strategy, which aligns with its culture, has been established and is promoted by the Board.	B1
C. The Board ensures that necessary resources are in place for the Company to meet its objectives and measure performance and has established a framework of effective controls which enables risk to be assessed and managed	B8
D. The Board ensures effective engagement with stakeholders and encourages their participation.	B4.3
E. The Board ensures that workforce policies and practices are consistent with the Company's values and support its long-term sustainable success. The workforce should be able to raise any matters of concern.	B4.3

Section 2: Division of Responsibilities	Section
F. The Chair is objective and leads the Board effectively, facilitating constructive relations and effective contribution from non-executive directors.	B4.1
G. The Board includes an appropriate combination of executive and non-executive directors, with a clear division of responsibilities.	B4.1
H. Non-executive directors have sufficient time to meet their board responsibilities.	B4.1
I. The Board, supported by the Company Secretary, has the policies, processes, information, time and resources required to function effectively and efficiently.	B4.1

Section 3: Composition, Succession and Evaluation	Section
J. Appointments to the Board are subject to a formal, rigorous and transparent procedure, and an effective succession plan is in place for the Board and senior management. Appointments and succession plans are based on merit and objective criteria and promote diversity.	B5
K. There is an appropriate mix of skills, experience and knowledge. Tenure and membership of the Board and its committees are regularly reviewed.	B4.4
L. As part of an annual evaluation the Board, and each individual director, considers composition, diversity and effectiveness.	B4.4

Section 4: Audit, Risk and Internal Control	Section
M. The policies and procedures, established by the Board, ensure the independence and effectiveness of internal and external audit functions. The Board has satisfied itself of the integrity of financial and narrative statements.	B6
N. The Board presents a fair, balanced and understandable assessment of the Company's position and prospects.	B6
O. The Board has established procedures to manage risk, oversee the internal control framework, and determine the principal risks the Company is willing to take in order to achieve its long-term strategic objectives.	B8

Section 5: Remuneration	Section
P. Remuneration policies and practices support strategy and promote long-term sustainable success. Executive remuneration is aligned to the Company's purpose, values and clearly linked to successful delivery of long-term strategy.	B7
Q. A formal and transparent procedure has been established to develop policy and determine director and senior management remuneration.	B7
R. Directors should exercise independent judgement and discretion over remuneration outcomes, taking account of company and individual performance, and wider circumstances	B7

B3. Board of Directors and Senior Management

B3.1 The Board of Directors

Members of the board of directors at the date of approval of the annual report are set out below.



1. Fiona J Clutterbuck

Chair of the Board (Age 62)

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

Non-executive director and senior independent director of M&G plc

Non-executive director of Hargreaves Lansdown PLC and its audit committee chair (to 08/10/2020)

3. Richard J Woodman

Chief Financial Officer (Age 55)

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, stress testing and capital management.

Current external appointments:

None

2. Nigel S Terrington

Chief Executive (Age 60)

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 UKF 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:

Board member of UKF

Chairman of UKF's Specialist Banks Advisory Committee

Member of HM Treasury's Home Finance Forum

Member of Bank of England's Residential Property Forum

4. Hugo R Tudor

Non-executive director (Age 57)

Non-executive director since 2014 and became Senior Independent Director in July 2020

Appointed in 2014 – six 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, Nomination (from 24/09/20) and Risk and Compliance Committees

Current external appointments

Director: Damus Capital Limited

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

*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

John A Heron resigned from the Board on 6 January 2020 and Peter J N Hartill resigned from the Board on 30 September 2020.

5. Alison C M Morris
Non-executive director (Age 61)

Appointed in 2020 – one year served

Skills and experience

Alison is a chartered accountant and was a partner in PwC's financial services audit practice until the end of 2019.

She joined PwC in 1982 and spent her career with the organisation in a range of internal and external audit roles across asset and wealth management, as well as banking and capital markets.

She has led audit projects for a range of banking clients, as well as other companies across the FTSE 100 and FTSE 250, and has held a number of leadership roles within PwC including sitting on the executive management team which led their audit practice.

Specific areas of expertise*

- Recent and relevant experience of the financial services sector
- Detailed and specialist knowledge of accounting and auditing practice as well as of the audit market and accounting regulations

Committee membership

Chair: Audit Committee (from 24/09/20, member since appointment)

Member: Remuneration Committee, Risk and Compliance Committee

Current external appointments

Non-executive director of Vanquis Bank Limited, part of the Provident Financial Group PLC

Non-executive director of M&G Group Limited, part of the M&G plc group

6. Finlay F Williamson
Non-executive director (Age 60)

Appointed in 2017 – three years served

Not seeking re-election at 2021 AGM†

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

Non-executive director of Hampden & Co PLC

7. Barbara A Ridpath
Non-executive director (Age 64)

Appointed in 2017 – three 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 and Risk and Compliance Committees

Current external appointments

Non-executive director of ORX in Switzerland, a trade association for operational risk professionals and a director of ORX UK Limited

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

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

8. Graeme H Yorston
Non-executive director (Age 63)

Appointed in 2017 – three 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 and Risk and Compliance Committees

Current external appointments

None

9. Peter A Hill
Non-executive director (Age 59)

Appointed in 2020 – After the end of the financial year

Skills and experience

Peter Hill was the CEO of Leeds Building Society from 2011 until his retirement in 2019. Peter was also chairman of the Council of Mortgage Lenders for three years and a main board member of UK Finance.

Specific areas of expertise*

- Specialist retail banking and mortgage lending expertise
- Detailed knowledge of the financial services sector

Committee membership

Member: Risk and Compliance Committee

Current external appointments

Non-executive director of Pure Retirement Group Limited and Pure Retirement Limited

Chair of Mortgage Brain Holdings Limited

Director of Leeds Rugby Foundation

†Finlay Williamson has announced his intention to step down from the Board on 31 December 2020.

B3.2 Executive Committee

The members of the Group's Executive Committee ('ExCo') are set out below, with their tenure in their current role.



Nigel Terrington
Chief Executive Officer ('CEO')
Since 1995



Richard J Woodman
Chief Financial Officer ('CFO')
Since 2014



Richard Rowntree
Managing Director - Mortgages
Since 2020



Dave Newcombe
Managing Director – Commercial Lending
Since 2019



Michael Helsby
Strategic Development Director
Since 2018



Pam Rowland
Chief Operating Officer ('COO')
Since 2014



Peter Shorthouse
Treasury and Structured Finance Director
Since 2010



Deborah Bateman
External Relations Director
Since 2009



Anne Barnett
People Director
Since 2009



Marius van Niekerk
General Counsel and Company Secretary
Since 2019



Ben Whibley
Chief Risk Officer ('CRO')
Since 2019

All members sit on both the Performance Executive Committee and the Executive Risk Committee.

B3.3 The Board's activities in the year

Matters considered by the Board

During the year, the Board undertook a range of activities, in addition to its regular discussions of performance and strategy. The more significant of these included:

- Considering the impact of Covid-19, Brexit, and other macro-economic uncertainties on the Group
- Appointment of a new Audit Committee Chair and SID, and other changes to the structure of its committees
- Governance regulation changes reflecting the Code and the Companies (Miscellaneous Reporting) Regulations 2018 ('C(MR)R')

In addition, it regularly receives and reviews reports on matters prior to meetings, such as strategic matters, business performance and results in each of the Group's business areas. The Board also receives updates on legal and governance matters, treasury and funding, the work of the Board's committees and investor relations and shareholder feedback.

Significant other matters discussed are set out below by theme:

Topic	Meeting
Covid-19	
Upon the outbreak of the pandemic in March 2020, additional board meetings were arranged, and the Board received regular, additional updates from the Chair and ExCo. Presentations focussed on: strategy; governance; the macro environment, market uncertainties; available government initiatives; new lending activity; deposit strategy and activity; operational response and its impact on stakeholders; people response; communication (external and internal); risk management; and the Group's commercial status and approach. A significant focus in these discussions was the level of engagement with, and support being provided to, the Group's customers.	Mar 2020
Approval of the decision to apply for CBILS funding.	Apr 2020
Commencement of lending under BBLS was approved.	May 2020
Corporate governance	
Approved a restructure of the Group's executive committee governance structure. More detail on the restructure can be found in section B4.	Jan 2020
Approved a new Corporate Governance Policy Framework. More detail on the framework can be found in section B4.	Feb 2020
Following the 2020 AGM at which the resolutions for the Directors Remuneration Policy and Report received the support of 71.02% and 74.33% of shareholders respectively, and therefore are considered under the Code to have received a significant vote against, the Board received regular updates from the Remuneration Committee Chair on the key actions taken by the Remuneration Committee that reflected on the feedback from shareholders in respect of the resolutions put to the AGM.	Feb 2020 / Ongoing
Approved the Group's updated purpose.	Apr 2020
Received and participated in a culture deep dive review.	Jul 2020
Received a presentation on customer insights from the External Relations Director. The session was an opportunity for enhanced discussion on customer, employee and competition issues.	Jul 2020
Business strategy	
A major investment bank provided a market update on the financial services sector.	Feb 2020
Deep dive reviews into the mortgage and consumer finance operations were provided to the Board by the managing directors of the businesses. This was a further opportunity for the Board to meet key management individuals beyond strategy sessions, thereby enhancing engagement with senior management.	Apr 2020
Corporate update: The Board received quarterly updates on key project plans.	Jun 2020

Topic	Meeting
Risk and regulation	
Received training on, and approved, the ICAAP and Recovery Plan.	Mar 2020
Approved the submission of IRB Module 1 to the regulator. The Board noted good progress has been made with IRB implementation across the Group.	Mar 2020
Received further training on IRB.	Jun 2020
Completed a cyber security questionnaire (provided by, and required to be submitted to, the PRA every four years).	May 2020
Considered and approved the Group's principal risks.	Aug 2020
The General Counsel and Company Secretary provided the Board with a legal and regulatory training session which covered topics such as MAR and section 172 duties.	Sep 2020
The CRO reported on a deep dive on a review of the Group's product lifecycle.	Sep 2020

The way in which the Board discharged its duty to consider the interests of all stakeholders in these discussions is discussed in section B4.3.

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 parentheses. Directors who are unable to attend meetings still receive the relevant papers and any comments from them are reported to the meeting in question via the Chair. Directors have attended a number of ad hoc meetings, workshops and training sessions during the year and have contributed to discussions outside of the meeting calendar.

Director	Board	Audit Committee	Risk and Compliance Committee	Remuneration Committee	Nomination Committee
Fiona J Clutterbuck	12 (12)	-	4 (4)	5 (5)	5 (5)
Nigel S Terrington	12 (12)	-	-	-	-
Richard J Woodman	12 (12)	-	-	-	-
John A Heron	3 (3)	-	-	-	-
Peter J N Hartill	12 (12)	5 (5)	4 (4)	4 (5)	5 (5)
Alison C M Morris	8 (8)	4 (4)	2 (2)	3 (3)	-
Hugo R Tudor	12 (12)	5 (5)	4 (4)	5 (5)	0 (0)
Barbara A Ridpath	12 (12)	5 (5)	4 (4)	-	5 (5)
Finlay F Williamson	12 (12)	5 (5)	4 (4)	-	-
Graeme H Yorston	12 (12)	-	4 (4)	5 (5)	5 (5)

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

In addition to the formal meetings shown in the table above, the Board held regular, ad hoc meetings during the height of the Covid-19 pandemic to consider various matters, including:

- Operational, strategic and financial performance, in particular the liquidity, funding and capital position of the Group, in each of the Group's business areas
- The impact on shareholders, stakeholders and customers
- The impact on employees, working arrangements and the discussion of employee survey results and relevant actions
- The Group's application for authorisation under the CBILS and BBLS initiatives
- The decision to not declare an interim dividend for the year at the time of the half-year results announcement (discussed further in section A4.3.1)

B4. Governance Framework

This section describes how Corporate Governance operates within the Group, setting out

B4.1	Board and committee structure – the forums through which corporate governance operates and how they relate to each other
B4.2	Elements of the governance framework – how the framework operates
B4.3	Board and stakeholders – how the Board discharges its duty to promote the success of the Group having regard to stakeholder interests
B4.4	Board evaluation and development – how the Board ensures the framework is, and will remain, fit for purpose
B4.5	Whistleblowing – how concerns may be raised and the action that is taken

B4.1 Board and committee structures

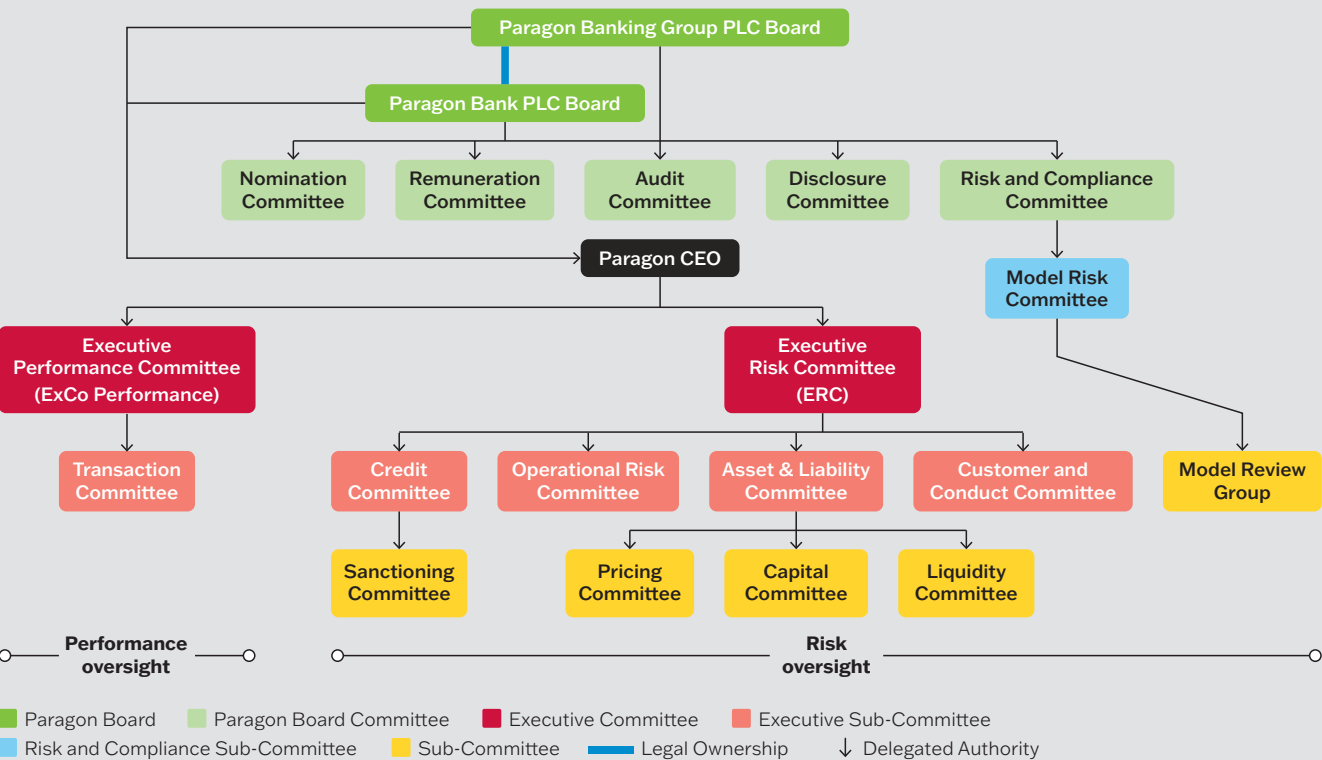
Board leadership, group purpose and the Corporate Governance Policy Framework

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 that these and the Group's culture are aligned. The Board is also responsible for delivery of these within a robust corporate governance framework. Purpose, values and strategy are described in Section A2 and the corporate governance framework is described in the following pages.

The Board of the Company and its subsidiaries are supported by the Group Corporate Governance Policy Framework ('the Framework'). The Framework provides key components of how the Board and its committees govern the business of the Company. Application of the Framework is within the context of other requirements, such as applicable laws, the regulatory regime for deposit taking banks, the Listing Rules, the Articles of Association of the Company and the Disclosure Guidance and Transparency Rules. On appointment, directors are briefed on their duties and responsibilities as a director of a listed company.

Board and committees structure and membership

The board operates through a number of sub-committees covering a range of matters, set out below



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

Committee	Audit	Remuneration	Risk and Compliance	Nomination
Chair	A C M Morris*	H R Tudor	F F Williamson	F J Clutterbuck
Minimum number of meetings	4	3	4	2
Further information	Section B6	Section B7	Section B8	Section B5

*P J N Hartill until June 2020.

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	Until 30 September 2020	Until 30 September 2020	Until 30 September 2020	Until 30 September 2020
H R Tudor	Yes	Yes	Yes	Yes	From 24 September 2020
B A Ridpath	Yes	Yes	No	Yes	Yes
F F Williamson	Yes	Yes	No	Yes	No
G H Yorston	Yes	No	Yes	Yes	Yes
A C M Morris	Yes	From 26 March 2020	From 26 March 2020	From 26 March 2020	No

*Fiona Clutterbuck was considered as independent on appointment as Chair of the Board of Directors on 10 May 2018.

In addition to the memberships above, Hugo Tudor represents the non-executive directors on the Model Risk Committee.

Finlay Williamson will be stepping down from the Board on 31 December 2020.

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

Executive committee structures

During the financial year, the Board reviewed the Group's broader committee structure, processes and procedures in order to enhance the wider governance framework and to further align it with the new edition of the Code. As a result, the responsibilities of the existing Executive Committee were divided between the Executive Performance Committee ('Performance ExCo') and the Executive Risk Committee ('ERC').

The ERC was established to support the CEO with further embedding the Group's risk management framework, monitoring adherence to risk appetite statements and identifying, assessing and controlling the principal risks within the Group and reporting the same to the Board.

The Performance ExCo continues to provide support to the CEO in the day-to-day running and management of the Group and, where appropriate, items discussed at the Performance ExCo are escalated to the Board for further discussion and decision.

Sub-committees

The Transaction Committee, which reports directly to the Performance ExCo, consists of the CEO, 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 Idem 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.

Four executive sub-committees, with membership consisting of executive directors and appropriate senior employees, report to the ERC. All of these committees are described further in the Risk Management Section B8.

All sub-committees which report to either the ERC or Performance ExCo continue to be reviewed to determine whether further enhancements can be introduced, whilst maintaining rigorous oversight and control. All sub-committees operate within defined terms of reference and sufficient resources are made available to them to undertake their duties.

B4.2 Elements of the Governance Framework

Culture

The Group is proud of its supportive culture, which has been noted as part of its Gold Investors in People accreditation (see Section A6.3.).

During the financial year, a review of the Group's culture was undertaken by PwC, which forms part of the Group's Compliance Monitoring Plan, a risk-based programme to review business activity in line with regulatory requirements, which is reviewed by the Board annually. The culture review outlined key themes such as staff communications, performance management processes and reward and the culture framework. Proposed actions to facilitate continuous improvement of the Group's culture were considered by the Risk and Compliance Committee and any necessary actions were considered by the Board. The first annual review of the Group's culture was also considered at the two-day strategy event in July 2020.

The welfare, development and engagement of employees is central to the Group's culture. There is a robust Wellbeing Strategy in place with an Emotional Wellbeing Team who are fully supported and invested in by keeping their knowledge current. The Group is a member of 'This is Me', which is a campaign supported by the Lord Mayor of London's Appeal to provide employers with the tools to change cultures relating to mental health. A central focus of the Group's Covid-19 response was the protection and support of its people. Additional welfare measures were introduced, which are described in Section A4.5.1. 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 A6.3 for more information on how the Group invests in its people.

To encourage employee participation within our communities, 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 A6.5.

Matters Reserved for the Board

The schedule of matters reserved for the Board is reviewed annually and details key matters for which the Board is responsible. Whilst a number of matters are reserved for the Board, the Board delegates certain responsibilities and authorities to the CEO and Board committees.

Division of Responsibilities between the Chair, CEO and Senior Independent Director

There is a clear division of responsibilities at the top of the Company between the running of the Board and the executive responsibility for the day-to-day running of the business of the Group. The Chair leads the Board and is responsible for its effectiveness and promoting, thereby, the high standard of corporate governance to which the Company subscribes. The CEO leads the day-to-day executive management of the business, reporting to the Board through the Chair.

The respective responsibilities of the Chair, the CEO and the SID are set out in the division of responsibilities statement, which is reviewed by the Board annually.

The Chair's other business commitments are set out in the biographical details Section B3.1.

Role of independent non-executive directors

Throughout the year the independent non-executive directors have formed the majority of the Board and consequently there has been a strong non-executive representation on the Board, including the SID, providing effective balance and challenge. In addition to the general legal and regulatory responsibilities of all directors, non-executive directors' more specific responsibilities include providing independent oversight and determining appropriate levels of remuneration for executive directors.

All non-executive directors are appointed for fixed terms, must ensure they have sufficient time available to discharge their responsibilities and regularly update their knowledge and familiarity with the Group's business. The Chair was considered independent on appointment in 2018, having originally been appointed as a non-executive director in 2012. The non-executive directors meet with the Chair, from time to time, without the presence of the executive directors.

At the AGM, 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 AGM.

Role of the Senior Independent Director

Hugo Tudor was appointed as the SID on 23 July 2020. The SID provides a sounding board for the Chair and serves as an intermediary for the other directors when necessary. The SID is available to shareholders if they have concerns for which contact through the normal channels has failed to resolve or for which such contact is inappropriate. The SID also leads the appraisal of the Chair's performance at least annually with the non-executive directors.

Conflicts of interest

The Board has agreed a policy for managing conflicts and a process to identify and authorise any conflicts that might arise in relation to significant shareholdings and/or third parties. At each meeting of the Board and its committees, actual or potential conflicts of interest in respect of any director are reviewed. A conflicts register is also maintained by the Company Secretary.

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 Group.

Company Secretary

All directors have access to the advice and services of the Company Secretary, who is responsible for ensuring that board procedures are complied with. Both the appointment and removal of the Company Secretary are matters reserved for the Board. Marius van Niekerk was appointed as Company Secretary on 24 June 2020.

Subsidiary governance

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

Composition and succession

Composition and succession for the Board and senior management are considered within the Nomination Committee's report (see Section B5).

Board evaluation and training

The Board, individual directors and the Board's main committees are reviewed annually, with triennial externally facilitated reviews as required by the Code. Details of how the effectiveness of the Board and its Committees is evaluated are given in Section B4.4. The non-executive directors have received training during the year on various topics relevant to the Group. Further detail on the training undertaken is set out in Section B4.4.

Audit, risk and internal control

Information on how the Group has applied the provisions of the Code relating to audit, risk and internal control is set out in Section B6.

The directors' responsibility for the financial statements is described in Section B10.

Remuneration

Information on how the Group has applied the provisions of the Code relating to remuneration is set out in the Directors' Remuneration Report in Section B7.

Whistleblowing

The Group maintains a whistleblowing process to enable employees or other stakeholders to raise concerns anonymously. Information on whistleblowing is provided in Section B4.5.

Further information

Documentation referred to in the Corporate Governance section is available on the Group's website (www.paragonbankinggroup.co.uk). These include:

- Matters Reserved for the Board
- Division of responsibilities between the Chair, CEO and Senior Independent Director
- Terms of Reference – Audit, Disclosure, Nomination, Remuneration and Risk and Compliance Committees
- Group Corporate Governance Policy Framework
- Internal Audit Charter

B4.3 Board and Stakeholders

Board and stakeholders

While good corporate governance is important to the Board, so 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 A6 sets out information on corporate responsibility, including the Group's people policies and engagement with employees, involvement in industry initiatives, support for the community and environmental, social and conduct impacts.

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. The Board is mindful of its duty to act in good faith and to promote the success of the Group for the benefit of its shareholders and with regard to the interests of all of its stakeholders.

The Board is kept updated on all material issues by the executive directors and receives regular updates from ExCo members, other senior managers and external advisers. Members of the Board also engage directly with employees, shareholders and regulators.

The Board confirms that, for the year ended 30 September 2020, it has acted to promote the success of the Group for the benefit of its members as a whole and continues to have due regard to the following matters laid out in S172 (1) of the Companies Act 2006:

- a. The likely consequences of any decision in the long-term;
- b. The interests of the Company's employees;
- c. The need to foster the Company's business relationships with suppliers, customers and others;
- d. The impact of the Company's operations on the community and the environment;
- e. The desirability of the Company maintaining a reputation for high standards of business conduct; and
- f. The need to act fairly as between members of the Company.

From 2020, companies have been required to describe in the Annual Report how the directors have had regard to the matters set out above when performing their duties.

The table below sets out how the Board and senior management take the above factors into account when engaging with the Group's key stakeholders and how this is aligned to the Group's strategic priorities.

Shareholders

Creating long-term shareholder value through growing profits and dividends (s172 a)

How we engage and / or monitor

- Our ongoing Investor Relations Programme, where over fifty meetings were held with shareholders
- The Director of External Relations updates each meeting of the Executive Committee on shareholder movements and shareholder interaction
- The Chair and Chair of the Remuneration Committee have had a number of meetings with individual shareholders and shareholder advisory groups

Outcome

- The summary of shareholder feedback provided to the Board helps to align the Group's strategy with the interests of shareholders
- Shareholder feedback was taken into account when drafting and implementing the Remuneration Policy
- All resolutions approved by our shareholders at the AGM in February 2020
- Follow up meetings with shareholders following views expressed in the AGM process
- Final dividend of 14.4 pence per share

Further information on the Group's investor relations activities is given below. Discussions with investors on remuneration matters are discussed in the Remuneration Report (Section B7).



Capital management



Growth



Diversification



Specialisation

Customers

Supporting the ambitions of the people and businesses of the UK by delivering specialist financial services (s172 c)

How we engage and / or monitor

- Regular customer satisfaction surveys on key product lines are reported to the Board
- Focussed analysis on key customer groups
- Deep dive presentation on Customer Insights from the Director of External Relations
- Customer metrics were introduced as a key element of the Performance Share Plan ('PSP') from 2020



Specialisation



Sustainability



Diversification

Outcome

- Customer support designated as a strategic priority in the Group's Covid-19 response
- Customer feedback on key product lines, as measured by NPS, has remained strong
- Web portal updated to reflect specific customer feedback
- Greater understanding of our customers and their priorities refines product offerings, documentation and processes
- Roadmap to improve our savings maturity process is underway

Further information on the Group's relationship with its customers is set out in Section A6.2.

Employees

Helping all of our people to develop their career and reach their potential (s172 b)

How we engage and / or monitor

- Regular employee Pulse Surveys and employee check-ins conducted
- The People Director updates the Board and the Executive Committee on employee feedback from surveys and from the People Forum, as well as other metrics
- The Board received a deep dive presentation on culture from the People Director
- Members of the Board attend the People Forum at least twice a year
- Executive Committee members with responsibility for gender diversity and wider diversity have been designated and regularly report progress on these matters
- Nomination Committee receives six-monthly succession planning updates from the People Director
- People metrics were introduced as a key element of the PSP from 2020



Sustainability

Outcome

- Enhanced support for employees impacted by Covid-19 put in place
- The feedback from employee surveys enables the Board to support and understand employees.
- Tailored career development programmes embedded across the Group for apprentices through to high potential senior leaders
- Internal appointment of two Executive Committee appointments; CRO and Managing Director – Commercial Lending
- Increased communication to employees regarding culture and values
- Enhanced maternity provision and pension contributions in the year
- Creation of the Equality, Diversity and Inclusion network

Further information on the involvement of the Group's people and the impact of policies on them, including steps taken to support them during Covid-19, can be found in Section A6.3.

Regulators

Engaging transparently and openly with regulators to ensure we comply with current legislation and maintain the Company's reputation for high standards of business conduct (s172 c, e)

How we engage and / or monitor

- Regular engagement with the PRA, throughout the year on key regulatory matters, including the IRB implementation
- Direct contact between the Chair and non-executive directors and regulators
- The Executive Committee and Board are kept updated on all interaction with the FCA and PRA
- SMCR is embedded across the Group, with conduct measures monitored monthly, overseen by ERC
- Dialogue maintained with HMRC, with the CFO designated as Senior Accounting Officer, directly responsible for the Group's tax policies
- The risk element of the PSP includes an assessment of any material regulatory breaches



Capital management



Sustainability

Outcome

- The Board approved the submission of IRB Module 1 to the PRA in March 2020
- All changes to the Board and Senior Management Functions are approved by the PRA and FCA

Further information on the Group's tax policies is set out in Section A6.5.

Society and community

Helping the UK economy grow and supporting the communities in which we operate (s172 d)

How we engage and / or monitor

- Members of the senior team are active in industry bodies, gaining insight into thinking about how the sector impacts communities and public policy
- Executive Committee members actively support community activities within the business
- Employees support a nominated charity each year via payroll donations and fund-raising efforts



Sustainability

Outcome

- During the first nine months of 2020 our employees raised over £25,000 for this year's nominated charity, Macmillan Cancer Support
- The Board approved the donation of £100,000 across four different organisations supporting people impacted by Covid-19

Further information on the Group's community involvement is set out in Section A6.5.

Environment and climate change

Reducing our environmental impact and designing products that support positive environmental change (s172 d)

How we engage and / or monitor

- The Board took part in an Insight session on climate change in the context of financial services.
- Reporting to the Board on potential risks and business impacts from climate change
- The CFO has been designated as the responsible director for climate change exposures and reports to the Board
- The Group complies with all applicable laws and regulations relating to the environment



Sustainability

Outcome

- Climate Change has been designated as a principal risk for the Group in the year
- The Board established new objectives against current energy performance to further reduce consumption

Further information on the Group's management of climate change risk and its environment policies is set out in Section A6.4.

Business partners and suppliers

Commitment to the fair treatment of all business partners. In return, we expect our partners to help us deliver a high standard of service to our customers and act responsibly (s172 c)

How we engage and / or monitor

- Key business partner relationships, including intermediaries and suppliers are identified, actively monitored and reported to the Board and Executive Committee



Sustainability

Outcome

- This year the Group published a new Supplier Code of Conduct which sets out our overall approach to supplier engagement and corporate responsibility
- Our suppliers understand the minimum standards we expect from them and our commitments and expectations around bribery and corruption, data protection and modern slavery
- Ongoing engagement with our key suppliers ensuring operational resilience and reduced risk

The Group's management of business partner relationships is discussed further in Section A6.7.

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 normally 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 2021 AGM, scheduled for February, may be affected by Covid-19 restrictions on gatherings. The Group will make appropriate arrangements to comply with any such restrictions but remains mindful of the importance of ensuring that shareholders have sufficient opportunity to express their views to the Board.

The Chair, CEO and CFO have a full programme of meetings with institutional investors during the year. During the year ended 30 September 2020 meetings were held with investors from the UK, Europe and North America.

The Chair, the Chair of the Remuneration Committee and the People Director have had a number of meetings with shareholders and shareholder advisory groups covering governance and remuneration matters (as set out in the Remuneration Report).

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.

Investors' comments from all of these interactions are communicated to the Board, enabling the Board to develop an understanding of major shareholders' views of the Group, and take those views into account when determining strategy.

The SID 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. Meetings between the SID and shareholders can be arranged via the Company Secretary.

The Director of External Relations updates each meeting of the executive committee on shareholder movements and shareholder interaction.

B4.4 Board evaluation and development

Board evaluation

The effectiveness of the Board, individual directors and the Board's main committees is reviewed annually, with this year's review being internally facilitated as permitted by the Code. The Board also monitored progress on the recommendations from the external review carried out in 2019. The next external evaluation will be conducted by the end of 2022.

2019 External evaluation findings – Progress report

Following last year's externally facilitated evaluation, significant progress has been made on addressing actions arising out of the evaluation. Progress highlights are set out in the table below:

Recommendation / action	Progress update
Board	
Board composition and induction	
Certain skills gaps to be filled through future appointments with an emphasis on public company experience.	Alison Morris was appointed to the Board as a non-executive director in March 2020, with Peter Hill appointed a non-executive director following the year end.
Skills matrix to be updated and regularly reviewed by Nomination Committee, with enhanced training on bespoke topics for non-executive directors.	Updated skills matrices completed by individual Board members and revised to reflect requirements for future non-executive director appointments. Results were then calibrated by the Chair and CEO in conjunction with the Company Secretary and People Director to inform specific training needs and future skills required for the appropriate Board composition. A Board training plan was also agreed and implemented.
	Ongoing training was provided to the Board based on strategic priorities and market developments. The Board also received deep dives from the business, which provided greater access to senior management. See Board activities section B3.3 for more details.
Succession planning	
Succession plans to be enhanced with an emphasis on recruiting for public company experience and training internal candidates.	Succession plans were enhanced.
A long-serving executive team requires enhanced succession planning with the depth and range of executive team experience to be enhanced.	ExCo members and high potential senior individuals across the organisation were, and continue to be, given increased access to the Board. Additionally, the Covid-19 updates to the Board that commenced in March 2020, included updates from ExCo members on the pertinent points as regards the impact of Covid-19 on their respective business areas, and the steps undertaken to ensure operational resilience and risk mitigation.
The Board will identify opportunities to meet high-potential individuals throughout the business as part of its greater focus on succession planning.	The Nomination Committee agreed a proposal to further document a Board succession plan for the CEO and CFO roles as well as tracking the non-executive director development required to cover committee chair responsibilities. Broader succession plans for ExCo, their direct reports and key senior management roles are reviewed by the Nomination Committee on an ongoing basis.

Recommendation / action

Progress update

Board

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.

A new board paper template was agreed and implemented. The template requires authors to focus their presentation on key areas eg authors are asked to consider the impact of their proposals through a Section 172 (director's duties) lens.

The length and composition of papers is monitored on an ongoing basis and feedback given to ensure they continue to be appropriate.

A new customer insights section has been incorporated into the CEO report to the Board, together with enhanced data collated through customer surveys. Customer NPS data has also been enhanced.

Additional People Forum governance and engagement was implemented, and the outputs included in the People Director's updates to the Nomination Committee, as appropriate. ExCo updates to the Board during the pandemic focussed on customer and employee engagement, in particular.

Phase 1 of the corporate governance restructure was finalised during the year, which saw the establishment of the ERC. Phase 2 of the restructure will focus on the committees that sit below the Performance ExCo and ERC, to ensure continued enhancements to reporting.

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.

An enhanced focus on Section 172 considerations in the new board paper template and agendas encourages improved reporting via the committees to the Board.

Together with improved reporting, more structured agenda planning and better allocation of timings for items continues to facilitate enhanced challenge and sufficient time for more pertinent and pressing matters to be discussed.

Nomination Committee

Succession planning

Longer term 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.

See succession planning section above.

Recommendation / action**Progress update****Risk and Compliance Committee****Committee papers and segregation**

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.

Following Phase 1 of the governance restructure implemented during the year, the former executive risk sub-committees now report directly to the ERC rather than RCC. An outcome of the restructure is clear delegation and reporting lines, with defined separation between board and executive governance, ensuring a clear division of responsibilities.

Additionally, this allows for appropriate information flows up the delegation line, with a progressive decrease in detail / volume of information as appropriate eg ERC assesses more detailed business risks than RCC, which focusses on more strategic risks to the Group.

The revised governance structure will complement the proposed new Enterprise-wide Risk Management Framework, which is in the process of being designed and rolled out, with all risks appropriately mapped to the relevant / most appropriate sub-committees.

Finally, the ERC reviews and approves all papers (subject to any delegated authority) that are recommended to RCC and / or Board for formal approval.

2020 internal evaluation

The output of the 2019 external board evaluation was referred to in determining questions for this year's evaluation which, again, considered the performance of the Board, its committees, and all individual directors, including the Chair. In constructing the questions, the following sources were also considered: i) the 2018 internal evaluation; ii) the Code; and iii) FRC guidance.

The Board evaluation considered composition, the balance of skills, experience, independence, knowledge and diversity, how the Board works together and other points pertinent to its effectiveness. More detailed findings from the board evaluation included the following, against which progress will be reported next year.

Issue**Recommendation / action****Board****IT and digital experience**

The need for more IT and digital experience was a suggestion raised by some Board members.

A discussion should take place around how this will be achieved, and the Board is already considering options available to it.

Skills matrices

More formality and reference to skills matrix required for future non-executive director appointments.

The importance of the skills matrix in determining candidates in the future should be emphasised.

Senior management contact

More contact with the senior executives who are running the businesses is desired.

Once a settled business rhythm resumes, the Board should arrange to receive presentations from all ExCo members, which should be regularly scheduled into the Board diary. This was the intention for the current financial year but logistical challenges associated with Covid-19 at times prevented it.

Mentoring by non-executives

Non-executive director mentoring of high potential individuals was suggested.

The suggestion that non-executive directors could mentor high potential individuals should be considered.

Individual director evaluations considered whether each director continued to contribute effectively and demonstrated commitment to the role eg through devoting sufficient time to their Board duties. The evaluation also reviewed whether the Board and committees continued to have the requisite expertise to properly discharge their duties.

A review of the performance of the executive directors took place at the Remuneration Committee meeting in September 2020 that considered remuneration packages for 2020/21.

The performance evaluation of the Chair of the Board was carried out by the non-executive directors led by the SID (in the Chair's absence).

The Chair of the Board appraised the performance of the non-executive directors during August 2020, meeting with each non-executive director on a one-to-one basis to evaluate their performance and agree development areas. These conversations also provided an opportunity for the Chair to obtain individual non-executive directors' views on board effectiveness. Results of these discussions were distributed to the Board, who considered the results and a schedule of follow up matters / actions at its meeting in October 2020. An action plan was reviewed and agreed for implementation during the next financial year, which will be refined and monitored during the period.

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.

Induction

All directors receive an induction training schedule tailored to their individual requirements upon joining the Board. The induction, which is designed and arranged by the People Director, in consultation with the Chair and Company Secretary, includes meetings with existing directors, senior management and other key personnel, to assist new directors in increasing their knowledge of the Group's operations, management and governance structures, as well as key issues for the Group.

During the year Alison Morris has had meetings with senior employees in the Finance and Internal Audit areas to brief her on the work of those areas and the particular issues within those areas most relevant to her position as Chair of the Audit Committee. This process was facilitated and supported by Peter Hartill, the outgoing Chair of the Committee, as part of the handover process and has continued throughout the year end process.

Development

Further to the 2019 board evaluation, a skills matrix was produced for completion by each board member, the aim of which was to identify the key areas for ongoing board development and to assess the necessary skills and experience when considering future board succession planning. The output from the skills matrix was reviewed by the Board and individuals were given a further opportunity to update their self-assessment scores in order to ensure consistency of approach.

Following this, a number of topics have been agreed for board development over the coming year, in order to retain a diverse balance of skills and increase coverage in key areas to support oversight and delivery of the corporate plan.

Separately, ongoing individual development opportunities will be provided, as required, during the forthcoming financial year. A training schedule is maintained by the Group's Human Resources department in conjunction with the Company Secretary.

The non-executive directors have received presentations during the year on various aspects of the Group's activities to support their on-going business awareness and development. The Board has dedicated a number of days during the year to training and will undertake additional training as required by the Group's strategy and operational needs.

Topics for board training sessions are recommended by the Board, and provide for a balance of technical, governance and professional development. All directors completed a variety of regular training modules that are mandatory for all employees.

Further business insight / awareness sessions and deep dives on particular areas are held regularly to enable non-executive directors to continue to contribute effectively at board meetings on account of their enhanced understanding of key topics.

B4.5 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 Board during the year, in accordance with Code requirements, and any amendments to the policy required the approval of the Chair.

There is a right of appeal, currently to the Chair of the Board, where the employee is dissatisfied with the outcome.

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 2020, a small number of whistleblowing incidents were investigated. Each matter was fully reviewed by the Whistleblowing Committee and subsequently considered by the Board. The investigation found that none of the incidents were material in nature. Whilst actions did arise following the investigations, these were minor.



B5. Nomination Committee

B5.1 Introduction by the Chair

Dear Shareholder

The Nomination Committee is the channel used by the Board to consider certain governance matters and sustainability issues. These are vital issues for the Board and the Group and this has seen the Committee's workload increase rapidly over recent years, with additional formal duties taken on under the new Code.

During the year the Committee has overseen the appointment of a new Audit Committee Chair and Senior Independent Director. It also supervised the initial stages of the process to appoint a new Chair of the Risk and Compliance Committee, which was finalised after the year end.

These roles are central to the governance of the Group and the primary aims of the Committee in recruiting for them were to ensure that the person appointed has the requisite skills and knowledge for the role, benchmarked against the board skills matrix; that there was a strong cultural fit with the Group; and that an orderly handover process would be achieved. When determining the outcome for each of these appointments, consideration was also given to the diversity of the Board as a whole.

These appointments further strengthen the diversity of the Board as well as provide it with the skills it requires to oversee the future strategic development of the business.

The Committee's remit also covers people-related sustainability issues, with the introduction of employee voice arrangements and the Group's EDI network in the period being particularly noteworthy. I look forward with anticipation to the contribution these initiatives will make to the Group's strategy and culture in the future.

Overall, I believe the Committee has enjoyed a year of positive achievement and fully satisfied its remit from the Board.

Fiona Clutterbuck

Chair of the Board and the Nomination Committee

3 December 2020

B5.2 Operation of the Committee

The Nomination Committee is chaired by the Chair of the Board and includes four independent non-executive directors. The Committee's role is to ensure that there is a formal, rigorous and transparent procedure for the appointment of new directors to the Boards of the Company and of Paragon Bank PLC; to lead the process for board appointments and make recommendations to the Board. Ultimate responsibility for any appointment remains with the Board. Its role also includes:

- 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 of 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
- Monitoring workforce engagement and seeking employee feedback on behalf of the Board

The membership of the Committee and the record of their attendance at meetings is given in Section B3.3.

B5.3 Matters considered by the Committee during the year

Board appointments

During the year, following a rigorous external search the Committee appointed a new Audit Committee Chair, Alison Morris, to succeed Peter Hartill who retired in September 2020. Alison followed a structured induction and handover both prior to starting her role and in the first few months and this will continue throughout her first year of appointment.

Hugo Tudor, an independent non-executive director, was appointed as Senior Independent Director ('SID') in July 2020, due to Peter Hartill's planned retirement. The Committee undertook a review of both internal and external candidates for this role and determined that Hugo's experience and knowledge was the best fit for this appointment. This determination was based on a series of external discussions with potential external candidates and a 'role play' scenario whereby Hugo deputised for the Chair at a Board meeting, as if the Chair was unavailable, this being a role that might potentially fall to the SID in certain circumstances.

The Committee also conducted a search for a new Risk and Compliance Committee Chair to replace Finlay Williamson who will step down from the Board on 31 December 2020. As part of the overall board succession plan and following the Board triennial external evaluation in July 2019, the Committee identified that the Board would benefit from recruiting an experienced non-executive director who would also bring senior executive experience with a strong customer, operational and technology focus.

In October 2020, following a number of interviews and after receiving regulatory approval, the Group announced that Peter Hill was appointed to the Board with immediate effect and will become Risk and Compliance Committee Chair effective from 31 December 2020 following a period of transition and handover. Peter brings with him a wealth of experience in financial services and a proven track record in risk oversight, gained during his executive and non-executive career. Peter's experience and other appointments are set out in the board profiles in Section B3.1.

As it has done for a number of years the Committee considered the re-appointment of the serving directors and recommended to the Board that resolutions for their re-appointment should be proposed at the AGM.

Executive appointments

The Committee oversaw appointments to the Executive Committee during the period and ensured that the search and selection processes were robust and that the candidates had demonstrably relevant skills and experience.

Dave Newcombe was appointed as Managing Director - Commercial Lending in October 2019. He has been a member of the Executive Committee since 2015, having held a number of senior positions across the Group throughout his 32 year career.

Marius Van Niekerk joined the Group and the Executive Committee in October 2019 as General Counsel and Company Secretary. He brings extensive board, regulatory and legal experience to the Group.

Richard Rowntree joined the Group and Executive Committee in January 2020, succeeding John Heron as Managing Director - Mortgages. Richard was previously the Managing Director of Mortgages for Bank of Ireland and he has almost three decades of retail banking leadership experience across five major UK banks.

Ben Whibley was appointed as CRO and member of the Executive Committee in April 2020, following Malcolm Hayes' departure. Ben joined the Group in 2015 and was previously CRO of Paragon Bank PLC and Deputy CRO of the Group. Ben's appointment to the role of CRO illustrates the effectiveness of the Group's succession planning and senior leadership development programme.

Succession planning

Succession plans for the Board 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.

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 A6.3.

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 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. It also acknowledges the benefits which can arise from the hire of strong external candidates to add experience and bring a fresh perspective to strategic thinking. In addition, the senior leadership development programme is also focussing 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 initially following the outputs from the Strategy Event in June 2019. This was further reviewed and updated by the Committee in February 2020 and subsequently approved by the Board.

The matrix reflects the strategy of the Group becoming a technology-enabled specialist bank and includes skills consideration on such matters as demonstrating sound knowledge of the UK retail banking sector; understanding capital requirements and liquidity models; insight into the application of technology in a financial services environment; customer insight and understanding the specialist lending sector.

The board skills matrix is reviewed annually by the Committee and forms the basis for future succession plan requirements.

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 proud to have achieved 33% female representation at Board and senior management level, in alignment with the Hampton-Alexander Review targets.

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.

The Group's target is to achieve 35% female representation at senior management level, using the Hampton-Alexander measure, by January 2022. By the end of September 2020 33.9% of senior roles had female incumbents. The Group is committed to ensuring it meets its targets by 2022 and is endeavouring to make progress towards this target. The recently formed Equality, Diversity and Inclusion Network is an important initiative to help the Group achieve this target, and the network will regularly update the Committee on its work.

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 rules in the management structure and in the nature of strategic developments in the Group that make balancing gender pay difficult, as it is 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. 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 2018 Code requirements.

The Group's diversity policies were updated during the year and are described in Section A6.3. Information on the composition of the workforce, including the gender balance of those in senior management and their direct reports is given in Section A6.3 and the Group's gender pay gap statistics are also discussed in that section.

Workforce engagement

The Committee has received regular updates on workforce engagement and board members have engaged directly with the workforce throughout the year through both formal and informal channels. The Group has run regular employee surveys during the year in response to the Covid-19 pandemic and the People Director provides updates on the results of these to the executive.

Additionally, non-executive directors have attended People Forum meetings to discuss topics including executive pay and reward, pay and reward for the wider workforce and how the Group has managed the impact from Covid-19 from customer and employee perspectives. These meetings provide employees with an opportunity to ask questions of board members and provide direct feedback. These meetings will continue to be a regular feature of the board calendar.

**Our responsibility
is to ensure
that financial
information
published by the
Group properly
presents its
activities to all
stakeholders...**

Alison Morris,
Chair of the Audit Committee



B6. Audit Committee

B6.1 Statement by the Chair of the Audit Committee

Dear Shareholder

This is my first report to you as Chair of the Group's Audit Committee and it marks a year in which the challenges faced by the business, both in its accounting and its financial control systems, have been some of the most complex in recent years.

While these challenges have been shared by much of the UK corporate sector, that does not lessen their impact, nor the calls on the Committee to ensure that these have been properly addressed by the business on behalf of all of the stakeholders.

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. The impact of the Covid-19 pandemic in the year has increased the complexity of making any accounting judgement based on future expectations as well as necessitating changes in working practices around the Group which internal audit have had to evaluate.

From an accounting standpoint the issue which engaged the largest part of the Committee's attention was the level of impairment provision appropriate for the Group's loan assets under IFRS 9 and the way this is presented in this annual report. The crisis highlighted the inherent weakness of the model-based approaches used throughout the financial services industry in situations outside the range of previously observed data, however good the modelling. The longer term effects of government and regulatory relief for loan customers

are uncertain, while the short-term effects distort many of the measures generally used to monitor credit quality, such as arrears levels and credit scores. Overall, the lasting impact of Covid-19 on the UK economy and therefore on the future financial health of the consumers and SMEs who are the Group's principal customers is impossible to predict accurately.

All of these factors have meant that management judgement has had a more significant role than usual in the determination of appropriate levels of provision, and the Committee has taken its role to examine and challenge those judgements very seriously, including the insertion of an extra meeting during the early part of the crisis.

The Committee has also carefully considered the impact of the crisis on the carrying value of goodwill assets and on the going concern status of the Group, noting that the capital disciplines which it is subject to under banking regulation have left it better placed than businesses in other industries to address this issue.

The changes in working practices and systems necessitated by Covid-19, such as the rapid transfer to home working and the introduction of CBILS and BBLS, meant that I was involved in a rapid reprioritisation of the work of internal audit to ensure that sufficient new controls had been properly devised and implemented to deal with these changes and protect the risk environment. The Committee was pleased with internal audit's findings on these areas. I am happy to be able to confirm that the Group was not forced to divert internal audit resource to other areas as a result of Covid-19, as many other UK companies have done, according to the Chartered Institute of Internal Auditors ('CIIA').

All of these issues required the detailed engagement of the Committee and I would like to thank my colleagues for their input and their level of engagement on these matters.

In the coming financial year ending 30 September 2021 the Committee's main priorities will include:

- Monitor the continuing developments of the IFRS 9 response to Covid-19 as economic outcomes become clearer, customer behaviour starts to manifest itself and regulators provide further guidance
- Continued monitoring of the Group's wider 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, whether generated through Covid-19 or otherwise
- Commencing the annual process of formal review of the need for an audit tender

Finally I would like to thank Peter Hartill, my predecessor as Chair of the Committee, on behalf of myself and the rest of the Committee for his contribution to the Group over nine very eventful years, and for the support he has given me during the transition period. We wish him all the best for the future.

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 February 2021.

Alison Morris

Chair of the Audit Committee

3 December 2020

B6.2 Operations of the Committee

The Audit Committee currently comprises four independent non-executive directors of the Company whose relevant experience is set out in Section B3. In addition, Peter Hartill was a member of the Committee until his resignation from the Board on 30 September 2020 and Alison Morris joined the Committee on 26 March 2020. Alison Morris succeeded Peter Hartill as Chairman of the Committee, chairing her first meeting in September 2020, the overlap of their terms on the Committee facilitating a smooth handover.

The terms of reference of the Committee include all matters indicated by Disclosure and Transparency Rule DTR 7.1 and the Code. These terms of reference were most recently updated in September 2020 and are available on the Group's website. The Committee's key responsibilities include:

- Monitoring the integrity of the Group's financial reporting
- Reviewing the Group's risk management and internal financial 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.

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 which the Code requires. Alison Morris and Peter Hartill have 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.

During the year ended 30 September 2020, the Committee met five times, the additional meeting being added to consider Covid-19 related accounting issues in more depth. 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

- The review of other financial information published by the Group, such as Pillar III disclosures required by banking regulations
- Review of the terms of reference of the Committee and approval of revised terms
- Consideration of the Group's readiness to address other forthcoming accounting changes which will affect it

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 have been major changes in the Group's accounting policies or audit arrangements in progress, the Chair of the Committee at the time has held meetings with shareholders. Future meetings with investors to discuss such matters will be organised if and when required.

Details of the Committee members' attendance at meetings and the Board's evaluation of the Committee's effectiveness are given in Section B3.3.

B6.3 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 2020 the Committee considered particularly:

- The levels of impairment provision against loan assets and, in particular, the economic impact of the Covid-19 pandemic on both customer credit and the operation of provisioning methodologies
- 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 requirement for any impairment provision against the purchased goodwill carried in the Group's balance sheet
- 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 and their impact on the going concern assessment for the Group

In each case the Committee considered whether these matters were clearly and sufficiently disclosed in the accounts with appropriate sensitivities shown for all significant estimates.

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 prepared by management and reviewed by the external auditor 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 focussed on in each of these areas were:

Matter	Particular areas of focus
Loan impairment	<p data-bbox="416 421 1437 470">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 data-bbox="416 495 1437 568">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 data-bbox="416 593 1437 642">In the current economic environment dominated by Covid-19 this consideration of future credit losses is particularly complex.</p> <p data-bbox="416 667 1362 716">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 data-bbox="416 741 1437 1081" 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 • The appropriateness of the calculated provisions in the light of government interventions in the UK lending market and the economy more generally • The appropriateness of adjustments made to calculated amounts to compensate for factors not fully addressed in the modelling <p data-bbox="416 1106 1362 1205">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 data-bbox="416 1229 1414 1303">In respect of the impact of Covid-19, the Committee considered particularly the extent to which modelled approaches based on past history may not be relevant in current economic conditions and the implications for impairment calculations of Covid-19 reliefs.</p> <p data-bbox="416 1328 1437 1426">A particular focus continued to be 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 other factors not allowed for in the impairment process.</p> <p data-bbox="416 1451 1385 1500"><i>Further information on these estimates can be found in note 64a to the accounts, the impairment charge for the year and the movements in provision for impairment are shown in note 19.</i></p> <p data-bbox="416 1525 1002 1547"><i>The Group's exposure to credit risk is discussed in note 56.</i></p>

Matter	Particular areas of focus
Interest income and expense recognition	<p data-bbox="379 217 1362 367">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 data-bbox="379 392 1386 465">The Committee assessed the appropriateness of the assumptions made, considering performance of the portfolios against expectations and the impact of changes in product specifications, together with the replacement of certain spreadsheet models with more sophisticated loan-level modelling.</p> <p data-bbox="379 490 1318 539">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 data-bbox="379 564 1374 638">For acquired assets which were considered credit impaired on purchase, where valuations are based on expected cash flows, the potential economic impacts of Covid-19 on customer behaviour were carefully considered.</p> <p data-bbox="379 663 1353 712"><i>Further information on these estimates can be found in note 64b to the accounts, and the interest income and expense recognised on this basis is shown in notes 4 and 5.</i></p>
Goodwill impairment	<p data-bbox="379 795 1382 920">The Group is required to assess, at least 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. Due to the impact of Covid-19 this was also considered in full at the half-year.</p> <p data-bbox="379 945 1401 1019">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 data-bbox="379 1043 1075 1066"><i>The potential impairment of goodwill is discussed in notes 64c and 26.</i></p>
Defined benefit pension obligations	<p data-bbox="379 1149 1404 1223">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 data-bbox="379 1247 1366 1348">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 data-bbox="379 1373 1326 1447"><i>Further information on the Plan deficit, the basis of valuation and the assumptions underlying it can be found in note 53 to the accounts, along with an analysis of sensitivities to the more significant assumptions</i></p>
Viability statement	<p data-bbox="379 1529 1358 1603">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 data-bbox="379 1628 1347 1753">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, particularly focussing on the impact of Covid-19 both on the Group's business and the levels of potential variability in the forecasting.</p> <p data-bbox="379 1778 1353 1800"><i>A fuller discussion of the directors' consideration of the viability statement is set out in Section A5.</i></p>

Matter	Particular areas of focus
Going concern	<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, including the uncertainties created by the impact of Covid-19 on the UK economy generally and the Group's operations in particular.</p> <p><i>A fuller discussion of the directors' consideration of the going concern statement is set out in Section A5.</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 B10.</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 or considerations were to be reported on.</p> <p>For the current financial year this included particularly the presentation of the impact of Covid-19 on the Group's business and results.</p> <p>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 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 2020 to the Board for approval.

The Committee's consideration of the financial statements for the year ended 30 September 2019, which took place in the year under review, is discussed in the Audit Committee report for that year.

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.

B6.4 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

The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 (the 'Order') 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 2020 is the fifth 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. After the completion of the fifth audit which was not subject to a formal tender process (the year ending 30 September 2021), and in each subsequent year thereafter, the Committee is required to report to shareholders its conclusions on whether a further tender is in the Group's interest at that time. The Committee will be conducting a formal review in line with this requirement in the coming financial year and will report its findings to shareholders in next year's Audit Committee Report.

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 2020 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 2019 audit, undertaken at the time of approval of the Group's 2019 consolidated accounts, was updated once the external audit process for all Group companies had been completed. This 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 2020. The Committee noted particularly the FRC's concerns regarding KPMG's auditing of banks and discussed these findings and the steps being taken by the firm to address them 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 2021 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 setting out measures to ensure that independence is preserved. 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.

In September 2020 the policy was revised to be consistent with the FRC Ethical Standard for auditors. The current policy limits the use of its external auditor to supply non-audit services to those services where the use of the external auditor is expected or mandated by legislation or regulation. The Committee must approve any engagement of the external auditor for non-audit work, except where the fee involved is clearly trivial. The policy also 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 and the nature of any ongoing relationships with the Group 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 10 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 8.6% to £1,468,000 (2019: £1,352,000). This was a result of an increase in scope in certain areas and inflation in professional services fees more generally.

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'). For this purpose, non-audit services includes audit-related services other than those services required by EU or national law such as reporting on interim financial information and regulatory profit confirmations, which are required by non-statutory regulations. The calculation applies for the first year commencing after June 2019 which means that this restriction applies from the current financial year.

Non-audit fees paid to the auditor for the year ended 30 September 2020, should be no more than 70% of the average of the audit fees for 2017, 2018 and 2019, £929,000. Fees were paid to KPMG, the Group's external auditor, such for non-audit services during the year were £168,000 (2019: £112,000), well within the cap. All of these fees were for audit related services.

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 in considering appointments 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:

	2020	2019
	£000	£000
Auditors – KPMG	-	-
Other big four firms	3,043	2,393
Other firms	-	6
	3,043	2,399

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

B6.5 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. It also receives the functions reports and evaluates

the adequacy of Group's responses to them. 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.

The roles and responsibilities of Internal Audit are set out in the Internal Audit Charter which is reviewed and approved by the Committee on an annual basis. A copy of the Charter is available on the Group's website.

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. With the approval of the Committee, the audit plan may be revised during the year, based on the ongoing assessment of the key risks or in response to the requirements of the Group. In 2020, the plan was subject to several revisions in response to Covid-19, with internal audit reviews added to the Plan to confirm the ongoing operation of key controls during this period.

The Internal Audit Director provides the Committee with regular assessments of the skills required to conduct the Plan and whether the internal audit budget is sufficient to recruit and retain staff, or to procure other resources, with relevant expertise and experience. The Committee assesses, on an ongoing basis, whether the internal audit function has sufficient and appropriate skilled resources to complete the plan and, on an annual basis, formally confirms that it is satisfied that these resources are appropriate.

During the year, several technical and specialist reviews have been co-sourced under an agreement with a third-party accounting firm on a subject matter expertise basis where it was deemed by the Internal Audit Director that such skills would complement and develop those of the internal team.

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. Since the appointment of Alison Morris as Chair of the Committee, these meetings have formed part of the Chair's overall induction plan. Ahead of finalisation of the audit plan for the year ending 30 September 2021, the Chair of the Committee met with the Internal Audit Director to discuss audit planning priorities, key business risks and assess current resourcing.

All internal audit reports are circulated to the Board. Significant findings of internal audit reports and management's responses 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 2020, 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. As a matter of policy, the Committee intends to commission an EQA at least every five years.

Paragon's overall performance has demonstrated its fundamental resilience during this challenging year...

Hugo Tudor,
Chair of the Remuneration Committee



B7. Remuneration Committee

This report covers the activities of the Remuneration Committee for the year ended 30 September 2020 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 (B7.1) and the Annual Report on Remuneration (B7.2). The policy summary tables extracted from the detailed Remuneration Policy are reproduced for reference as Section B7.3.

The full Remuneration Policy is set out in the Annual Report and Accounts for the year ended 30 September 2019, a copy of which can be found at www.paragonbankinggroup.co.uk.

B7.1 Statement by the Chair of the Remuneration Committee

Dear Shareholder

Group's remuneration philosophy

The philosophy underpinning Paragon's Remuneration Policy seeks to recognise fairly the contributions of all employees. This philosophy remains unchanged and continues to apply throughout the organisation, with oversight from the Remuneration Committee. The aim, for executive directors and senior management, is to ensure that their rewards are aligned with the interests of shareholders and other stakeholders. This is achieved through both the Group's short and long-term strategic objectives, whilst the policy also meets the core objectives of motivating and retaining employees.

In addition to shareholder and investor groups, as Chair of the Committee, I engage with employees specifically on executive remuneration and also on wider pay policy. These discussions are mainly focussed through the Group's People Forum and are helpful in providing constructive feedback for Committee members as well as giving the opportunity for me to explain the rationale for Committee decisions to the wider workforce.

Introduction of the 2020 Remuneration Policy

The 2020 policy was approved by shareholders at the Company's AGM in February 2020. The new Remuneration Policy was designed to meet the developing regulatory and governance landscape and reflected feedback from extensive stakeholder interaction during 2019.

At the AGM both the remuneration report and the policy achieved well in excess of the required voting levels for the resolutions to be approved. However, as more than 20% of the votes cast were against each resolution further interaction with shareholders was undertaken. Following this engagement, and in direct response to shareholder feedback, the Committee announced to the Stock Exchange in August 2020 that instead of the originally scheduled introduction date of 1 October 2019, the policy changes to salaries and pensions, and the introduction of role-based allowances, would instead be introduced from 14 February 2020 (being the day after AGM approval). In addition, the Committee also disclosed further detail around the use of customer metrics within the 2020 PSP awards. The Committee welcomed the engagement with shareholders and proxy advisors regarding the introduction of the new policy and carefully considered the feedback that was provided. I would like to thank all who engaged with us for their interest and constructive contributions.

Business performance

Paragon's overall performance has demonstrated its fundamental resilience during this challenging year. Of particular note, was the ability of the business to switch to home working very quickly, with over 90% of employees working from home effectively within two weeks of the lockdown on 23 March, maintaining customer focus and support throughout the pandemic. This was evidenced through the provision of payment holidays, maintaining the availability of new lending throughout, giving our customers efficient and effective access to CBILS and BBLS and continuing to offer attractively priced deposits to our savings customers.

Paragon's capital base is robust and the IRB application, phase one of which was submitted this year, is intended to strengthen longer term risk management capabilities and in turn capital efficiency. Liquidity has been healthy with the average LCR significantly above the levels envisaged in the business planning and scenario analysis conducted by the Group at the start of the year.

Investing for the future has continued to be a high priority during this unusual year with digital systems development, for example in customer portals, and an increase in savings market capacity achieved alongside the delivery of CBILS and BBLS. These were realised together with the delivery of module 1 of the Group's IRB application to the regulator.

As with every organisation there has been an impact on the Group's financial performance from Covid-19 and the full details of this are discussed in the Strategic Report. In terms of the direct relationship of performance to remuneration this can be seen in the balanced scorecard outcome for the executive directors shown later in the report (Section B7.2).

Exemplary leadership throughout the pandemic has been shown by the senior management team and it has been apparent that the longevity of the executive directors and other members of the senior team has underpinned Paragon's strong resilience and response to the crisis.

Variable pay earned in the year

To further enhance alignment between shareholders and the executive directors during the current uncertain environment, the Committee determined that the entire value of the executive directors 2020 bonuses would be satisfied in shares deferred for three years under the terms of the existing Deferred Share Bonus Plan ('DSBP') with no cash bonus being paid.

Normally, there has been a deferral for executive directors of 25% of the bonus amount in excess of £50,000, under this plan. We have also enhanced the deferral provisions for other senior managers. Members of the Group's Executive Committee have had 50% of their cash bonuses deferred under the DSBP. Other members of the senior management team, whose award is in excess of £30,000, will have 25% of the award deferred. These changes to deferral patterns increase interests in shares and therefore the alignment between the experience of executive directors, senior managers and other employees with our shareholders.

In light of the resilient performance of Paragon in this challenging climate, the executive directors will receive a total bonus of 66.1% of maximum bonus opportunity for the year (which was derived on the basis shown in Section B7.2). The Committee determined that the formulaic outcomes under the bonus framework were fair and appropriate in light of the very strong non-financial performance and exemplary leadership shown over the period, therefore it was decided that no discretion be applied to outcomes. This represents a 34% reduction in total bonuses when compared to 2019 and, as noted above, has no cash element.

In reaching this decision, the Committee took into account the shareholder and employee experience during 2020. Executive director bonuses were reduced in line with profitability and aligned with the wider workforce bonus outcome. In addition to this, the Committee noted that the Group did not join the UK Government's furlough scheme, has not made any redundancies due to the pandemic and further, any employee who was requested to 'shield' because of their vulnerability did so on full pay. The Committee noted the share price performance of the Group which performed well compared to its peers across the period. Whilst the Group did not pay an interim dividend, it has agreed that a final dividend of 14.4 pence per share will be paid, subject to shareholder approval. Consequently, the dividend level paid in respect of 2020 will be 32.1% lower than that paid in respect of 2019 and this decline is reflected in the 34% decrease in the executive directors' bonus outturn year on year.

Long-term incentive awards under the Paragon Performance Share Plan ('PSP') which were granted in December 2017 are due to mature in December 2020. These awards are subject to performance conditions, with the TSR, representing 50% of the award, vesting in full due to Paragon's strong share price performance relative to peers over the three-year period, and the risk condition, representing 25% of the award, vesting at 88%. However, the EPS element, representing the remaining 25% of the award, did not vest, resulting in an expected overall vesting percentage of 72%.

The PSP awards for the year beginning 1 October 2019 that would usually have been granted in December 2019 were deferred until after the AGM in 2020. This enabled the awards granted to executive directors to be made in accordance with the new Remuneration Policy, including increasing the time before which awards may be exercised from three to five years. Due to this deferment and the impact of Covid-19 the awards were granted to both the executive directors and other senior managers within the Group in July 2020. The conditions of these awards incorporate discretion for the Committee to make adjustments in respect of any 'windfall' gains that may arise on these awards given the lower share price position at the award date. The operation of any 'windfall' gain adjustment would not only apply to the executive directors but to all employees receiving an award in July 2020.

Regulatory regime

When the 2020 Remuneration Policy was drafted it was expected that during the lifetime of the policy the Group would become subject to increased levels of remuneration regulation as a larger financial services firm (known as a Level 2 CRD IV firm). The updated policy rebalanced pay to ensure compliance with the variable pay cap in readiness for becoming a Level 2 firm and to give shareholders full visibility of the necessary remuneration changes ahead.

CRD V, which is due to be implemented in December 2020, is expected to accelerate the applicability of Level 2 remuneration requirements to the Group. Consequently, it is likely that the Level 2 remuneration rules will apply to the Group in respect of the pay awarded for its financial year ending 30 September 2022. In anticipation of this, and as mentioned in last year's report, the Company is putting to the AGM a resolution to apply a ratio of the variable to fixed components of remuneration for executive directors and Group material risk takers that does not exceed twice fixed pay. No further changes need to be made to the current Directors' Remuneration Policy to comply with the regulations. Maximum bonus levels therefore would be able to remain at 150% of salary and PSP awards at 180% of salary for executive directors, as approved under the new policy, once the Group becomes a Level 2 firm.

The proposed cap, which is in line with the policies adopted by many other financial institutions, enables the Group to maintain its competitive flexibility to attract and retain key staff members with the necessary skills and experience to deliver the Group's strategy and to continue to generate value for shareholders. Furthermore, the passing of this resolution will not have any effect on the Group's ability to maintain a sound capital base.

As the Committee designed the Remuneration Policy so that it was compliant with the requirements applicable to a Level 2 CRD IV firm, the changes which will be applied to the Group through CRD V are already structured into the policy and consequently, no changes to the Directors' Remuneration Policy are proposed to be brought to shareholders for their approval at the 2021 AGM.

All employee rewards

The Group decided, in light of the impact of Covid-19, that there would generally be no salary rises for the 2021 financial year, other than the increases in the Real Living Wage recommended by the Living Wage Foundation. The Committee agreed this in respect of the executive directors and other employees for which it is responsible, including SMCR employees and material risk takers. No employee within the Committee's direct remit had their salary increased and overall less than 2% of employees received a pay rise.

Additionally, the Group agreed that all employees below executive committee level and their senior direct reports will receive a grant of £1,000 (gross) of shares. This grant, to over 95% of employees, is intended to be a one-off award to thank our people for all their hard work in support of the business and our customers in this difficult and unusual year. More details on this award are provided later in the report.

The profit related pay scheme ('PRP'), which the Group has operated for a number of years for all employees below a senior level, will continue. Eligible employees will receive the PRP payment in December 2020 as usual.

As part of Paragon's established commitment to fairness and respect, fair pay for all employees has long been a central tenet of the Group, which is a Living Wage employer. Further, the Committee has reviewed and taken into account remuneration elsewhere in the Group as part of its deliberations on senior management remuneration for a number of years. However, over the next year the fair pay agenda will increasingly form a focus of the Committee's work. The CEO pay ratio analysis together with the additional disclosures required this year (see Section B7.2) alongside the outcomes they show will be used to inform those discussions. Considerations on how to reduce identified gaps will be a priority for the Committee in the upcoming years.

Changes proposed for the year ending 30 September 2021

No salary increases for executive directors are proposed in the forthcoming year.

In respect of the PSP awards that will be granted in December 2020 the EPS targets have been updated to reflect the current macro-economic climate whilst maintaining an appropriate level of stretch in the target. There are no other changes envisaged for the financial year ending 30 September 2021 but the Committee will continue to monitor the ongoing impact of Covid-19 on the business and how this might impact on remuneration.

Conclusion

This report reflects continued engagement with shareholders and provides the Group with a regulatory compliant and competitive remuneration structure and I commend it to shareholders and ask you to support the resolutions to approve the Company's Directors' Remuneration Report and to increase the bonus cap to twice fixed pay at the AGM in 2021.

Hugo Tudor

Chair of the Remuneration Committee

3 December 2020

B7.2 Annual Report on Remuneration

Contents:
<p>The annual remuneration report includes:</p> <ul style="list-style-type: none"> • Remuneration summary (B7.2) • The Remuneration Committee, key responsibilities and advisers (B7.2.1) • Directors' remuneration for the year ended 30 September 2020 (B7.2.2) • Application of remuneration policy for the year ending 30 September 2021 (B7.2.3) • Other information (B7.2.4) • Policy summary (B7.3)

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 2020:

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
Margins	Future value of new business and financial performance	EPS growth and relative TSR
Liquidity	Risk measure and financial performance	EPS growth, relative TSR and risk assessment
Sustainable earnings	Financial performance	Relative TSR, EPS and risk assessment
Capital strength and efficiency	Risk measures	Relative TSR and risk assessment
Cost control	Profit measures and personal objectives	EPS growth
A customer-focussed culture	Personal objectives	Customer metrics adopted from July 2020 grant
These success factors deliver enhancement of shareholder value and align with the Group's reward structure		

How our pay principles aligned to the Code during the year ended 30 September 2020:

Principle	Application	Example
Clarity	The executive director and Group remuneration policies are clearly communicated to directors and all employees	The Remuneration Report in this document is available to all employees as is the group-wide internal remuneration policy
	The Remuneration Committee Chair and Chair of the Board regularly consult with our major shareholders as part of our commitment to a transparent and open relationship	Details on the application of the Directors' Remuneration Policy, including incentive outcomes for the current year as well as proposed performance measures and targets for future years, are clearly set out in this report. The internal policy details the available remuneration structures which are aligned across the Group and consist of salary; pension; variable cash bonuses; share schemes and benefits
Simplicity	Straightforward remuneration structures apply to all levels of the Group's employees	Discussion on executive remuneration and how it aligns to the workforce forms part of the regular People Forum discussions with the Committee Chair
	The Committee has sought to ensure that the Directors' Remuneration Policy and outcomes under the Policy are easy to understand for both participants and shareholders	
Proportionality	Bonus awards reflect annual performance and PSP awards reflect performance over the longer term with performance measures and targets clearly linked to strategy	The links between awards and delivery of strategy and performance are shown in the table above
	The Committee also has the discretion to override formulaic outturns to ensure outcomes do not reward poor performance	Performance conditions require a minimum level of performance to be achieved before any payout under variable pay schemes is considered
Predictability	Minimum, target and maximum levels of award for executive directors are shown in this report within the summary of our Remuneration Policy	See Section B7.3 for the summary policy and the full policy in the Annual Report and Accounts 2019
Alignment to culture	Paragon's strong culture is reflected throughout its pay structures through consideration of the demonstration of the Group's values when determining incentive outcomes for all employees as well as through its commitment to the Living Wage Foundation and Equality, Diversity and Inclusion policies	Demonstration of the Group's values underpins our variable incentive frameworks, in addition 25% of PSP awards for executive directors and other senior managers are assessed against Customer and People metrics.
	The Remuneration Policy is fully aligned with our pay principles	Paragon has paid the Living Wage Foundation rate for a number of years as part of its commitment to workforce equality and is committed to reducing its gender pay gap
Risk	The pay arrangements for executive directors are consistent with and promote effective risk management	The risk conditions in the annual and long-term incentives are tested annually by the Committee. The Committee has discretion to override formulaic outcomes
	Risk conditions are included within variable remuneration arrangements to align with regulatory expectations and shareholder interests. The Committee is mindful of conflicts of interest arising in the operation of the Remuneration Policy and has measures in place to address this such as no individual being present when decisions are made on their own remuneration	Both annual bonus and PSP outcomes are subject to malus and clawback provisions
	All members of the Remuneration Committee are also members of the Risk Committee, ensuring that risk is appropriately taken into account when determining remuneration policy and outturns	

B7.2.1 The Remuneration Committee, key responsibilities and advisers

The information provided in this section is not subject to audit

The Committee's membership is detailed in Section B4.1.

The Committee currently comprises three independent non-executive directors of the Company and the Chair of the Board whose relevant experience is set out in Section B3.1. In addition, Peter Hartill was a member of the Committee until his resignation from the Board on 30 September 2020 and Alison Morris joined the Committee on 26 March 2020.

None of the Committee members 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:

- Decides the Company's policy on executive remuneration, including pension rights and compensation payments of the executive directors
- Sets the remuneration for each of the executive directors, the Chair of the Board, the Company Secretary, all Senior Managers and Certification Regime ('SMCR') personnel and Material Risk Takers ('MRTs') under the rules of the PRA/FCA including the Internal Audit Director and the CRO
- Reviews workplace remuneration and related policies and the alignment of incentives and rewards with culture; and when setting the policy for executive director remuneration, takes into account those matters
- Considers the Group Remuneration Policy for all employees and reviews and approves the Group's schedule of MRTs, under financial services regulatory remuneration rules

Attendees

The CEO, People Director, CRO, Company Secretary, Director of External Relations, other non-executive directors (including the Chair of the Risk and Compliance Committee) and external remuneration advisors 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 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 £140,340 (including VAT). Deloitte provided other professional services to the Group during the year including share scheme and tax advice, regulatory support, customer contact support, securitisation and co-sourced internal audit services.

The Committee is comfortable that the Deloitte engagement partner and team providing remuneration advice to the Committee do not have any connections with the Group or any individual director that may impair their independence and objectivity.

- The CEO, the Chair of the Risk and Compliance Committee, the People Director, the CRO and the Director of External Relations 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 and the Remuneration Policy at the Company's AGM on 13 February 2020.

Resolution	Votes for	% for	Votes against	% against	Total votes cast	Votes withheld
Annual Report on Remuneration	150,343,775	71.02%	61,340,110	28.98%	211,683,885	3,082
Remuneration Policy	157,352,402	74.33%	54,331,483	25.67%	211,683,885	3,082

Due to the 'significant' vote (more than 20%) against both the policy and the report, in accordance with the Code, the Company engaged further with its shareholders and announced the outcome of that follow up action to the Stock Exchange in August 2020.

These outcomes included provision of further information regarding the customer metrics that will be utilised for the long-term incentive plan and they are detailed later in Section B7.2. Additionally, changes to executive directors' salaries and pensions together with the introduction of role-based allowances which were originally scheduled to take effect from 1 October 2019 were introduced on 14 February 2020, the day after their approval at the AGM.

B7.2.2 Directors' remuneration for the year ended 30 September 2020

The information provided in this section has been audited.

Single total figure of remuneration for executive directors

Year ended 30 September 2020	N S Terrington £000	R J Woodman £000	J A Heron ¹ £000	Total £000
Fixed remuneration				
Salaries and fees	563	354	69	986
Allowances and benefits ²	26	12	10	48
Role based allowance ³	88	56	-	144
Pension allowance	160	101	31	292
Total fixed remuneration	837	523	110	1,470
Variable remuneration				
Cash bonus	-	-	-	-
Deferred bonus	594	374	-	968
Dividend on vested deferred bonus ⁴	-	43	-	43
Share awards ⁵	584	368	216	1,168
Total variable remuneration	1,178	785	216	2,179
Total	2,015	1,308	326	3,649

Year ended 30 September 2019	N S Terrington £000	R J Woodman £000	J A Heron ¹ £000	Total £000
Fixed remuneration				
Salaries and fees	503	317	268	1,088
Allowances and benefits ²	25	12	27	64
Role based allowance ³	-	-	-	-
Pension allowance	226	143	121	490
Total fixed remuneration	754	472	416	1,642
Variable remuneration				
Cash bonus	687	437	372	1,496
Deferred bonus	212	129	107	448
Dividend on vested deferred bonus ⁴	-	-	25	25
Share awards ⁵	1,348	849	719	2,916
Total variable remuneration	2,247	1,415	1,223	4,885
Total	3,001	1,887	1,639	6,527

¹ J A Heron retired from the Board on 6 January 2020 and the remuneration shown above is in respect of his service to that date. He received no additional remuneration for cessation of office.

² 'Allowances and benefits' includes private health cover, fuel benefit and company car provision or company car allowance (£10,000 to £12,000). It also includes reimbursement from the Company in respect of certain travel costs incurred in connection with the performance of executive director 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 included represent the payments HMRC treats as taxable together with an allowance to cover the tax.

³ 'Role based allowance' was introduced following the AGM in 2020. The fixed pay allowance will be paid quarterly in shares and released over five years in equal tranches. The allowance is £140,000 per annum for N S Terrington and £90,000 per annum for R J Woodman. The RBA is not subject to performance conditions.

⁴ 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, dividends will accrue to the point of vesting on deferred share awards made in respect of the year ended 30 September 2016 and thereafter.

⁵ The PSP value for the year ended 30 September 2020 has been determined using the average closing share price for the three months ended 30 September 2020 as an estimate. The actual value of the awards will not be finalised until the closing share price is known when the awards vest in December 2020 post the Preliminary Results announcement.

The share awards value for the year ended 30 September 2019 has been restated to reflect the market value of the shares under the PSP that vested on 1 December 2019 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. They ceased pension accrual 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 fixed at 45% of base salary during 2017 so that the Group would have known costs associated with pension provision. This fixed percentage was a lower amount than the actual contractual entitlement based on the most recent figures presented by the Group's actuaries.

From 14 February 2020, for Nigel Terrington and Richard Woodman, a reduction to 20% of base salary was made as part of the new Remuneration Policy approved at the 2020 AGM (John Heron had retired as a director on 6 January 2020). This change further aligned executive directors' pension contribution with the average contribution of the wider workforce. No compensation was paid or payable to the executive directors in respect of this change. Contributions in respect of pension provision for each of the directors are shown as 'pension allowance' in the single total figure of remuneration table. Newly appointed executive directors will receive a pension contribution of 10%.

A small number of former members of the Plan receive a cash supplement of 45% of salary for having left the Plan. About 10% of employees are still accruing benefits in the Plan. Those employees contribute 5% of salary and there is an employer contribution, which at the start of the year was 32% of salary, and which increased to 43.8% in July 2020. The majority, in terms of numbers, of the workforce are members of the defined contribution scheme where the maximum employer contribution is 10% of salary (subject to an employee contribution level of 6% of salary). When the Group's contribution rose to 10% in January 2020 approximately half of eligible employees increased their contribution to 6% to receive the additional matching funds.

Consequently, the Committee considers that the executive directors' pension contribution is aligned to the workforce average contribution as well as reflecting other employees whose service to the Group is of equivalent longevity and were members of the Plan. There is, therefore, at this point in time, no intention to adjust the contribution level further. The next review of pension arrangements will take place in 2022 as part of the three year policy review.

Annual bonus

The annual bonus for the year ended 30 September 2020 was based on performance against business, financial and risk measures and personal strategic objectives (as detailed below) which resulted in a bonus of 66.1% of maximum opportunity for each of the executive directors:

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	Maximum	Actual	Outcome
Financial performance	30%					4.7%
Underlying profit	40%	£163.8m	£167.8m	£172.8m	£120.0m	0.0%
Underlying RoTE	30%	13.7%	13.9%	14.3%	9.8%	0.0%
Underlying NIM progression	10%	+2bp	+6bp	+11bp	-5bp	0.0%
Cost: income ratio	10%	44%	43.2%	42.4%	43.0%	6.2%
CET1	10%	13.0%	13.7%	14.4%	14.3%	9.3%
						15.5%
Future value and strategy	30%	Qualitative assessment by the Remuneration Committee of:				23.4%
Development activities	25%	Increased savings market capacity BBLS/CBILS delivery Digital systems development for intermediaries and customers, providing online platforms for existing mortgage operations and for new products which delivered an improved customer experience and processing efficiencies				18.0%
Pipeline	25%	Buy-to-let pipeline is strong, at £868.1m, with embedded returns materially stronger Development finance post-offer pipeline now £171.5m				18.0%
Embedded value	25%	IRB module 1 completed New business volumes lower but inception margins and credit quality increased Retention levels materially stronger across the Group including for buy-to-let at 93.4% (up from 91.4% in 2019) Savings margin enhancements which will drive future NIM benefits together with strong savings outperformance driving value in 2021 and beyond				18.5%
Liability management	25%	Funding cost reduced Effective management of direct / platform mix Increased contingent funding Completion of a fully-retained securitisation during the year and accessing TFSME funding Prudent LCRs – offset to P&L in the Covid-stressed environment Enhanced treasury management systems				23.5%
						78.0%
Risk	20%	Qualitative assessment by the Remuneration Committee of:				18.0%
		Enhanced stress testing, delivered ICAAP, ILAAP, RP with strong PRA engagement. Excellent operational resilience clearly demonstrated. Applied tighter risk appetite across new lending including lower LTVs				90.0%
Personal performance	20%	Individual targets for each of the CEO and CFO detailed below:				20.0%
		For each director				100%

	Individual targets	Actual performance
N S Terrington	Continue to focus the Group's presence as a leading UK specialist lender	Strong buy-to-let pipeline at year end £868.1 million Specialist landlord finance (92.8%) of new business
	Expand the addressable savings market	Savings expansion with margin enhancements of 47bps Additional platform relationships established
	Continuing technology development to digitise the business for our customers, with faster decision making and improved cost efficiencies	Digital implementations to deliver business and customer benefits; intermediary portal phase 2, mortgage servicing portal, CBILS portal, implemented use of Clarity data
	Further develop the Group's risk management framework, including operational resilience	Established prudential risk team and increased specialist operational risk resource Launched the Executive Risk Committee to increase first line oversight of principal risks
	Continue to build a succession plan pipeline for Executive Committee roles	Four internal appointments to senior roles (50% male, 50% female) from the internal succession planning pool of high performers, including appointment of the CRO
R J Woodman	Optimise the Group's funding costs to support lending activities	Strong management of the reforecast in response to Covid-19, to ensure the Group remained prudent in both capital and liquidity terms with excellent liability performance
	Deliver Module 1 of IRB together with ICAAP, ILAAP and Recovery Plan submissions to the regulator	Module 1 IRB delivered to original timescale and Module 2 well progressed Capital reporting enhanced and IRB shadow metrics embedded Enhanced stress-testing capabilities generated through the IRB project
	Oversee the Group's transition away from LIBOR in terms of project governance, conduct risk oversight and treasury management	Project sponsor establishing a project team covering lending, treasury, operational risk and conduct functions with key milestones delivered to plan including regulatory updates, website, product and system developments
	Understand and assess the financial risks from climate change that affect the firm and oversee these risks within the firm's overall business strategy and risk appetite	Climate change adopted as a principal risk by the Board Project team established covering governance, data, disclosure, scenario testing and products. A plan and a charter have been developed for each work stream with a lead manager appointed to oversee progress
	Ensure actions progress to support the Group's diversity targets	50% of senior appointments were female Equality, Diversity and Inclusion Network launched

Annual bonus outcome

The resulting bonuses for the year ended 30 September 2020 were as follows:

Executive director	Financial performance	Future value and strategy	Risk	Personal performance	Total	Total £000	Cash £000	Share value £000
N S Terrington	4.7%	23.4%	18.0%	20.0%	66.1%	594	-	594
R J Woodman	4.7%	23.4%	18.0%	20.0%	66.1%	374	-	374

The Committee determined that the formulaic outcomes under the bonus framework were fair and appropriate in light of the very strong non-financial performance and exemplary leadership shown over the period, therefore it was decided that no discretion should be applied to outcomes.

In reaching this decision, the Committee took into account the shareholder and employee experience during 2020. The reduction in executive director bonuses was commensurate with the shareholder experience in terms of dividend performance and was also aligned with the wider workforce bonus outcome.

No cash bonus will be paid to the executive directors for 2020, instead 100% of amounts awarded will be 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; details on the applicability of malus and clawback provisions to these awards are provided in the Remuneration Policy in the Annual Report and Accounts 2019.

Paragon Performance Share Plan

Awards vesting in respect of the year ended 30 September 2020

Awards granted in December 2017 under the Group's PSP are subject to performance conditions measured over the three financial years ended 30 September 2020.

Performance condition	Weighting	Threshold vesting for 25% of maximum award	Maximum vesting	Actual performance	Vesting outcome
Relative TSR	50%	Median performance	Upper quartile performance	Upper quartile performance	100%
EPS growth	25%	RPI plus 3% p.a.	RPI plus 7% p.a.	Below threshold	0%
Risk	25%	n/a	n/a	88%	88%
Total as a % of maximum award					72%
Total as a % of salary at grant					144%

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 and 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.

Performance in all risk areas discussed and reviewed by the Committee was strong throughout the performance period, in particular the Committee noted that during the period:

- There had been no material regulatory breaches
- The capital base was robust and regulatory compliant
- Complaints, the main measure for customer service, were within risk appetite for the majority of the period
- Operational risk outcomes were reflective of the Group's exemplary resilience shown in the pandemic

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 and it was concluded that the vesting level was appropriate.

The vesting percentage has been reviewed by the Committee and details of the shares which will vest in December 2020, following the announcement of the Preliminary Results, are set out below.

	Total shares granted	Vesting outcome	Total shares awarded	Share price ¹	PSP value ^{2,3}
				£	£000
N S Terrington	205,192	72%	147,738	3.439	584
R J Woodman	129,227	72%	93,043	3.439	368
J A Heron ⁴	109,401	72%	54,547	3.439	216

¹The PSP value has been estimated using the average closing share price for the three months ended 30 September 2020. The actual value of the awards will not be known until the awards vest in December 2020, as it will be based on closing share price at that date.

²In 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 £0.5160 per vested share in respect of such dividends.

³As part of the December 2017 PSP award, each executive director was granted a tax-qualifying option under the Company Share Option Plan ('CSOP') over 6,279 shares (which will vest at 4,186 shares) at a per share exercise price of £4.7776. The CSOP option is subject to similar performance conditions to the main PSP award. 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.

⁴J A Heron's PSP 2017 is shown pro-rated to his retirement date of 6 January 2020.

Impact of the share price on vesting awards in 2020 and 2019

The final vesting value in 2020 reflected a 28% decline in the share price between grant and vesting and in 2019 a 35% increase on the same basis. The Committee did not apply discretion on vesting outcomes for either award.

	Number of shares granted	Grant basis	Vesting outcome	Vested shares	Share price at 30 September 2020 ¹	Impact of share price appreciation/depreciation
		£				£
2017 PSP awards						
N S Terrington	205,192	4.7614	72%	147,738	3.439	(195,369)
R J Woodman	129,227	4.7614	72%	93,043	3.439	(123,040)
J A Heron ²	109,401	4.7614	72%	54,547	3.439	(72,133)
Total	443,820					(390,542)

	Number of shares granted	Grant basis	Vesting outcome	Vested shares	Share price at 1 December 2019 ³	Impact of share price appreciation/depreciation
		£				£
2016 PSP awards						
N S Terrington	262,114	3.6188	95.44%	250,161	4.876	314,502
R J Woodman	165,074	3.6188	95.44%	157,546	4.876	198,066
J A Heron	139,753	3.6188	95.44%	133,380	4.876	167,685
Total	566,941					680,253

¹The PSP value has been estimated using the average closing share price for the three months ended 30 September 2020. The actual value of the awards will not be known until the awards vest in December 2020, as it will be based on closing share price at that date.

²The vested shares for J A Heron's PSP awards 2017 shown above have been calculated at the pro-rata amount.

³The share awards value for the year ended 30 September 2019 have been valued based on the market value on the date of vesting being 1 December 2019.

Awards granted during the year ended 30 September 2020

On 6 July 2020 the following awards were granted under the PSP with a face value of 180% of salary.

Executive director	Salary	Percentage grant	Face value of grant	Share price ¹	Number of shares
	£000		£000	£	
N S Terrington	599	180%	1,078	3.4496	312,429
R J Woodman	377	180%	678	3.4496	196,763

¹Based 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 half-year ended 31 March 2020, being the price used to determine the number of shares in accordance with the Directors' Remuneration Policy.

The PSP awards granted in July 2020 are subject to the following performance conditions, with a performance period of three years, from 1 October 2019, ending on 30 September 2022. The executive directors' awards, which are tested over the three-year performance period, will vest after five years, following the end of a two year holding period.

Performance measure	Weighting	Threshold vesting for 25% of maximum award		Maximum vesting
Relative TSR	25%	Median performance	Upper quartile performance	
Basic EPS	25%	60 pence	67 pence 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	12.5%	Consideration will be given to (i) customer insight feedback on key product lines, (ii) customer complaints relative to risk appetite levels and (iii) average overturn rate for customer complaints relative to the FOS’s reported rates		
People	12.5%	Consideration will be given to (i) employee engagement, (ii) voluntary attrition compared to industry averages and (iii) gender diversity of senior management		

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.

Application of 'windfall' gains

The Committee may reduce the extent to which an award would vest if any value in the award at the date on which the performance conditions are assessed is deemed to be a 'windfall gain' by the Committee as a result of the number of the shares subject to the award having been determined by reference to the average share price over the five dealing days following the announcement of the interim results. The Committee will consider such items as the share price used for determining the grant and subsequent share price performance over the performance period, the degree of vesting, dividend equivalents and the broader macro-economic climate in which the Group has operated to determine whether or not an adjustment to the vesting level should be made.

Relative TSR measure

The comparator group for the purposes of the relative TSR condition is:

Amigo Holdings PLC	Arrow Global Group PLC	Barclays PLC
Close Brothers Group PLC	Funding Circle Holdings PLC	Lloyds Banking Group PLC
Metro Bank PLC	NatWest Group PLC (formerly Royal Bank of Scotland Group PLC)	OSB Group PLC
Provident Financial PLC	Secure Trust Bank PLC	S&U PLC
Virgin Money UK PLC		

This group is unchanged from the previous year, other than reflecting the acquisition of Charter Court Financial Services PLC by OneSavings Bank during the period. OSB Group PLC replaced One Savings Bank as parent company of that group under a scheme of arrangement on 30 November 2020.

Payments to past directors

J A Heron retired from the Board on 6 January 2020. No payment was made for loss of office. He remains entitled, under the usual 'good leaver' provisions to awards received under the PSP and DSBP when a director. In respect of the PSP these will vest, subject to performance on a pro-rata basis (from the date of grant to the date of cessation of employment) at the end of the relevant vesting period and for the DSBP these will vest in full once the vesting period has elapsed. Both PSP and DSBP remain subject to malus and clawback provisions.

Payments for loss of office

No payments for loss of office were made during the year ended 30 September 2020.

Chair of the Board and non-executive director fees

	Year ended 30 September 2020			Year ended 30 September 2019		
	Fees £000	Benefits £000	Total £000	Fees £000	Benefits £000	Total £000
Chair of the Board						
F J Clutterbuck	255	14	269	255	14	269
Non-executive directors						
P J N Hartill ¹	87	-	87	95	-	95
A C M Morris ²	44	-	44	-	-	-
B A Ridpath	65	-	65	65	-	65
H R Tudor ³	87	-	87	85	-	85
F F Williamson	85	-	85	85	-	85
G H Yorston	65	-	65	65	-	65
Total	688	14	702	650	14	664

¹P J N Hartill resigned from the Board on 30 September 2020, ceased to be Audit Committee Chair on 10 June 2020 and Senior Independent Director on 23 July 2020

²A C M Morris was appointed to the Board on 26 March 2020

³H R Tudor became Senior Independent Director on 23 July 2020

Directors' share interests

The interests of the executive directors in the shares of the Company at 30 September 2020 (including those held by their connected persons) were:

	N S Terrington Number	R J Woodman Number	J A Heron ¹ Number
Unvested awards subject to performance conditions			
PSP ^{2,3}	539,585	339,822	121,117
Unvested awards not subject to performance conditions			
DSBP	136,772	83,076	67,080
Sharesave	12,026	12,026	-
Role based allowance ⁴	12,987	8,348	-
Total unvested awards	701,370	443,272	188,197
Vested but unexercised awards			
PSP ⁵	289,828	250,589	187,927
DSBP	212,725	26,742	17,849
Total vested but unexercised awards	502,553	277,331	205,776
Shares beneficially held	801,269	241,051	274,723
Total interest in shares	2,005,192	961,654	668,696
Awards exercised in the year⁶			
PSP	400,000	279,672	-
DSBP	-	63,482	-
Sharesave	-	-	-
Total awards exercised in the year	400,000	343,154	-

¹ J A Heron retired from the Board on 6 January 2020, the table reflects his interests as at that date, excepting that for the purposes of consistency with N S Terrington and R J Woodman his December 2017 PSP award is shown on the same basis (as detailed in note 3 below) and at an amount pro-rated to his leave date.

² As part of the December 2017 PSP award, each executive director was granted a tax-qualifying option under the Company Share Option Plan ('CSOP') over 6,279 shares (which will vest at 4,186 shares) at a per share exercise price of £4.7776. The CSOP option is subject to similar performance conditions to the main PSP award. 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.

³ For the purposes of the table above the awards granted in December 2017 to Nigel Terrington and Richard Woodman are assumed to be vested but unexercised in respect of the percentage which it is estimated will vest (72%) and to have lapsed in respect of the balance.

⁴ The role based allowance awards include those purchased on 1 October 2020 as these awards relate to the quarterly payment to September 2020.

⁵ The PSP awards exercised by Nigel Terrington were exercised on 21 February 2020, when the share price was £5.1729. The aggregate amount received, pre-tax and national insurance, was £2,069,160.

⁶ The PSP and DSBP awards exercised by Richard Woodman were exercised on 3 December 2019, when the share price was £4.8047. The aggregate amount received, pre-tax and national insurance, was £1,648,752.

The interests of the Chair of the Board and the non-executive directors at 30 September 2020, which consist entirely of ordinary shares, beneficially held, were as follows:

	2020
F J Clutterbuck	8,372
A C M Morris	4,000
B A Ridpath	4,358
H R Tudor	70,000
F F Williamson	3,000
G H Yorston	7,517

As at 2 December 2020, 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.

Peter Hartill who resigned from the Board on 30 September 2020 was interested in 7,000 ordinary shares as at the date of his retirement. Peter Hill was appointed to the Board on 27 October 2020 and at that date and at 2 December 2020 held 2,459 ordinary shares in the Company.

Share ownership guidelines

Executive directors are encouraged to hold a minimum number of shares in the Company with a value of 200% of their salary, usually calculated at 31 December each year. The shares which count towards the aggregate shares held by each director for the purposes of this calculation are:

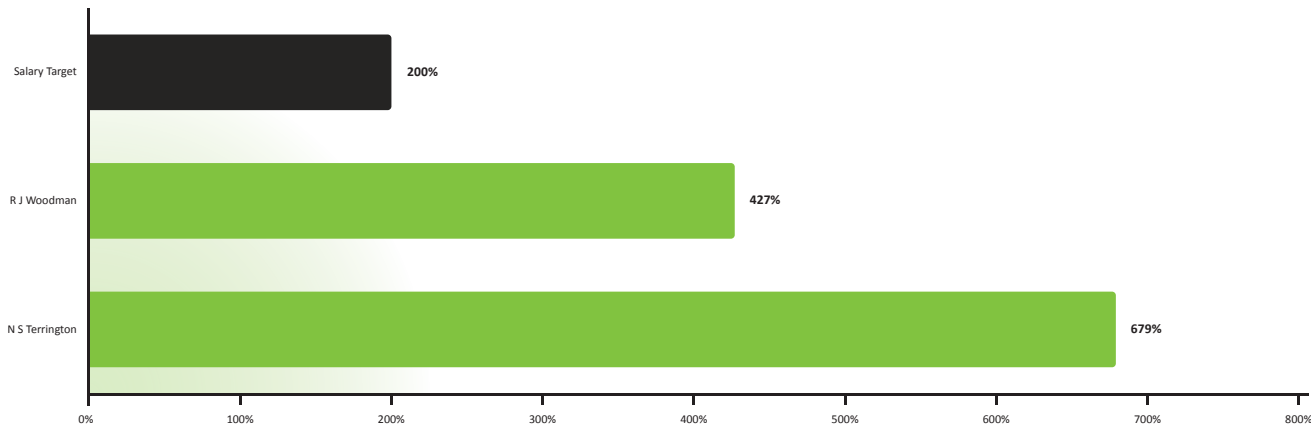
1. Unexercised but vested share awards
2. Share awards with no performance conditions attached such as the DSBP and RBA and share awards with performance conditions no longer attached such as PSP awards once the performance conditions have been tested
3. Shares purchased with own funds where those shares are unconnected to a share award exercise
4. Other beneficially owned shares such as exercised and retained share awards and shares held in the name of spouses etc

The valuation is calculated on a net of income tax and national insurance basis where relevant

The chart below compares the executive directors' holdings at 30 September 2020 to those required by the guidelines, expressed in value terms as a percentage of salary. The 30 September 2020 salary has been used this year due to the increase in salary, noted above, which occurred following the 2020 AGM.

Directors' shareholding guidelines

30 September 2020



At 30 September 2020, the holdings of executive directors were in accordance with guideline levels.

Post-employment shareholding requirement

With effect from the approval of the Remuneration Policy in February 2020 the Committee has adopted a post-cessation shareholding requirement. This requires that for two years following cessation of employment, based on his immediately pre-cessation salary, an executive director must retain such of his 'relevant' shares as have a value (as at cessation) equal to the shareholding guideline, or (if lower) the number of shares actually held at the date of departure.

'Relevant' shares are shares acquired under items 1 and 2 above. They may also include shares noted under item 4 above if such shares were originally derived from a share exercise. It does not include shares acquired under item 3 above.

B7.2.3 Application of remuneration policy for the year ending 30 September 2021

The information provided in this section of the Directors' Remuneration Report is not subject to audit.

Overview

The Committee has, for a number of years, considered as part of its regular review of executive director remuneration the wider external market and consulted with stakeholders on the structure of remuneration packages on a regular basis. Further, it will review during the year the pay ratios analysis undertaken as part of the year end processes and consider executive director remuneration and the fair pay agenda in the light of this analysis.

Executive directors

Base salary

The salaries of the executive directors were changed, in line with the newly adopted Remuneration Policy, on 14 February 2020.

It was agreed by the Remuneration Committee that there would be no increase in base salary for the year ending 30 September 2021 for the executive directors.

Nil increases were also agreed for most other employees across the Group except where a pre-existing contractual agreement was in place, or, where a person's role had substantially changed or their responsibilities significantly increased (increases were awarded to less than 2% of employees).

	Salary with effect from		
	1 October 2020	14 February 2020	1 October 2019
	£	£	£
N S Terrington	598,754	598,754	503,150
R J Woodman	377,087	377,087	316,875

Allowances and benefits and pension contributions

No change from the stated policy.

Annual bonus

The annual bonus structure and maximum opportunity remain unchanged. As noted earlier in this report deferral for the year ended 30 September 2020 will be 100% in comparison to prior years where deferral has been 25% of amounts over £50,000. This change has been agreed for the 2020 bonuses only, but the Committee has always had the right to require higher levels of deferral and in addition the executive director may elect to defer a greater proportion and therefore higher deferral may operate in future.

In line with the policy, the Committee has determined that for 2021 performance will be assessed against a balanced scorecard of measures consisting of: financial performance (30%) including core profit, RoTE and cost to income ratio targets, together with a range of other metrics derived from the Group's financial plans; future value and strategic development (30%); risk management (20%); and personal performance (20%). The Committee added an additional measure to its financial performance target this year to reflect the Group's performance in the strategically and regulatory important area of capital (addition of CET1 measure) and will review financial performance metrics to ensure they each reflect the ongoing priorities of the Group. The two core measures of underlying profit and underlying RoTE comprise 70% of the financial performance award, but the Committee will annually determine the appropriate secondary measures by reference to the strategic focus for the year. For example, in a strong position in the business cycle, loan growth and margins may carry the most weight, whereas in more challenging times capital and liquidity strength may have greater importance. In all cases, the measures chosen will relate back to the board-approved Corporate Plan. For 2021 the secondary measures will continue to be underlying NIM progression, cost:income ratio and CET1.

The Committee has chosen not to disclose, in advance, the targets which apply to these measures as it considers them 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.

PSP awards

Award levels for executive directors are 180% of base salary. The performance conditions (in respect of TSR, risk and customer and people metrics), targets, individual performance and Group underlying performance requirements are as summarised above for the awards granted in the year ended 30 September 2020. The TSR grouping remains the same. However, the EPS targets have been updated to reflect the current macro-economic climate whilst maintaining an appropriate level of stretch in the target. The EPS performance metric will be as follows:

Performance measure	Weighting	Threshold vesting for 25% of maximum award	Maximum vesting
Basic EPS	25%	58.0p	66.0p or more

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.

Chair of the Board's and non-executive directors' fees

	Fee with effect from	
	1 October 2020	1 October 2019
	£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

¹The additional fee for chairing a committee is currently payable to the Chairs of the Remuneration, Audit, and Risk and Compliance Committees but not the Nomination Committee, and would be payable for the chairing of such additional committees as might be authorised by the Board.

B7.2.4 Other information

The information provided in this section of the Directors' Remuneration Report is not subject to audit.

Pay alignment across the Group

Groupwide remuneration philosophy

Paragon's groupwide philosophy on remuneration is to reward all of its employees fairly for their contribution, whilst ensuring they are motivated to always deliver the best outcomes for its customers. The Group's approach to remuneration reflects its culture, vision and values and supports its purpose whilst being aligned to the long-term interests of the Group and helping to deliver fair customer outcomes.

All employee views and the Committee

The People Forum considers the relationship between executive remuneration and pay and reward across the Group on a regular basis. Discussions with the Chair of the Committee on executive remuneration and remuneration across the wider workforce have taken place twice in the year ended 30 September 2020 and will be a regular part of the Forum's calendar in future years as well.

Additionally, employees have the opportunity to make comments on any aspects of the Group's activities through 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 also helps to ensure that decisions are made with appropriate insight to employees' views.

Alignment of all employee remuneration with stakeholders' interests

Living Wage Foundation

For a number of years the Group has been accredited by the Living Wage Foundation which means that it pays the Living Wage to all employees, and ensures that contractors' staff employed at Paragon sites such as cleaners and security personnel also receive it.

Deferred Share Bonus Plan

In 2020, in recognition of the efforts by the Group's employees during the pandemic and the need to manage costs carefully with a group-wide salary freeze, a one-off award of £1,000 (gross) of shares to all staff (below executive committee and their senior direct reports) will be made utilising the DSBP scheme. The awards will be granted in December 2020 to all eligible employees, which will be all staff employed on 3 December 2020, subject to minimum performance. The awards will have a three year vesting period and will be delivered at the end of that period, excepting 'good leavers' whose awards will vest on leaving. As the population for the award will include a few employees subject to CRD IV, malus and clawback provisions will be applicable.

This award is in addition to the usual cash-based profit related pay distribution of 1% of group profits, which has been paid for many years and forms a part of the Group's culture of ensuring a strong connection between the outcomes of the business and employees. Employees below director and head of function level are eligible to participate in this scheme, which pays out a flat sum to all eligible staff.

The DSBP will also be utilised to defer an increased number of senior management bonuses; for members of the Executive Committee 50% of their bonus above £30,000 will be deferred and for most other senior managers it will be 25% of their award above £30,000. For this pool of employees, the DSBP will operate as it does for the executive directors.

Directors and senior management participate in the annual bonus scheme, which is designed to incentivise them 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.

Discussions regarding both the group-wide salary freeze and the utilisation of the DSBP for the all employee and wider senior management pool grants took place at Committee meetings alongside discussions on executive director pay arrangements.

Sharesave

Paragon's sharesave scheme has operated for many years and encourages employees to become shareholders in the Group through this tax efficient mechanism. Take up over the five years up to and including 2020 has averaged at about 50% of eligible employees, but this year take up was just over 60% of eligible employees. The total take up across all schemes currently operating, at the point of grant of the 2020 sharesave was 72% of eligible employees reflecting the continued and ongoing alignment between employees and shareholders and employee commitment to the growth of the Group.

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.

	<i>Note</i>	2020	2019	Change
		£m	£m	£m
Wages and salaries	50	64.0	62.6	1.4
Dividend paid	41	35.9	54.0	(18.1)
Loan advances and investment in portfolios		2,050.5	2,536.6	(486.1)
Corporation tax paid	42	46.1	39.4	6.7

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.

Comparison of annual change in directors' pay with the average employee

The following table shows the percentage change in the salary, benefits and bonuses of each of the directors between 2019 and 2020 compared to the percentage change in the average of each of those components of pay for an employee. The increases in salary reflect the salary review implemented in October 2019 for most employees but which for the executive directors, was as noted in the Chair's letter, effective from 14 February 2020.

The changes to fees for P J N Hartill and H R Tudor reflect P J N Hartill's departure from the Board during the year and H R Tudor's appointment as Senior Independent Director. The table illustrates a decrease of 100% in the cash bonus for the current executive directors as a result of the decision taken by the Remuneration Committee to defer the entire value of their respective annual bonuses for the year ended 30 September 2020.

The table also reflects changes in the employee population since 30 September 2019.

The table will build over the next five years and consequently the data, will in due course, provide more detailed information to the Committee regarding pay averages across the Group.

	Salaries and fees ¹	Allowances and benefits ²	Cash bonus
	%	%	%
N S Terrington	11.9	4.0	(100.0)
R J Woodman	11.7	-	(100.0)
J A Heron	(74.3)	(63.0)	(100.0)
F J Clutterbuck	-	-	-
P J N Hartill	(8.4)	-	-
A C M Morris	-	-	-
B A Ridpath	-	-	-
H R Tudor	2.3	-	-
F F Williamson	-	-	-
G H Yorston	-	-	-
Average employee	8.5	19.2	(35.2)

¹'Salary and fees' are calculated using the 'Salaries and fees' data provided in the single figure table for executive directors above and in the 'Chair of the Board's and non-executive directors' fees' table also above. It does not include 'Pension allowance' or the 'Role based allowance' ('RBA'). Whilst the 'Pension allowance' and RBA are fixed pay, and are detailed as such in the single figure table for the executive directors, they are not included in this table to enable a more direct comparison with the average employee information.

²'Allowances and benefits' are calculated using the data provided in the single figure table above for 'Allowances and benefits' and in the 'Chair of the Board's and non-executive directors' fees' table also above.

CEO pay comparatives over 10 years

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, Nigel 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	%	%
2020	2,015	66.1	72.00
2019	3,001	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

CEO pay ratio

The table below sets out the CEO pay ratio compared to the 25th, median and 75th percentile employee 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.

Year	Method	25th percentile pay ratio	Median pay ratio	75th percentile pay ratio
2020	Option A	81:1	59:1	34:1
2019	Option A	125:1	95:1	55:1

	25th percentile pay ratio	Median pay ratio 2020	75th percentile pay ratio	25th percentile pay ratio	Median pay ratio 2019	75th percentile pay ratio
Base salary	£23,000	£28,000	£36,000	£21,000	£29,000	£53,000
Total remuneration	£25,000	£34,000	£58,000	£24,000	£32,000	£54,000

Base salaries and total remuneration shown above are the details relating to the relevant identified employees in each year.

Change in CEO pay ratios

As with the information included in the 'Comparison of annual change in directors' pay with the average employee' the ratio appears significantly reduced for the year ended 30 September 2020, as a result of the decision taken by the Remuneration Committee to defer the entire value of the executive directors' bonuses for the year ended 30 September 2020. Shareholders should not presume that the significant differentials shown in the ratios will be repeated in future years.

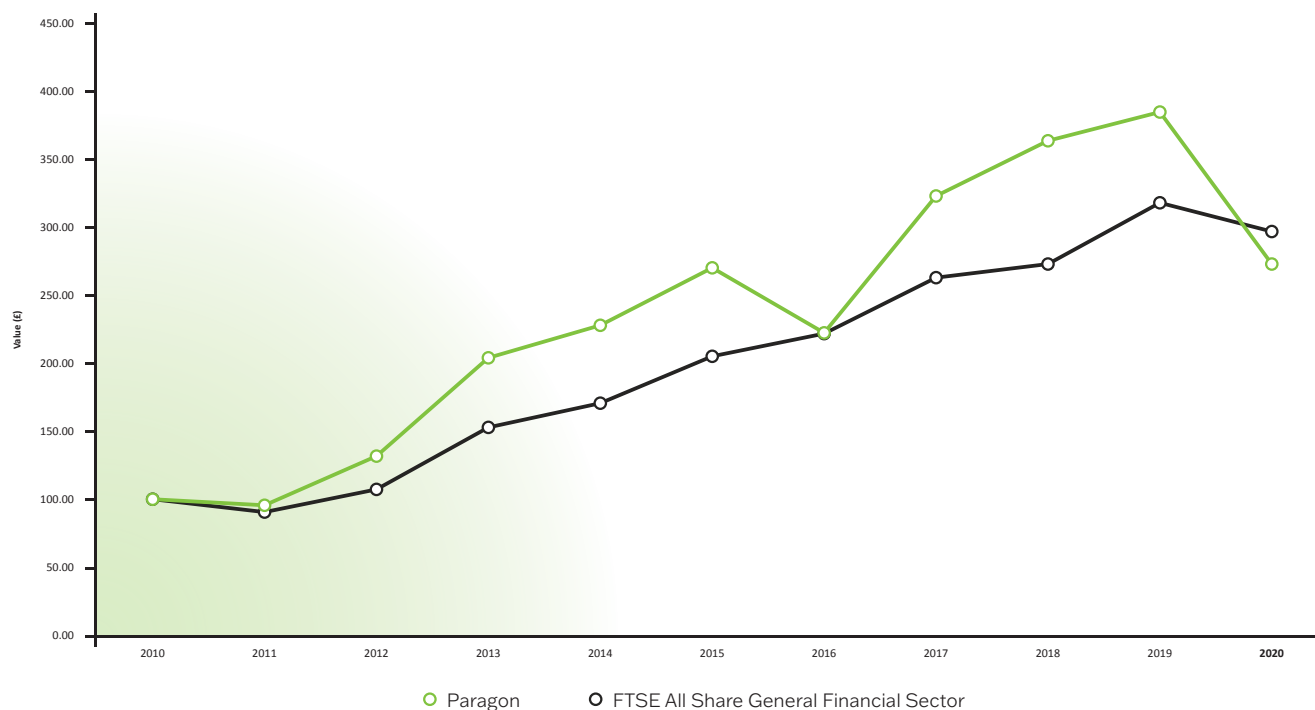
Gender pay

Details of the Group's gender pay gap analysis are shown in Section A6.3. Gender pay review and reporting are overseen by the Nomination Committee as part of its responsibilities in respect of diversity.

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 2020, of £100 invested in Paragon Banking Group PLC on 30 September 2010, 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 as at 30 September 2020



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:

Director	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)

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 A Hill	27 October 2020 to 26 October 2023
A C M Morris	26 March 2020 to 25 March 2023
B A Ridpath	20 September 2020 to 19 September 2023
H R Tudor	24 November 2020 to 23 November 2023
F F Williamson*	20 September 2020 to 19 September 2023
G H Yorston	20 September 2020 to 19 September 2023

*F F Williamson will step down from the Board on 31 December 2020.

B7.3 Policy Summary

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 was adopted at the AGM in 2020. However, this is a summary only, included here for ease of reading the Annual Report on Remuneration, and these pages do not constitute a Policy Statement in accordance with the Regulations. From 1 October 2021, Paragon is expected to be subject to CRD V and therefore a number of the changes noted in the Remuneration Policy will come into effect. For the full Policy Report, including information relating to the impact of becoming a Level 2 bank, please refer to the Annual Report and Accounts for the year ended 30 September 2019 available at www.paragonbankinggroup.co.uk.

Changes to the executive directors' salaries and pensions together with the introduction of role-based allowances were originally scheduled to take effect from 1 October 2019. Following shareholder engagement these changes were introduced on the day after their approval at the 2020 AGM. This engagement also led to greater clarity regarding the customer metrics used in the July 2020 PSP awards being published to the Stock Market as detailed in Section B7.2 above. There have been no other changes to the policy put to the AGM in 2020.

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.</p>	Whilst no formal performance conditions apply, an individual's performance in role is taken into account in determining any salary increase.
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.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
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 following approval at the 2020 AGM, 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>	None.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Annual bonus			
To incentivise executives to achieve specific, predetermined goals that drive delivery of the Company's operational objectives.	Each executive director's annual bonus is based on a mix of financial and non-financial performance measures measured over one year.	Maximum annual bonus potential is 150% of salary in respect of any given financial year.	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.
To reward individual performance.	The annual bonus is non-pensionable. Malus and clawback apply to the annual bonus as described in the full Remuneration Policy in the Annual Report and Accounts 2019.	For target performance, a bonus of 50% of maximum potential will be awarded, with additional amounts being awarded for exceptional performance.	Performance measures and their weightings are reviewed annually to maintain appropriateness and relevance.
To encourage retention and alignment with shareholders' interests through deferral of a proportion of bonus, awarded in shares.	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.	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.	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.
		For performance below threshold, no bonus is payable.	

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
Paragon Performance Share Plan ('PSP')			
To incentivise executives to achieve enhanced returns for shareholders.	An annual award of shares subject to continued service and performance conditions assessed over a three-year performance period.	Maximum award is 180% of salary in respect of any financial year.	The Committee will take into consideration prior performance when assessing the value of the PSP grant.
To encourage long-term retention of key executives.		25% of the awards will vest for threshold performance, with full vesting taking place for equalling or exceeding the maximum performance target.	Forward-looking performance is measured against a long-term scorecard of challenging performance measures that reflect the Company's strategic priorities.
To align the interests of executives and shareholders.	The performance conditions used are reviewed on an annual basis to ensure they remain appropriate.	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.	Performance conditions may include financial measures (eg adjusted EPS and/or relative TSR), and non-financial measures which may include risk-based, people and/or customer measures.
	Awards are structured as nil cost options with a ten-year life, a conditional award of shares or an award of forfeitable shares.	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.	Performance measures and their weightings, where multiple measures are used, are reviewed annually to maintain appropriateness and relevance.
	Implementation of the vesting rules is described below the table.		
	Malus and clawback apply to the PSP as described in the full Remuneration Policy in the Annual Report and Accounts 2019.		

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.

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.

B7.4 Approval of Director's Remuneration Report

The information provided in this part of the Directors' Remuneration Report is not subject to audit.

This Directors' Remuneration Report, Section B7 of the Annual Report and Accounts, including the Statement by the Chair of the Committee, the Annual Report on Remuneration and the Policy Summary, 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

3 December 2020

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...

Finlay Williamson,
Chair of the Risk and Compliance Committee



B8. Risk management

B8.1 Statement by the Chair of the Risk and Compliance Committee

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. I will be stepping down as Chair of the Committee at the end of 2020 and my final year has seen the impact of Covid-19 posing unique challenges to the Group's risk framework.

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 ensuring it is supportive of the overall risk appetite set by the Board and adequately embedded in the Group's operations.

The Committee structure has been further enhanced during 2020 with the new monthly Executive Risk Committee. The addition of this layer of governance is crucial in ensuring that the RCC maintains its focus on the key material and strategic risk issues that the Group faces. This will enable the RCC to spend more time pro-actively identifying and assessing new and emerging risks.

Following the retirement of the Group's Chief Risk Officer ('CRO') Malcolm Hayes at the end of 2019, the Group is pleased to announce the appointment of Ben Whibley as his successor.

Ben has been with the Group for 6 years, previously holding the position of Deputy CRO. Prior to this Ben was CRO for Paragon Bank PLC. The Committee and I would like to wish him well in his new role and look forward to working closely with Ben as the Group continues to enhance its risk management capabilities.

Given the inevitable challenges of Covid-19 and the impact on the risk profile, much of the Committee's agenda since March has focussed on the new and emerging risks from the pandemic and the resultant regulatory, economic and people-related impacts. In particular, the Committee has regularly reviewed:

- The impacts of the revised working arrangements for employees given the UK Government's announcement of a full lockdown in March 2020
- The implementation of payment holidays and other forbearance strategies ensuring customer treatment remains at the forefront of our considerations
- Increased risks and additional mitigation required due to restricted ability to carry out onsite property surveys and the limitations on the completeness of credit bureau data
- The issuance of CBILS and BBLS including the associated credit risk, financial crime and processing risks

The Committee continues to monitor the implications of these changes together with any further regulatory requirements that are being issued to manage customer and prudential risks arising from Covid-19.

Despite the heavy focus on Covid-19 and the heightened risks thereof, the Committee has continued to balance the need to provide close oversight of the developing situation in respect of the pandemic with standing agenda items. This has also included non-Covid-19 specific risks which still require in-depth focus in the normal course of business.

During the coming year, the Committee's priorities will include:

- Ongoing oversight of the Group's response to Covid-19 and any further government or regulatory measures that are implemented
- Continuing to review the potential impacts on the Group of the consequences of UK's decision to withdraw from the EU as the transition period ends in December 2020 and the basis of the future relationship becomes clearer
- Monitoring the progress of the Group in managing exposures to LIBOR as the primary sterling interest rate benchmark as this is phased out
- Continued oversight of the Group's project to implement an IRB approach for credit risk
- Reviewing the Group's progress in enhancing its enterprise-wide risk management framework including ensuring risk appetite remains consistent with delivery of the Group's strategic objectives and proposing any required changes in risk appetite to the Board
- Overseeing the Group's progress on responding to the increasing challenges posed by climate change and addressing any impact this may have on the Group's risk profile
- 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
- 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 there remain significant challenges which the Group will continue to face. It is clear that the economic, political and regulatory environment is highly dependent on the trajectory of the pandemic which remains uncertain. However, I have been impressed with the way that the Group has and continues to respond. The Group responded efficiently, effectively and considerably to the challenge of mobilising the workforce from home in the face of lockdown and in maintaining levels of service across all products. Whilst payment holiday requests were a relatively low percentage across the whole portfolio, the revised processes and associated risks were managed promptly despite the short timeframes within which these were implemented.

The Group also faces added non-Covid-19 specific challenges within the operating environment that could materially impact on the Group's risk profile. These include the transition away from LIBOR which is being overseen through a comprehensive programme to manage the associated risks. However, there are a number of dependencies which will need to continue to be monitored closely to ensure successful delivery.

In addition, the ongoing level of uncertainty surrounding the basis of the UK's status post-2020 following its departure from the EU remains high, with the future of its 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 of the need to reinforce these should circumstances change materially.

As I indicated earlier, this is the last time I shall be writing to you as Chair of Paragon's Risk Committee, as I will be stepping down from the Board at the end of the year. Peter Hill, who was appointed to the Board in October, will take over as Chair of the Committee on my departure, following a handover period.

Looking back over my time with the Group, firstly with Paragon Bank in its earliest years, and then on the main board, the level of progress in the Group's risk infrastructure is striking, I am proud of what has been achieved and of the team we have put together. I would like to thank my fellow directors and the Group's risk function for their support over my tenure as Chair of the Committee, and to extend to them and to Peter, my best wishes for the future.

Finlay Williamson

Chair of the Risk and Compliance Committee
3 December 2020

B8.2 Risk governance

The Group's approach to governance and the committee structures are described in Section B4. This covers revisions during the year including the implementation of a new Executive Risk Committee ('ERC'). The Committee structure and lines of oversight in place at the year end are set out below.

Risk and Compliance Committee

The Risk and Compliance Committee assists the Board in fulfilling its responsibilities for risk management. It comprises the independent non-executive directors and the Chair of the Board. The terms of reference, which were reviewed and approved by the Board in October 2020, include all matters indicated by the 2018 Code.

The Committee's responsibilities include reviewing:

- Recommendations and matters for escalation from the ERC
- The effectiveness of the Group's risk management framework and the extent to which risks inherent in the Group's business activities and strategic objectives 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 Committee provides ultimate oversight and challenge to the Group's enterprise-wide risk management arrangements which are managed through the ERC. It also retains oversight responsibility for model risk within the Group. The Risk and Compliance Committee delegates day-to-day oversight for model risk to the Model Risk Committee ('MRC').

The Risk and Compliance Committee meets at least four times a year and normally invites the executive directors, 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.

Standing items covered in each meeting of the Committee have included:

- Reviews of the principal risks facing the Group including a comprehensive refresh of the risks during 2020
- Consideration of new or emerging risks and regulatory developments and their impact on the Group
- 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
- Continued to monitor progress in respect of the Group's application for regulatory approval to enhance credit risk management by implementing an IRB approach
- 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
- Conducted deep dive reviews into targeted risk areas, such as the potential impact on the Group of negative interest rates
- 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
- Continued to monitor the progress of the Group in addressing its approach to operational resilience following the issuance of the regulatory consultation paper in December 2019. This has included significant focus on the Group's third party provided services
- 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 Recovery Plan recommending approval to the Board
- Challenged and approved various key risk policies

Executive Risk Committee ('ERC')

ERC was established during the year to assist the CEO in designing and embedding the Group's risk management framework, monitoring adherence to risk appetite statements and identifying, assessing and controlling the principal risks within the Group. It includes all Executive Committee members and reports to the CEO. The ERC monitors the interaction and integration of the Group's business objectives, strategy and business plans with the Group's risk appetite and risk strategy and escalates breaches and significant matters to the Risk and Compliance Committee, recommending changes as appropriate.

Key areas of focus for the ERC include:

- Developing and, at least annually, reviewing the appropriateness and effectiveness of the overall risk management framework to manage and mitigate risk
- Reviewing the Group's approach to controlling each principal risk and its capability to identify and manage such risks
- Reviewing emerging risks as they arise, including consideration of their potential impact on the Group's business objectives, strategy and business plans, as well as risk choices, appetite and thresholds

- Periodically reviewing the effectiveness of the Group's internal control and risk systems including the Group's material outsourced arrangements and risks associated therewith, particularly where they might impact customers
- Ensuring compliance with relevant PRA and FCA regulations (excluding the SMCR, which is overseen by the Executive Committee)
- Reviewing the process and outcome of the Group's ICAAP, ILAAP, Recovery Plan and Resolution Pack together with recommendations to the Risk and Compliance Committee and Board for approval
- Considering the implications of any proposed legislative or regulatory changes that may be material to the Group's risk appetite, risk exposure, risk management and regulatory compliance

The ERC is supported by an Asset and Liability Committee, Customer and Conduct Committee, Credit Committee, and Operational Risk Committee. Each of these executive committees operates within terms of reference formally approved by the ERC. Their primary functions are described below.

Asset and Liability Committee ('ALCO')

ALCO comprises heads of relevant functions and is chaired by the Chief Financial Officer.

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 through ERC to the Risk and Compliance Committee.

Customer and Conduct Committee ('CCC')

The CCC comprises heads of relevant functions and is chaired by the Chief Risk Officer.

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 Monitoring Plan.

Credit Committee

The Credit Committee comprises senior managers from the risk, finance and collections functions and is chaired by the Credit Risk Director.

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 through ERC to the Risk and Compliance Committee. The Committee also operates the Group's most senior lending mandate.

Operational Risk Committee ('ORC')

The ORC comprises heads of relevant functions and is chaired by the Operational Risk Director.

The ORC is responsible for overseeing the Group's operational risk and resilience 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.

Model Risk Committee ('MRC')

The MRC reports directly to the Risk and Compliance Committee and comprises senior managers from Risk, Finance and the main business areas, it is chaired by the CRO and attended by Hugo Tudor, a non-executive director. 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.

B8.3 Risk Management Culture

The Board is committed to maintaining a strong risk culture as a fundamental element of the Group's corporate culture. This risk culture promotes effective risk management that is consistent and commensurate with the nature, complexity and risk profile of the business.

The importance of risk management is embedded at all levels of the business and all staff are expected to understand and have accountability for the risks they take. Appropriate risk management is core to the Group's performance management process. The Group's risk culture has been central in ensuring historically low levels of credit and operational losses and the absence of any material conduct issues affecting customers.

The Group's strong risk culture is embedded through various practices which support and protect the Group's wider strategic goals and remain essential to protecting the Group's customers, shareholders, creditors and its reputation. These include:

- 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
- Robust risk management remains at the heart of all decision-making and is conducted 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 remains within its defined risk appetite
- The Group has a risk management framework which ensures that risks are owned and managed in a consistent way

B8.4 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 and the associated governance arrangements are designed to ensure there that there is clear organisational structure with distinct, transparent and consistent lines of responsibility in the facilitation of risk management.

Effective risk management is core to the execution of the Group's strategy. A key priority for the Group is to ensure that the framework continues to evolve to reflect the changing landscape and emerging threats necessitating ongoing investment and enhancement in the enterprise-wide risk management system. The Group continues to ensure that the tools for effective risk identification, assessment and monitoring are appropriate and embedded at all levels across the Group. Significant work has been undertaken over the past twelve months, and is ongoing, to develop the framework to support the Group's strategic aspirations. This includes refinement of core risk processes and language and strengthening the committee structure to support effective challenge and escalation.

Risk management framework

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:

- Determine a defined strategy in the Group's attitude to risk including outlining the approach taken in respect of setting qualitative statements and quantitative metrics to measure the Group's tolerance and appetite for risk
- Establish a consistent risk taxonomy which describes the principal risk categories and the more granular aspects of each of these categories
- 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
- 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 the Recovery Plan
- Provide senior management and relevant committees with risk reporting that is relevant and appropriate, enabling timely action to be taken in response to the information included within these reports
- Determine a suite of risk policies which align to the principal risks and identify the key controls to measure and manage these risks

Three lines of defence model

The Group employs a 'three lines of defence model' to delineate responsibilities in the management of risk ensuring adequate segregation in the oversight and assurance of risk as follows:

- The *first line of defence*, comprising executive directors, together with managers and employees in operational and support areas. The first line has day-to-day responsibility for:
 - o Risk identification, assessment and measurement
 - o Control and ongoing monitoring of operations
 - o Escalation and reporting of risk issues in line with stated appetite

Risk Champions are appointed within all business areas to support the embedding of an effective risk culture across the Group.
- The *second line of defence* is provided by the Risk function headed by the CRO, who reports directly to the CEO. The function is overseen by the Risk and Compliance Committee and its supporting executive committees. Risk and Compliance provide support and independent challenge on all risk related issues specifically:
 - o Developing and maintaining the risk management framework covering all areas of the Group
 - o Developing and maintaining risk policies within that framework, ensuring these are consistent with the Board's risk appetite
 - o Ensuring that risks generated by the business are measured, monitored, controlled and reported on a timely basis
 - o Maintaining open and constructive engagement with the regulatory authorities
- 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. Internal Audit provides independent assurance on:
 - o First and second lines of defence
 - o The appropriateness and effectiveness of internal controls
 - o Effectiveness of policy implementation

Risk appetite framework

The risk appetite framework outlines the Group's approach to setting and monitoring risk appetite. The framework stipulates the approach to setting risk appetite, reporting and escalation obligations and the frequency of review. The framework is subject to annual board approval.

In determining the Group's risk appetite, the following principles are integral:

- Alignment to principal risks
- Alignment to strategic objectives
- Appropriateness of calibration to drive timely action
- Ongoing monitoring of the risk profile

The Group has developed a tiered approach to setting and monitoring of risk appetite. A set of board-owned (Level 1) metrics has been established. These are monitored on an ongoing basis and any threshold breaches in respect of these are immediately escalated to the Board. Executive committees are responsible for reviewing more extensive (Level 2) metrics. Any breaches of Level 2 metrics are escalated to the ERC who determine whether these are sufficiently material to be reported to the Board.

As part of the evolution of the enterprise-wide risk management framework, work is in progress to ensure that the risk appetite framework continues to mature. Ongoing development is being undertaken to ensure:

- All the revised principal risks have qualitative and quantitative appetites
- There are appropriate Level 1 and 2 appetites monitored on an ongoing basis
- Calibration of appetite is appropriate and will drive timely management action

B8.5 Principal risks and mitigations

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.

The risks are set out in accordance with the Group's amended classification of its principal risks, approved by the Board in the year. Therefore, the headings shown differ from those presented in previous annual reports. In particular, reputational risk, model risk and climate change risk are separately identified as principal risks for the first time.

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



Capital Risk

Description

The Group faces the risk of insufficient capital to operate effectively including meeting minimum regulatory requirements, operating within Board approved risk appetite and supporting the Group's strategic goals.

In addition, the changes made in the Basel III capital regime by the BCBS regarding minimum capital requirements, which will now impact from 1 January 2023 could have an impact on the capital position of the Group.

Mitigation

A robust process exists over Pillar 1 reporting with a comprehensive annual ICAAP assessment including all material capital risks.

An internal capital buffer is maintained in excess of minimum regulatory requirements to protect against unexpected losses or risk-weighted asset growth.

The Group took a strategic decision in 2016 to seek the necessary regulatory approval to implement an IRB ('Internal Ratings Based') approach for credit risk. The first stage of the Group's application for the accreditation of its IRB approach to credit risk for capital adequacy purposes was submitted to the PRA in March 2020. Models have been built and tested, governance frameworks enhanced, and IRB outputs are now being regularly considered internally.

Change



Outside of the impact of Covid-19, which resulted in the delay of the BCBS changes by 12 months (to 2023) and policy amendments to the Pillar 2A regime there has been little impact on the overall capital risk framework and the Group's assessment of the likely impact of these changes.

Liquidity and Funding Risk

Description

The Group is exposed to the risk that it has insufficient funds to meet its obligations as they fall due.

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 funding required to sustain normal business activity.

Mitigation

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.

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, even under stressed conditions.

The Group has a dedicated Treasury function which is responsible for the day-to-day management of its overall liquidity and wholesale funding arrangements. The Board, through the delegated authority provided to the ALCO, sets limits as to the level, composition and maturity of liquidity resources.

Change



The Group remains well placed to access funding from a wide range of sources to meet its future funding requirements. During the year, the Group completed a fully retained securitisation which boosted its contingent funding options and also obtained access to the TFSME which remains open for drawings until April 2021.

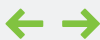
Market Risk

Description	Mitigation	Change
<p>The Group is exposed to the risk that changes in interest rates at which it lends and those at which it borrows may adversely affect its net interest income and profitability. In addition, its financial performance may be affected by fluctuations in the exchange rates between currencies.</p>	<p>This risk is managed within Board approved risk appetite limits with comprehensive treasury policies in place to ensure that the risk posed by changes and mismatches in interest or exchange rates are effectively managed.</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.</p> <p>The Group seeks to match the maturity profile of assets and liabilities and uses financial instruments, such as interest rate swaps, to hedge the exposure arising from repricing gaps.</p>	<p>↑</p> <p>The Group's market risk profile, relative to its balance sheet, has remained broadly similar and therefore associated risk levels remain generally stable compared to previous periods. However, with LIBOR expected to cease to exist before the end of December 2021, the Group will need to transition LIBOR referenced assets and liabilities to alternative risk-free rates, and this process is expected to increase interest rate risk over the next 12 months.</p> <p>A LIBOR Transition steering committee has been established to oversee the transition and the Group is working with several industry and regulatory bodies as part of the process.</p>


Credit Risk

Description	Mitigation	Change
<p>Credit risk elements which could expose the Group to the risk of unexpected material losses include:</p> <ul style="list-style-type: none"> Customer risks through failure to screen potential borrowers, and manage repayments Concentration risk in credit portfolios through an uneven distribution of exposures of borrowers, asset classes, sectors or geographies Reduction in value of collateral owned by the Group, or secured against debt owed to it Wholesale counterparty risk Outsourcer default risk 	<p>The Group has a robust limit framework supported by comprehensive policies in place that set out detailed criteria which must be met before loans are approved. Exceptions to credit policies require approval by the Credit Risk function, operating under a mandate from the Credit Committee.</p> <p>The Group uses a range of sources to inform expectations of key external factors such as interest rate movements and house price inflation which are in turn used to guide policy and underwriting.</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> <p>The majority of the Group's loans by value continue to be secured against residential property in England and Wales at conservative loan-to-value levels. The primary collateral therefore benefits from the features of UK property which forms part of a highly mature, liquid, sustainable market demonstrated over many decades of operation.</p> <p>Exposure to wholesale counterparty credit risk is limited to counterparties that meet specific credit rating criteria per the Group's comprehensive treasury policies. Exposure to approved counterparties is monitored daily by senior management within the Group's Treasury function with all exposure managed within ALCO approved limits.</p> <p>Ongoing monitoring of the credit rating and financial performance of all outsourced relationships and critical suppliers is undertaken.</p>	<p>↑</p> <p>At the onset of the Covid-19 pandemic, the Group immediately tightened credit criteria for new lending to preserve credit standards and reflect immediate lending uncertainty.</p> <p>The Group's credit discipline remains firm, but in view of the wider economic conditions, additional provision for credit losses has been allocated in line with a prudent, forward-looking view of loan performance.</p>

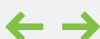
Model Risk

Description	Mitigation	Change
Models are used across the Group to inform financial decision making and hence it is imperative that the environment in which the models are designed, implemented and operate is subject to appropriate rigour.	<p>As the use of internally developed models has increased across the Group, a robust framework and governance has been developed to manage the associated risks. This includes the MRC which oversees the development, implementation and ongoing monitoring of models across the Group.</p> <p>The Model Governance Framework provides a structured and disciplined approach to the management of model risk. This includes clear development, implementation and ongoing oversight principles together with the requirements for independent validation based on model materiality criteria.</p>	 <p>It is recognised that the increasing use of internally developed models will drive a commensurate risk to the Group. However, given the strength of the framework and oversight processes, model risk remains within appetite and the outlook remains stable.</p>

Pension Obligation Risk

Description	Mitigation	Change
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.	<p>The Group conducts regular asset-liability reviews in conjunction with the Trustee to determine the optimal long-term asset allocation with regards to the structure of liabilities within the Plan.</p> <p>The Plan is subject to triennial formal valuation by the Plan actuary. The valuation process as at 31 March 2019 was completed in the year, including the agreement of a recovery plan between the Trustee and the Group which will aim to clear the deficit in the Plan. As part of that agreement a £20.0 million additional contribution was made in the year.</p>	 <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. The additional contribution made in the year has reduced the scope for further commitments.</p>


Reputational Risk

Description	Mitigation	Change
<p>Maintenance of a strong reputation across all lines of business and operational activities is core to the Group's philosophy.</p> <p>Detrimental reputational impacts may result from crystallisation of other principal risks, but also through failure to safeguard the integrity of the brand or failing to meet external expectations in conducting business practices.</p>	<p>The reputational impacts of any changes to strategy, pricing, or processes are explicitly considered in the decision-making process and are reviewed by the Director of External Relations.</p> <p>The Group has an experienced External Relations function who manage all Group communications and ensure that the reputational profile of the Group remains protected at all times.</p> <p>All material risk events are reviewed for reputational impact and mitigating actions are initiated as appropriate.</p>	 <p>The Group continues to manage its reputation effectively in all its dealings. Whilst it is mindful that the threat to reputation can emanate from many sources, the Group remains well-placed to respond quickly and efficiently to any reputational issue.</p>

Strategic Risk

Description	Mitigation	Change
<p>The Group's strategy as a specialist lender is key to its operating model and business planning. However, there is a risk that changes to the business model or macroeconomic, geopolitical, regulatory, competitive or other factors may impact delivery of strategic objectives.</p>	<p>The Group closely monitors economic developments in the UK and overseas, with support from leading independent macro-economic and other advisors.</p> <p>Stress testing is performed 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.</p> <p>The Group 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 lender.</p>	<p></p> <p>UK economic performance remains highly uncertain. The medium and longer- term impacts of Covid-19 are still to be determined. Whilst the Group has continued to remain resilient in the immediate crisis, the potential for future waves of the pandemic and associated lockdowns still present a significant risk.</p> <p>In addition, there is still a lack of clarity as to the basis of the UK's withdrawal from and future relationship with the EU. The continuing high levels of uncertainty have resulted in an increase in the overall risk assessment.</p>

Climate Risk

Description	Mitigation	Change
<p>The Group considers the impact of climate change either directly on the Group or indirectly through its third-party relationships.</p> <p>This includes the transitional risk to its strategy and profile through moving to a low carbon environment and any physical risks arising from changes to the natural environment.</p>	<p>The Group proactively manages physical risk and has specific underwriting policies aimed at mitigation, for example, risks associated with flooding and coastal erosion.</p> <p>The potential for transition risk is monitored within the different business lines, with external events prompting consideration of amendments to credit policy and underwriting criteria.</p> <p>The tightening of efficiency standards for domestic properties has the potential to impact the buy-to-let market and the energy performance of property stock. The Credit Committee has considered the EPC data to provide an insight into the energy efficiency of properties on which the Group lends.</p> <p>Longer term strategic planning will also be informed by the ongoing analysis.</p>	<p></p> <p>During the year the CFO has been assigned the SMF with responsibility for climate change and has taken the lead in developing Paragon's understanding of the issue.</p> <p>The Board has adopted climate change as a new principal risk. A working group reporting to ERC has been established to consider the plan of work required to embed the management of climate related risks within the Group.</p>

Conduct Risk

Description	Mitigation	Change
<p>The commitment to delivering fair customer outcomes is at the heart of the Group's culture.</p> <p>Conduct risk arises where the culture and behaviours fail to promote the customer's best interests resulting in unfair outcomes for the customer.</p>	<p>The Group has a formal Conduct Risk Management framework, which includes detailed policies addressing the fair treatment of customers. At the centre of these is the Conduct Risk Policy. This sets out the Group's overarching approach to the management of conduct risk.</p> <p>The management of conduct risk within the Group is tailored to the specific product and customer type concerned including dedicated quality and control teams which validate process adherence and the delivery of fair treatment for customers and appropriate management of vulnerable customers.</p> <p>All employees are required to undertake conduct risk related training.</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>	<p>↑</p> <p>Given the unprecedented challenges of Covid-19 and the need to respond quickly to changing circumstances, there is a heightened risk that customer outcomes have not been fully considered or unintended consequences may arise.</p>

Operational Risk

Description	Mitigation	Change
<p>Operational Risk arises across the Group through the possible inadequacy or failure of internal processes, people and systems or from external events.</p> <p>Operational risk is inherently diverse in nature. All the Group's activities create various forms of operational risk which need to be managed through a strong control and oversight structure. Exposure to operational risk is exacerbated through any periods of transformation and / or stress.</p>	<p>The Group has enhanced its operational risk framework over the last 18 months to ensure that it is comprehensive and enables timely and accurate analysis of operational risk exposures and drives accountability and remedial actions where issues are identified.</p> <p>Management of operational risk is enabled through a comprehensive framework of policies which are designed to ensure that all key operational risks are managed consistently across the business. This includes risk areas such as Change Management, Procurement, Data Protection, Financial Crime and People.</p> <p>The Group is committed to ensuring it remains resilient particularly in respect of IT capability. Significant investment has been undertaken to ensure it is well-protected in the face of the evolution of cyber threats. The Group relies on third party providers for a number of key services including in the provision of its savings offering and in respect of critical IT services. The robust oversight of third parties is seen as critical to overall resilience.</p> <p>Continued investment in people has been undertaken to ensure that risk exposures are minimised. This includes management of key dependency risk through effective succession planning, recruitment, development and retention strategies.</p>	<p>↑</p> <p>Inevitably with the Covid-19 pandemic there have been increased challenges in managing the business operations. The impacts of new working arrangements, rapid redeployment of people to support additional processes such as payment holidays and the need to manage the IT challenges arising as a consequence, increase the risk that process failings may occur.</p> <p>Whilst the Group has successfully navigated the transition to operating effectively in the pandemic environment, given the ongoing uncertainties and economic outlook, the potential for operational risk issues remains heightened.</p>

B9. 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 listing and disclosure rules of the FCA.

Certain information required by these requirements is included in other sections of this Annual Report and incorporated in this Directors Report by reference. These items are discussed in detail at the end of this report.

Directors

The names of the directors of the company at the date of this report, together with biographical details, are given in Section B3.1. All the directors listed in that section were directors of the company throughout the year, apart from Alison Morris, who was appointed as a director on 26 March 2020, and Peter Hill, who was appointed as a director on 27 October 2020, after the year end. In addition, Peter Hartill retired on 30 September 2020.

Finlay Williamson has announced his intention to step down from the Board on 31 December 2020.

Directors' interests

The directors' interests in the shares of the Company are disclosed in the Directors' Remuneration Report in Section B7. There have been no changes in the directors' interests in the share capital of the Company since 30 September 2020.

Other than as outlined in the Directors' Remuneration Report in Section B7, 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.

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 of Association of the Company ('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. Further details on the directors' remuneration and service contracts / appointment letters can be found in the Directors' Remuneration Report in Section B7.

Directors' powers and appointment of directors

The appointment and replacement of the Company's directors is governed by 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, Section B4.

The Articles may only be amended by special resolution of the Company's shareholders in a general meeting and were last amended in 2018. The Company's Articles set out the powers of the directors and rules governing the appointment and removal of directors. The Articles can be viewed at the Group's website at www.paragonbankinggroup.co.uk.

The Company is proposing to amend its Articles with the principal changes primarily to reflect best market practice and changes in light of the Code. A resolution to adopt the amended Articles is to be proposed at the forthcoming AGM, with explanatory notes on the proposed changes to be found in the Notice of AGM circulated with this Annual Report.

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 Finlay Williamson, who has announced his intention to step down from the Board on 31 December 2020, will retire and seek reappointment at the AGM.

Annual retirement of directors will be required by the amended Articles to be proposed at the forthcoming AGM.

None of the directors have a service contract with the Company requiring more than 12 months' notice of termination to be given.

Directors' indemnity and insurance

Under Article 161 of the Articles, the Company has qualifying third party indemnity provisions for the benefit of its directors, for the purposes of section 234 of the Companies Act 2006, 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.

Share capital and distributions

Share capital

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 38 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 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 52 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 £85.3 million and to make market purchases of up to 25.6 million £1 ordinary shares. These authorities expire at the conclusion of the forthcoming AGM on 24 February 2021 and resolutions will be put to that meeting proposing that they be renewed.

Purchase of own shares

The existing authority under section 724 of the Companies Act 2006, referred to above, given to the company at the AGM on 13 February 2020 enables it to purchase treasury shares (a Company's own shares purchased by it to be held in treasury) of up to 10% of its issued share capital.

This authority will expire at the conclusion of the next AGM, and the Board considers it would be appropriate to renew this authority. It therefore intends to seek shareholder approval to purchase Treasury Shares of up to 10% of its issued share capital at the forthcoming AGM in line with current investor sentiment. Details of the resolution renewing the authority will be included in the Notice of AGM. Shares held as treasury shares can in the future be cancelled, re-sold or used to provide shares for employee share schemes.

The number of treasury shares held at 30 September 2020 was 5,218,702 (2019: 5,218,702), representing 2.03% of the issued share capital excluding treasury shares (2019: 2.04%). The maximum holding of treasury shares during the year was 5,218,702 (2019: 21,769,034). The highest proportion of issued share capital excluding treasury shares held during the year was 2.04% (2019: 8.37%).

Dividends

The directors recommend a final dividend of 14.4p per share (2019: 14.2p per share) which would give a total dividend for the year of 14.4p per share (2019: 21.2p per share). No interim dividend was paid during the year (an interim dividend of 7.0p per share was paid in 2019).

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, had been received by the Company as at 30 September 2020.

Shareholder	% Held	Notification date
Dimensional Fund Advisers LP	5.0%	09/08/19
Franklin Templeton Fund Management	5.0%	21/02/19
Liontrust Investment Partners LLP	5.1%	21/09/20
M&G PLC	6.6%	22/10/19
Norges Bank	5.0%	27/03/20
Royal London Asset Management	7.0%	19/09/19

The percentages quoted above were calculated by reference to the Company's issued share capital at the date the holding was disclosed.

On 12 October 2020, Norges Bank notified the Company that it had reduced its interest to 5.0%. On 13 November 2020, J O Hambro Capital Management Limited notified the Company that it had increased its interest to 5.0%. As at 2 December 2020, no further changes had been notified to the Company.

Significant agreements

A change of control of the company, following a takeover bid, may cause a number of agreements to which the company is a party to take effect, alter or terminate. These include certain insurance policies and employee share plans.

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 outstanding awards and options to vest and become exercisable on a change of control, subject, where applicable, to the satisfaction of any performance conditions at that time and pro-rating of awards.

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

During the year ended 30 September 2020 no political donations were made by any Group company (2019: £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. This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

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, as well as a resolution to give the directors the authority to determine the auditors' remuneration.

The full text of the relevant resolutions is set out in the Notice of AGM accompanying this Annual Report. The evaluation process is described more fully in the Audit Committee Section B6.

Annual General Meeting

The Annual General Meeting of the Company will take place on 24 February 2021 in London. A notice convening the AGM and outlining the resolutions to be proposed at the AGM is being circulated to shareholders with this Annual Report and Accounts.

At the present time, there remains uncertainty as to the impact that Covid-19 will have on the Company's AGM in 2021. The Board's current expectation is that government guidance may allow shareholders to attend the meeting in person. If this is not the case the Group will put in place alternative arrangements to allow shareholders to communicate their views, within the parameters set out by the UK Government.

More information is set out in the Notice of AGM and further updates will be provided in due course, if necessary.

Listing Rule LR9.8.4

There are no matters which the Company is required to report under Listing Rule LR9.8.4, other than certain matters concerning its employee share ownership trust (note 40).

The Paragon Banking Group PLC Employee Trust is an independent trust which holds shares for the benefit of employees and former employees of the Group in order to satisfy awards under employee share plans. The Company funds the trust from time to time, to enable it to acquire shares to satisfy these awards. During the year, the trust made market purchases of 1.5 million ordinary shares. As the shares included in these arrangements are held on the consolidated balance sheet, this has no effect on the amounts reported by the Group.

The trustee will only vote on those shares in accordance with the instructions given to the trustee and in accordance with the terms of the trust deed. The trustee has waived the trust's right to dividends on all shares held within the trust.

Details of the shares held by the trust are set out in note 40 and details of the share-based remuneration arrangements are given in note 52.

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. Readers are also referred to the cautionary statement on page 2.

- The Group's business activities, together with commentary on the likely future developments in the business of the Group (including the factors likely to affect future development and performance) and its summarised financial position is included in the Strategic Report (Section A)
- A description of the Group's financial risk management objectives and policies, including hedging policies, and its exposure to risks (including price/credit/liquidity/cash flow risk) arising from its use of financial instruments are set out in note 55 to the accounts and related notes
- Information concerning directors' contractual arrangements and entitlements under share-based remuneration arrangements is given in Section B7, the Directors' Remuneration Report
- An explanation of the Board's activities in relation to assessing and monitoring how the company has aligned with its stated purpose and culture can be found in Sections B1 and B3.3

- Information concerning employment practices, employee engagement, the Group's approach to diversity, the employment of disabled persons and the involvement of employees in the business, is given in Section A6.3 – 'People'
- Information on the Group's business relationships and how the directors have had regard to the need to foster these relationships with suppliers, customers and other stakeholders, and the effect of that regard, including on the principal decisions taken by the Group during the financial year (which is crucial to the long-term sustainability of the business), can be found in Section B4.3 of the Corporate Governance Report and in Section A6 of the Strategic Report
- Disclosures concerning greenhouse gas emissions are given in Section A6.4 – 'Environmental Issues'
- Disclosures concerning events taking place after the balance sheet date are set out in note 29 to the accounts.
- Disclosures concerning the Group's ability to continue to adopt the going concern basis of accounting and the Group's viability statement are given in Section A5.

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 B2, B3, B4, B5, B6, B7 and B8 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 2020, for the purposes of the Disclosure Guidance and Transparency Rules.

This section B9 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.

Marius van Niekerk

Company Secretary
3 December 2020

B10. 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 2020, 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 that 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.

Marius van Niekerk

Company Secretary

3 December 2020



We have implemented a comprehensive wellbeing programme for our people, providing a range of support for mental and physical health.

C. Independent Auditor's Report

**Report by the independent auditor of the Company, KPMG LLP,
on the financial statements**

P152 C1. Independent Auditor's Report to the members of Paragon Banking Group PLC
Report by the independent auditor of the Company, KPMG LLP, on the financial statements

C1. 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 2020 which comprise the:

- Consolidated Statement of Profit or Loss
- Consolidated Statement of Comprehensive Income
- Consolidated and Company Balance Sheets
- Consolidated and Company Cash Flow Statements
- Consolidated and Company Statements of Changes in Equity
- Related notes, including the accounting policies in note 62, other than the disclosures labelled as unaudited in note 54.

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 2020 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 have fulfilled our ethical responsibilities under, and are independent of the group in accordance with, UK ethical requirements including the FRC Ethical Standard. 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 five financial years ended 30 September 2020. 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 decreasing order of audit significance, 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

Impairment allowances on loans to customers

Risk vs 2019 ↑

(£81.8 million; 2019: £41.9 million)

Refer to the Audit Committee Report, accounting policy note and note 19 (financial disclosures).

Subjective estimate

The measurement of expected credit losses ('ECL') involves significant judgements and estimates. There is increased risk of material misstatement of ECL in the current year due to the increased judgement and estimation uncertainty as a result of Covid-19. The key areas where we identified greater levels of management judgement and therefore increased levels of audit focus in the Group's estimation of ECL are:

Economic scenarios – IFRS 9 requires the Group to measure ECL on a forward-looking basis reflecting a range of future economic conditions. Significant management judgement is applied to determining the economic scenarios used, particularly in the context of Covid-19, and the probability weightings assigned to each economic scenario.

Qualitative adjustments – Adjustments to the model-driven ECL results are raised by management to address issues relating to model responsiveness or emerging trends relating to Covid-19. They represent approximately 24.2% of the ECL. Such adjustments are inherently uncertain and significant management judgement is involved in estimating these amounts.

Significant Increase in Credit Risk ('SICR') – 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. Increased judgement exists in the current year relating to the treatment of those customers who were granted one or more Covid-19 payment reliefs.

Model estimations – Inherently judgmental modelling is used to estimate ECLs which involves determining Probabilities of Default ('PD'), Loss Given Default ('LGD'), and Exposures at Default ('EAD'). The LGD models used in the portfolios are the key drivers of the Group's ECL results and are therefore the most significant judgmental aspect of the Group's ECL modelling approach.

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 (note 19).

Disclosure quality

The disclosures regarding the Group's application of IFRS 9 are key to explaining the key judgements and material inputs to the IFRS 9 ECL results.

Our response

Our audit procedures included:

- **Test of details:** Key aspects of our testing involved:
 - We tested 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; and
 - We performed recalculations of the ECL measured on each of Paragon's loan portfolios.
- **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 assessed 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 economic uncertainty relating to Covid-19.
- **Qualitative adjustments:** For each of the adjustments to the model-driven ECL results we assessed the reasonableness of the adjustments by challenging, the key assumption being the probability of default floors, inspecting the calculation methodology and tracing a sample of data used back to source data.
- **SICR:** We assessed the ongoing predictability of the SICR criteria and independently recalculated the loans' stage for 100% of Paragon's loans and receivables. In addition, we assessed the reasonableness of management's treatment of Covid-19 payment relief customers from a SICR perspective.
- **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.
- **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, including in respect of Covid-19, was sufficiently clear.

Our results

The results of our testing were satisfactory, and we considered the ECL charge, provision recognised and the related disclosures to be acceptable (2019: acceptable).

Key audit matter

Interest receivable on loan accounts

Risk vs 2019 ↑

(£440.4 million; 2019: £449.3 million)

Refer to the Audit Committee Report, accounting policy note and note 4 (financial disclosures).

Subjective estimate

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. The subjectivity in respect of these assumptions has increased further at the current year end as a result of the uncertainties arising from Covid-19.

Originated assets:

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 degree 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 judgmental overlays by management.

The cohorts of loans and advances which require the most judgement are buy-to-let products which were originated by the Group post-2010.

Acquired loan portfolios:

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.

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 (note 64).

Our response

Our procedures included:

Originated assets:

- **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 considering the impact of uncertainties arising from Covid-19 in the current behavioural life forecasts;
- **Our sector experience:** We critically assessed key assumptions behind the expected behavioural lives against our own knowledge of industry experience and trends, and challenged the appropriateness of the level of segmentation applied to the loan portfolios by management when determining the expected behavioural lives; and
- **Sensitivity analysis:** We performed sensitivity analysis over the repayment profiles by applying alternative profiles based upon the above procedures.

Acquired loan portfolios:

- **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;
- **Tests of details:** We vouched historical cash collections data to supporting evidence to critically assess the completeness and accuracy of the collections data used in determining the expected future cash collections of individual portfolios;
- **Independent performance:** We independently reperformed management's calculation of its estimated future cash collections to assess the accuracy of the forecasts generated; and
- **Sensitivity analysis:** We have performed sensitivity analysis over the forecast cash flows by applying alternative profiles based upon the above procedures.

Originated assets and acquired loan portfolios:

- **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the Group's EIR adjustments and interest receivable. As a part of this, we assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the critical estimates and assumptions made, including in respect of Covid-19, was sufficiently clear;

Our results

We found the resulting estimate of interest receivable on loan accounts and the related disclosures to be acceptable (2019: acceptable).

Key audit matter

Recoverability of goodwill

Risk vs 2019 ↑

(£164.4 million; 2019: £164.4 million)

Refer to the Audit Committee Report, accounting policy note and note 26 (financial disclosures).

Forecast-based valuation:

The carrying amount of goodwill is significant to the financial statements 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. The subjectivity in respect of these forecasts has increased further at the current year end as a result of the uncertainties arising from Covid-19.

In calculating the recoverable amount, the directors make assumptions over key inputs, being forecast future cash flows and the discount rate.

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 26) disclose the sensitivity estimated by the Group.

Our response

Our procedures included:

- **Historical comparisons:** We compared the Group's previous forecasting with actual results to assess forecasting accuracy;
- **Benchmarking assumptions:** We compared the Group's assumptions to externally derived data in relation to key inputs such as discount rates, and challenged management on the forecast business performance. This included considering the impact of uncertainties arising from Covid-19 in the current forecasts;
- **Our valuations expertise:** We engaged our own valuations specialists to assess the reasonableness of the valuation approach adopted (and its implied valuation results derived) by management to estimate the recoverable amount of the CGUs to which goodwill is allocated. This was done with inference to a series of sensitivity analyses which we performed to challenge the key assumptions, including discount rates, applied in estimating the recoverable amount. 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 key assumptions.
- **Sensitivity analysis:** We performed breakeven analysis and applied alternative scenarios based on the assumptions noted above;
- **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the estimated recoverable amount. 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, including in respect of Covid-19, was sufficiently clear.

Our results

We found the resulting carrying amount of goodwill and the related disclosures to be acceptable (2019: acceptable).

Key audit matter

Valuation of the defined benefit pension scheme obligation

Risk vs 2019 ← →

(£154.9 million, 2019: £147.3 million)

Refer to the Audit Committee Report, accounting policy note and note 53 (financial disclosures).

Subjective estimate

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.

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

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. The financial statements disclose the sensitivity estimated by the Group (note 53).

Our response

Our procedures included:

- **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 and the increased estimation uncertainty in respect of Covid-19.

Our results

We found the valuation of the defined benefit scheme obligation and the related disclosures to be acceptable (2019: acceptable).

Key audit matter

Going concern including the impact of Covid-19

New risk in 2020

Refer to the Chief Executive's Review and accounting policy note 60 (financial disclosures).

Disclosure quality

The financial statements explain how the Directors have formed a judgement that it is appropriate to adopt the going concern basis of preparation for the Group and Company.

That judgement is based on an evaluation of the inherent risks to the Group and Company's business model and how those risks might affect the Group and Company's financial resources or ability to continue operation over a period of at least a year from the date of approval of the financial statements.

The risk most likely to affect the Group and Company's available financial resources over the period is an increase in the level of expected credit losses measured against loans to customers due to the impact of Covid-19. This impact could lead to insufficient regulatory capital levels over the course of the next 12 months. There are also less predictable but realistic impacts, such as the impact of Covid-19 on liquidity and operational resilience.

The risk for our audit was whether or not those risks were such that they amounted to a material uncertainty that may have cast significant doubt on the ability to continue as a going concern. Had they been such, then that fact would have been required to have been disclosed.

Our response

Our audit procedures included:

- **Our sector experience:** We considered the directors' assessment of Covid-19 related sources of risk for the Company's business and financial resources compared with our own understanding of the risks. We assessed the directors' plan to take action to mitigate the risks;
- **Sensitivity analysis:** We assessed the stressed scenarios used by the Company in forecasting profitability, capital and liquidity taking account of possible adverse effects that could arise from these risks individually and collectively;
- **Challenge of assumptions:** We assessed the Company's forecast profitability, and the Company's capital and liquidity models to identify key assumptions. We challenged the reasonableness of assumptions underpinning the Company's forecasts; and
- **Assessing transparency:** We critically assessed the completeness and accuracy of the matters covered in the going concern disclosure within the financial statements using our knowledge of the relevant facts and circumstances developed during our audit work, considering the economic outlook, key areas of estimation uncertainty, including in particular the level of expected credit losses for loans to customers and mitigating actions available to the Company to respond to these risks.

Our results

We found the going concern disclosure without any material uncertainty to be acceptable.

Key audit matter

Recoverability of Parent Company's investment in subsidiaries

Risk vs 2019 ← →

(£1,030.1 million; 2019: £940.7million)

Refer to the accounting policy note and note 27 (financial disclosures).

Low risk, high value

The carrying amount of the Parent Company's investments in subsidiaries represents 90.0% (2019: 88.3%) of the Parent Company's total assets.

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 the area that had the greatest effect on our overall Parent Company audit.

Our response

Our procedures included:

- **Tests of detail:** We compared the carrying amount of 100% of investments with the relevant subsidiaries' draft balance sheet 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.

Our results

We found the resulting carrying amount of the investments in subsidiaries to be acceptable (2019: acceptable).

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 £6.5million (2019: £7.6million), determined with reference to a benchmark of the Group's profit before tax from continuing operations, normalised by averaging over the last three years due to the impact of Covid-19 on the financial performance in the period to 30 September 2020, of which it represents 4.4%. The averaging of the benchmark as a result of the impact of Covid-19 reflected a revision to our initial materiality set for planning purposes, which was based on current year forecast profit before tax.

Materiality for the Parent Company financial statements as a whole was set at £3.9million (2019: £3.5million), determined with reference to a benchmark of net assets, of which it represents 0.6% (2019: 0.6%).

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.33million, in addition to other identified misstatements that warranted reporting on qualitative grounds.

Of the Group's 2 (2019: 1) reporting components, we subjected 2 (2019: 1) to full scope audits for group purposes. The components within the scope of our work accounted for 100.0% (2019: 100.0%) of total Group revenue, 100.0% (2019: 100.0%) of Group profit before tax, and 100.0% (2019: 100.0%) of Group total assets. The work on the 2 components was performed by the Group team.

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.

We identified going concern as a key audit matter (see section 2 of this report). Based on the work described in our response to that key audit matter, 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 62 of 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 the approval of the financial statements.

We have nothing to report in these respects.

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 emerging and 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 B10, 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
3 December 2020



We have a structured approach to learning and development and employees received an average of 4.2 days virtual training in 2020.

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

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D1. Primary Financial Statements

D1.1 Consolidated statement of profit or loss

For the year ended 30 September 2020

	Note	2020 £m	2020 £m	2019 £m	2019 £m
Interest receivable	4		491.7		505.7
Interest payable and similar charges	5		(213.6)		(227.3)
Net interest income			278.1		278.4
Other leasing income	6	19.2		18.3	
Related costs	6	(16.2)		(14.5)	
Net leasing income		3.0		3.8	
Gain on derecognition of financial assets	7	-		9.7	
Other income	8	14.0		15.4	
Other operating income			17.0		28.9
Total operating income			295.1		307.3
Operating expenses	9		(126.8)		(125.2)
Provisions for losses	19		(48.3)		(8.0)
Operating profit before fair value items			120.0		174.1
Fair value net (losses)	11		(1.6)		(15.1)
Operating profit being profit on ordinary activities before taxation			118.4		159.0
Tax charge on profit on ordinary activities	12		(27.1)		(31.6)
Profit on ordinary activities after taxation for the financial year			91.3		127.4
	Note		2020		2019
Earnings per share					
- basic	14		36.0p		49.4p
- diluted	14		35.6p		48.2p

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 2020

	Note	2020 £m	2020 £m	2019 £m	2019 £m
Profit for the year			91.3		127.4
Other comprehensive income					
<i>Items that will not be reclassified subsequently to profit or loss</i>					
Actuarial (loss) on pension scheme	53	(7.4)		(16.5)	
Tax thereon		2.1		2.4	
			(5.3)		(14.1)
<i>Items that may be reclassified subsequently to profit or loss</i>					
Cash flow hedge gains taken to equity	20	(0.6)		0.5	
Tax thereon		0.1		(0.1)	
Reclassification on derecognition	7	-		(0.9)	
Tax thereon		-		0.2	
			(0.5)		(0.3)
Other comprehensive income for the year net of tax			(5.8)		(14.4)
Total comprehensive income for the year			85.5		113.0

D1.3 Consolidated balance sheet

For the year ended 30 September 2020

	Note	2020 IFRS 9 £m	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m
Assets					
Cash – central banks	15	1,637.1	816.4	895.9	895.9
Cash – retail banks	15	287.9	409.0	414.7	414.7
Loans to customers	16	12,741.1	12,250.3	12,076.5	12,103.7
Derivative financial assets	20	463.3	592.4	855.7	855.7
Sundry assets	21	128.0	92.8	19.0	19.0
Current tax assets	22	5.7	-	-	-
Deferred tax assets	23	6.2	6.2	-	-
Property, plant and equipment	24	66.1	57.3	56.8	56.8
Intangible assets	25	170.1	171.1	169.3	169.3
Total assets		15,505.5	14,395.5	14,487.9	14,515.1
Liabilities					
Short-term bank borrowings		0.4	1.0	1.1	1.1
Retail deposits	28	7,867.0	6,395.8	5,292.4	5,292.4
Derivative financial liabilities	20	132.4	80.5	4.7	4.7
Asset backed loan notes	29	3,270.5	4,419.4	5,554.7	5,554.7
Secured bank borrowings	30	657.8	787.5	935.6	935.6
Retail bond issuance	31	296.8	296.5	296.1	296.1
Corporate bond issuance	32	149.8	149.6	149.3	149.3
Central bank facilities	33	1,854.4	994.4	1,024.4	1,024.4
Sundry liabilities	34	100.0	112.7	114.4	114.4
Current tax liabilities	22	-	15.2	21.4	21.4
Deferred tax liabilities	23	-	-	0.8	5.6
Retirement benefit obligations	53	20.4	34.5	19.5	19.5
Total liabilities		14,349.5	13,287.1	13,414.4	13,419.2
Called up share capital	38	261.8	261.6	281.6	281.6
Reserves	39	932.0	887.3	895.9	918.3
Own shares	40	(37.8)	(40.5)	(104.0)	(104.0)
Total equity		1,156.0	1,108.4	1,073.5	1,095.9
Total liabilities and equity		15,505.5	14,395.5	14,487.9	14,515.1

Approved by the Board of Directors on 3 December 2020.

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 2020

	Note	2020 IFRS 9 £m	2019 IFRS 9 £m	2018 IAS 39 £m
Assets				
Cash – retail banks	15	12.6	14.1	24.9
Sundry assets	21	84.6	107.3	217.0
Current tax assets	22	-	2.8	-
Property, plant and equipment	24	17.4	-	-
Investment in subsidiary undertakings	27	1,030.1	940.7	984.4
Total assets		1,144.7	1,064.9	1,226.3
Liabilities				
Retail bond issuance	31	296.8	296.5	296.1
Corporate bond issuance	32	149.8	149.6	149.3
Sundry liabilities	34	43.1	27.4	128.5
Deferred tax liabilities	23	1.8	1.6	1.8
Total liabilities		491.5	475.1	575.7
Called up share capital	38	261.8	261.6	281.6
Reserves	39	414.4	351.2	460.8
Own shares	40	(23.0)	(23.0)	(91.8)
Total equity		653.2	589.8	650.6
		1,144.7	1,064.9	1,226.3

Approved by the Board of Directors on 3 December 2020.

Signed of 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 2020

	<i>Note</i>	2020	2019
		£m	£m
Net cash generated by operating activities	42	1,028.7	397.9
Net cash (utilised) / generated by investing activities	43	(2.8)	8.3
Net cash (utilised) by financing activities	44	(325.7)	(491.3)
Net increase / (decrease) in cash and cash equivalents		700.2	(85.1)
Opening cash and cash equivalents		1,224.4	1,309.5
Closing cash and cash equivalents		1,924.6	1,224.4
Represented by balances within:			
Cash	15	1,925.0	1,225.4
Short-term bank borrowings		(0.4)	(1.0)
		1,924.6	1,224.4

D1.6 Company cash flow statement

For the year ended 30 September 2020

	<i>Note</i>	2020	2019
		£m	£m
Net cash generated by operating activities	42	129.8	170.9
Net cash (utilised) by investing activities	43	(94.7)	(105.1)
Net cash (utilised) by financing activities	44	(36.6)	(76.6)
Net (decrease) in cash and cash equivalents		(1.5)	(10.8)
Opening cash and cash equivalents		14.1	24.9
Closing cash and cash equivalents		12.6	14.1
Represented by balances within:			
Cash	15	12.6	14.1
Short-term bank borrowings		-	-
		12.6	14.1

D1.7 Consolidated statement of changes in equity

For the year ended 30 September 2020

	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	-	-	-	-	-	91.3	-	91.3
Other comprehensive income	-	-	-	-	(0.5)	(5.3)	-	(5.8)
Total comprehensive income	-	-	-	-	(0.5)	86.0	-	85.5
Transactions with owners								
Dividends paid (note 41)	-	-	-	-	-	(35.9)	-	(35.9)
Shares cancelled	-	-	-	-	-	-	-	-
Own shares purchased	-	-	-	-	-	-	(5.2)	(5.2)
Exercise of share awards	0.2	0.4	-	-	-	(7.7)	7.9	0.8
Charge for share based remuneration (note 50)	-	-	-	-	-	2.7	-	2.7
Tax on share based remuneration	-	-	-	-	-	(0.3)	-	(0.3)
Net movement in equity in the year	0.2	0.4	-	-	(0.5)	44.8	2.7	47.6
Opening equity	261.6	68.3	50.3	(70.2)	3.0	835.9	(40.5)	1,108.4
Closing equity	261.8	68.7	50.3	(70.2)	2.5	880.7	(37.8)	1,156.0

For the year ended 30 September 2019

	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 41)	-	-	-	-	-	(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 50)	-	-	-	-	-	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 61)	-	-	-	-	-	(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

D1.8 Company statement of changes in equity

For the year ended 30 September 2020

	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	-	-	-	-	96.0	-	96.0
Other comprehensive income	-	-	-	-	-	-	-
Total comprehensive income	-	-	-	-	96.0	-	96.0
Transactions with owners							
Dividends paid (note 41)	-	-	-	-	(35.9)	-	(35.9)
Shares cancelled	-	-	-	-	-	-	-
Own shares purchased	-	-	-	-	-	-	-
Exercise of share awards	0.2	0.4	-	-	-	-	0.6
Charge for share based remuneration (note 50)	-	-	-	-	2.7	-	2.7
Net movement in equity in the year	0.2	0.4	-	-	62.8	-	63.4
Opening equity	261.6	68.3	50.3	(23.7)	256.3	(23.0)	589.8
Closing equity	261.8	68.7	50.3	(23.7)	319.1	(23.0)	653.2

For the year ended 30 September 2019

	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 41)	-	-	-	-	(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 50)	-	-	-	-	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

D2. Notes to the Accounts

For the year ended 30 September 2020

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 into four sections:

- Analysis – providing further analysis and information on the amounts shown in the primary financial statements
- Employment costs – providing information on employee and key management remuneration arrangements including share schemes and pension arrangements
- Capital and Financial Risk – 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 2020

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:

- Mortgage Lending, 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.

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 2020

	Mortgage Lending	Commercial Lending	Idem Capital	Unallocated items	Total Segments
	£m	£m	£m	£m	£m
Interest receivable	344.9	112.9	30.4	3.5	491.7
Interest payable	(154.9)	(30.8)	(4.3)	(23.6)	(213.6)
Net interest income	190.0	82.1	26.1	(20.1)	278.1
Other operating income	6.5	9.9	0.6	-	17.0
Total operating income	196.5	92.0	26.7	(20.1)	295.1
Direct costs	(16.4)	(24.4)	(6.3)	(79.7)	(126.8)
Provisions for losses	(25.8)	(21.7)	(0.8)	-	(48.3)
	154.3	45.9	19.6	(99.8)	120.0

Year ended 30 September 2019

	Mortgage Lending	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

The segmental profits disclosed above reconcile to the group results as shown below.

	2020	2019
	£m	£m
Results shown above	120.0	174.1
Fair value items	(1.6)	(15.1)
Operating profit	118.4	159.0

The assets and liabilities attributable to each of the segments at 30 September 2020, 30 September 2019 and 1 October 2018 on the basis described above were:

	<i>Note</i>	Mortgage Lending	Commercial Lending	Idem Capital	Total Segments
		£m	£m	£m	£m
30 September 2020					
Segment assets					
Loans to customers	16	10,819.5	1,514.8	297.1	12,631.4
Operating lease assets	24	-	39.5	-	39.5
Cross-currency basis swaps	20	445.3	-	-	445.3
Securitisation cash	15	223.4	-	-	223.4
		11,488.2	1,554.3	297.1	13,339.6
Segment liabilities					
Allocated deposits		7,692.2	1,882.2	236.1	9,810.5
Securitisation funding		3,928.3	-	-	3,928.3
		11,620.5	1,882.2	236.1	13,738.8
	<i>Note</i>	Mortgage Lending	Commercial Lending	Idem Capital	Total Segments
		£m	£m	£m	£m
30 September 2019					
Segment assets					
Loans to customers	16	10,344.1	1,452.1	389.9	12,186.1
Operating lease assets	24	-	36.3	-	36.3
Cross-currency basis swaps	20	582.7	-	-	582.7
Securitisation cash	15	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
	<i>Note</i>	Mortgage Lending	Commercial Lending	Idem Capital	Total Segments
		£m	£m	£m	£m
1 October 2018					
Segment assets					
Loans to customers	16	10,449.5	1,131.3	519.8	12,100.6
Operating lease assets	24	-	35.4	-	35.4
Cross-currency basis swaps		829.7	-	-	829.7
Securitisation cash	15	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

An analysis of the Group's financial assets by type and segment is shown in note 16. 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 £12.9m (2019: £11.6m) 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.

	2020 £m	2019 £m
Total segment assets	13,339.6	13,158.2
Unallocated assets		
Central cash and investments	1,701.6	872.3
Unallocated derivatives	18.0	9.7
Operational property, plant and equipment	26.6	21.0
Intangible assets	170.1	171.1
Other	249.6	163.2
Total assets	15,505.5	14,395.5

	2020 £m	2019 £m
Total segment liabilities	13,738.8	12,699.7
Unallocated liabilities		
Unallocated retail deposits	(1,953.9)	(1,100.9)
Derivative financial instruments	132.4	80.5
Central borrowings	2,301.4	1,441.5
Tax liabilities	-	15.2
Retirement benefit obligations	20.4	34.5
Other	110.4	116.6
Total liabilities	14,349.5	13,287.1

3. Revenue

	Note	2020 £m	2019 £m
Interest receivable	4	491.7	505.7
Operating lease income	6	19.2	18.3
Gain on derecognition of financial assets	7	-	9.7
Other income	8	14.0	15.4
Total revenue		524.9	549.1
Arising from:			
Mortgage Lending		351.4	348.9
Commercial Lending		139.0	121.2
Idem Capital		31.0	62.7
Total revenue from segments		521.4	532.8
Unallocated revenue		3.5	16.3
Total revenue		524.9	549.1

4. Interest receivable

	2020 £m	2019 £m
Interest receivable in respect of		
Loan accounts	440.4	449.3
Finance leases	44.3	44.5
Invoice finance income	2.4	3.1
Interest on loans to customers	487.1	496.9
Other interest receivable	4.6	8.8
Total interest on financial assets	491.7	505.7

The above interest arises from:

	2020 £m	2019 £m
Financial assets held at amortised cost	447.4	461.2
Finance leases	44.3	44.5
	491.7	505.7

5. Interest payable and similar charges

	Note	2020 £m	2019 £m
On retail deposits		129.7	114.2
On asset backed loan notes		42.2	63.4
On bank loans and overdrafts		5.4	9.6
On corporate bonds		10.9	10.9
On retail bonds		18.5	18.6
On central bank facilities		4.5	8.0
Total interest on financial liabilities		211.2	224.7
On pension scheme deficit	53	0.4	0.5
Discounting on contingent consideration	35	0.4	0.5
Discounting on lease liabilities		0.2	-
Other finance costs		1.4	1.6
		213.6	227.3

All interest payable on financial liabilities relates to financial liabilities held at amortised cost.

6. Net operating lease income

	<i>Note</i>	2020	2019
		£m	£m
Income			
Operating lease rentals		14.5	14.0
Maintenance income		4.7	4.3
Total operating lease income		19.2	18.3
Costs			
Depreciation of lease assets	24	(8.3)	(7.6)
Maintenance salaries	50	(2.1)	(1.9)
Other maintenance costs		(5.8)	(5.0)
Total operating lease costs		(16.2)	(14.5)
Net operating lease income		3.0	3.8

7. Gain on derecognition of financial assets

During the year ended 30 September 2019, on 26 June 2019, the Group disposed of its residual interest in the Paragon Mortgages (No. 12) PLC ('PM12') 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.

Loans to customers of £695.8m and borrowings of £784.1m were derecognised on the completion of this transaction and a gain of £9.7m was recognised in profit.

The cash flow hedge in the securitisation vehicle, ceased to be recognised in the Group at the point of the transaction 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 for the year ended 30 September 2019.

Information on the Group's continuing involvement with the PM12 transaction is given in note 46.

8. Other income

	2020	2019
	£m	£m
Loan account fee income	5.7	7.2
Broker commissions	1.7	2.2
Third party servicing	5.0	5.0
Other income	1.6	1.0
	14.0	15.4

All loan account fee income arises from financial assets held at amortised cost.

9. Operating expenses

	<i>Note</i>	2020	2019
		£m	£m
Employment costs	50	77.6	79.3
Auditor remuneration	10	2.0	1.8
Amortisation of intangible assets	25	2.0	2.4
Depreciation of operational assets	24	3.5	1.5
Operating lease rentals payable	47	-	2.9
Other administrative costs		41.7	37.3
		126.8	125.2

Operating lease rentals in 2019 included amounts no longer recognised immediately under IFRS 16 (note 36).

10. 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.

	2020	2019
	£000	£000
Audit fee of the company	478	462
Other services		
Audit of subsidiary undertakings pursuant to legislation	990	890
Total audit fees	1,468	1,352
Audit related assurance services		
Interim review	133	90
Other	35	22
Total fees	1,636	1,464
Irrecoverable VAT	327	293
Total cost to the Group (note 9)	1,963	1,757

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.

11. Fair value net (losses) / gains

	2020	2019
	£m	£m
Ineffectiveness of fair value hedges (note 20)		
Portfolio hedges of interest rate risk		
Deposit hedge	0.2	(0.2)
Loan hedge	0.1	(6.3)
	0.3	(6.5)
Ineffectiveness of cash flow hedges	-	-
Other hedging movements	(2.9)	(5.8)
Net (losses) / gains on other derivatives	1.0	(2.8)
	(1.6)	(15.1)

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.

12. Tax charge on profit on ordinary activities

(a) Analysis of charge in the year

	2020	2019
	£m	£m
Current tax		
UK Corporation Tax on profits of the period	25.5	36.3
Adjustment in respect of prior periods	0.5	(2.4)
Total current tax	26.0	33.9
Deferred tax	1.1	(2.3)
Tax charge on profit on ordinary activities	27.1	31.6

The standard rate of corporation tax in the UK applicable to the Group in the period was 19.0% (2019: 19.0%), based on currently enacted legislation. During the period, legislation was substantively enacted, reversing the reduction in the tax rate to 17.0% which had been due to come into effect from April 2020. Consequently, temporary differences which had been expected to reverse at a tax rate of 18.0% in the current year, or 17.0% in subsequent years, have either reversed or are expected to reverse at a rate of 19.0%. The impact of this change has been accounted for in the year.

The Bank Corporation Tax Surcharge 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 charge / (credit) for the year

The deferred tax charge / (credit) in the income statement comprises the following temporary differences:

	2020	2019
	£m	£m
Accelerated tax depreciation	(0.4)	0.2
Retirement benefit obligations	1.2	0.3
Impairment and other provisions	(1.2)	(2.1)
Utilisation of tax losses	(0.9)	(0.2)
Other timing differences	2.8	(1.9)
Deferred tax charge / (credit) for the year	1.5	(3.7)
Prior period adjustment	(0.4)	1.4
Deferred tax charge / (credit) (note 23)	1.1	(2.3)

The expected impact on deferred tax balances of the withdrawal of the reduction in the rate of Corporation Tax to 17.0% described above was accounted for in the year, the effect of the expected change having been accounted for when originally 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 (a) above, the UK corporation tax rate applicable to the Group for the year was 19.0% (2019: 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.

	2020	2019
	£m	£m
Profit on ordinary activities before taxation	118.4	159.0
Profit on ordinary activities multiplied by the UK standard rate of corporation tax	22.5	30.2
Effects of:		
Permanent differences		
Recurring disallowable expenditure and similar items	0.1	0.4
Mismatch in timing differences	0.2	0.3
Change in rate of taxation on deferred tax assets and liabilities	0.1	(0.6)
Bank Corporation Tax Surcharge	4.0	2.1
Tax losses created with no corresponding deferred tax asset recognised	-	0.1
Prior year charge / (credit)	0.2	(0.9)
Tax charge for the year	27.1	31.6

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, the relationship of its future effective tax rate to the standard rate of UK corporation tax is expected to be primarily driven by the proportion of its taxable profit subject to the Bank Surcharge.

The Group includes various asset leasing businesses within its Commercial Lending division. 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').

13. Profit attributable to members of Paragon Banking Group PLC

The Company's profit after tax for the financial year amounted to £96.0m (2019: £9.9m). 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 2020 or 30 September 2019.

14. Earnings per share

Earnings per ordinary share is calculated as follows:

	2020	2019
Profit for the year (£m)	91.3	127.4
Basic weighted average number of ordinary shares ranking for dividend during the year (million)	253.6	257.6
Dilutive effect of the weighted average number of share options and incentive plans in issue during the year (million)	2.5	6.7
Diluted weighted average number of ordinary shares ranking for dividend during the year (million)	256.1	264.3
Earnings per ordinary share		
- basic	36.0p	49.4p
- diluted	35.6p	48.2p

15. Cash and cash equivalents

'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. It is analysed as set out below.

	2020 £m	2019 £m	2018 £m
Deposits with the Bank of England	1,637.1	816.4	895.9
Balances with central banks	1,637.1	816.4	895.9
Deposits with other banks	287.9	409.0	393.1
Money Market Fund investments	-	-	21.6
Balances with other banks	287.9	409.0	414.7
Cash and cash equivalents	1,925.0	1,225.4	1,310.6

Not all of the Group's cash is immediately available for its general purposes, including liquidity management. Cash received in respect of loan assets funded through warehouse facilities and securitisations is not immediately available, due to the terms of those arrangements.

Cash held by the Trustee of the Group's employee share ownership plan ('ESOP') may only be used to invest in the shares of the Company, pursuant to the aims of that plan.

The total consolidated 'Cash and Cash Equivalents' balance may be analysed as shown below:

	2020 £m	2019 £m	2018 £m
Available cash	1,701.1	872.1	962.9
Securitisation cash	223.4	353.1	338.8
ESOP cash	0.5	0.2	8.9
	1,925.0	1,225.4	1,310.6

The 'Cash and Cash Equivalents' amount of £12.6m (2019: £14.1m; 2018: £24.9m) shown in the Company balance sheet is not subject to restrictions. This amount includes £nil of Money Market Fund investments (2019: £nil; 2018: £150.0m).

Cash and cash equivalents are classified as Stage 1 exposures (see note 19) for the purposes of impairment provisioning. The probabilities of default have been assessed to be so low as to require no significant impairment provision.

16. Loans to customers

	Note	2020 IFRS 9 £m	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m
Loan accounts	17	11,907.0	11,394.3	11,381.5	11,407.4
Finance lease receivables	18	724.4	791.8	719.1	720.4
Loans to customers		12,631.4	12,186.1	12,100.6	12,127.8
Fair value adjustments from portfolio hedging	20	109.7	64.2	(24.1)	(24.1)
		12,741.1	12,250.3	12,076.5	12,103.7

The Group's loans to customers at 30 September 2020, analysed between the segments described in note 2 are as follows:

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Total £m
At 30 September 2020				
First mortgages	10,636.9	-	-	10,636.9
Consumer loans	182.6	-	281.6	464.2
Motor finance	-	256.9	15.5	272.4
Asset finance	-	478.0	-	478.0
Development finance	-	609.0	-	609.0
Other commercial loans	-	170.9	-	170.9
Loans to customers	10,819.5	1,514.8	297.1	12,631.4

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Total £m
At 30 September 2019				
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 commercial loans	-	172.1	-	172.1
Loans to customers	10,344.1	1,452.1	389.9	12,186.1

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Total £m
At 1 October 2018				
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

The Group's purchased loan portfolios are analysed below.

	2020	2019
	£m	£m
First mortgage loans	15.0	15.7
Consumer loans	220.3	275.4
Motor finance loans	15.5	37.6
	250.8	328.7

Information on the Estimated Remaining Collections ('ERCs'), the undiscounted forecast collectible amounts, for first mortgages and consumer loans is given in note 56. All other loans above are internally generated or arise from acquired operations.

17. Loan accounts

Loan accounts at 30 September 2020, 30 September 2019, 1 October 2018 and 30 September 2018, which are all denominated and payable in sterling, were:

	2020	2019	2018	2018
	IFRS 9	IFRS 9	IFRS 9	IAS 39
	£m	£m	£m	£m
First mortgage loans	10,636.9	10,172.5	10,308.3	10,332.2
Second charge mortgage loans	354.5	389.2	414.4	415.9
Other unsecured consumer loans	109.7	134.7	173.8	173.7
Development finance loans	609.0	506.5	352.9	352.8
Other secured commercial lending	134.4	125.9	72.8	72.9
Other commercial loans	62.5	65.5	59.3	59.9
	11,907.0	11,394.3	11,381.5	11,407.4

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 finance.

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 33 or under the securitisation and warehouse funding arrangements described in notes 29 and 30 are shown below. These include notes retained by the Group described in note 57. The table also shows assets prepositioned with the Bank of England for use in future drawings.

	First Mortgages	Consumer Finance	Other	Total
	£m	£m	£m	£m
30 September 2020				
In respect of:				
Asset backed loan notes	4,106.5	-	-	4,106.5
Warehouse facilities	881.9	-	-	881.9
Central bank facilities	2,875.3	-	-	2,875.3
Total pledged as collateral	7,863.6	-	-	7,863.6
Prepositioned with Bank of England	1,072.3	-	-	1,072.3
Other assets not pledged as collateral	1,701.0	464.2	805.9	2,971.1
	10,636.9	464.2	805.9	11,907.0
30 September 2019				
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				
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

18. Finance lease receivables

The Group's finance leases can be analysed as shown below.

	2020	2019	2018	2018
	IFRS 9	IFRS 9	IFRS 9	IAS 39
	£m	£m	£m	£m
Motor finance	272.4	318.9	329.2	329.4
Asset finance	452.0	472.9	389.9	391.0
Carrying value	724.4	791.8	719.1	720.4

With effect from 1 October 2019, the Group's finance leases have been accounted for in accordance with IFRS 16 (note 61). Balance shown in preceding periods are accounted for in accordance with IAS 17, however both standards require the same accounting treatment.

The minimum lease payments due under these loan agreements are:

	2020	2019	2018	2018
	IFRS 9	IFRS 9	IFRS 9	IAS 39
	£m	£m	£m	£m
Amounts receivable				
Within one year	269.5	292.9	258.5	259.5
Within one to two years	221.5	256.8	239.9	240.3
Within two to three years	163.6	177.2	165.6	165.8
Within three to four years	104.1	101.6	94.9	95.0
Within four to five years	43.2	31.1	29.0	29.1
After five years	41.6	40.2	30.9	30.9
	843.5	899.8	818.8	820.6
Less: future finance income	(103.4)	(101.4)	(95.2)	(95.2)
Present value	740.1	798.4	723.6	725.4

The present values of those payments, net of provisions for impairment, carried in the accounts are:

	2020	2019	2018	2018
	IFRS 9	IFRS 9	IFRS 9	IAS 39
	£m	£m	£m	£m
Amounts receivable				
Within one year	236.5	255.8	225.5	226.4
Within two to five years	467.1	506.6	470.8	471.7
After five years	36.5	36.0	27.3	27.3
Present value	740.1	798.4	723.6	725.4
Allowance for uncollectible amounts	(15.7)	(6.6)	(4.5)	(5.0)
Carrying value	724.4	791.8	719.1	720.4

None of the Group's finance lease receivables were pledged as collateral for liabilities at 30 September 2020 or 30 September 2019.

19. 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 16, including both finance leases, accounted for under IFRS 16, 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:

- (a) Basis of provision
- (b) Impairments by stage and division
- (c) Movements in impairment provision in the period
- (d) Impairments charged to income
- (e) Economic inputs to provision calculations
- (f) Sensitivity analysis

(a) 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. The provision may be based on either twelve month or lifetime ECL, dependent 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 (eg 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.

In extreme or unprecedented economic conditions, such as the Covid-19 pandemic, it is likely that mechanical models will be less predictive of outcomes as the historical data used for modelling will be insufficiently representative of present conditions. In these circumstances, management carefully review all outputs to ensure provision is adequate.

At 30 September 2020 the effects of the material reductions in GDP since the onset of the Covid 19 crisis had not yet been evidenced in customer credit performance and defaults, due to the lagging effect of government policy interventions. Where customers were given payment reliefs, arrears and adverse credit indicators were not recorded by the Group or other lenders, meaning that both internal credit metrics and external credit bureau data might not accurately reflect the customer's credit position leading to modelled PDs being underestimated.

While forecast economics assume the current economic situation, the future, generally upward, trends also tend to reduce PDs, in a way that may not be justifiable where an underlying credit issue on an account has not emerged, which may result in default as government support initiatives unwind.

In reviewing the subsequent payment patterns of accounts that have been granted Covid-19 reliefs, it is evident that there is higher payment volatility (both in terms of account improvement and deterioration) so whilst credit risk is increased, it is not significant in scale in all cases. The Group has reflected this position by applying PD floors to its payment holiday population in the main portfolios at Stage 1, and moved accounts with payment holiday extensions to Stage 2, again with floors reflecting extrapolations of recent cohort experience to reflect the more adverse economic conditions forecast within the Group's macroeconomic scenarios and to allow for the potential under-recognition of losses caused by these effects.

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 determining whether an account has an SICR in the Covid-19 environment the granting of Covid-19 reliefs, including payment holidays and similar arrangements, may mean that an SICR may exist without this being reflected in either arrears performance or credit bureau data. The Group has accepted the advice of UK regulatory bodies that the grant of initial Covid-19 relief does not, of itself, indicate an SICR, but has carefully considered internal credit and customer data to determine whether there might be any accounts with SICR not otherwise identified by the process.

For customers with extended payment reliefs in place, the account has been placed in Stage 2, regardless of other indicators, as a result of the analysis described above. This aligns the Group's approach to regulatory guidance which suggested that while initial payment reliefs should not automatically be taken as an indication of an SICR, an extension to such a relief was more likely to be so.

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 event 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.

Loans are retained in Stage 3 for three months after the point where they cease to exhibit the characteristics of default. After this point, they may move to Stage 2 or Stage 1 depending on whether an SICR trigger remains.

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 accounts, accounts subject to realisation / enforcement procedures and long-term managed accounts, all of which are treated as credit impaired.

(b) Impairments by stage

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 an 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 (ie 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.

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 2020					
Gross loan book					
Mortgage Lending	9,822.6	903.2	127.0	15.0	10,867.8
Commercial Lending	1,384.2	132.3	20.2	6.7	1,543.4
Idem Capital	122.9	9.9	28.9	140.3	302.0
Total	11,329.7	1,045.4	176.1	162.0	12,713.2
Impairment provision					
Mortgage Lending	(5.0)	(12.6)	(30.7)	-	(48.3)
Commercial Lending	(17.0)	(3.0)	(8.2)	(0.4)	(28.6)
Idem Capital	(0.2)	(0.2)	(4.5)	-	(4.9)
Total	(22.2)	(15.8)	(43.4)	(0.4)	(81.8)
Net loan book					
Mortgage Lending	9,817.6	890.6	96.3	15.0	10,819.5
Commercial Lending	1,367.2	129.3	12.0	6.3	1,514.8
Idem Capital	122.7	9.7	24.4	140.3	297.1
Total	11,307.5	1,029.6	132.7	161.6	12,631.4
Coverage ratio					
Mortgage Lending	0.05%	1.40%	24.17%	-	0.44%
Commercial Lending	1.23%	2.27%	40.59%	5.97%	1.85%
Idem Capital	0.16%	2.02%	15.57%	-	1.62%
Total	0.20%	1.51%	24.65%	0.25%	0.64%

	Stage 1	Stage 2*	Stage 3*	POCI	Total
	£m	£m	£m	£m	£m
30 September 2019					
Gross loan book					
Mortgage Lending	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					
Mortgage Lending	(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					
Mortgage Lending	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					
Mortgage Lending	-	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 2 and 3 balances are analysed in more detail below.

Finance leases included above, analysed by staging, were:

	Stage 1	Stage 2	Stage 3	POCI	Total
	£m	£m	£m	£m	£m
30 September 2020					
Gross loan book	676.6	33.6	14.4	15.5	740.1
Impairment provision	(9.3)	(0.9)	(5.5)	-	(15.7)
Net loan book	667.3	32.7	8.9	15.5	724.4
Coverage Ratio	1.37%	2.68%	38.19%	-	2.12%
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
Coverage Ratio	0.44%	3.33%	47.37%	-	0.83%

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. Additional provision arising on these assets post-acquisition is shown as 'Impairment Provision' above.

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 within the Mortgage Lending and Idem Capital segments 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.

Levels of Stage 2 assets have been increased significantly as a result of the Covid-19 outbreak. This is seen in an increased level of assets where an SICR has been identified in the absence of arrears on the account, particularly through the evaluation of the potential significance of extended payment holidays. In Mortgage Lending and Idem Capital the level of Stage 2 arrears accounts has fallen, due to regulatory interventions preventing arrears being recorded.

Coverage levels have increased in both Mortgage Lending and Commercial Lending, as a consequence of the harsher economic assumptions applied in 2020 and the PD floors applied to accounts with payment holiday extensions. Reduced expectations of security values have also increased provision requirements. Impacts on the highly seasoned Idem Capital books have been less and the levels of such assets in Stage 2 remain relatively small.

	< 1 month arrears £m	> 1 <= 3 months arrears £m	Total £m
30 September 2020			
Gross loan book			
Mortgage Lending	879.9	23.3	903.2
Commercial Lending	113.2	19.1	132.3
Idem Capital	4.8	5.1	9.9
Total	997.9	47.5	1,045.4
Impairment provision			
Mortgage Lending	(12.0)	(0.6)	(12.6)
Commercial Lending	(2.5)	(0.5)	(3.0)
Idem Capital	(0.1)	(0.1)	(0.2)
Total	(14.6)	(1.2)	(15.8)
Net loan book			
Mortgage Lending	867.9	22.7	890.6
Commercial Lending	110.7	18.6	129.3
Idem Capital	4.7	5.0	9.7
Total	983.3	46.3	1,029.6
Coverage ratio			
Mortgage Lending	1.36%	2.58%	1.40%
Commercial Lending	2.21%	2.62%	2.27%
Idem Capital	2.08%	1.96%	2.02%
Total	1.46%	2.53%	1.51%

	< 1 month arrears £m	> 1 <= 3 months arrears £m	Total £m
30 September 2019			
Gross loan book			
Mortgage Lending	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			
Mortgage Lending	(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			
Mortgage Lending	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			
Mortgage Lending	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%

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.

Accounts which no longer meet default criteria but which are being retained in Stage 3 for a probationary period are included with the > 3 month arrears accounts below.

The impact of Covid-19 on the Group's Stage 3 loans can be seen mostly in the level of > 3 month arrears accounts shown below, both in terms of increased numbers and in higher provision coverage. The impact is proportionally less in Idem Capital where there is a significant balance of second charge loans which are long-term arrears balances, the customer making regular payments, but not reducing arrears. Government and regulatory policy intervention have reduced the likelihood of new enforcement actions, particularly on consumer portfolios.

In Mortgage Lending the overall level of Stage 3 balances has continued to reduce, despite Covid-19, as the managed work-out of legacy receiver of rent cases continued in the period. Coverage for Stage 3 RoR managed and realisations cases has increased over the year as a result of a less positive outlook for property sale values. 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.

	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m
30 September 2020				
Gross loan book				
Mortgage Lending	19.4	86.7	20.9	127.0
Commercial Lending	11.4	-	8.8	20.2
Idem Capital	24.3	-	4.6	28.9
Total	55.1	86.7	34.3	176.1
Impairment provision				
Mortgage Lending	(1.7)	(20.8)	(8.2)	(30.7)
Commercial Lending	(4.2)	-	(4.0)	(8.2)
Idem Capital	(2.8)	-	(1.7)	(4.5)
Total	(8.7)	(20.8)	(13.9)	(43.4)
Net loan book				
Mortgage Lending	17.7	65.9	12.7	96.3
Commercial Lending	7.2	-	4.8	12.0
Idem Capital	21.5	-	2.9	24.4
Total	46.4	65.9	20.4	132.7
Coverage ratio				
Mortgage Lending	8.76%	23.99%	39.23%	24.17%
Commercial Lending	36.84%	-	45.45%	40.59%
Idem Capital	11.52%	-	36.96%	15.57%
Total	15.79%	23.99%	40.52%	24.65%

	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m
30 September 2019				
Gross loan book				
Mortgage Lending	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				
Mortgage Lending	(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				
Mortgage Lending	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				
Mortgage Lending	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%

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.

	2020	2019
	£m	£m
First mortgages	71.9	65.7
Second mortgages	17.3	14.0
Asset finance	6.7	2.2
Motor finance	1.5	1.0
	97.4	82.9

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 2020		30 September 2019	
	No.	£m	No.	£m
Managed accounts				
Appointment date				
2010 and earlier	369	62.4	402	70.5
2011 to 2013	72	12.4	86	17.3
2014 to 2016	29	4.2	31	4.5
2016 and later	46	7.7	84	14.0
Total managed accounts	516	86.7	603	106.3
Accounts in the process of realisation	104	19.7	80	11.9
	620	106.4	683	118.2

Receiver of rent accounts in the process of realisation at the period end are included under that heading in the Stage 3 tables above.

In addition to the cases analysed above, 3 POCI mortgage accounts also had a receiver of rent appointed (2019: 3), making a total of 623.

(c) Movements in impairment provision by stage

The movements in the impairment provision calculated under IFRS 9, analysed by business segments, are set out below.

	Mortgage Lending	Commercial Lending	Idem Capital	Total
	£m	£m	£m	£m
At 30 September 2019	26.8	10.7	4.4	41.9
Provided in period (note 19(d))	25.8	22.7	1.3	49.8
Amounts written off	(4.3)	(4.8)	(0.8)	(9.9)
Assets derecognised	-	-	-	-
At 30 September 2020	48.3	28.6	4.9	81.8
At transition – 1 October 2018	36.1	6.6	11.5	54.2
Provided in period (note 19(d))	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 2020, enforceable contractual balances of £5.5m (2019: £9.0m) were outstanding on non-POCI assets written off in the period. This excludes those accounts where a full and final settlement was agreed and those where the contractual terms do not permit any further action. Enforceable balances are kept under review for operational purposes, but no amounts are 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 2020 and 30 September 2019 is set out below.

	Stage 1	Stage 2	Stage 3	POCI	Total
	£m	£m	£m	£m	
Loss allowance at 30 September 2019	6.0	3.7	32.2	-	41.9
New assets originated or purchased	10.2	-	-	-	10.2
Changes in loss allowance					
Transfer to Stage 1	0.9	(0.7)	(0.2)	-	-
Transfer to Stage 2	(1.2)	1.3	(0.1)	-	-
Transfer to Stage 3	(0.5)	(0.4)	0.9	-	-
Changes due to credit risk	6.8	11.9	20.5	0.4	39.6
Write offs	-	-	(9.9)	-	(9.9)
Assets derecognised	-	-	-	-	-
Loss allowance at 30 September 2020	22.2	15.8	43.4	0.4	81.8
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	(2.9)	3.3	3.9	-	4.3
Write offs	-	-	(17.0)	-	(17.0)
Assets derecognised	(0.1)	(1.7)	(2.2)	-	(4.0)
Loss allowance at 30 September 2019	6.0	3.7	32.2	-	41.9

The principal factor generating the increase in the loss allowance in the period is the impact of the Covid-19 crisis, which has led to increased loss expectations across all of the Group's portfolios, primarily as a result of the forecast deterioration in key economic variables and their impact on the Group's customers. The broad availability of payment holidays has also been reflected, with floors applied for both payment holiday accounts and payment holiday extensions.

These increases in expected losses have also led to increased numbers of accounts having an SICR identified and therefore being transferred from Stage 1 to Stage 2. The transfers to Stage 2 in 2020 include £576.3m of balances with extended payment reliefs which were identified as having an SICR for this reason only.

Overall the impact of the PD floors and the transfer of additional accounts to the life-time ECL provisioning required by Stage 2 has increased the total provision by £19.8m from the £62.0m which would have been indicated had only the Group's standard SICR tests been used.

In the year ended 30 September 2019, the principal factors generating the reduction in the loss allowance were 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 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Balance at 30 September 2019	11,382.6	458.5	167.9	219.0	12,228.0
New assets originated or purchased	2,071.4	-	-	-	2,071.4
Changes in staging					
Transfer to Stage 1	202.3	(200.1)	(2.2)	-	-
Transfer to Stage 2	(846.2)	849.2	(3.0)	-	-
Transfer to Stage 3	(42.6)	(20.5)	63.1	-	-
Redemptions and repayments	(1,488.3)	(54.1)	(42.0)	(78.1)	(1,662.5)
Goodwill adjustment	-	-	-	-	-
Assets derecognised	-	-	-	-	-
Write offs	-	-	(9.9)	-	(9.9)
Other changes	50.5	12.4	2.2	21.1	86.2
Balance at 30 September 2020	11,329.7	1,045.4	176.1	162.0	12,713.2
Loss allowance	(22.2)	(15.8)	(43.4)	(0.4)	(81.8)
Carrying value	11,307.5	1,029.6	132.7	161.6	12,631.4
Balance 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	-	-	-	(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.

(d) Impairments charged to income

The amounts charged to the profit and loss account in the period are analysed as follows.

	Mortgage Lending	Commercial Lending	Idem Capital	Total
	£m	£m	£m	£m
30 September 2020				
Provided in period	25.8	22.7	1.3	49.8
Recovery of written off amounts	-	(1.0)	(0.5)	(1.5)
	25.8	21.7	0.8	48.3
Of which				
Loan accounts	25.8	9.5	0.8	36.1
Finance leases	-	12.2	-	12.2
	25.8	21.7	0.8	48.3
30 September 2019				
Provided in period	1.2	7.2	0.3	8.7
Recovery of written off amounts	(0.2)	-	(0.5)	(0.7)
	1.0	7.2	(0.2)	8.0
Of which				
Loan accounts	1.0	2.8	(0.2)	3.6
Finance leases	-	4.4	-	4.4
	1.0	7.2	(0.2)	8.0

(e) Economic impacts

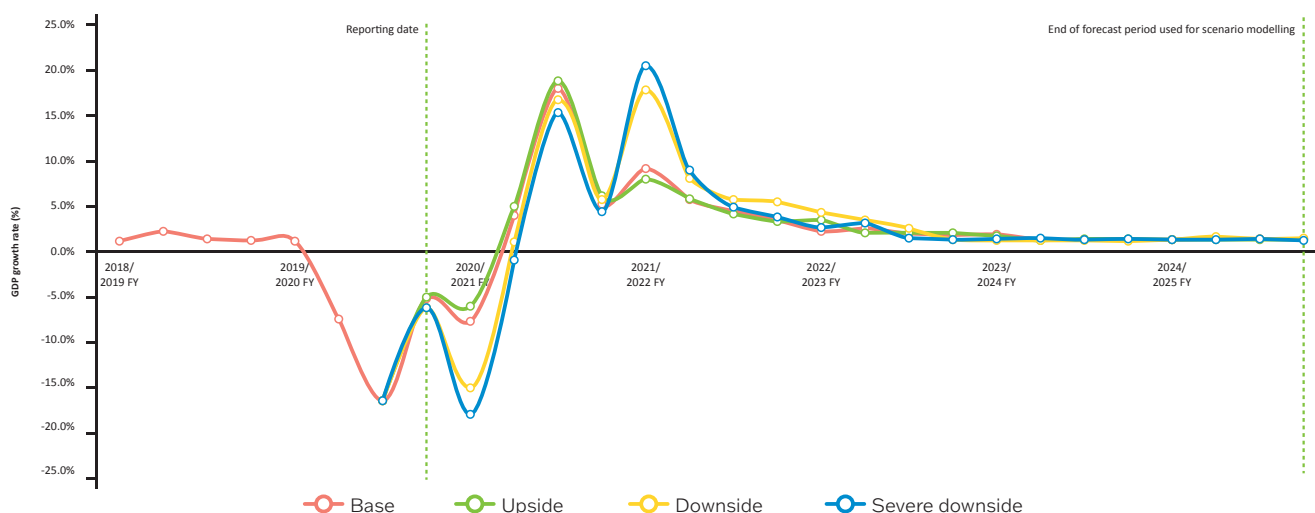
Impairment provision under IFRS 9 is calculated on a forward-looking ECL basis, based on expected economic conditions in multiple internally coherent scenarios. The Group uses four distinct economic scenarios chosen to represent the range of possible outcomes and allow for the impact of economic asymmetry in the calculations. 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.

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.

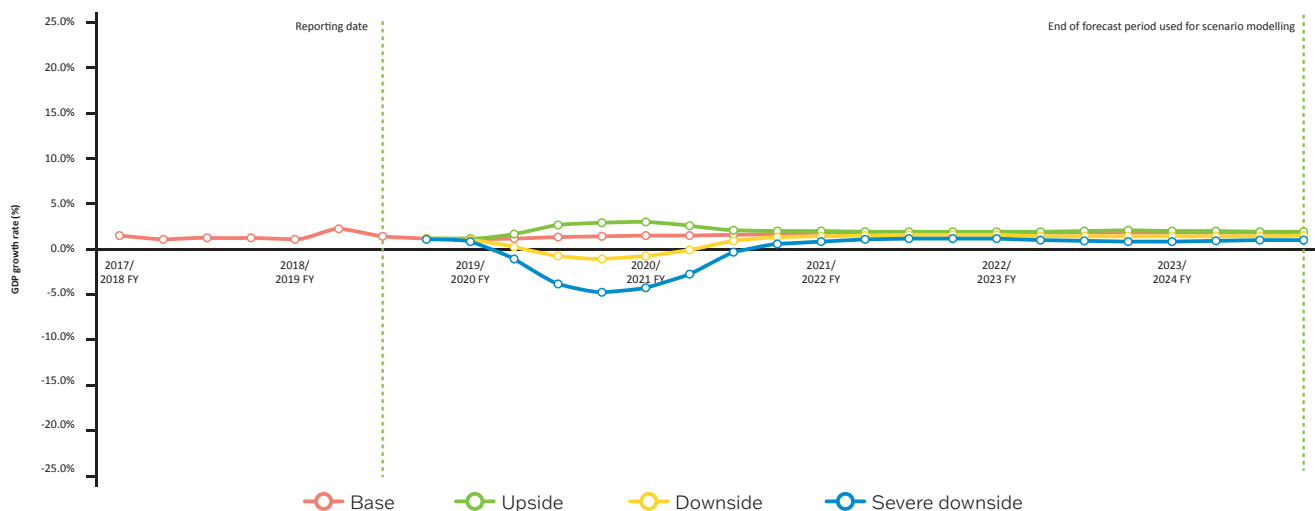
The four economic scenarios comprise a base case, which will normally carry the highest scenario weighting, an upside case, a downside and a severe downside, the latter typically being benchmarked to be at least as severe as scenarios provided by the Bank of England for stress testing purposes. For the 2020 year end, each of the Group's scenarios represents a differing level of impact of the pandemic on the economy and different timings of recovery. They have been reviewed against emerging economic data and updated external forecasts reflecting the most recent information available, including the impact of the UK's second lockdown. The approach utilises data and forecasts from both economic advisers and from public sources, such as Bank of England statements and projections.

The overall shape of the scenarios adopted, and the change in the forecasts year-on-year is illustrated by the forecasts of annual GDP growth rates set out in the charts below.

Historical and forecast GDP quarterly year-on-year growth rates - As at 30 September 2020



Historical and forecast GDP quarterly year-on-year growth rates - As at 30 September 2019



The fundamental rebasing of the Group's scenarios in the year, resulting from the impact of the Covid-19 pandemic, means that it is not useful to discuss detailed changes in the scenarios year-on-year.

The Group revised its weightings at the time of the half-year accounts. Whilst the base case represents the highest individually weighted scenario at 40%, the combined downside and severe downside cases carry a combined 50% weighting, reflecting the scale of uncertainty and potentially adverse economic impact from Covid-19.

It should be noted that 'Severe Downside' in the Covid-19 scenarios is based on a potential outcome and is less severe than that used at 30 September 2019 which was based on the PRA 'once in 200-year' stress test. Therefore, the 2020 scenario carries a higher probability.

The weightings attached to each scenario are set out below:

	2020	2019
Central Scenario	40%	40%
Upside Scenario	10%	20%
Downside Scenario	35%	35%
Severe Scenario	15%	5%
	100%	100%

The economic variables comprising each scenario, and their projected average rates of increase (or decrease) in each of the first five years of the forecast period are set out below.

30 September 2020

Gross Domestic Product ('GDP') (year-on-year change)

	2021	2022	2023	2024	2025
Central Scenario	4.9%	5.7%	2.2%	1.5%	1.4%
Upside Scenario	6.0%	5.4%	2.4%	1.5%	1.5%
Downside Scenario	2.1%	9.3%	2.9%	1.3%	1.5%
Severe Scenario	0.2%	9.5%	2.2%	1.4%	1.3%

House Price Index ('HPI') (year-on-year change)

	2021	2022	2023	2024	2025
Central Scenario	(0.8)%	0.3%	4.0%	4.0%	3.8%
Upside Scenario	1.3%	1.3%	3.0%	3.3%	3.8%
Downside Scenario	(3.5)%	(7.0)%	(0.1)%	3.8%	3.8%
Severe Scenario	(11.8)%	(13.8)%	(5.3)%	1.5%	3.8%

Bank Base Rate ('BBR') (rate)

	2021	2022	2023	2024	2025
Central Scenario	0.1%	0.1%	0.4%	0.8%	0.8%
Upside Scenario	0.1%	0.4%	0.7%	0.9%	1.0%
Downside Scenario	0.1%	0.1%	0.1%	0.3%	0.8%
Severe Scenario	0.0%	(0.2)%	0.1%	0.2%	0.6%

Consumer Price Inflation ('CPI') (rate)

	2021	2022	2023	2024	2025
Central Scenario	0.9%	1.7%	2.2%	2.1%	2.1%
Upside Scenario	1.2%	2.1%	2.1%	2.2%	2.1%
Downside Scenario	0.7%	1.3%	1.8%	2.1%	2.0%
Severe Scenario	(0.1)%	0.7%	1.5%	2.0%	2.0%

Unemployment (rate)

	2021	2022	2023	2024	2025
Central Scenario	7.1%	5.3%	5.0%	5.0%	4.4%
Upside Scenario	6.3%	4.8%	4.6%	4.5%	4.1%
Downside Scenario	8.2%	6.5%	5.7%	5.0%	4.8%
Severe Scenario	8.5%	7.8%	7.0%	6.3%	5.5%

Secured lending (annual change)

	2021	2022	2023	2024	2025
Central Scenario	3.6%	3.7%	3.8%	3.9%	3.9%
Upside Scenario	4.7%	4.5%	4.2%	4.1%	4.0%
Downside Scenario	1.8%	2.3%	3.2%	3.7%	3.8%
Severe Scenario	(0.9)%	0.2%	2.3%	3.4%	3.7%

Consumer credit (annual change)

	2021	2022	2023	2024	2025
Central Scenario	6.0%	6.1%	6.1%	6.3%	6.3%
Upside Scenario	8.7%	8.2%	7.3%	6.9%	6.7%
Downside Scenario	1.8%	2.8%	4.3%	5.4%	5.7%
Severe Scenario	(4.6)%	(2.3)%	1.6%	4.0%	4.8%

30 September 2019

Gross Domestic Product ('GDP') (year-on-year change)

	2020	2021	2022	2023	2024
Central Scenario	1.3%	1.7%	1.8%	1.5%	1.9%
Upside Scenario	2.2%	2.5%	2.0%	1.5%	2.1%
Downside Scenario	(0.1)%	0.4%	1.6%	1.3%	1.5%
Severe Scenario	(2.1)%	(1.6)%	1.2%	1.4%	1.0%

House Price Index ('HPI') (year-on-year change)

	2020	2021	2022	2023	2024
Central Scenario	1.3%	2.9%	4.0%	4.2%	4.3%
Upside Scenario	2.9%	7.4%	8.6%	4.6%	4.0%
Downside Scenario	(1.3)%	(4.4)%	(3.4)%	3.6%	4.8%
Severe Scenario	(5.2)%	(15.4)%	(14.4)%	2.7%	5.5%

Bank Base Rate ('BBR') (rate)

	2020	2021	2022	2023	2024
Central Scenario	0.8%	0.8%	0.8%	0.8%	0.8%
Upside Scenario	1.0%	1.5%	2.0%	2.4%	2.5%
Downside Scenario	0.5%	0.5%	0.5%	0.5%	0.5%
Severe Scenario	0.0%	0.0%	0.0%	0.0%	0.0%

Consumer Price Inflation ('CPI') (rate)

	2020	2021	2022	2023	2024
Central Scenario	2.1%	2.1%	2.1%	2.1%	2.1%
Upside Scenario	2.0%	1.5%	1.6%	2.0%	2.2%
Downside Scenario	2.3%	3.1%	2.9%	2.1%	2.1%
Severe Scenario	2.5%	4.6%	4.1%	2.2%	2.1%

Unemployment (rate)

	2020	2021	2022	2023	2024
Central Scenario	4.9%	4.0%	3.9%	3.9%	3.8%
Upside Scenario	3.6%	3.5%	3.5%	3.5%	3.5%
Downside Scenario	4.9%	6.1%	5.9%	5.6%	5.3%
Severe Scenario	6.4%	9.2%	8.8%	8.2%	7.5%

Secured lending (annual change)

	2020	2021	2022	2023	2024
Central Scenario	3.3%	3.6%	3.7%	3.8%	3.9%
Upside Scenario	3.6%	4.7%	4.5%	4.2%	4.0%
Downside Scenario	2.8%	1.8%	2.3%	3.2%	3.7%
Severe Scenario	1.9%	(0.9)%	0.2%	2.3%	3.4%

Consumer credit (annual change)

	2020	2021	2022	2023	2024
Central Scenario	6.0%	6.0%	6.1%	6.1%	6.3%
Upside Scenario	6.9%	8.7%	8.2%	7.3%	6.9%
Downside Scenario	4.8%	1.8%	2.8%	4.3%	5.4%
Severe Scenario	(2.9)%	(4.6)%	(2.3)%	1.6%	4.0%

After the end of the initial five year period, the final rate or rate of change (as appropriate) is assumed to continue into the future in each scenario.

To illustrate the levels of non-linearity in the various scenarios, the maximum and minimum quarterly levels for each variable over the five year period are set out below.

30 September 2020

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max	Min	Max	Min	Max	Min	Max	Min
	%	%	%	%	%	%	%	%
Economic driver								
GDP	18.0	(7.6)	18.8	(5.9)	17.8	(15.1)	20.5	(17.9)
HPI	5.0	(4.0)	4.0	0.0	4.0	(10.0)	4.0	(20.0)
BBR	0.8	0.1	1.0	0.1	1.0	0.1	0.8	(0.4)
CPI	2.4	0.6	2.3	0.7	2.3	0.2	2.3	(0.3)
Unemployment	7.6	4.0	7.0	4.0	9.0	4.5	9.0	5.3
Secured lending	3.9	3.5	4.8	4.0	3.8	1.7	3.7	(1.2)
Consumer credit	6.3	6.0	8.8	6.7	5.7	1.5	4.8	(5.2)

30 September 2019

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max	Min	Max	Min	Max	Min	Max	Min
	%	%	%	%	%	%	%	%
Economic driver								
GDP	1.9	1.2	3.1	1.2	1.6	(1.0)	1.3	(4.7)
HPI	4.3	0.7	9.7	0.9	4.9	(4.7)	5.7	(17.8)
BBR	0.8	0.8	2.5	0.8	0.5	0.5	0.0	0.0
CPI	2.2	2.0	2.2	1.4	3.2	2.0	4.9	2.0
Unemployment	4.1	3.8	3.9	3.5	6.1	4.2	9.2	4.5
Secured lending	3.9	3.2	4.8	3.3	3.8	1.7	3.7	(1.2)
Consumer credit	6.3	6.0	8.8	6.2	6.0	1.5	5.9	(5.2)

The asymmetry in the models is demonstrated by comparing the calculated impairment provision with that which would have been produced using the Central scenario alone, 100% weighted.

	2020	2019
	£m	£m
Calculated provision	81.8	41.9
100% weighted central scenario	67.4	37.7
Effect of multiple economic scenarios	14.4	4.2

(f) 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

To illustrate the potential impact of differing future economic scenarios on the total impairment, the provision which would be calculated if each of the economic scenarios were 100% weighted would be:

Scenarios	2020	
	Provision £m	Difference £m
Central	67.4	(14.4)
Upside	58.0	(23.8)
Downside	82.4	0.6
Severe downside	134.3	52.5

The weighted average of these 100% weighted provisions need not equal the weighted average ECL due to the impact of the differing PDs on staging. However due to the significant impact of post model stage adjustments, the effect on the PD SICR test of 100% weighting has not been taken into account above.

Significant increase in credit risk

The most important driver of SICR is relative PD. If all PDs across the Group's principal buy-to-let mortgage book were increased by 10%, loans with a gross value of £53.3m would transfer from Stage 1 to Stage 2 (2019: £25.8m), and the total provision would increase by £1.6m from the combined effects of higher PDs on expected losses and the impact of providing for expected lifetime losses, rather than 12-month losses on the additional Stage 2 cases (2019: £0.6m).

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 after the forecast minimum were halved, ignoring any PD effects, then the provision for the Group's first and second mortgage assets under the central scenario would increase by £5.9m.

At 30 September 2019, 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 mortgage assets under the central scenario would increase by £5.5m.

As the house price index is not predicted to increase consistently from 30 September 2020, the sensitivity calculation at 30 September 2019 cannot be repeated exactly.

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 £0.8m (2019: £0.7m).

20. 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 59) 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 2020 or the preceding year.

	2020	2020	2019	2019
	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m
Derivatives in hedge accounting relationships				
<i>Fair value hedges</i>				
Interest rate swaps				
Fixed to floating	-	(130.0)	0.2	(78.3)
Floating to fixed	14.4	-	7.6	(0.2)
	14.4	(130.0)	7.8	(78.5)
<i>Cash flow hedges</i>				
Cross-currency basis swaps				
Dollar-sterling	213.2	-	274.6	-
Euro-sterling	232.1	-	308.1	-
	445.3	-	582.7	-
Total derivatives in hedge accounting relationships	459.7	(130.0)	590.5	(78.5)
Other derivatives				
Interest rate swaps	3.4	(2.4)	1.9	(2.0)
Currency futures	0.2	-	-	-
Total recognised derivative assets/(liabilities)	463.3	(132.4)	592.4	(80.5)

The credit risk inherent in the derivative financial assets shown above is discussed in note 56.

(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 or duration risk and is controlled within limits under the Group's interest rate risk management process, described in note 58. In order to manage these exposures, they are hedged with financial derivatives and form part of the Group's portfolio hedging arrangements. Duration risk is monitored regularly to ensure mismatches or gaps remain within limits set by policy.

Responsibility to direct and oversee structural interest rate risk management has been delegated by the Board to the Executive Risk Committee ('ERC') and by ERC to the Assets and Liabilities Committee ('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 changes in interest rates between the point at which fixed rate products are priced and the advance date, it may be necessary to undertake hedging of 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, or other fixed rate assets, with interest rate swaps to convert the interest receivable to a floating rate; and
- 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 and all new interest rate swap agreements since 1 February 2020 have referenced SONIA.

This means that each of these macro hedges can be divided into two sections, one referencing LIBOR and one SONIA. Through the year, as assets and deposits matured and were replaced by new business, the LIBOR-linked element of the hedges reduced, and the SONIA-linked element increased.

All new interest rate hedging arrangements for fixed rate assets or liabilities are executed with SONIA as a reference rate. In addition, hedging related to fixed rate assets funded in the most recent securitisation transactions, PM 26 and PM 27, where the funding rate is SONIA-linked, was also undertaken with reference to SONIA.

During the year the Group also began hedging interest rate risk on fixed rate CBILS and BBLS exposures using SONIA-linked basis guarantee swaps, which are included in the loan hedge.

There remains a back book of swaps referencing three-month LIBOR, which is currently running off as the instruments reach maturity. Certain of these swaps have a maturity after December 2021, when LIBOR is expected to become unavailable and the Group is closely following emerging market practice for the treatment of such contracts. The International Swaps and Derivative Association ('ISDA'), the trade organisation for derivatives, have released a protocol which incorporates fallback provisions to facilitate transition to SONIA when LIBOR ceases or if it is deemed unrepresentative by the FCA. The Group expects to adhere to transition in accordance with the protocol by December 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 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 56).
- 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 2020 and 30 September 2019 consist of a large number of sterling denominated swaps. In addition, at 30 September 2020 there were a small number of balance guarantee swaps ('BGS') in place. Settlement on all swaps is generally quarterly (monthly for BGS) 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.

On the BGS the nominal value of the swap is linked to the principal value of a pool of assets and reduces in line with redemptions and repayments until maturity. Other interest rate swaps have a fixed nominal value throughout their lives.

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.

	2020		2019	
	Deposit Hedge	Loan Hedge	Deposit Hedge	Loan Hedge
Average fixed notional interest rate	0.42%	0.91%	0.83%	1.04%
Average notional margin over LIBOR	-	-	-	-
Average notional margin over SONIA	-	-	-	-
	£m	£m	£m	£m
Notional principal value				
LIBOR swaps	1,147.5	3,968.8	1,619.0	4,304.5
SONIA BGS	-	25.2	-	-
Other SONIA swaps	1,043.0	1,317.3	-	486.8
	2,190.5	5,311.3	1,619.0	4,791.3
Maturing				
Within one year	1,287.5	531.5	805.5	465.4
Between one and two years	669.0	1,012.1	449.5	595.2
Between two and five years	234.0	3,731.0	364.0	3,554.7
More than five years	-	36.7	-	176.0
	2,190.5	5,311.3	1,619.0	4,791.3
Fair value	14.3	(129.9)	7.5	(78.2)

The value included above for BGS are analysed by their contractual maturity dates although, due to the terms of the instruments, it is likely that the balance outstanding will reduce more quickly.

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.

	2020		2019	
	Deposit Hedge	Loan Hedge	Deposit Hedge	Loan Hedge
	£m	£m	£m	£m
Hedging instruments				
<i>Interest rate swaps</i>				
Included in derivative financial assets	14.3	-	7.6	0.2
Included in derivative financial liabilities	-	(129.9)	(0.1)	(78.4)
	14.3	(129.9)	7.5	(78.2)
Notional principal value	2,190.5	5,311.3	1,619.0	4,791.3
Change in fair value used in calculating hedge ineffectiveness	6.6	(48.1)	7.9	(98.5)
	2020		2019	
	Deposit Hedge	Loan Hedge	Deposit Hedge	Loan Hedge
	£m	£m	£m	£m
Hedged items				
<i>Fixed rate deposits</i>				
Monetary amount of risk relating to Retail Deposits	2,083.9	-	1,473.7	-
<i>Fixed rate loans</i>				
Monetary amount of risk relating to Loans to Customers	-	5,353.4	-	4,834.8
Accumulated amount of fair value hedge adjustments included on balance sheet (notes 16 and 28)*	(10.4)	109.7	(3.9)	64.2
Of which: amounts related to discontinued hedging relationships being amortised	-	(11.6)	-	(8.8)
Change in fair value used in recognising hedge ineffectiveness	(6.4)	48.2	(8.1)	92.2
Hedge ineffectiveness recognised				
Included in fair value (losses) / gains in the profit and loss account	0.2	0.1	(0.2)	(6.3)

* 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.

These arrangements will be affected by the withdrawal or amendment of IBOR rates (sterling LIBOR, US dollar LIBOR and EURIBOR). While sterling LIBOR is to be retired any changes to other rates may not be parallel or take place at the same time. The Group expects a common solution to be developed across securitisation issuers in conjunction with other market participants and expects this to be implemented in the coming financial year.

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.

	2020		2019	
	Swap currency		Swap currency	
	USD	EUR	USD	EUR
Average fixed exchange rate	2.0	1.5	2.0	1.5
Average margin over LIBOR on interest payable	0.23%	0.48%	0.24%	0.49%
Average margin over US dollar LIBOR / EURIBOR on interest receivable	0.19%	0.54%	0.19%	0.52%
Notional principal value (£m)	397.0	687.5	447.5	1,007.4
Fair value (£m)	213.2	232.1	274.6	308.1
Average remaining term (years)	20	21	21	22

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 £445.3m of the cross-currency basis swap balance at 30 September 2020 (2019: £582.1m), with post-2010 assets representing £nil (2019: £0.6m).

The decrease in notional principal related to note repayments in the period, with no new currency-denominated notes issued in the year.

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 may be partially collateralised, depending on the rating of the counterparties from time to time. Additional collateral is conditionally available, as described in note 56, under the terms of the instruments. 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.

	2020		2019	
	Swap currency		Swap currency	
	USD £m	EUR £m	USD £m	EUR £m
Hedging Instruments				
<i>Cross-currency basis swaps</i>				
Included in derivative financial assets	213.2	232.1	274.6	308.1
Included in derivative financial liabilities	-	-	-	-
	213.2	232.1	274.6	308.1
Notional principal value	397.0	687.5	447.5	1,007.4
Change in fair value used in calculating hedge ineffectiveness	(29.5)	(42.6)	71.3	(21.2)
Hedged Items				
<i>Floating rate notes</i>				
Included in Asset Backed Loan Notes	397.0	687.5	447.5	1,007.4
Changes in fair value used in calculating hedge ineffectiveness	(29.5)	(42.6)	71.3	(21.2)
Cash flow hedging reserve before tax	0.7	2.3	0.8	2.8

The table below summarises the amounts which have affected total comprehensive income as a result of the cash flow hedges described above.

	2020 £m	2019 £m
Change of value in hedging instrument recognised in cash flow hedge reserve		
US dollar swaps	(29.5)	71.3
Euro swaps	(42.6)	(21.2)
	(72.1)	50.1
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 dollar swaps	(29.0)	71.1
Euro swaps	(42.5)	(21.5)
	(71.5)	49.6
Net amount recognised in Other Comprehensive Income before tax	(0.6)	0.5

All amounts reclassified to profit in the financial year have been transferred because the hedged item has affected profit or loss. In the year ended 30 September 2019 amounts were additionally reclassified to profit on the derecognition of the PM12 FRNs (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

	2020		2019	
	Pay fixed	Pay floating	Pay fixed	Pay floating
Average fixed notional interest rate	0.28%	0.23%	0.75%	0.77%
Average notional margin over LIBOR	-	-	-	-
Average notional margin over SONIA	-	-	-	-
	£m	£m	£m	£m
Notional principal value				
LIBOR swaps	145.7	237.0	315.4	554.0
SONIA BGS	422.0	698.0	-	8.0
	567.7	935.0	315.4	562.0
Maturing				
Within one year	128.1	715.0	68.4	424.0
Between one and two years	60.6	47.0	43.5	95.0
Between two and five years	182.0	173.0	92.5	43.0
More than five years	197.0	-	111.0	-
	567.7	935.0	315.4	562.0
Fair value	3.4	(2.4)	1.9	(2.0)

Currency futures

	2020	2019
<i>US dollar futures</i>		
Average future exchange rate	1.27	1.22
	£m	£m
Notional principal value	14.1	5.7
Maturing		
Within one year	14.1	5.7
Between one and two years	-	-
Between two and five years	-	-
	14.1	5.7
Fair value	0.2	-

21. Sundry assets

(a) The Group

	<i>Note</i>	2020	2019	2018
		£m	£m	£m
Current assets				
Accrued interest income		0.1	0.4	0.6
Trade receivables		3.2	3.6	2.2
CSA assets		103.5	72.2	3.8
CRDs		15.1	11.4	6.2
Sovereign receivables		0.2	-	-
Other receivables		3.2	2.7	2.5
Sundry financial assets	65	125.3	90.3	15.3
Prepayments		2.7	2.1	2.6
Other tax		-	0.4	1.1
		128.0	92.8	19.0

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.

Sovereign receivables includes amounts receivable from the UK Government under the CBILS and BBLS schemes.

CRDs, CSA assets, sovereign receivables and accrued interest are considered to be Stage 1 assets for IFRS 9 impairment purposes. The probabilities of default of the obligor institutions (the UK Government, Bank of England and major banks) have been assessed and are considered to be so low as to require no significant impairment provision.

(b) The Company

	2020	2019	2018
	£m	£m	£m
Current assets			
Amounts owed by Group companies	84.0	106.6	216.3
Accrued interest income	0.6	0.7	0.7
	84.6	107.3	217.0

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.

22. Current tax assets / liabilities

Current tax in the Group and the Company represents UK corporation tax owed or recoverable.

23. Deferred tax

(a) The Group

The movements in the net deferred tax asset / (liability) are as follows:

	Note	2020 £m	2019 £m	2018 £m
Opening net asset / (liability)				
As previously reported		6.2	(5.6)	(4.8)
Change of accounting policy	61	-	5.0	-
Restated		6.2	(0.6)	(4.8)
Derecognition	7	-	1.8	-
Acquisitions		-	0.5	(0.3)
Income statement (charge)/credit	12	(1.1)	2.3	1.2
Credit to equity		1.1	2.2	(1.7)
Closing net asset / (liability)		6.2	6.2	(5.6)

The net deferred tax asset for which provision has been made is analysed as follows:

	2020 £m	2019 £m	2018 £m
Accelerated tax depreciation	2.9	2.3	4.1
Retirement benefit obligations	6.7	5.9	3.7
Temporary differences on loans to customers	(3.8)	(5.3)	(14.0)
Tax losses	1.3	0.4	0.2
Other timing differences	(0.9)	2.9	0.4
Net deferred tax asset / (liability)	6.2	6.2	(5.6)

As stated in note 12, legislation in the year has reversed the expected reduction in the standard rate of UK tax to 17.0% which had already been accounted for. This change has been reflected in the deferred tax balance. The temporary differences shown above have been provided at the rate prevailing when the Group anticipates these temporary differences 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 (eg the timing and nature of the refinancing of certain portfolios) and matters outside the Group's control (eg 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 to the temporary differences, the Group has tax losses of £2.3m (2019: £2.3m) 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:

	2020 £m	2019 £m	2018 £m
Opening net liability	1.6	1.8	1.8
Income statement charge / (credit)	0.2	(0.2)	-
Closing net liability	1.8	1.6	1.8

The net deferred tax liability for which provision has been made is analysed as follows:

	2020	2019	2018
	£m	£m	£m
Other timing differences	1.8	1.6	1.8
Net deferred tax liability	1.8	1.6	1.8

24. Property, plant and equipment

(a) The Group

	Leased assets	Land and buildings	Plant and machinery	Total
	£m	£m	£m	£m
Cost				
At 30 September 2018	46.4	22.8	10.7	79.9
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
Adoption of IFRS 16 (note 61)	-	6.0	1.0	7.0
Additions	12.9	0.7	1.5	15.1
Disposals	(7.5)	-	(0.6)	(8.1)
At 30 September 2020	58.1	29.5	12.5	100.1
Accumulated depreciation				
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
Charge for the year	8.3	1.8	1.7	11.8
On disposals	(6.1)	-	(0.5)	(6.6)
At 30 September 2020	18.6	5.9	9.5	34.0
Net book value				
At 30 September 2020	39.5	23.6	3.0	66.1
At 30 September 2019	36.3	18.7	2.3	57.3
At 30 September 2018	35.4	19.2	2.2	56.8

Land and buildings and plant and machinery shown above are used within the Group's business. Leased assets includes £27.0m in respect of assets leased under operating leases (2019: £25.6m) and £12.5m of assets available for hire (2019: £10.7m).

The carrying values of right of use of assets, in respect of leases where the Group is the lessee, included in property, plant and equipment are set out below.

	Land and buildings £m	Plant and machinery £m	Total £m
Cost			
At 30 September 2019	-	-	-
Adoption of IFRS 16 (note 61)	6.0	1.0	7.0
Additions	-	0.3	0.3
Disposals		(0.1)	(0.1)
At 30 September 2020	6.0	1.2	7.2
Accumulated depreciation			
At 30 September 2019	-	-	-
Charge for the year	1.4	0.6	2.0
On disposals	-	(0.1)	(0.1)
At 30 September 2020	1.4	0.5	1.9
Net book value			
At 30 September 2020	4.6	0.7	5.3
At 30 September 2019	-	-	-

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 £17.7m (2019: £18.0m).

(b) The Company

The property, plant and equipment balance of the Company represents a right of use asset in respect of a building leased from a fellow Group entity. The carrying value of this asset is set out below.

	Land and buildings £m
Cost	
At 30 September 2019	-
Adoption of IFRS 16 (note 61)	18.8
Additions	-
Disposals	-
At 30 September 2020	18.8
Accumulated depreciation	
At 30 September 2019	-
Charge for the year	1.4
On disposals	-
At 30 September 2020	1.4
Net book value	
At 30 September 2020	17.4
At 30 September 2019	-

25. Intangible assets

	Goodwill (note 26)	Computer software	Other intangible assets	Total
	£m	£m	£m	£m
Cost				
At 30 September 2018	168.2	9.4	10.6	188.2
Acquisitions	2.2	-	-	2.2
Additions	-	2.0	-	2.0
At 30 September 2019	170.4	11.4	10.6	192.4
Acquisitions	-	-	-	-
Additions	-	1.0	-	1.0
At 30 September 2020	170.4	12.4	10.6	193.4
Accumulated amortisation and impairment				
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
Amortisation charge for the year	-	1.2	0.8	2.0
At 30 September 2020	6.0	10.2	7.1	23.3
Net book value				
At 30 September 2020	164.4	2.2	3.5	170.1
At 30 September 2019	164.4	2.4	4.3	171.1
At 30 September 2018	162.2	2.1	5.0	169.3

Other intangible assets comprise brands and the benefit of business networks recognised on the acquisition of businesses.

Movements in goodwill in the year ended 30 September 2019 relate to the finalisation of the acquisition accounting for Titlestone described in the accounts for that year.

26. Goodwill

The goodwill carried in the accounts is attributable to three cash generating units ('CGU's), which have not changed in the year. The balance is as analysed below:

	2020	2019
	£m	£m
CGU		
SME lending	113.0	113.0
Development finance	49.8	49.8
TBMC	1.6	1.6
	164.4	164.4

(a) SME lending

The goodwill carried in the accounts relating to the SME lending (formerly asset finance) CGU was recognised on acquisitions in the years ended 30 September 2016 and 30 September 2018.

An impairment review undertaken at 30 September 2020 indicated that no write down was required.

The recoverable amount of the SME lending CGU 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. These forecasts reflect the potential ongoing impact of Covid-19 on the business, with overall average growth increased to include the recovery from the Covid-19 low point.

The key assumptions underlying the value in use calculation for the SME lending CGU 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 19.7%, compared with 12.0% used in the calculation at 30 September 2019. Cash flows beyond the five-year budget are extrapolated using a constant growth rate of 1.5% (2019: 1.9%) 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 15.0% (2019: 13.2%)

As an illustration of the sensitivity of this impairment test to movements in the key assumptions, the Group has calculated that a 10.0% reduction in profit levels coupled with a 100 basis point increase in the pre-tax discount rate would eliminate the headroom in the projection.

In the testing carried out at 30 September 2019, a 24.0% reduction in profit levels coupled with a 370 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 CGU was first recognised on a business acquisition in the year ended 30 September 2018.

An impairment review undertaken at 30 September 2020 indicated that no write down was required.

The recoverable amount of the development finance CGU 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. These forecasts include the potential ongoing impact of Covid-19 on the business.

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 16.9%, compared with 18.3% used in the calculation at 30 September 2019. Cash flows beyond the five-year budget are extrapolated using a constant growth rate of 1.5% (2019: 1.9%) 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 14.2% (2019: 13.2%)

Management believes any reasonably possible change in the key assumptions above would not cause the recoverable amount of the development finance CGU to fall below the balance sheet carrying value. This was also the case in the testing carried out at 30 September 2019.

(c) TBMC

The goodwill carried in the accounts relating to the TBMC cash generating unit was recognised on an acquisition in December 2008 and impaired by £6.0m in 2009.

An impairment review was undertaken at 30 September 2020 which indicated no further impairment. The recoverable amount of the TBMC CGU 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 4.41% (2018: 4.74%) and cash flows beyond the five year budget are extrapolated using a 1.6% (2019: 1.6%) 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 recoverable value of the CGU to fall below its balance sheet carrying value. This was also the case at 30 September 2019.

27. Investment in subsidiary undertakings

	Shares in group companies	Loans to group companies	Loans to ESOP Trusts	Total
	£m	£m	£m	£m
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	-	-	-	-
Capital distributions	(15.6)	-	-	(15.6)
Loans advanced	-	90.0	4.7	94.7
Loans repaid	-	-	-	-
Provision movements	14.7	-	(4.4)	10.3
At 30 September 2020	639.6	390.0	0.5	1,030.1

Investments in subsidiaries represent transactions between the Company and various of its subsidiaries.

During the years ended 30 September 2020 and 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 2020 the Company received £113.9m in dividend income from its subsidiaries (2019: £44.3m) and £18.2m of interest on loans to Group companies (2019: £15.1m).

The Company's subsidiaries, and the nature of its interest in them, are shown in note 66.

28. 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 notice and easy access accounts. The method of interest calculation on these deposits is analysed as follows:

	2020	2019	2018
	£m	£m	£m
Fixed rate	4,975.9	4,154.4	3,643.1
Variable rates	2,880.7	2,237.5	1,653.5
	7,856.6	6,391.9	5,296.6

The weighted average interest rate on retail deposits at 30 September 2020, analysed by charging method, was:

	2020	2019	2018
	%	%	%
Fixed rate	1.69	2.02	1.94
Variable rates	0.72	1.43	1.36
All deposits	1.34	1.81	1.76

The contractual maturity of these deposits is analysed below.

	2020	2019	2018
	£m	£m	£m
Amounts repayable			
In less than three months	565.0	466.6	256.8
In more than three months, but not more than one year	2,725.6	2,088.4	2,024.7
In more than one year, but not more than two years	1,541.6	1,158.0	1,010.6
In more than two years, but not more than five years	664.8	900.9	655.3
Total term deposits	5,497.0	4,613.9	3,947.4
Repayable on demand	2,359.6	1,778.0	1,349.2
	7,856.6	6,391.9	5,296.6
Fair value adjustments for portfolio hedging (note 20)	10.4	3.9	(4.2)
	7,867.0	6,395.8	5,292.4

29. Asset backed loan notes

The Group's asset backed loan notes ('Notes') are rated and publicly listed and are secured on portfolios comprising variable and fixed rate mortgages. 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.

The Group also has an option to repay all of the Notes on any issue 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 and Paragon Mortgages (No. 27) PLC
- The compounded Sterling Overnight Interbank Average Rate ('SONIA') on notes denominated in sterling issued by Paragon Mortgages (No. 26) PLC and Paragon Mortgages (No. 27) 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

The IBOR rates, LIBOR, EURIBOR and US dollar LIBOR are intended to be withdrawn and replacement rates will be substituted for the note issues affected in line with market practice.

All payments in respect of the Notes are required to be made in the currency in which they are denominated.

The Group publishes detailed information on the performance of all of its 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 57.

On 30 April 2020, a Group company, Paragon Mortgages (No. 27) PLC, issued £735.8m of sterling mortgage backed floating rate notes, analysed below, at par.

Class	Fitch rating	Moody's rating	Interest margin above compounded SONIA	Principal value £m
A	AAA	Aaa	1.1%	648.3
B	AA	Aa1	1.5%	41.9
C	A	Aa3	1.8%	22.8
D	BBB	Baa1	2.1%	22.8
				735.8

All of the above notes were retained by the Group.

Notes in issue at 30 September 2020 and 30 September 2019, net of any held by the Group, were:

Issuer	Maturity date	Call date	Principal outstanding		Average interest margin	
			2020	2019	2020	2019
Sterling notes			£m	£m	%	%
Interest based on LIBOR						
Paragon Mortgages (No. 9) PLC	15/05/41	15/05/09	-	95.2	-	0.38
Paragon Mortgages (No. 10) PLC	15/06/41	15/12/09	-	155.7	-	0.52
Paragon Mortgages (No. 11) PLC	15/10/41	15/04/10	221.1	237.7	0.15	0.15
Paragon Mortgages (No. 13) PLC	15/01/39	15/10/10	416.4	443.7	0.27	0.27
Paragon Mortgages (No. 14) PLC	15/09/39	15/03/11	390.0	423.8	0.23	0.23
Paragon Mortgages (No. 15) PLC	15/12/39	15/06/11	108.5	117.7	0.30	0.30
Paragon Mortgages (No. 23) PLC	15/01/43	15/10/19	-	34.5	-	1.84
Paragon Mortgages (No. 24) PLC	15/07/43	15/04/20	-	45.7	-	2.85
Paragon Mortgages (No. 25) PLC	15/05/50	15/05/23	379.4	423.6	0.72	0.72
First Flexible No. 6 PLC	01/12/35	01/03/08	-	47.7	-	1.27
Interest based on SONIA						
Paragon Mortgages (No. 26) PLC	15/05/45	15/08/24	231.3	364.3	1.05	1.05
Paragon Mortgages (No. 27) PLC†	15/04/47	15/10/25	-	-	-	-
US dollar notes			\$m	\$m	%	%
Paragon Mortgages (No. 9) PLC	15/05/41	15/05/09	-	15.5	-	0.36
Paragon Mortgages (No. 13) PLC	15/01/39	15/10/10	134.6	143.4	0.18	0.18
Paragon Mortgages (No. 14) PLC	15/09/39	15/03/11	150.7	166.1	0.20	0.20
Paragon Mortgages (No. 15) PLC	15/12/39	15/06/11	502.1	552.9	0.19	0.19
First Flexible No. 6 PLC	01/12/35	01/03/08	-	7.5	-	0.56
Euro notes			€m	€m	%	%
Paragon Mortgages (No. 9) PLC	15/05/41	15/05/09	-	147.7	-	0.56
Paragon Mortgages (No. 10) PLC	15/06/41	15/12/09	-	247.0	-	0.39
Paragon Mortgages (No. 11) PLC	15/10/41	15/04/10	182.4	196.1	0.54	0.54
Paragon Mortgages (No. 13) PLC	15/01/39	15/10/10	268.3	285.9	0.42	0.42
Paragon Mortgages (No. 14) PLC	15/09/39	15/03/11	317.0	326.4	0.48	0.48
Paragon Mortgages (No. 15) PLC	15/12/39	15/06/11	244.0	248.9	0.73	0.72
Paragon Mortgages (No. 23) PLC	15/01/43	15/10/19	-	2.2	-	0.70
Paragon Mortgages (No. 24) PLC	15/07/43	15/04/20	-	0.6	-	1.10
First Flexible No. 6 PLC	01/12/35	01/03/08	-	26.8	-	1.05

[†] All notes issued by Paragon Mortgages (No. 27) were retained by the Group (see note 57)

The details of the assets backing these securities are given in note 17.

During the year, the Group redeemed all of the outstanding notes of the following securitisations at par:

- Paragon Mortgages (No. 9) PLC on 18 February 2020
- Paragon Mortgages (No. 10) PLC on 15 September 2020
- Paragon Mortgages (No. 23) PLC on 15 October 2019
- Paragon Mortgages (No. 24) PLC on 15 April 2020
- First Flexible No. 6 PLC on 1 September 2020

The underlying assets were subsequently funded by other Group companies.

On 23 September 2020, notice was given of the Group's intention to redeem all of the outstanding notes of Paragon Mortgages (No. 11) PLC at par, and this took place on 15 October 2020, after the year end.

On 23 November 2020, after the end of the year, the Group gave notice of its intention to redeem all of the outstanding notes of Paragon Mortgages (No. 15) PLC at par. This was expected to take place on 15 December 2020.

On 11 November 2020, after the end of the year, a Group company, Paragon Mortgages (No. 28) PLC, issued £703.1m of rated sterling mortgage backed floating rate notes, analysed below, at par.

Class	Fitch rating	Moody's rating	Interest margin above compounded SONIA	Principal value £m
A	AAA	Aaa	0.95%	623.8
B	AA	Aa1	1.35%	39.7
C	A	Aa3	1.65%	21.6
D	BBB-	Baa1	1.95%	18.0
				703.1

All of the above notes were retained by the Group.

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. The Group's continuing involvement in the transaction is described in note 46.

30. 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 57 and details of assets held within the warehouse facilities are given in note 17. Details of the Group's bank borrowings are set out below.

	2020			2019		
	Principal value	Maximum available facility	Carrying value	Principal value	Maximum available facility	Carrying value
	£m	£m	£m	£m	£m	£m
i) Paragon Second Funding	657.8	657.8	657.8	787.5	787.5	787.5
ii) Paragon Seventh Funding	-	400.0	-	-	200.0	-
	657.8	1,057.8	657.8	787.5	987.5	787.5

- 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 (2019: 0.675% above LIBOR).
- ii) On 14 November 2018, a £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. This was renewed for 12 months on 24 October 2019 and was increased to £400.0m and renewed for a further 18 months on 25 September 2020. Interest was payable at 0.95% over three month LIBOR up to 25 September 2020 and 1.05% over three month LIBOR thereafter. The renewal also included terms on which the reference rate would be transitioned to SONIA during the commitment period.

The weighted average margin above LIBOR on bank borrowings at 30 September 2020 was 0.675% (2019: 0.675%).

31. 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	2020 £m	2019 £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 £296.8m (2019: £296.5m), of which £60.0m falls due within one year (2019: £nil).

32. 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 30 September 2018 the Notes were rated BBB- by Fitch and, during the year, the Notes were downgraded to BB+ following the application of updated bank rating criteria.

The carrying value of these bonds in the accounts of the Group and the Company at 30 September 2020 was £149.8m (2019: £149.6m).

33. 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 and / or for the retained Notes described in note 57, with the amount available based on the value of the security given, subject, where appropriate, to a haircut.

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. While no drawings under the ILTR were outstanding at 30 September 2020, the scheme was regularly accessed during the year. At 30 September 2019 the average rate of interest on the Group's ILTR drawings was 0.90%.

Drawings under the original 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 9 months (2019: 22 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.

Drawings under the Term Funding Scheme for SMEs ('TFSME') have a maturity of four years and bear interest at bank base rate. The average remaining maturity of the Group's drawings is 46 months.

During the year, the Group also accessed the Contingent Term Repo Facility ('CTRF'), which was a temporary short-term facility for collateralised drawings introduced by the Bank of England in response to the Covid-19 pandemic.

Drawings under the FLS were used to provide off balance sheet liquidity and formed part of the Bank's HQLA. Fees were charged under the FLS at 0.25% of the market value of the liquidity drawn and the facility expired in June 2020.

The amounts drawn under these facilities are set out below.

	2020	2019
	£m	£m
TFSME	910.0	-
TFS	944.4	944.4
ILTR	-	50.0
On balance sheet funding	1,854.4	994.4
FLS	-	109.0
Total central bank facilities	1,854.4	1,103.4

TFS includes £700.0m falling due within one year (2019: £nil).

Further first mortgage assets of the Bank have been pre-positioned with the Bank of England for future use in such schemes and eligible retained Notes can also be used to support this funding (note 57). The mortgage assets pledged in support of these drawings are set out in note 17.

The balances arising from the TFSME and TFS carried in the Group accounts are shown below.

	2020	2020	2019	2019
	£m	£m	£m	£m
TFSME at IAS 20 carrying value	874.1		-	
Deferred government assistance	35.9		-	
		910.0		-
TFS at IAS 20 carrying value	937.5		930.5	
Deferred government assistance	6.9		13.9	
		944.4		944.4
		1,854.4		944.4

34. Sundry liabilities

(a) The Group

	2020 £m	2019 £m	2018 £m
Current liabilities			
Accrued interest	29.2	37.4	27.5
Trade creditors	1.6	0.9	2.7
CSA liabilities (note 56)	-	-	10.3
Other accruals	29.5	29.7	29.7
Sundry financial liabilities at amortised cost	60.3	68.0	70.2
Contingent consideration (note 35)	3.2	2.2	-
Sundry financial liabilities	63.5	70.2	70.2
Lease payables (note 36)	1.5	-	-
Deferred income	1.0	1.3	0.9
Conduct (note 37)	-	-	-
Other taxation and social security	3.3	2.4	2.5
	69.3	73.9	73.6
Non-current liabilities			
Accrued interest	14.3	14.9	12.4
Other accruals	-	0.2	0.2
Sundry financial liabilities at amortised cost	14.3	15.1	12.6
Contingent consideration (note 35)	10.3	21.5	25.7
Sundry financial liabilities	24.6	36.6	38.3
Lease payables (note 36)	4.1	-	-
Deferred income	2.0	2.2	2.5
	30.7	38.8	40.8
Total sundry financial liabilities at amortised cost	74.6	83.1	82.8
Total sundry financial liabilities at fair value	13.5	23.7	25.7
Total other sundry liabilities	11.9	5.9	5.9
Total sundry liabilities	100.0	112.7	114.4

(b) The Company

	2020 £m	2019 £m	2018 £m
Current liabilities			
Amounts owed to Group companies	22.7	23.8	125.7
Accrued interest	2.9	3.6	2.8
Sundry financial assets at amortised cost	25.6	27.4	128.5
Lease payables (note 36)	1.2	-	-
	26.8	27.4	128.5
Non-current liabilities			
Lease payables (note 36)	16.3	-	-
Total sundry liabilities	43.1	27.4	128.5

35. 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.

	2020	2019
	£m	£m
At 1 October 2019	23.7	25.7
Payments	(4.4)	(2.5)
Revaluation	(6.2)	-
Unwind of discounting (note 5)	0.4	0.5
At 30 September 2020 (note 34)	13.5	23.7

The write down is a result of the reconsideration of future business volumes following the impact of Covid-19.

36. Lease payables

The Group's lease liabilities arise under the leasing arrangements described in note 47. Related right of use assets are shown in note 24.

	The Group		The Company	
	2020	2019	2020	2019
	£m	£m	£m	£m
Leasing liabilities falling due:				
In more than five years	0.6	-	11.0	-
In more than two but less than five years	2.4	-	4.0	-
In more than one year but less than two years	1.1	-	1.3	-
In more than one year (note 34)	4.1	-	16.3	-
In less than one year (note 34)	1.5	-	1.2	-
	5.6	-	17.5	-

37. 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 misselling of payment protection insurance ('PPI'), though the sums involved have not been material.

The regulatory environment continues to develop, 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.

38. 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:

	2020 Number	2019 Number
Ordinary shares		
At 1 October 2019	261,573,351	281,596,936
Shares issued	204,621	1,606,849
Shares cancelled	-	(21,630,434)
At 30 September 2020	261,777,972	261,573,351

During the year, the Company issued 204,621 shares (2019: 1,606,849) to satisfy options granted under Sharesave schemes for a consideration of £585,315 (2019: £4,075,843).

On 31 July 2019, 21,630,434 shares held in treasury were cancelled by the Company.

39. Reserves

(a) The Group

	2020 IFRS 9 £m	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m
Share premium account	68.7	68.3	65.8	65.8
Capital redemption reserve	50.3	50.3	28.7	28.7
Merger reserve	(70.2)	(70.2)	(70.2)	(70.2)
Cash flow hedging reserve (note 20)	2.5	3.0	3.3	3.3
Profit and loss account	880.7	835.9	868.3	890.7
	932.0	887.3	895.9	918.3

(b) The Company

	2020 IFRS 9 £m	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m
Share premium account	68.7	68.3	65.8	65.8
Capital redemption reserve	50.3	50.3	28.7	28.7
Merger reserve	(23.7)	(23.7)	(23.7)	(23.7)
Profit and loss account	319.1	256.3	390.0	390.0
	414.4	351.2	460.8	460.8

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.

40. Own shares

	The Group		The Company	
	2020	2019	2020	2019
	£m	£m	£m	£m
Treasury shares				
At 1 October 2019	23.0	91.8	23.0	91.8
Shares purchased	-	26.7	-	26.7
Shares cancelled	-	(95.5)	-	(95.5)
At 30 September 2020	23.0	23.0	23.0	23.0
ESOP shares				
At 1 October 2019	17.5	12.2	-	-
Shares purchased	5.2	7.6	-	-
Options exercised	(7.9)	(2.3)	-	-
At 30 September 2020	14.8	17.5	-	-
Balance at 30 September 2020	37.8	40.5	23.0	23.0
Balance at 1 October 2019	40.5	104.0	23.0	91.8

At 30 September 2020 the number of the Company's own shares held in treasury was 5,218,702 (2019: 5,218,702). These shares had a nominal value of £5,218,702 (2019: £5,218,702). 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 2020, the trust held 3,636,218 ordinary shares (2019: 3,912,516) with a nominal value of £3,636,218 (2019: £3,912,516) and a market value of £12,108,606 (2019: £18,873,977). Options, or other share-based awards, were outstanding against all of these shares at 30 September 2020 (2019: all). The dividends on all of these shares have been waived (2019: all).

41. Equity dividend

Amounts recognised as distributions to equity shareholders in the Group and the Company in the period:

	2020	2019	2020	2019
	Per share	Per share	£m	£m
<i>Equity dividends on ordinary shares</i>				
Final dividend for the previous year	14.2p	13.9p	35.9	35.9
Interim dividend for the current year	-	7.0p	-	18.1
	14.2p	20.9p	35.9	54.0

Amounts paid and proposed in respect of the year:

	2020	2019	2020	2019
	Per share	Per share	£m	£m
Interim dividend for the current year	-	7.0p	-	18.1
Proposed final dividend for the current year	14.4p	14.2p	36.4	35.8
	14.4p	21.2p	36.4	53.9

The proposed final dividend for the year ended 30 September 2020 will be paid on 26 February 2021, subject to approval at the Annual General Meeting, with a record date of 29 January 2021. The dividend will be recognised in the accounts when it is paid.

42. Net cash flow from operating activities

(a) The Group

	2020	2019
	£m	£m
Profit before tax	118.4	159.0
Non-cash items included in profit and other adjustments:		
Depreciation of operating property, plant and equipment	3.5	1.5
Profit on disposal of operating property, plant and equipment	-	-
Amortisation of intangible assets	2.0	2.4
Foreign exchange movement on borrowings	(136.8)	(124.8)
Other non-cash movements on borrowings	1.5	3.6
Impairment losses on loans to customers	48.3	8.0
Charge for share based remuneration	2.7	5.9
Gain on derecognition	-	(9.7)
Derecognition of cash flow hedge	-	(0.9)
Net (increase) / decrease in operating assets:		
Assets held for leasing	(3.2)	(0.9)
Loans to customers	(493.6)	(792.0)
Derivative financial instruments	129.1	169.7
Fair value of portfolio hedges	(45.5)	(88.3)
Other receivables	(35.6)	(73.8)
Net increase / (decrease) in operating liabilities:		
Retail deposits	1,464.7	1,095.3
Derivative financial instruments	51.9	75.8
Fair value of portfolio hedges	6.5	8.1
Other liabilities	(39.1)	(1.6)
Cash generated by operations	1,074.8	437.3
Income taxes (paid)	(46.1)	(39.4)
	1,028.7	397.9

Cash flows relating to plant and equipment held for leasing under operating leases are classified as operating cash flows.

(b) The Company

	2020	2019
	£m	£m
Profit before tax	93.7	6.5
Non-cash items included in profit and other adjustments:		
Depreciation on property, plant and equipment	1.4	-
Non-cash movements on borrowings	0.5	0.7
Impairment provision / (release) on investments in subsidiaries	5.3	148.8
Charge for share based remuneration	2.7	5.9
Net decrease in operating assets:		
Other receivables	22.7	109.7
Net (decrease) in operating liabilities:		
Other liabilities	(1.8)	(101.1)
Cash generated by operations	124.5	170.5
Income taxes received	5.3	0.4
	129.8	170.9

43. Net cash flow from investing activities

	The Group		The Company	
	2020	2019	2020	2019
	£m	£m	£m	£m
Proceeds from sales of operating property, plant and equipment	0.1	-	-	-
Purchases of operating property, plant and equipment	(1.9)	(1.1)	-	-
Purchases of intangible assets	(1.0)	(2.0)	-	-
Movement in loans to subsidiary undertakings	-	-	(94.7)	(105.1)
Residual disposal (note 7)	-	11.4	-	-
Investment in subsidiary undertakings	-	-	-	-
Net cash (utilised) / generated by investing activities	(2.8)	8.3	(94.7)	(105.1)

44. Net cash flow from financing activities

	The Group		The Company	
	2020	2019	2020	2019
	£m	£m	£m	£m
Shares issued (note 38)	0.6	3.9	0.6	4.1
Dividends paid (note 41)	(35.9)	(54.0)	(35.9)	(54.0)
Issue of asset backed floating rate notes	-	362.5	-	-
Repayment of asset backed floating rate notes	(1,013.3)	(591.1)	-	-
Movement on central bank facilities	860.0	(30.0)	-	-
Movement on other bank facilities	(130.1)	(148.3)	-	-
Capital element of lease payments	(2.0)	-	(1.3)	-
Purchase of shares (note 40)	(5.2)	(34.3)	-	(26.7)
Sale of shares	0.2	-	-	-
Net cash (utilised) by financing activities	(325.7)	(491.3)	(36.6)	(76.6)

45. Reconciliation of net debt

(a) The Group

		Cash flows		Non-cash movements			
	Opening debt	Debt issued	Other	Recognition/ Derecognition	Foreign exchange	Other	Closing debt
	£m	£m	£m	£m	£m	£m	£m
30 September 2020							
Asset backed loan notes	4,419.4	-	(1,013.3)	-	(136.8)	1.2	3,270.5
Bank borrowings	787.5	-	(130.1)	-	-	0.4	657.8
Corporate bonds	149.6	-	-	-	-	0.2	149.8
Retail bonds	296.5	-	-	-	-	0.3	296.8
Central bank borrowings	994.4	-	860.0	-	-	-	1,854.4
Lease liabilities	-	-	(2.0)	7.3	-	0.3	5.6
Bank overdrafts	1.0	-	(0.6)	-	-	-	0.4
Gross debt	6,648.4	-	(286.0)	7.3	(136.8)	2.4	6,235.3
Cash	(1,225.4)	-	(699.6)	-	-	-	(1,925.0)
Net debt	5,423.0	-	(985.6)	7.3	(136.8)	2.4	4,310.3
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
Lease liabilities	-	-	-	-	-	-	-
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

Non-cash movements arising from recognition in the year ended 30 September 2020 include include amounts recognised on transition to IFRS 16.

Non-cash movements arising from recognition/derecognition in the year ended 30 September 2019 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 and the inception of new lease assets.

(b) The Company

		Cash flows		Non-cash movements			
	Opening debt	Debt issued	Other	Recognition	Foreign exchange	Other	Closing debt
	£m	£m	£m	£m	£m	£m	£m
30 September 2020							
Corporate bonds	149.6	-	-	-	-	0.2	149.8
Retail bonds	296.5	-	-	-	-	0.3	296.8
Lease liabilities	-	-	(1.3)	18.8	-	-	17.5
Gross debt	446.1	-	(1.3)	18.8	-	0.5	464.1
Cash	(14.1)	-	1.5	-	-	-	(12.6)
Net debt	432.0	-	0.2	18.8	-	0.5	451.5
30 September 2019							
Corporate bonds	149.3	-	-	-	-	0.3	149.6
Retail bonds	296.1	-	-	-	-	0.4	296.5
Lease liabilities	-	-	-	-	-	-	-
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

Other non-cash changes shown above represent EIR adjustments relating to the spreading of initial costs of the bonds. Recognition includes amounts recognised on transition to IFRS 16.

46. Unconsolidated structured entities

Following the Group's disposal of its residual interest in the Paragon Mortgages (No. 12) PLC securitisation (note 7) in June 2019, 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 of £1.9m is included in third party servicing fees (note 8) (2019: £0.5m) and £0.3m is included in other debtors in respect of unpaid fees at the year end (2019: £0.3m). Outstanding collection monies due to the structured entity of £0.4m are included in other creditors at 30 September 2020 (2019: £0.4m).

47. Leasing arrangements

(a) As Lessor

The Group, through its motor finance and asset finance businesses, leases assets under both finance and operating leases. In respect of certain of these assets, the Group also provides maintenance services to the lessee.

Accounting for these balances from 1 October 2019 is governed by IFRS 16, while in previous periods IAS 17 applied, however the change in standards has not had a significant impact on the amounts presented (note 61).

Disclosures in respect of these balances are set out in these financial statements as follows

Disclosure	Note
Investment in finance leases	18
Finance income on net investment in finance leases	4
Assets leased under operating leases	24
Operating lease income	6

The undisclosed future minimum lease payments receivable by the Group under operating lease arrangements may be analysed as follows:

	2020	2019
	£m	£m
Amounts falling due:		
Within one year	12.4	7.1
Within one to two years	6.8	6.7
Within two to three years	4.3	3.3
Within three to four years	2.9	1.8
Within four to five years	1.7	0.9
After more than five years	1.3	0.5
	29.4	20.3

(b) As Lessee

The Group's use of leases as a lessee relates to the rental of office buildings and company cars. Under IFRS 16 these have been accounted for as right of use assets and corresponding lease liabilities.

The average term of the current building leases from inception or acquisition is 9 years (2019: 7 years) with rents subject to review every five years, while the average term of the vehicle leases is 3 years (2019: 3 years).

The Company's use of leases as lessee is limited to the rental of an office building from a subsidiary entity. The lease term from inception is 15 years.

Disclosures relating to these leases are set out in these financial statements as follows.

Disclosure	Note
Depreciation on right of use assets	24
Interest expense on lease liabilities	5
Expense relating to short-term leases	8
Additions to right of use assets	24
Carrying amount of right of use assets	24
Maturity analysis of lease liabilities	57

There was no subleasing of any right of use asset and the total cash flows relating to leasing as a lessee were £2.2m.

Disclosures made in respect of IAS 17 requirements for 2019 are set out below.

	The Group	The Company
	2019	2019
	£m	£m
Minimum lease payments under operating leases recognised in operating expenses for the year		
Office buildings	1.9	-
Motor vehicles	0.9	-
Office equipment	0.1	-
	2.9	-

At 30 September 2019 the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fell due as follows:

	The Group	The Company
	2019	2019
	£m	£m
Amounts falling due:		
Within one year	3.2	-
Between two and five years	5.8	-
After more than five years	1.7	-
	10.7	-

48. 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. Deposits of £301,000 were outstanding at the year end (2019: none), and the maximum amount outstanding during the year was £500,000 (2019: £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.

The Plan is a related party of the Group. Transactions with the Plan are described in note 53.

The Group had no other transactions with related parties other than the key management compensation disclosed in note 51.

(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 52.

Details of the Company's investments in subsidiaries and the income derived from them are shown in notes 27 and 66.

Outstanding current account balances with subsidiaries are shown in notes 21 and 34.

During the year the Company incurred interest costs of £1.0m in respect of borrowings from its subsidiaries (2019: £1.6m).

The Company leased an office building from a subsidiary entity (note 47). Finance charges recognised in respect of this lease were £0.5m.

49. 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 66 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 2020 were:

	United Kingdom £m
Year ended 30 September 2020	
Total operating income	295.1
Profit before tax	118.4
Corporation tax paid	46.1
Public subsidies received	-
Average number of full time equivalent employees	1,285
	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

The Group's participation in Bank of England funding schemes is set out in note 33.

D2.2 Notes to the Accounts - Employment costs

For the year ended 30 September 2020

The notes set out below give information on the Group's employment costs, including the disclosures on share based payments and pension schemes required by accounting standards.

50. Employees

The average number of persons (including directors) employed by the Group during the year was 1,385 (2019: 1,365). The number of employees at the end of the year was 1,392 (2019: 1,368).

Costs incurred during the year in respect of these employees were:

	2020 £m	2020 £m	2019 £m	2019 £m
Share based remuneration	2.7		5.9	
Other wages and salaries	64.0		62.6	
Total wages and salaries		66.7		68.5
National Insurance on share based remuneration	(0.1)		1.0	
Other social security costs	8.0		7.7	
Total social security costs		7.9		8.7
Defined benefit pension cost	2.0		1.9	
Other pension costs	3.1		2.1	
Total pension costs		5.1		4.0
Total employment costs		79.7		81.2
Of which				
Included in operating expenses (note 9)		77.6		79.3
Included in maintenance costs (note 6)		2.1		1.9
		79.7		81.2

Details of the pension schemes operated by the Group are given in note 53.

The Company has no employees. Details of the directors' remuneration are given in note 51.

51. 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 B7.2.2.

	2020	2020	2019	2019
	£m	£m	£m	£m
Salaries and fees	1.9		1.8	
Cash amount of bonus	-		1.5	
Social security costs	0.5		0.5	
Short-term employee benefits		2.4		3.8
Post-employment benefits		0.3		0.5
IFRS 2 cost in respect of directors	0.7		2.1	
National Insurance thereon	(0.1)		0.4	
Share based payment		0.6		2.5
		3.3		6.8

Post-employment benefits shown above are shown as 'pension allowance' in Section B7.2.2. 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.

The negative charge in respect of National Insurance accrued on share based payments in 2020 is principally a result of reduced vesting estimates.

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.

52. 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 50.

Further details of share based payment arrangements are given in the Annual Report on Remuneration in Section B7.2.2.

A summary of the number of share awards outstanding under each scheme at 30 September 2020 and at 30 September 2019 is set out below.

	2020	2019
	Number	Number
(a) Sharesave Plan	4,134,577	2,558,569
(b) Performance Share Plan	4,842,196	4,762,886
(c) Company Share Option Plan	444,771	730,816
(d) Deferred Bonus Plan	819,265	774,046
(e) Restricted Stock Units	265,672	134,827
	10,506,481	8,961,144

(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 2020 and the year ended 30 September 2019 is shown below.

	2020 Number	2020 Weighted average exercise price p	2019 Number	2019 Weighted average exercise price p
Options outstanding				
At 1 October 2019	2,558,569	338.06	3,265,788	281.60
Granted in the year	2,748,494	278.56	1,147,016	360.16
Exercised or surrendered in the year	(940,709)	348.35	(1,606,849)	253.65
Lapsed during the year	(231,777)	351.68	(247,386)	361.53
At 30 September 2020	4,134,577	295.40	2,558,569	338.06
Options exercisable	345,756	341.85	119,846	249.44

The weighted average remaining contractual life of options outstanding at 30 September 2020 was 36.8 months (2019: 26.1 months). The weighted average market price at exercise for share options exercised in the year was 441.06p (2019: 400.88p).

Options are outstanding under the Sharesave plans to purchase ordinary shares as follows:

Grant date	Period exercisable	Exercise price	Number 2020	Number 2019
11/06/2015	01/08/2020 to 01/02/2021	345.68p	8,242	9,977
20/06/2016	01/08/2019 to 01/02/2020	249.44p	-	119,846
20/06/2016	01/08/2021 to 01/02/2022	249.44p	432,210	439,425
28/07/2017	01/09/2020 to 01/03/2021	341.76p	337,514	493,841
28/07/2017	01/09/2022 to 01/03/2023	341.76p	22,726	44,667
31/07/2018	01/09/2021 to 01/03/2022	408.80p	169,359	278,873
31/07/2018	01/09/2023 to 01/03/2024	408.80p	21,124	38,581
30/07/2019	01/09/2022 to 01/03/2023	360.16p	411,334	1,049,338
30/07/2019	01/09/2024 to 01/03/2025	360.16p	6,574	84,021
27/07/2020	01/09/2023 to 01/03/2024	278.56p	2,187,502	-
27/07/2020	01/09/2025 to 01/03/2026	278.56p	537,992	-
			4,134,577	2,558,569

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 2020 and the year ended 30 September 2019, are shown below.

Grant date	27/07/20	27/07/20	30/07/19	30/07/19
Number of awards granted	2,210,502	537,992	1,058,831	88,185
Market price at date of grant	343.2p	343.2p	422.0p	422.0p
Contractual life (years)	3.5	5.5	3.5	5.5
Fair value per share at date of grant (£)	0.62	0.55	0.51	0.53
Inputs to valuation model				
Expected volatility	34.24%	32.98%	22.58%	26.44%
Expected life at grant date (years)	3.45	5.45	3.48	5.47
Risk-free interest rate	(0.13)%	(0.11)%	0.36%	0.40%
Expected annual dividend yield	4.34%	4.34%	4.95%	4.95%
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 normally vest in the third financial year after the date of grant, to the extent that the applicable performance criteria have been satisfied, if the holder is still employed by the Group.

Awards vest on the date on which the Remuneration Committee determines the extent to which the performance conditions have been satisfied. For employees, other than the executive directors, awards may be exercised from the vesting date to the day before the tenth anniversary of the grant date. Executive directors' awards made in 2020 are exercisable from the time of the Group's fifth results announcement after the date of the grant to the day before the tenth anniversary of the grant date. Where performance conditions are not met in full, awards lapse at this point. Awards will also lapse on cessation of employment, other than in 'good leaver' circumstances. 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 2020 and 30 September 2019 were:

Grant date	Period exercisable	Number	Number
		2020	2019
04/01/2010	04/01/2013 to 03/01/2020 [†]	-	18,702
17/12/2010	17/12/2013 to 16/12/2020 [†]	9,925	12,424
21/12/2011	21/12/2014 to 20/12/2021 [†]	5,093	15,335
28/02/2013	28/02/2016 to 27/02/2023 [†]	5,443	6,981
10/12/2013	10/12/2016 to 09/12/2023 [†]	6,210	76,614
18/12/2014	18/12/2017 to 17/12/2024 [†]	6,277	233,550
22/12/2015	22/12/2018 to 21/12/2025 [†]	16,887	411,800
01/12/2016	01/12/2019 to 30/11/2026 [‡]	462,076	1,339,409
08/12/2017	08/12/2020 to 07/12/2027 [‡]	1,155,740	1,161,803
14/12/2018	14/12/2018 to 13/12/2028 [‡]	1,479,563	1,486,268
06/07/2020	07/12/2022* to 05/07/2030 [‡]	1,185,790	-
06/07/2020	07/12/2024* to 05/07/2030 [‡]	509,192	-
		4,842,196	4,762,866

* Estimated date

[†] These awards, which were conditional on the achievement of performance-based criteria, vested before the start of the financial year. Any reduction in entitlements resulting from the application of those criteria is reflected in the numbers above.

[‡] These awards are (or were) subject to performance criteria, assessed over a period of three financial years, starting with the year of grant.

- 50% to a Total Shareholder Return ('TSR') test based on a ranking of the Company's TSR against those of a comparator group of UK listed financial services companies, determined at the date of grant. This tranche vests in full for upper quartile performance, 25% vests for median performance and vesting between those points is determined on a straight line basis

- 25% to an EPS test. This tranche vests in full if EPS increases by at least 7% more than the retail price index ('RPI') over the test period, 25% vests if this increase is at least 3% more than the RPI and vesting between those points is determined on a straight line basis
- 25% to a risk test. The risk test is based on an internal scorecard of the Group's performance against its principal risk metrics

At the point of exercise, the gross number of awards vesting will be reduced so that the gain to the recipient from the PSP and the CSOP described below, evaluated at that point, is equal to the gain from the gross PSP vesting.

ψ These awards are subject to performance criteria, similar to those described at ⁸ above, except that:

- The EPS condition is measured against an absolute target. Full vesting occurs if EPS for the third year of the test period is at least 68p, 25% vesting if EPS in this year is 60p and vesting between those points on a straight line basis

φ These awards are subject to performance criteria, similar to those described at ⁸ above, except that:

- The TSR condition related to 25% of the grant, not 50%
- The EPS condition is measured against an absolute target. Full vesting occurs if EPS for the third year of the test period is at least 67p, 25% vesting if EPS in this year is 60p and vesting between those points on a straight line basis
- The risk condition comprises two components. 50% of the risk element is based on an assessment by the Chief Risk Officer of the six key measures of the Group's risk appetite: regulatory breaches; customer service performance; conduct; operational risk incidents; capital and liquidity; and credit losses. The remaining 50% is based on a strategic risk assessment reflecting the management of risk as it impacts on the delivery of the Group's medium term strategy
- 12.5% of the grant is determined based on a customer service test assessed by the Chair of the Risk and Compliance Committee. The customer service test is based on the performance of the Group against its most significant customer service metrics including insight feedback on key product lines and complaint levels. 50% of this tranche will vest for on-target performance
- 12.5% of the grant is determined based on a people test. The people test is based on the performance of the Group against its most significant employment metrics including employee engagement, voluntary attrition and gender diversity levels. 50% of this tranche will vest for on-target performance
- Due to the volatility of the share price at the time of grant, the Remuneration Committee may adjust the vesting levels at the vesting date if it believes that the use of this share price has created a potential windfall gain
- No CSOP grants were made in conjunction with this award, therefore no adjustment on vesting will take place

For each of the risk, customer and people tests set out above, the Remuneration Committee will determine the extent to which this condition has been met, between 0% and 100%, and vesting for the relevant tranche will occur at that level, subject to a 25% threshold, below which no awards in the tranche will vest.

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 2020 and the year ended 30 September 2019 are shown below:

Grant date	06/07/20	14/12/18
Number of awards granted	1,694,982	1,493,230
Market price at date of grant	360.60p	401.00p
Contractual life (years)	2.4	3.0
Fair value per share at date of grant	301.32p	307.32p
Inputs to valuation model		
Expected volatility	33.93%	28.86%
Expected life (years)	2.4	3.0
Risk-free interest rate	(0.06)%	1.20%

For all of the above grants 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. No new CSOP awards were made in the year ended 30 September 2020.

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 2020 and the year ended 30 September 2019 is shown below.

	2020	2020	2019	2019
	Number	Weighted average exercise price	Number	Weighted average exercise price
		p		p
Options outstanding				
At 1 October 2019	730,816	398.19	549,061	399.16
Granted in the year	-	-	191,543	396.04
Exercised or surrendered in the year	(218,008)	361.88	-	-
Lapsed during the year	(68,037)	372.15	(9,788)	410.72
At 30 September 2020	444,771	419.97	730,816	398.19
Options exercisable	93,974	361.88	-	-

The weighted average remaining contractual life of options outstanding at 30 September 2020 was 89.5 months (2019: 96.5 months). The weighted average market prices at exercise for share options exercised in the year was 365.62p.

The conditional entitlements outstanding under this scheme at 30 September 2020 and 30 September 2019 were:

Grant date	Period exercisable	Exercise price	Number	Number
			2020	2019
01/12/2016	01/12/2019 to 30/11/2026 ^β	361.88p	93,974	370,445
08/12/2017	08/12/2020 to 07/12/2027 ^β	477.76p	169,502	174,049
14/12/2018	14/12/2021 to 13/12/2028 ^β	396.04p	181,295	186,322
			444,771	730,816

^β 66.7% of these awards are (or were) 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 on exercise 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 2020 and 30 September 2019 were:

Grant date	Period exercisable	Number	Number
		2020	2019
10/12/2013	10/12/2016 to 09/12/2023	55,302	55,302
18/12/2014	18/12/2017 to 17/12/2024	52,888	79,853
22/12/2015	22/12/2018 to 21/12/2025	60,042	96,559
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	334,498
12/12/2019	12/12/2022 to 11/12/2029	108,701	-
		819,265	774,046

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 2020 and the year ended 30 September 2019 are shown below.

Grant date	12/12/19	14/12/18
Number of awards granted	108,701	334,498
Market price at date of grant	489.20p	401.00p
Fair value per share at date of grant	489.20p	401.00p

(e) Restricted Stock Units ('RSUs')

Since 2016, the Company has permitted certain employees to elect to receive RSU awards instead of PSP awards. For RSU awards to vest, the grantee's personal performance must be satisfactory during the financial year preceding the vesting date. In addition, a risk based performance condition, assessed against the Group's risk management metrics and, additionally from 2020, against its strategic management of risk for the medium term, considered over the vesting period, must also be met. The level to which this condition is met will be determined by the Remuneration Committee and vesting levels scaled back as appropriate.

The conditional entitlements outstanding under this scheme at 30 September 2020 and 30 September 2019 were:

Grant date	Period exercisable	Number 2020	Number 2019
01/12/2016	01/12/2019 to 30/11/2026	-	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	52,040
06/07/2020	06/12/2022* to 05/07/2030	190,960	-
		265,672	134,827

* Estimated date

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 2020 and the year ended 30 September 2019 are shown below.

Grant date	06/07/20	14/12/18
Number of awards granted	190,690	52,040
Market price at date of grant	360.60p	401.00p
Contractual life (years)	2.4	3.0
Fair value per share at date of grant	360.60p	401.00p

For all of these grants no departures are expected.

53. 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 2019, 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, the level of assets which would be required to buy insurance policies for benefits earned to the valuation date, was £203.6m, with a shortfall against the assets of £85.0m (2016: £118.4m). The deficit on the Technical Basis, the basis agreed by the Trustee as being appropriate to meet member benefits, assuming the plan continues as a going concern, was £18.2m (2016: £18.0m). This valuation was agreed with the Trustee during the period and forms the basis of the IAS 19 valuation.

Following the agreement of the 2019 actuarial valuation in the period, the Trustee put in place a revised recovery plan. On current forecasts the Trustee's recovery plan would to meet the statutory funding objective by 31 July 2025. The revised recovery plan continues to include a Pension Funding Partnership ('PFP') arrangement effectively granting the Plan a first charge over the Group's head office building as security for payments under the plan (note 24). 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 24) but this arrangement provides the Plan with additional security in a stress event.

(b) Defined benefit plan – financial impact

For accounting purposes, the valuation at 31 March 2019 was updated to 30 September 2020 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 2020, 30 September 2019 and 30 September 2018 and their fair values were:

	2020	2019	2018
	£m	£m	£m
Cash and cash equivalents	28.6	7.1	0.6
Equity instruments	60.7	60.7	61.8
Debt instruments	34.9	34.2	28.4
Real estate funds	10.3	10.8	10.7
Total fair value of Plan assets	134.5	112.8	101.5
Present value of Plan liabilities	(154.9)	(147.3)	(121.0)
(Deficit) in the Plan	(20.4)	(34.5)	(19.5)

At 30 September 2020 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.

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 estimated effect of this ruling was accounted for in the accounts of the Group for the year ended 30 September 2019 as a 'past service cost'. However, this estimate is based on one permissible method, method C2, and therefore the actual amount may vary due to the method which the Trustee chooses to apply, which is yet to be finalised, idiosyncratic impacts on individual members and the development of a wider legal and accounting consensus on the proper interpretation of the courts' requirements as further cases are determined.

The movement in the fair value of the Plan assets during the year was as follows:

	2020	2019
	£m	£m
At 1 October 2019	112.8	101.5
Interest on Plan assets	2.3	3.0
Cash flows		
Contributions by the Group	24.5	4.6
Contributions by Plan members	0.2	0.2
Benefits paid	(2.9)	(2.4)
Administration expenses paid	(0.6)	(0.7)
Remeasurement gain		
Return on Plan assets (excluding amounts included in interest)	(1.8)	6.6
At 30 September 2020	134.5	112.8

Contributions by the Group in the year ended 30 September 2020 included a one-off £20.0m payment made as part of the new recovery plan agreed between the Group and the Trustee in the year.

The actual return on Plan assets in the year ended 30 September 2020 was £0.5m (2019: £9.6m).

The movement in the present value of the Plan liabilities during the year was as follows:

	2020	2019
	£m	£m
At 1 October 2019	147.3	121.0
Current service cost	2.0	1.6
Past service cost	-	0.3
Funding cost	2.7	3.5
Cash flows		
Contributions by Plan members	0.2	0.2
Benefits paid	(2.9)	(2.4)
Remeasurement loss / (gain)		
Arising from demographic assumptions	1.2	(1.4)
Arising from financial assumptions	6.0	24.5
Arising from experience adjustments	(1.6)	-
At 30 September 2020	154.9	147.3

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 2020	30 September 2019	30 September 2018
In determining net pension cost for the year			
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%
In determining benefit obligations			
Discount rate	1.75%	1.85%	2.95%
Rate of compensation increase	2.95%	3.20%	3.60%
Rate of price inflation	2.95%	2.70%	3.10%
Rate of increase of pensions	2.85%	2.65%	2.95%
Further life expectancy at age 60			
Male member aged 60	28	28	28
Female member aged 60	29	29	29
Male member aged 40	30	30	30
Female member aged 40	31	31	31

The amounts charged in the consolidated income statement in respect of the Plan are:

	Note	2020 £m	2019 £m
Current service cost		2.0	1.6
Past service cost		-	0.3
Total service cost	50	2.0	1.9
Administration expenses		0.6	0.7
Included within operating expenses		2.6	2.6
Funding cost of Plan liabilities		2.7	3.5
Interest on Plan assets		(2.3)	(3.0)
Net interest expense	5	0.4	0.5
Components of defined benefit costs recognised in profit or loss		3.0	3.1

The amounts recognised in the consolidated statement of comprehensive income in respect of the Plan are:

	2020 £m	2019 £m
Return on Plan assets (excluding amounts included in interest)	(1.8)	6.6
Actuarial gains/(losses)		
Arising from demographic assumptions	(1.2)	1.4
Arising from financial assumptions	(6.0)	(24.5)
Arising from experience adjustments	1.6	-
Total actuarial (loss)	(7.4)	(16.5)
Tax thereon	2.1	2.4
Net actuarial (loss)	(5.3)	(14.1)

Of the remeasurement movements reflected above:

- The return on plan assets represents worse 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 marginally higher life expectancy among members than the previous versions reversing the trend of recent years
- The change in financial assumptions reflects principally the impact of market-implied inflation expectations on discount rates, where reduced gilt and bond yields in the year have led to a lower rate
- The inflation assumptions used over the year have changed to reflect the latest information, including market pricing and the UK Government's RPI consultation, and the extent to which the Plan's assets hedge inflation
- the experience adjustments arise on the adoption of the 2019 Plan valuation as the basis of the IAS 19 valuation in the year

(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 2020, 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.	(2.1)%
Rate of inflation*	0.1% p.a.	2.1%
Rate of salary growth	0.1% p.a.	0.3%
Rates of mortality	1 year of life expectancy	3.0%

* maintaining a 0.0% 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 current target asset allocations for the year ending 30 September 2021 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. Following the finalisation of the March 2019 valuation, the agreed rate of employer contributions increased to 43.8% from 32.0% with effect from 1 July 2020. 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. An additional contribution of £20.0m was made by the Group in June 2020.

The present best estimate of the contributions to be made to the Plan by the Group in the year ending 30 September 2021 is £4.4m.

The average durations of the benefit obligations in the Plan at the year end are shown in the table below:

	2020 Years	2019 Years
Category of member		
Active members	24	25
Deferred pensioners	23	24
Current pensioners	15	16
All members	22	24

(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. During the year the Group increased its contribution to the scheme for those employees making the maximum 6% contribution to 10% of salary from 6%, generating an increase in the amounts being saved by employees.

The Group also sponsors a number of other defined contribution pension plans relating to acquired entities 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 2020, which represent the total cost charged against income, were £3.1m (2019: £2.1m) (note 50).

D2.3 Notes to the Accounts - Capital and financial risk

For the year ended 30 September 2020

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.

54. 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's response to the Covid-19 situation has been planned and executed with the protection of its capital base and its long-term viability as key strategic priorities.

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 39) and, other than the regulatory requirement to retain an appropriate level of capital in Paragon Bank PLC, 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.

At the time of approving the half yearly report, the Board considered the exceptional level of uncertainty in the UK and global economy, together with the public statements of government and regulatory bodies and emerging market practice and concluded that, while the capital position and liquidity position of the Company remained strong, it would not be advisable to declare an interim dividend for the year.

The appropriate level of dividend for the full-year was considered in light of economic and regulatory developments in the second half of the year. In particular the levels of provision in the Group's loan portfolios and the potential for further provision under stress were considered by the Board, along with the capital requirements of the Group both under the base case medium term forecast and under stress, discounting the effects of the current temporary reduction in regulatory buffers in response to Covid-19. On the basis of the analysis the Board concluded that a dividend payment for the year of around 40% of earnings, in line with policy, could be made.

The dividend cover for the year, which is subject to approval at the forthcoming AGM is set out below.

	<i>Note</i>	2020	2019
		£m	£m
Earnings per share (p)	14	36.0	49.4
Proposed dividend per share in respect of the year (p)	41	14.4	21.2
Dividend cover (times)		2.50	2.33

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 most recent policy review, in November 2020, also confirmed the existing dividend policy would continue to apply for future periods, subject to the impact of any future events, and the Board will consider the appropriateness and scale of any interim dividend in the context of the Group's results and the operating and economic environment at the time.

(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 2020 is derived as follows:

	<i>Note</i>	2020	2019
		£m	£m
Profit for the year after tax		91.3	127.4
Amortisation of intangible assets	25	2.0	2.4
Adjusted profit		93.3	129.8
Divided by			
Opening equity		1,108.4	1,073.5
Opening intangible assets	25	(171.1)	(169.3)
Opening tangible equity		937.3	904.2
Closing equity		1,156.0	1,108.4
Closing intangible assets	25	(170.1)	(171.1)
Closing tangible equity		985.9	937.3
Average tangible equity		961.6	920.7
Return on Tangible Equity		9.7%	14.1%

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 in order to safeguard depositors from loss in the event of severe losses being incurred by the Group. This comprises variable elements based on its total risk exposure and also fixed elements. This requirement is set in accordance with the international Basel III rules, issued 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 Group has elected to take advantage of the IFRS 9 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 applying to transition adjustments will allow for a 95% add back to CET1 capital and Risk Weighted Assets ('RWA') 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.

As part of the regulatory response to Covid-19, Article 473a was revised to extend the transitional arrangements for Stage 1 and Stage 2 impairment provisions created in the financial year ended 30 September 2020 and the financial year ending 30 September 2021, while maintaining the transitional arrangements for impairment provisions created before the current period. In order to increase institutions lending capacity in the short-term, the EU has determined that these additional provisions should be phased into capital over the financial years ending 30 September 2022 to 30 September 2024, rather than recognising the reduction in capital immediately.

These responses also allow, under paragraph 7a of the Article, the impact of transitional adjustments to be weighted at 100% in calculating RWA. The Group has taken advantage of this derogation and hence the IFRS 9 adjustment to RWA is equal to the adjustment to capital at 30 September 2020.

Where these reliefs are taken, firms are also required to disclose their capital positions calculated as if the relief were not available (the 'fully loaded' basis).

The tables below demonstrate that at 30 September 2020 the Group's regulatory capital of £1,141.2m (2019: £1,072.0m) exceeded the amounts required by the regulator, including £749.6m (2019: £742.9m) in respect of Pillar 1 and Pillar 2a capital (unaudited), which is comprised of fixed and variable elements.

The total regulatory capital at 30 September 2020 on the fully loaded basis of £1,098.9m was in excess of the Pillar 1 and 2a requirement of £745.3m (2019: £741.8m) on the same basis (amounts not subject to audit).

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 2020) (2019: 2.5%) and a Counter-Cyclical Buffer ('CCyB'), currently 0.0% of risk weighted assets (2019: 1.0%). The reduction in the CCyB in the year was a response to the Covid-19 pandemic and the long-term rate in a standard risk environment is expected to be 2.0%. 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 2020 is set out below.

	Note	Regulatory basis		Fully loaded basis	
		2020 £m	2019 £m	2020 £m	2019 £m
Total equity		1,156.0	1,108.4	1,156.0	1,108.4
<i>Deductions</i>					
Proposed final dividend	41	(36.4)	(35.8)	(36.4)	(35.8)
IFRS 9 transitional relief	*	42.3	21.2	-	-
Intangible assets	25	(170.1)	(171.1)	(170.1)	(171.1)
Prudent valuation adjustments	5	(0.6)	(0.7)	(0.6)	(0.7)
Common Equity Tier 1 ('CET1') capital		991.2	922.0	948.9	900.8
Other tier 1 capital		-	-	-	-
Total Tier 1 capital		991.2	922.0	948.9	900.8
Corporate bond	32	150.0	150.0	150.0	150.0
Total Tier 2 capital		150.0	150.0	150.0	150.0
Total regulatory capital ('TRC')		1,141.2	1,072.0	1,098.9	1,050.8

* Firms are permitted to phase in the impact of IFRS 9 transition over a five-year period.

⁹ 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.

The total risk 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.

	Regulatory basis		Fully loaded basis	
	2020	2019	2020	2019
	£m	£m	£m	£m
<i>Credit risk</i>				
Balance sheet assets	6,171.7	5,997.2	6,171.7	5,997.2
Off balance sheet	104.1	85.5	104.1	85.5
IFRS 9 transitional relief	42.3	10.5	-	-
Total credit risk	6,318.1	6,093.2	6,275.8	6,082.7
Operational risk	544.3	516.6	544.3	516.6
Market risk	-	-	-	-
Other	85.7	114.0	85.7	114.0
Total risk exposure amount ('TRE')	6,948.1	6,723.8	6,905.8	6,713.3
Solvency ratios				
	%	%	%	%
CET1	14.3	13.7	13.7	13.4
TRC	16.4	15.9	15.9	15.7

This table is not subject to audit

The CRD IV risk weightings for credit risk exposures are currently calculated using the Standardised Approach. The Basic Indicator Approach is used for operational risk.

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	2020	2019
		£m	£m
Total balance sheet assets		15,505.5	14,395.5
Less: Derivative assets	20	(463.3)	(592.4)
Central bank deposits	15	(1,637.1)	(816.4)
CRDs	21	(15.1)	(11.4)
Accrued interest on sovereign exposures		-	(0.2)
On-balance sheet items		13,390.0	12,975.1
Less: Intangible assets	25	(170.1)	(171.1)
Total on balance sheet exposures		13,219.9	12,804.0
Derivative assets	20	463.3	592.4
Potential future exposure on derivatives		92.3	120.0
Total derivative exposures		555.6	712.4
Post offer pipeline at gross notional amount		949.1	903.4
Adjustment to convert to credit equivalent amounts		(773.8)	(739.2)
Off balance sheet items		175.3	164.2
Tier 1 capital		991.2	922.0
Total leverage exposure before IFRS 9 relief		13,950.8	13,680.6
IFRS 9 relief		42.3	25.8
Total leverage exposure		13,993.1	13,706.4
UK leverage ratio		7.1%	6.7%

This table is not subject to audit

The fully loaded leverage ratio is calculated as follows

	2020	2019
	£m	£m
Fully loaded Tier 1 capital	948.9	900.8
Total leverage exposure before IFRS 9 relief	13,950.8	13,680.6
Fully loaded UK leverage exposure	6.8%	6.6%

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.

55. 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 56 to 59 respectively.

The Board has a Risk and Compliance Committee, consisting of the Chair of the Board and the non-executive directors which is responsible for providing oversight and challenge to the Group's risk management arrangements. Executive responsibility for the oversight and operation of the Group's risk management framework is delegated to the Executive Risk Committee ('ERC'). ERC discharges its duties through a number of sub-committees and escalates issues of concern to the Risk and Compliance Committee where appropriate.

The Credit Committee and ALCO are sub-committees of the ERC 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 56 to 59 is materially similar to that existing throughout the year.

56. Credit risk

The assets of the Group and the Company which are subject to credit risk are set out below:

		The Group		The Company	
	Note	2020	2019	2020	2019
		£m	£m	£m	£m
Financial assets at amortised cost					
Loans to customers	16	12,631.4	12,186.1	-	-
Trade receivables	21	3.2	3.6	-	-
Amounts owed by Group companies	21	-	-	84.0	106.6
Cash	15	1,925.0	1,225.4	12.6	14.1
CSA assets	21	103.5	72.2	-	-
CRDs	21	15.1	11.4	-	-
Accrued interest income	21	0.1	0.4	0.6	0.7
		14,678.3	13,499.1	97.2	121.4
Financial assets at fair value					
Derivative financial assets	20	463.3	592.4	-	-
Maximum exposure to credit risk		15,141.6	14,091.5	97.2	121.4

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 57, 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 Credit Risk Director. 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 2020 are analysed as follows:

	2020 £m	2020 %	2019 £m	2019 %
Buy-to-let mortgages	10,583.8	83.8%	10,101.9	82.9%
Owner-occupied mortgages	53.1	0.4%	70.6	0.6%
Total first charge residential mortgages	10,636.9	84.2%	10,172.5	83.5%
Second charge mortgage loans	354.5	2.8%	389.2	3.2%
Loans secured on residential property	10,991.4	87.0%	10,561.7	86.7%
Development finance	609.0	4.8%	506.5	4.1%
Loans secured on property	11,600.4	91.8%	11,068.2	90.8%
Asset finance loans	452.0	3.6%	472.9	3.9%
Motor finance loans	272.4	2.2%	318.9	2.6%
Aircraft mortgages	26.0	0.2%	19.3	0.2%
Structured lending	94.9	0.7%	88.1	0.7%
Invoice finance	13.5	0.1%	18.5	0.1%
Total secured loans	12,459.2	98.6%	11,985.9	98.3%
Professions finance	22.3	0.2%	46.2	0.4%
CBILS and BBLS	25.2	0.2%	-	-
Other unsecured commercial loans	15.0	0.1%	19.3	0.2%
Unsecured consumer loans	109.7	0.9%	134.7	1.1%
Total loans to customers	12,631.4	100.0%	12,186.1	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.

Loans made under the Coronavirus Business Interruption Loan Scheme ('CBILS') and the Bounce Back Loan Scheme ('BBLS') have the benefit of a guarantee underwritten by the UK Government.

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.

	2020 £m	2019 £m
Buy-to-let mortgages	154.3	149.7
Development finance	240.0	212.7
Structured lending	72.7	78.8
Asset finance	-	-
	467.0	441.2

The threshold of £10.0m is used internally for monitoring large exposures.

Credit grading

An analysis of the Group's loans to customers by absolute level of credit risk at 30 September 2020 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 2020					
Very low risk	8,771.2	453.3	20.8	45.9	9,291.2
Low risk	1,229.2	120.9	10.7	21.7	1,382.5
Moderate risk	742.2	184.7	12.1	32.8	971.8
High risk	285.2	143.9	50.7	32.0	511.8
Very high risk	48.3	67.9	49.9	22.9	189.0
Not graded	253.6	74.7	31.9	6.7	366.9
Total gross carrying amount	11,329.7	1,045.4	176.1	162.0	12,713.2
Impairment	(22.2)	(15.8)	(43.4)	(0.4)	(81.8)
Total loans to customers	11,307.5	1,029.6	132.7	161.6	12,631.4
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 19, 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 (2020: 2.9%, 2019: 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.

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 2020 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.

	First charge mortgages		Second charge mortgages	
	2020	2019	2020	2019
	%	%	%	%
Loan to value ratio				
Less than 70%	59.9	54.3	74.5	66.5
70% to 80%	35.9	36.2	16.7	18.5
80% to 90%	2.3	7.2	5.2	8.9
90% to 100%	0.4	0.6	1.2	2.7
Over 100%	1.5	1.7	2.4	3.4
	100.0	100.0	100.0	100.0
Average LTV ratio	65.7	67.3	62.2	65.7
<i>Of which:</i>				
Buy-to-let	65.8	67.4		
Owner-occupied	49.2	53.2		

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 5.0% in the year ended 30 September 2020 (2019: 0.2%).

The geographical distribution of the Group's residential mortgage assets by gross carrying value is set out below.

	First charge		Second charge	
	2020	2019	2020	2019
	%	%	%	%
East Anglia	3.2	3.2	3.3	3.3
East Midlands	5.4	5.3	6.1	6.3
Greater London	18.7	18.9	8.2	7.8
North	3.2	3.3	3.9	4.2
North West	10.4	10.1	7.4	8.0
South East	31.6	31.9	39.5	37.7
South West	8.7	8.9	8.0	7.9
West Midlands	5.4	5.1	7.3	7.6
Yorkshire and Humberside	8.4	8.6	5.9	6.2
Total England	95.0	95.3	89.6	89.0
Northern Ireland	0.1	0.1	1.7	1.9
Scotland	1.7	1.4	5.2	5.6
Wales	3.2	3.2	3.5	3.5
	100.0	100.0	100.0	100.0

Development finance

Development finance loans have an average term of 21 months (2019: 20 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.

	2020 By value %	2020 By number %	2019 By value %	2019 By number %
LTGDV				
50% or less	7.6	4.8	8.5	3.4
50% to 60%	22.4	13.2	18.2	15.5
60% to 65%	34.0	41.0	31.6	39.1
65% to 70%	31.3	36.1	32.3	32.4
70% to 75%	2.8	4.0	6.8	8.2
Over 75%	1.9	0.9	2.6	1.4
	100.0	100.0	100.0	100.0

The average LTGDV cover at the year end was 63.1% (2019: 64.8%).

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. The Covid-19 pandemic had yet to have a significant impact on expected valuations by the year end.

At 30 September 2020, the development finance portfolio comprised 229 accounts (2019: 207) with a total carrying value of £609.0m (2019: £506.5m). Of these accounts only 7 were included in Stage 2 at 30 September 2020 (2019: 6), with 1 account classified as Stage 3 (2019: none). In addition, 1 account acquired in the Titlestone purchase had been classified as POCI (2019: 3). 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.

	2020 %	2019 %
East Anglia	5.1	3.1
East Midlands	5.5	2.9
Greater London	8.2	12.1
North	1.8	1.0
North West	0.4	0.1
South East	58.8	56.8
South West	14.0	13.9
West Midlands	4.0	7.2
Yorkshire and Humberside	1.1	1.5
Total England	98.9	98.6
Northern Ireland	-	-
Scotland	1.1	1.4
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 IFRS 16 (2019: IAS 17). The average contractual life of the asset finance loans was 52 months (2019: 56 months) while that of the motor finance loans was 60 months (2019: 57 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.

	2020	2019
	%	%
Commercial vehicles	32.0	30.3
Construction plant	33.7	34.8
Technology	6.9	7.8
Manufacturing	6.7	6.1
Print and paper	3.7	4.8
Refuse disposal vehicles	4.8	5.2
Other vehicles	3.6	3.0
Agriculture	2.9	2.7
Other	5.7	5.3
	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.

	2020	2019
Number of transactions	8	8
Total facilities (£m)	139.0	135.0
Carrying value (£m)	94.9	88.1

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 a 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 2020, 4 of these facilities were identified as Stage 2 (2019: none) with the remainder in Stage 1.

CBILS and BBLS

Loans under these schemes, which were launched in the year as a response to the impact of Covid-19 on UK SMEs, have the benefit of guarantees underwritten by the UK Government.

The Group offers term loans and asset finance loans under the CBIL scheme. Interest and fees are paid by the UK Government for the first twelve months and the government guarantee caps the lender's losses at up to 80% of the outstanding balance.

Loans under the BBL scheme are six year term loans at a standard 2.5% per annum interest rate. The UK Government pays the interest on the loan for the first twelve months and provides lenders with a guarantee covering the whole outstanding balance.

The Group's outstanding CBILS and BBLS loans at 30 September 2020 were:

	2020	2019
	£m	£m
CBILS		
Term loans	20.6	-
Asset finance	1.0	-
Total CBILS	21.6	-
BBLS	3.6	-
	25.2	-

At 30 September 2020, all of these accounts were considered to be performing accounts.

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 remain 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 2020 and 30 September 2019, compared to the industry averages at those dates published by UK Finance ('UKF') and the FLA, was:

	2020 %	2019 %
First mortgages		
Accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	0.15	0.18
Buy-to-let accounts excluding receiver of rent cases	0.10	0.07
Owner-occupied accounts	3.72	2.44
UKF data for mortgage accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	0.52	0.42
Buy-to-let accounts excluding receiver of rent cases	0.50	0.37
Owner-occupied accounts	0.90	0.81
All mortgages	0.82	0.73
Second charge mortgage loans		
Accounts more than 2 months in arrears		
All accounts	14.77	14.08
Post-2010 originations	0.62	0.38
Legacy cases (Pre-2010 originations)	21.17	19.85
Purchased assets	17.85	16.05
FLA data for secured loans	8.40	8.70
Motor finance loans		
Accounts more than 2 months in arrears		
All accounts	4.58	5.25
Originated cases	1.76	1.27
Purchased assets	13.10	12.13
FLA data for point of sale hire purchase	*	2.70
Asset finance loans		
Accounts more than 2 months in arrears	1.75	0.43
FLA data for business lease / hire purchase loans	1.70	1.10

* Not published

No published industry data for asset classes comparable to the Group's other books has been identified. Where revised data at 30 September 2019 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.

It should be noted that, where customers have been allowed to defer payments as part of Covid 19 reliefs, these deferrals are not included in arrears measures above.

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 Idem 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. No additional loans to customers treated as POCI were acquired in the year ended 30 September 2020. 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 (which will be treated as POCI under IFRS 9), 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.

	2020	2019	2018
	£m	£m	£m
All purchased consumer assets			
Carrying value	235.3	291.1	364.2
84 month ERC	277.8	342.3	434.9
120 month ERC	313.7	387.5	489.6
POCI assets only			
Carrying value	139.8	168.3	204.4
84 month ERC	176.9	214.1	269.9
120 month ERC	203.7	246.0	306.2

Amounts shown above are disclosed as loans to customers (note 16). They include first mortgages, second charge mortgage loans and unsecured consumer loans.

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.

	2020 £m	2019 £m
The Group		
Cash with central banks rated:		
AA	-	816.4
AA-	1,637.1	-
	1,637.1	816.4
Cash with retail banks rated:		
AA-	112.0	230.5
A+	175.9	173.5
A-	-	5.0
	287.9	409.0
Total exposure	1,925.0	1,225.4
The Company		
Cash with retail banks rated:		
A+	12.6	9.1
A-	-	5.0
	12.6	14.1

The reduction in the rating on central bank deposits is a result of the downgrade of the UK's sovereign rating in the year.

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 20).

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 21, while collateral pledged to the Group is shown in note 34.

Since June 2019, the Group has been centrally clearing eligible derivatives with a Central Clearing Counterparty ('CCP') which removes credit risk between bilateral counterparties and ensures timely settlement and / or porting of derivative contracts in the event of the failure of a counterparty.

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.

	2020	2019
	£m	£m
Carrying value of derivative financial assets		
Counterparties rated		
AA	-	7.3
AA-	97.8	155.6
A+	364.2	388.8
A	1.3	5.5
A-	-	35.2
Gross exposure (note 20)	463.3	592.4
Collateral amounts posted		
Cross-currency basis swap arrangements	-	64.1
CSA collateral amounts (note 34)	-	-
Total collateral	-	64.1
Net exposure	463.3	528.3

57. 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; and
- 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.

As an authorised deposit taker, the liquidity position of Paragon Bank PLC, the Group's banking subsidiary, is also managed on a stand-alone basis.

Set out below is a summary of the contractual cash flows expected to arise from the Group's financial and leasing 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 2020					
Retail deposits	5,740.0	1,608.2	704.5	-	8,052.7
Borrowings	792.9	398.7	1,079.0	161.5	2,431.5
Total non-derivative liabilities	6,532.9	2,066.3	1,783.5	161.5	10,484.2
Derivative liabilities	5.1	5.2	1.8	-	12.1
	6,538.0	2,071.5	1,785.3	161.5	10,496.3
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

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 overall responsibility for the management of liquidity risk rests with ALCO which makes recommendations for the Group's liquidity policy for board approval. ALCO monitors liquidity risk metrics within limits set by the Board or regulators and uses detailed cash flow projections to ensure that an adequate level of liquidity is available at all times.

The Group's and the Bank'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, 97.3% (2019: 97.8%), 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:

	2020	2019
	£m	£m
Payable on demand	2,363.8	1,783.9
Payable in less than three months	598.3	482.7
Payable in less than one year but more than three months	2,777.9	2,151.4
Payable in less than one year or on demand	5,740.0	4,418.0
Payable in one to two years	1,608.2	1,210.1
Payable in two to five years	704.5	982.4
	8,052.7	6,610.5

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 2020 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	2020	2019
		£m	£m
Balances with central banks		1,386.9	646.4
Total on balance sheet liquidity		1,386.9	646.4
FLS drawings	33	-	109.0
Long/ short repo transaction		150.0	-
		1,536.9	755.4

Balances with central banks above exclude group cash balances placed on deposit at the Bank of England through Paragon Bank.

Paragon 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 2020, 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 2020 and 30 September 2019 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.

The Group

	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
30 September 2020					
Secured bank borrowings	-	-	-	657.8	657.8
Asset backed loan notes	-	-	-	3,207.5	3,207.5
Total non-recourse funding	-	-	-	3,928.3	3,928.3
Bank overdrafts	0.4	-	-	-	0.4
Retail bonds	60.0	124.8	112.0	-	296.8
Corporate bond	-	-	-	149.8	149.8
Central bank facilities	700.0	244.4	910.0	-	1,854.4
Lease liabilities	1.5	1.1	2.4	0.6	5.6
	761.9	370.3	1,024.4	4,078.7	6,235.3
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
Lease liabilities	-	-	-	-	-
	51.0	759.9	481.0	5,356.5	6,648.4

The Company

	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
30 September 2020					
Retail bonds	60.0	124.8	112.0	-	296.8
Corporate bond	-	-	-	149.8	149.8
Lease liabilities	1.2	1.3	4.0	11.0	17.5
	61.2	126.1	116.0	160.8	464.1
30 September 2019					
Retail bonds	-	59.9	236.6	-	296.5
Corporate Bond	-	-	-	149.6	149.6
Lease liabilities	-	-	-	-	-
	-	59.9	236.6	149.6	446.1

IFRS 7 requires the disclosure of future contractual cash flows (including interest) on these borrowings, and these are described and set out on the following pages.

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 29 and the assets backing the Notes are shown in note 17.

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 2020 or the year ended 30 September 2019. 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 £25.0m of additional cash would be retained in the SPV companies (2019: £55.8m). The cash balances of the SPV companies are included within the restricted cash balances disclosed in note 15 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 increased 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 2020 or 30 September 2019, but undrawn facilities of £400.0m were available at the year end (2019: £200.0m).

Further details of the warehouse facilities are given in note 30 and details of the loan assets within the warehouses are given in note 17.

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 2039 and the latest in 2050.

The equivalent sterling principal amount outstanding at 30 September 2020 under the SPV and warehouse arrangements, allowing for the effect of the cross-currency basis swaps, described under currency risk (note 59), which are net settled with the loan payments, was £3,489.1m (2019: £4,706.1m). The total sterling amount payable under these arrangements, were these principal amounts to remain outstanding until the final repayment date, would be £4,423.0m (2019: £6,276.6m). 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 £150.0 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. Fitch's published outlook for the rating was, however, revised to negative in March 2020, due to the agency's expectation of weaker UK growth in 2020 as a result of Covid-19, in common with the ratings of other UK banks.

Of the Group's corporate and retail bond issuance, £60.0m falls due for payment in the next twelve months.

Central bank facilities

The Group has accessed term facilities under the central bank schemes described in note 33. 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 2020 the amount of drawings available in respect of prepositioned assets was £684.0m (2019: £1,095.0m).

Additional Liquidity

The Group holds certain of its own listed, externally rated, asset backed securities which may be used as security to access credit facilities, including those offered by the Bank of England. The principal value of these notes is analysed by credit grade and utilisation status below.

	2020			2019		
	Utilised £m	Available £m	Total £m	Utilised £m	Available £m	Total £m
Rating						
AAA	367.8	643.6	1,011.4	57.5	341.2	398.7
AA+ / AA / AA-	3.4	64.2	67.6	1.2	24.6	25.8
A+ / A / A-	3.6	51.8	55.4	2.5	30.1	32.6
BBB+ / BBB / BBB-	3.4	64.2	67.6	18.5	43.4	61.9
	378.2	823.8	1,202.0	79.7	439.3	519.0

As these notes are held internally, they are not included in balance sheet liabilities. Mortgage assets backing these securities remain on the Group's balance sheet and are included in amounts pledged as collateral in note 17.

Utilised notes includes those which the Group is obliged to hold under regulations governing securitisation issuance.

The available AAA notes would give access to £502.5m (2019: £276.0m) if used to secure drawings on Bank of England facilities.

Additional notes issued after the year end (note 29) provide access to further liquidity.

During the year, the Group entered in to a back-to-back long / short repo transaction with a UK bank. This provides £150.0m of liquidity, utilising £178.5m of the loan notes shown above, but does not appear on the Group's balance sheet.

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	Corporate bonds	Retail bonds	Central bank facilities	Lease liabilities	Total
	£m	£m	£m		£m	£m
a) The Group						
30 September 2020						
Payable in:						
Less than one year	3.2	10.9	75.3	701.9	1.6	792.9
One to two years	5.0	10.9	135.6	245.4	1.2	398.1
Two to five years	5.8	32.6	126.0	912.0	2.6	1,079.0
Over five years	-	160.9	-	-	0.6	161.5
	14.0	215.3	336.9	1,859.3	6.0	2,431.5

30 September 2019

Payable in:						
Less than one year	5.7	10.9	18.0	55.3	-	89.9
One to two years	6.2	10.9	75.3	702.2	-	794.6
Two to five years	12.7	32.6	261.6	244.9	-	551.8
Over five years	-	171.8	-	-	-	171.8
	24.6	226.2	354.9	1,002.4	-	1,608.1

	Corporate bonds	Retail bonds	Lease liabilities	Total
	£m	£m	£m	£m
a) The Company				
30 September 2020				
Payable in:				
Less than one year	10.9	75.3	1.7	87.9
One to two years	10.9	135.6	1.7	148.2
Two to five years	32.6	126.0	5.0	163.6
Over five years	160.9	-	12.0	172.9
	215.3	336.9	20.4	572.6

30 September 2019

Payable in:				
Less than one year	10.9	18.0	-	28.9
One to two years	10.9	75.3	-	86.2
Two to five years	32.6	261.6	-	294.2
Over five years	171.8	-	-	171.8
	226.2	354.9	-	581.1

Amounts payable in respect of the 'other accruals' and 'trade creditors' shown in note 34 fall due within one year. The cash flows described above will include those for interest on borrowings accrued at 30 September 2020 disclosed in note 34.

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:

	2020	2019
	Total cash outflow / (inflow)	Total cash outflow / (inflow)
	£m	£m
On derivative liabilities		
Payable in less than one year	5.1	(0.1)
Payable in one to two years	5.2	2.9
Payable in two to five years	1.8	1.8
Payable in over five years	-	-
	12.1	4.6
On derivative assets		
Payable in less than one year	(38.1)	(14.0)
Payable in one to two years	(43.4)	(20.8)
Payable in two to five years	(45.7)	(42.0)
Payable in over five years	(0.1)	(0.5)
	(127.3)	(77.3)
	(115.2)	(72.7)

58. 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 has historically been LIBOR, which has been used to set rates for certain loan assets and borrowings. However, the Group has continued to move towards the use of alternative reference rates during the year, with new wholesale debt and interest rate swaps referencing SONIA in response to the expected withdrawal of LIBOR from late 2021. This process is expected to continue in the new financial year.

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:

- Duration 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
- Optionality 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. The Bank of England's Working Group on Sterling Risk-Free Interest Rates has recommended SONIA as its replacement. 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 an internal working group exists to identify the impact on the business and ensure an orderly transition from LIBOR to other reference rates across all classes of financial instrument.

The current balances of the Group's loans to customers where the interest rate or the reversionary interest rate is set by reference to IBOR are set out below.

	2020	2019
	£m	£m
First mortgages	3,750.0	4,079.0
Development finance facilities	234.6	101.6
Second charge mortgages	61.4	-
Structured lending	94.9	88.1
Aviation mortgages	24.1	17.2
	4,165.0	4,285.9

The second charge mortgages shown above were moved to LIBOR as a temporary measure following the withdrawal of the Finance House Base Rate in the year.

All structured lending agreements include fallback language to manage the transition from LIBOR.

Borrowings where interest rates are based on LIBOR and other IBOR rates are shown in notes 29 and 30. Derivative financial assets and liabilities where cash flows are based on IBOR rates are shown in note 20, where the Group's transition planning activities are also discussed.

The Group's use of financial derivatives for hedging interest rate risk is discussed further in note 20.

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 2020, 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 2020 by £0.9m (2019: £1.1m) and increase profit before tax by £19.8m (2019: increase by £10.1m).

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 dollar or euro interest rates would be to increase the Group's equity by £0.3m (2019: £0.4m) and £0.9m (2019: £1.1m) 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. The interest charging rates on the Company's financial assets and liabilities with other group entities will be transitioned away from LIBOR as part of the overall group project.

59. Currency risk

The Group has little 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 29. 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, ie 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 2020 and 30 September 2019 are set out below:

	2020 Equivalent sterling principal £m	2020 Carrying value £m	2019 Equivalent sterling principal £m	2019 Carrying value £m
US dollar notes	397.0	609.6	447.5	721.6
Euro notes	687.5	917.8	1,007.4	1,314.1
	1,084.5	1,527.4	1,454.9	2,035.7

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 20.

None of the assets or liabilities of the Company are denominated in foreign currencies.

D2.4 Notes to the Accounts - Basis of preparation

For the year ended 30 September 2020

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.

60. 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 62 and the critical accounting judgements and estimates which have been required in preparing these financial statements are described in notes 63 and 64 respectively.

The Group has historically chosen to present an additional comparative balance sheet. The Group adopted IFRS 9 in its 2019 financial statements and, as required by that standard, did not restate its 2018 comparative information. In the financial statements for the year ended 30 September 2019, the Group presented an IFRS 9 transition date balance sheet as at the first day of that financial year, 1 October 2018. In the current year, as the Group presents three years of balance sheet information it has continued to present the IFRS 9 transition date balance sheet as an additional comparative.

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 16 – 'Leases'
- 2019 amendments to IAS 39 – 'Interest Rate Benchmark Reform' and consequential amendments to IFRS 7

The effect on the Group's and the Company's accounting of the adoption of these standards is discussed in note 61.

Impact of UK departure from the EU

Under the International Accounting Standards and European Public Limited Liability Company (Amendment etc.) (EU Exit) Regulations 2019, despite the UK's exit from the EU on 31 January 2020, the EU endorsed IFRS regime remains applicable to the Group until its first financial year commencing after the conclusion of the UK's Transition Period, currently expected to end on 31 December 2020.

Therefore, while EU endorsed IFRS applies to these financial statements and will apply to the financial statements for the year ending 30 September 2021, those for the year ending 30 September 2022 will instead be prepared under 'UK-adopted international accounting standards'. It is anticipated that 'UK-adopted international accounting standards' will be equivalent to IFRS as adopted by the EU at the point of transition and that there would be no amendments required in the Group's accounting as a result of that change.

Comparability of information

IFRS 16 does not require that the balance sheet information at 30 September 2018 and 30 September 2019 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 17 - 'Leases' ('IAS 17'), and therefore may not be directly comparable with the balance sheet at 30 September 2020 and the profit and loss account for the year then ended which are prepared under IFRS 16.

Similarly, on the introduction of IFRS 9 in the year ended 30 September 2019, restatement of the position at 30 September 2018 was not required, with transition effectively taking place on 1 October 2018. 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. There were no significant impacts from the introduction of IFRS 9 in the Company's accounting.

Standards not yet adopted

In August 2020 the IASB issued a further amendment to IAS 39 'Interest Rate Benchmark Reform – Phase 2'. This amendment sets out accounting requirements for the treatment of IBOR-linked financial assets and liabilities under the amortised cost method and IBOR related hedge accounting when a firm replaces the IBOR linkage in the underlying instruments with a replacement benchmark. It is therefore potentially applicable to the Group's LIBOR-linked loan assets and those FRN liabilities where interest is charged on the basis of LIBOR or other IBOR rates (note 29). It also affects the Group's LIBOR (and other IBOR) referenced derivative assets and liabilities (note 20) and the hedging relationships which they form part of.

The intention of the standard is that, where the transition is effectively a like for like replacement, no windfall gain or loss should occur on transition, and hedging relationships should be able to continue.

This amendment is effective from the Group's financial year ending 30 September 2022 but will be available for early adoption once endorsed by the EU. The Group expects to implement the provisions of the amendment when it transitions its IBOR linked assets and liabilities, subject to appropriate endorsement. The impact of the amendment will depend upon the IBOR-related assets liabilities and hedging relationships at the point at which transition occurs.

Other standards and interpretations in issue but not effective do not address matters relevant to the Group's accounting and reporting.

61. Changes in accounting standards

a) IFRS 16 – 'Leases'

The Group is required to adopt IFRS 16, which replaces IAS 17, the standard currently governing the accounting for operating and finance leases, in preparing its financial statements for the year ended 30 September 2020. It has transitioned to the new standard with effect from 1 October 2019, in accordance with the transitional provisions set out in the standard, using the modified retrospective approach. The standard addresses accounting by lessees and lessors which are considered separately below.

Lessor accounting

The provisions for lessor accounting under IFRS 16 are little changed from those in IAS 17 and so the accounting for the Group's finance lease receivables, shown in note 18 is not materially changed.

Lessee accounting

Accounting by lessees is changed significantly under IFRS 16, with a right of use asset recognised on the balance sheet for all leases, representing the economic benefit of controlling the underlying asset over the term of the lease. This includes leases previously treated as operating leases and not recognised on the balance sheet under IAS 17. The right of use asset on initial recognition is based on the discounted value of future minimum lease payments. It is recognised within fixed assets and depreciated over the term of the lease.

A corresponding liability arises representing the present value of future lease commitments and this is recognised within other liabilities. This balance is reduced over the life of the lease by lease payments made and the unwinding of the initial discount is recognised in interest expense.

Under IAS 17, the Group disclosed arrangements to lease office buildings, equipment and motor vehicles as operating leases and these have been restated in accordance with IFRS 16. Additionally, the Group has undertaken an exercise to identify potential lease agreements arising from service contracts. No such arrangements were identified. The Group had no involvement as a lessee in finance leases, as defined by IAS 17.

The Group has made use of practical expedients within IFRS 16 when performing its transition accounting. 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.

At transition, on 1 October 2019, the Group recognised a right of use asset of £7.0m and a corresponding liability of £7.3m, in accordance with the provisions of IFRS 16 paragraph C5(b), referred to as the modified retrospective approach. Under this approach, there is no impact on equity on transition.

The difference between the asset and liability on recognition represents amounts prepaid or accrued in respect of lease rentals in the Group's balance sheet at 30 September 2019.

The leasing activities of the Company are limited to the lease of an office building from a subsidiary entity. At transition the Company recognised a right of use asset of £18.8m and a corresponding liability of £18.8m in accordance with the modified approach. There was no impact on the Company's equity at transition.

The discount rate used to derive the right of use asset was 2.5% based on a 5-year corporate bond yield, while the minimum lease payments used were materially similar to those disclosed as operating lease commitments at 30 September 2019 in note 51 to the annual accounts for the year then ended, except that irrecoverable VAT was excluded.

There was no immediate tax impact from transition and the Group's regulatory capital is unaffected. Under IFRS 16, the amount charged to profit and loss represents depreciation on the ROU asset and a finance charge on the liability instead of rents or similar charges. While this is a change of classification, the overall effect on profit is insignificant. There is no impact on reported cash flows, nor on earnings per share.

IFRS 16 does not require the restatement of comparative information and therefore all balance sheets and results for periods on or before 30 September 2019 are presented in accordance with IAS 17.

b) IAS 39 amendments 'Interest Rate Benchmark Reform'

This amendment was issued by the IASB to address the impact of uncertainties arising from IBOR reform (including the withdrawal of LIBOR) on hedge accounting. The Standard excludes the effect of such uncertainties from the evaluation of hedging relationships for accounting purposes and allows the continuation of IBOR-based hedging relationships despite these uncertainties, all other things being equal.

This amendment is applicable for periods beginning on or after 1 January 2020, but early application is permitted. The Group has elected to early apply this amendment retrospectively in these financial statements. As the amendment allows the continuation of existing arrangements, its adoption has no impact on reported amounts.

c) Accounting changes at 1 October 2018

The accounting changes affecting equity at 1 October 2018 relate to the adoption of IFRS 9 – 'Financial Instruments' and IFRS 15 – 'Revenue' and are described in detail in note 62 to the accounts for the year ended 30 September 2019.

62. 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 2019 and earlier periods has not been restated for IFRS 16, as permitted by that standard, the accounting policies applied differ to those used in the accounts for the year ended 30 September 2020. 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 2020. 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 66, 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.

Particular focus is given to the Group's financial forecasts to ensure the adequacy of resources available for the Group to meet its business objectives on both a short-term and strategic basis.

In compiling the most recent forecast, for the period commencing 1 October 2020, particular attention was paid to the potential consequences of Covid-19 on the Group's operations, customers, funding and prospects, both in the short and longer term. This included consideration of a number of different scenarios with impacts of varying duration and severity. In common with the Group's approach to IFRS 9, the economics used in the forecasting process were updated in October in light of the continuing development of the Covid-19 crisis, based on updated external projections. Future business activity was reforecast reflecting the potential impacts of the pandemic on markets and products.

The forecast was based on the best available information at the time of its approval, but the uncertainties surrounding the potential ongoing impact of Covid-19 and the nature, duration and effectiveness of government and regulatory measures to address it, mean that accurate forecasting is a more complex task than in normal circumstances. Therefore, further scenario modelling was undertaken to evaluate the impact of adverse stresses of the forecast variables with the greatest impact.

The key stresses modelled in detail to evaluate the forecast were:

- An increase of 10% in buy-to-let volumes. This examined the impact of volumes on profitability and illustrated the extent to which capital resources and liquidity would be stretched due to the higher cash and capital requirements
- Higher funding costs – 20bps higher cost on all new savings deposits throughout. This scenario illustrates the impact of a significant margin squeeze on profitability and whether this would cause significant impacts on any capital, liquidity or encumbrance ratios
- An increase in impairment due to more Covid-19 disruption. This scenario models a significant short-term profitability stress and the consequent stress on capital
- A 10% reduction in development finance volumes. Development finance is the highest yielding product and this scenario illustrates the effect of product mix on contribution and other ratios

- A stress combining higher funding costs and more Covid-19 disruption, without reducing lending. Although it is not deemed likely that such a scenario would materialise, since severe stresses almost always result in lower lending volumes, the output from this stress provides a benchmark for a plausible worst-case position that impacts all aspects of business performance and ratios, in particular, capital

These stresses did not take account of management actions which might mitigate the impact of the adverse assumptions used. They were designed to demonstrate how such stresses would affect the Group's financing, capital and liquidity positions and highlight any areas which might impact the Group's going concern and viability assessments. Under all these scenarios, the Group had the ability to meet its obligations over the forecast horizon and maintain a surplus over its regulatory requirements for both capital and liquidity through normal balance sheet management activities.

A further, more material impairment stress was modelled, based on the Group's severe macroeconomic scenario. This, together with the outputs from the other stresses described, presents the Board with enough information to assess the Group's ability to continue on a going concern basis and ensure that there are enough management actions within their control to mitigate any plausible and foreseeable failure scenario.

The Group started the Covid-19 period with a strong capital surplus and has also built up a significant liquidity buffer during the second half of the year, as described below, to ensure that any significant outflows of deposits and / or reduced inflows from customer receipts can be managed. Overall, the forecasts, even under reasonable further levels of stress show the Group retaining sufficient equity, capital, cash and liquidity throughout the forecast period to satisfy its regulatory and operational requirements.

The availability of funding and liquidity is a key consideration, including retail deposit, wholesale funding, central bank and other contingent liquidity options.

The Group's retail deposits of £7,856.6 million (note 28), raised through Paragon Bank, are repayable within five years, with 71.9% of this balance (£5,650.2 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 2020 Paragon Bank held £1,637.1 million of balance sheet assets for liquidity purposes, in the form of central bank deposits (note 15). A further £150.0 million of liquidity was provided by an off balance sheet swap arrangement (note 57), bringing the total to £1,787.1 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 £684.0 million. Holdings of the Group's own externally rated mortgage backed loan notes can also be used to access the Bank of England's liquidity facilities or other funding arrangements. At 30 September 2020 the Group had £1,063.5 million of such notes available for use, of which £872.9 million were rated AAA.

The Group's securitisation funding structures, described in note 57, ensure that a significant proportion of its originated loan portfolio is match-funded, although this was reduced in the period by the retirement of five securitisation transactions. 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. While the Group has not accessed the public securitisation market in the year, the market has remained active throughout the Covid-19 crisis and remains a potential funding source.

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, of £60.0 million matures. The Group's TFS borrowings also start to mature in the coming financial year, with £700.0 million falling due within twelve months.

The Group's access to debt is enhanced by its corporate BBB rating, affirmed by Fitch Ratings in March 2020, and its status as an issuer is evidenced by the BB+ rating of its £150.0 million Tier 2 bond. It has regularly accessed the capital markets for warehouse funding and corporate and retail bonds over recent years and continues to be able to access these markets.

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

As described in note 54 the Group's capital base is subject to consolidated supervision by the PRA. Its capital at 30 September 2020 was in excess of regulatory requirements and its forecasts indicate this will continue to be the case.

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) Leases

Year ended 30 September 2020 under IFRS 16

For leases where the group is the lessee a right of use asset is recognised in property, plant and equipment on the inception of the lease based on the discounted value of the minimum lease payments at inception. A lease liability of the same amount is recognised at inception, with the unwinding of the discount included in the interest payable.

Leases where the Group is lessor are accounted for as operating or finance leases in accordance with IFRS 16 – 'Leases'. A finance lease is one which transfers substantially all of the risks and rewards of the ownership of the asset concerned. Any other lease is an operating lease.

Finance lease receivables are accounted for as loans to customers, with impairment provisions determined in accordance with IFRS 9.

Rental income and costs on operating leases are charged or credited to the profit and loss account on a straight-line basis over the lease term. The associated assets are included within property, plant and equipment.

Year ended 30 September 2019 under IAS 17

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.

(g) Loans to customers

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.

(h) 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 IFRS 16 – 'Leases' and accounted for on the actuarial basis.

(i) Impairment of loans to customers

The carrying values of all loans to customers, whether accounted for under IFRS 9 or IFRS 16, 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, ie the total 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; or
- For Stage 2 and 3 accounts, at an amount equal to lifetime ECL, ie the total 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 POCL. 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.

(j) 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.

(k) 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. Vehicles held for short-term hire are depreciated in equal annual instalments to their estimated residual value over their expected useful life. 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	Short leasehold premises	Computer hardware	Furniture, fixtures and office equipment	Company motor vehicles
2% per annum	over the term of the lease	25% per annum	15% per annum	25% per annum

Depreciation on right of use assets recognised in accordance with IFRS 16 is provided on a straight line basis over the term of the lease.

(l) 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.

(m) Investments in subsidiaries

The Company's investments in subsidiary undertakings are valued at cost less provision for impairment.

(n) 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.

(o) 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.

(p) 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.

(q) 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.

(r) 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.

(s) 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.

(t) 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.

(u) 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.

(v) 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.

(w) 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.

(x) 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

(y) 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.

(z) 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.

(aa) 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.

(bb) 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.

63. Critical accounting judgements

The most significant judgements which the directors have made in the application of the accounting policies set out in note 62 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.

In determining whether an account has an SICR in the Covid-19 environment the granting of Covid-19 reliefs, including payment holidays and similar arrangements, may mean that an SICR may exist without this being reflected in either arrears performance or credit bureau data. The Group has accepted the advice of UK regulatory bodies that the grant of Covid-19 relief does not, of itself, indicate an SICR, but has carefully considered internal credit and customer data to determine whether there might be any accounts with SICR not otherwise identified by the process.

Where accounts have received secondary periods of relief beyond the initial three month period, this has generally been considered to be strongly indicative of underlying problems and such accounts have been identified as having an SICR. Furthermore, adjustments to correct probabilities of default in models will also have a consequent result of identifying more SICRs.

More information on the definition of SICR adopted is given in note 19.

(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 19.

(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.

64. 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 (eg 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.

All of this information may be impacted by Covid-19, its economic effect on customers and the forms of the reliefs given to ameliorate that impact. These may both change the underlying data and impact on the derivation of metrics normally used to monitor credit performance.

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. These scenarios at 30 September 2020 have been derived specifically in light of the Covid-19 situation, modelling a variety of possible outcomes. It should be noted, however, that there is currently little agreement between economists on the longer term prospects for the UK and there is unlikely to be so until the country's path out of lockdown becomes clearer.

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.

In addition to uncertainty created by the economic scenarios, the Group recognises that the present situation lies outside the range of situations considered when it originally derived its IFRS 9 approach to impairment. It therefore considered, for each class of asset, whether any adjustment to the normal approach was required to ensure sufficient provision was created and also reviewed other available data, both from account performance and customer feedback to form a view of the underlying reasons for observed customer behaviours and of their future intentions and prospects.

The position after considering all these matters is set out in note 19, together with further information on the Group's approach and sensitivity analysis. The Covid-19 economic scenarios described above and their impact on the overall provision are also set out in that note.

(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.

In the case of purchased loan accounts, the assessment of future cash flows is significantly complicated by the uncertain impacts of Covid-19. The likely future cash flows have been assessed by the management on the basis of available performance data and customer contacts. The amount of income recognised to date at 30 September 2020 has been revised to allow for reduced future collections based on these assessments.

No evidence has so far been identified which would require the adjustment of EIR income for other products as a result of Covid-19.

To illustrate the potential variability of the estimate, 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 £11.2m (2019: £7.2m), while an increase of the assumed asset lives of such assets by three months would increase balance sheet assets by £10.3m (2019: £6.0m)
- 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 £7.3m (2019: £4.2m)
- A reduction (or increase) in estimated cash flows from purchased loan assets of 5% would reduce (or increase) balance sheet assets by £9.4m (2019: £12.5m)

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 CGU, based on management forecasts and other assumptions described in note 26, 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 CGU is able to achieve in practice. The impact of Covid-19 means that there is a greater risk of inaccuracy in compiling these forecasts. 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 26.

(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 53. 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 53.

65. 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 2020 or the year ended 30 September 2019 carried at fair value and valued using level 3 measurements, other than contingent consideration amounts (note 35).

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	2020 £m	2019 £m
Financial assets			
Derivative financial assets	20	463.3	592.4
		463.3	592.4
Financial liabilities			
Derivative financial liabilities	20	132.4	80.5
Contingent consideration	35	13.5	23.7
		145.9	104.2

All of these financial assets and financial liabilities are required to be carried at fair value by IFRS 9.

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 US 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 20.

Contingent consideration

The value of the contingent consideration balances shown in note 35 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	2020 Carrying amount £m	2020 Fair value £m	2019 Carrying amount £m	2019 Fair value £m
The Group					
Financial assets					
Cash	15	1,925.0	1,925.0	1,225.4	1,225.4
Loans to customers	16	12,631.4	12,856.1	12,186.1	12,370.1
Sundry financial assets	21	125.3	125.3	90.3	90.3
		14,681.7	14,906.4	13,501.8	13,685.8
Financial liabilities					
Short-term bank borrowings		0.4	0.4	1.0	1.0
Asset backed loan notes		3,270.5	3,270.5	4,419.4	4,419.4
Secured bank borrowings		657.8	657.8	787.5	787.5
Retail deposits	28	7,856.6	7,900.6	6,391.9	6,408.9
Corporate and retail bonds		446.6	455.7	446.1	474.9
Other financial liabilities	34	74.6	74.6	83.1	83.1
		12,306.5	12,359.6	12,129.0	12,174.8

	Note	2020 Carrying amount £m	2020 Fair value £m	2019 Carrying amount £m	2019 Fair value £m
The Company					
Financial assets					
Cash	15	12.6	12.6	14.1	14.1
Loans to group companies	21	84.0	84.0	106.6	106.6
Sundry financial assets	21	0.6	0.6	0.7	0.7
		97.2	97.2	121.4	121.4
Financial liabilities					
Corporate and retail bonds		446.6	455.7	446.1	474.9
Amounts owed to group companies	34	22.7	22.7	23.8	23.8
Other financial liabilities	34	2.9	2.9	3.6	3.6
		472.2	481.3	473.5	502.3

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.

66. Details of subsidiary undertakings

Subsidiary undertakings of the Group at 30 September 2020, 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

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 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
Colonial Finance (UK) Limited	100%	Non-trading
Earlswood Finance Limited	100%	Non-trading
First Flexible (No. 7) PLC	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
Paragon Car Finance (1) Limited	100%	Non-trading
Paragon Dealer Finance Limited	100%	Non-trading
Paragon Fourth Funding 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 Secured Finance (No. 1) PLC	100%	Non-trading
Paragon Third Funding Limited	100%	Non-trading
Paragon Vehicle Contracts Limited	100%	Non-trading
Plymouth Funding Limited	100%	Non-trading
Paragon Loan Finance (No. 3) Limited	100%	Non-trading

Company	Holding	Principal activity
Direct subsidiaries of Paragon Banking Group PLC		
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
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
Specialist Fleet Services Limited	100%	Asset finance and contract hire
City Business Finance Limited	100%	Non-trading
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
Moorgate Asset Administration 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 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 2020 comprise:

Company	Principal activity
Paragon Seventh Funding Limited	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
Paragon Mortgages (No. 27) Holdings Limited	Holding company
Paragon Mortgages (No. 27) PLC	Residential mortgages
Paragon Mortgages (No. 28) Holdings Limited	Holding company
Paragon Mortgages (No. 28) PLC	Residential mortgages
Arianty Holdings Limited	Holding company
Arianty No. 1 PLC	Non-trading
First Flexible No. 5 PLC	Non-trading
Paragon Fifth Funding Limited	Non-trading
Paragon Sixth Funding Limited	Non-trading
Paragon Mortgages (No. 18) Holdings Limited	Non-trading
Paragon Mortgages (No. 18) PLC	Non-trading
Paragon Mortgages (No. 19) Holdings Limited	Non-trading
Paragon Mortgages (No. 19) PLC	Non-trading
Paragon Mortgages (No. 20) Holdings Limited	Non-trading
Paragon Mortgages (No. 20) PLC	Non-trading
Paragon Mortgages (No. 21) Holdings Limited	Non-trading
Paragon Mortgages (No. 21) PLC	Non-trading
Paragon Mortgages (No. 22) Holdings Limited	Non-trading
Paragon Mortgages (No. 22) PLC	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.

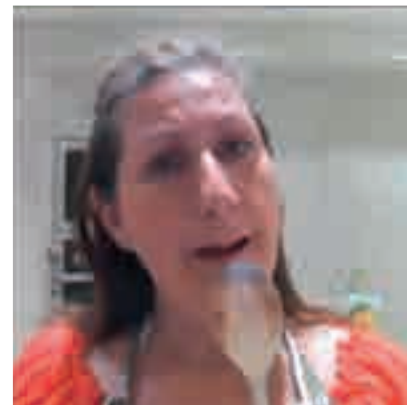
The Paragon Pension Partnership LP is a limited partnership established under Scots law, in which control is vested in members which are Group companies. It is therefore considered to be a subsidiary entity. The outside member is the Group's Pension Plan and the Plan's rights to income from the partnership 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 entities is Citypoint, 65 Haymarket Terrace, Edinburgh, EH12 5HD
- 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.

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.



WE ARE MACMILLAN. CANCER SUPPORT

Our chosen charity of the year for 2020 was Macmillan Cancer Support and employees set themselves an ambitious target to raise £30,000 through a variety of fundraising activities

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

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E1. Appendices to the Annual Report

For the year ended 30 September 2020

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 Group's 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.

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.

	2020	2019
	£m	£m
Profit on ordinary activities before tax	118.4	159.0
Less: Gain on disposal of financial assets	-	(9.7)
Add back: Fair value adjustments	1.6	15.1
Underlying profit	120.0	164.4

Underlying basic earnings per share, calculated on the basis of underlying profit, charged at the overall effective tax rate, is derived as follows.

	2020	2019
	£m	£m
Underlying profit	120.0	164.4
Tax at effective rate (note 12)	(27.5)	(32.7)
Underlying earnings	92.5	131.7
Basic weighted average number of shares (note 14)	253.6	257.6
Underlying earnings per share	36.5p	51.1p

Underlying return on tangible equity is derived using underlying earnings calculated on the same basis.

	2020	2019
	£m	£m
Underlying earnings	92.5	131.7
Amortisation of intangible assets (note 9)	2.0	2.4
Adjusted underlying earnings	94.5	134.1
Average tangible equity (note 54(b))	961.6	920.7
Underlying RoTE	9.8%	14.6%

B. Income statement ratios

Net interest margin ('NIM') and cost of risk (impairment charge as a percentage of average loan balance) for the Group are calculated as follows:

Year ended 30 September 2020

	<i>Note</i>	Mortgage Lending	Commercial Lending	Idem Capital	Total
		£m	£m	£m	£m
Opening loans to customers	16	10,344.1	1,452.1	389.9	12,186.1
Closing loans to customers	16	10,819.5	1,514.8	297.1	12,631.4
Average loans to customers		10,581.8	1,483.4	343.5	12,408.7
Net interest		190.0	82.1	26.1	278.1
NIM		1.80%	5.53%	7.60%	2.24%
Impairment provision	19	25.8	21.7	0.8	48.3
Cost of risk		0.24%	1.46%	0.23%	0.39%

Year ended 30 September 2019

	<i>Note</i>	Mortgage Lending	Commercial Lending	Idem Capital	Total
		£m	£m	£m	£m
Opening loans to customers	16	10,449.5	1,131.3	519.8	12,100.6
Closing loans to customers	16	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	19	1.0	7.2	(0.2)	8.0
Cost of risk		0.01%	0.56%	(0.04)%	0.07%

Not all interest is allocated to segments (note 2).

C. Cost:income ratio

Cost:income ratio is derived as follows:

	<i>Note</i>	2020 £m	2019 £m
Cost – operating expenses	9	126.8	125.2
Total operating income		295.1	307.3
Cost / Income		43.0%	40.7%

Underlying cost:income ratio is derived as follows:

	2020 £m	2019 £m
Cost – as above	126.8	125.2
Adjusted cost	126.8	125.2
Income – as above	295.1	307.3
Gain on disposal of financial asset	-	(9.7)
Adjusted income	295.1	297.6
Underlying cost:income ratio	43.0%	42.1%

D. Net asset value

	<i>Note</i>	2020	2019
Total equity (£m)		1,156.0	1,108.4
Outstanding issued shares (m)	38	261.8	261.6
Treasury shares (m)	40	(5.2)	(5.2)
Shares held by ESOP schemes (m)	40	(3.6)	(3.9)
		253.0	252.5
Net asset value per £1 ordinary share		£4.57	£4.39
Tangible equity (£m)	54	985.9	937.3
Tangible net asset value per £1 ordinary share		£3.90	£3.71



F. Useful information

Information which may be helpful to shareholders and other users of the Annual Report and Accounts

- P294 F1. Glossary**
A summary of abbreviations used in the Annual Report and Accounts
- P296 F2. Shareholder information**
Information about dividends, meetings and managing shareholdings
- P298 F3. Other Public Reporting**
Current and future public reporting information for the Group
- P299 F4. Contacts**
Names and addresses of the Group's advisers

F1. Glossary

AGM	Annual General Meeting	EPC	Energy Performance Certificate
ALCO	Asset and Liability Committee	EPS	Earnings per Share
ASHE	Annual Survey of House and Earnings	EQA	External Quality Assessment
AT1	Additional Tier 1	ERC	Estimated Remaining Collections
BBLS	Bounce Back Loan Scheme	ESG	Environmental, Social and Governance
BBR	Bank Base Rate	ESOP	Employee Share Ownership Plan
BCBS	Basel Committee on Banking Supervision	ESOS	Energy Savings and Opportunities Scheme
BEIS	Department for Business, Energy and Industrial Strategy	EU	European Union
BEPS	Base Erosion and Profit Shifting	EUR	Euro
BGS	Balance Guarantee Swaps	EURIBOR	Euro Interbank Offered Rate
CAGR	Compound Annual Growth Rate	EV	Economic Value
CBI	Confederation of British Industry	ExCo	Executive Performance Committee
CBILS	Coronavirus Business Interruption Loan Scheme	FCA	Financial Conduct Authority
CCC	Customer and Conduct Committee	FLA	Finance and Leasing Association
CCoB	Capital Conservation Buffer	FLS	Funding for Lending Scheme
CCP	Central Counterparty	FOS	Financial Ombudsman Service
CCyB	Counter-Cyclical Buffer	FRC	Financial Reporting Council
CEO	Chief Executive Officer	FRN	Floating Rate Note
CET1	Core Equity Tier 1	FSC	Forest Stewardship Council
CFO	Chief Financial Officer	FSCS	Financial Services Compensation Scheme
CGU	Cash Generating Unit	FVTPL	Fair Value Through Profit and Loss
CIIA	Chartered Institute of Internal Auditors	GDP	Gross Domestic Product
CIPD	Chartered Institute of Personnel Development	GHG	Greenhouse Gases
CMI	Chartered Management Institute	GMP	Guaranteed Minimum Pension
CML	Council of Mortgage Lenders	HA	Hampton-Alexander
C(MR)R	Companies (Miscellaneous Reporting) Regulations 2018	HMRC	Her Majesty's Revenue and Customs
CO2	Carbon Dioxide	HPI	House Price Index
COO	Chief Operating Officer	HQLA	High Quality Liquid Assets
Compliance Plan	Compliance Monitoring Plan	HR	Human Resources
CPI	Consumer Price Index	IAS	International Accounting Standard(s)
CRD IV	The current EU Capital Requirements Regulation and Directive Regime	IASB	International Accounting Standards Board
CRDs	Cash Ratio Deposits	IBE	Institute of Business Ethics
CRO	Chief Risk Officer	IBOR	Interbank Offered Rates
CRR	Capital Requirements Regulation – EU Regulation 575/2013	ICAAP	Internal Capital Adequacy Assessment Process
CSA	Credit Support Annex	IFRS	International Financial Reporting Standard(s)
CSOP	Company Share Option Plan	IIP	Investors in People
CTRF	Contingent Term Repo Facility	ILAAP	Internal Liquidity Adequacy Assessment Process
DEFRA	Department for Environment, Food and Rural Affairs	ILG	Individual Liquidity Guidance
Deloitte	Deloitte LLP	ILTR	Indexed Long Term Repo Scheme
DISP	FCA's Dispute Resolution: Complaints Sourcebook	IMLA	Intermediary Mortgage Lenders Association
DSBP	Deferred Share Bonus Plan	IRB	Internal Ratings Based
DTR	Disclosure and Transparency Rule	IRRBB	Interest Rate Risk in the Banking Book
EBA	European Banking Authority	ISA	Individual Savings Account
ECL	Expected Credit Loss	ISDA	International Swaps and Derivatives Association
EDI	Equality, Diversity and Inclusion	ISO14001:2015	International Organization for Standardization 14001:2015, 'Environmental Management Systems'
EIR	Effective Interest Rate	ISO45001:2018	International Organization for Standardization 45001:2018, 'Management Systems of Occupational Health and Safety'
		KPMG	KPMG LLP, the Group's auditor
		LCR	Liquidity Coverage Ratio

LGD	Loss Given Default	RoTE	Return on Tangible Equity
LIBOR	London Interbank Offered Rate	ROU	Right of Use
Ltd	Limited (company)	RPI	Retail Price Index
LTGDV	Loan to Gross Development Value	RP	Recovery Plan
LTIP	Long-term Incentive Plan	RSUs	Restricted Stock Units
LTV	Loan to Value	RWA	Risk Weighted Assets
M&A	Mergers and Acquisitions	RWG	Risk Working Group
MRC	Model Risk Committee	SA	Standardised Approach
MRT	Material Risk Taker	Schedule 7	Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008
MWh	Mega-Watt Hours	SFS	Specialist Fleet Services
NHS	National Health Service	SICR	Significant Increase in Credit Risk
NI	National Insurance	SID	Senior Independent Director
NII	Net Interest Income	Sharesave	All Employee Share Option scheme
NIM	Net Interest Margin	SME	Small and / or Medium-sized Enterprise(s)
Notes	Asset backed loan notes	SMF	Senior Management Function
NPS	Net Promoter Score	SMCR	Senior Managers and Certification Regime
NSFR	Net Stable Funding Ratio	SONIA	Sterling Overnight Interbank Average Rate
OBR	Office of Budget Responsibility	SPPI	Solely Payments of Principal and Interest
OCI	Other Comprehensive Income	SPV	Special Purpose Vehicle
OFGEM	Office of Gas and Electricity Markets	The 2018 Code	UK Corporate Governance Code (2018 version)
OHSMS	Occupational Health and Safety Management System	TBMC	The Business Mortgage Company
OLAR	Overall Liquidity Adequacy Requirement	TFS	Term Funding Scheme
ONS	Office for National Statistics	TFSME	Term Funding Scheme for SMEs
ORC	Operational Risk Committee	The Act	The Companies Act 2006
PAF	Paragon Asset Finance	The Articles	The Articles of Association of the Company
PAYE	Pay As You Earn	The Bank	Paragon Bank PLC
PD	Probability of Default	The Company	Paragon Banking Group PLC
PFP	Pension Funding Partnership	The Group	The Company and all of its subsidiary undertakings
PIDA	Public Interest Disclosure Act 1998	The Order	The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014
PIEs	Public Interest Entities	The Plan	The Paragon Pension Plan
PLC	Public Limited Company	TRC	Total Regulatory Capital
PMA	Post-model Adjustments	TRE	Total Risk Exposure
PM12	Paragon Mortgages (No.12) PLC	TPF	Titlestone Property Finance Limited
PM26	Paragon Mortgages (No.26) PLC	TSR	Total Shareholder Return
POCI	Purchased or Originated Credit Impaired (assets)	UK	United Kingdom
PPI	Payment Protection Insurance	UKF	UK Finance
PRA	Prudential Regulation Authority (of the Bank of England)	UK GAAP	UK Generally Accepted Accounting Practice
Premier	Premier Asset Finance Limited	US	United States of America
PRP	Profit Related Pay	USD	US Dollar
PRS	Private Rented Sector	US Dollar LIBOR	The London Interbank Offered Rate on balances denominated in US dollars
PSP	Performance Share Plan	VAT	Value Added Tax
PwC	PricewaterhouseCoopers	WEEE	Waste Electrical and Electronic Equipment
RBA	Role Based Allowance	WFH	Working from Home
RBS	Royal Bank of Scotland		
RCC	Risk and Compliance Committee		
RICS	Royal Institution of Chartered Surveyors		
RIDDOR	Reporting of Incidents, Disease and Dangerous Occurrences Regulation 2013		
RMBS	Residential Mortgage Backed Securities		
RoR	Receiver of Rent		

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.investorcentre.co.uk
- 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

Financial calendar

January 2021

Trading update

June 2021

Half-year results

July 2021

Trading update

December 2021

Full-year results

Dividend calendar

28 January 2021

Ex-dividend date for 2020 final dividend

29 January 2021

Record date for 2020 final dividend

26 February 2021

Payment date for 2020 final dividend

1 July 2021

Ex-dividend date for 2021 interim dividend

2 July 2021

Record date for 2021 interim dividend

23 July 2021

Payment date for 2021 interim dividend

Annual General Meeting

24 February 2021

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 Number.

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 2020, 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 2020, 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 fourth report against its Women in Finance charter commitments in September 2020.

All of this reporting will be continued in the financial year ending 30 September 2021.

F4. Contacts

Registered and head office	51 Homer Road Solihull West Midlands B91 3QJ Telephone: 0121 712 2323		
London office	Tower 42 Level 12 25 Old Broad Street London EC2N 1HQ Telephone: 020 7786 8474		
Investor Relations	investor.relations@paragonbank.co.uk		
Company Secretariat	company.secretary@paragonbank.co.uk		
Internet	www.paragonbankinggroup.co.uk		
Auditor	KPMG LLP One Snowhill Snow Hill Queensway Birmingham B4 6GH		
Solicitors	Slaughter and May One Bunhill Row London EC1Y 8YY		
Registrars	Computershare Investor Services PLC The Pavilions Bridgwater Road Bristol BS99 6ZZ Telephone: 0370 707 1244		
Brokers	Jefferies International Limited 100 Bishopsgate London EC2N 4JL	Peel Hunt LLP Moor House 120 London Wall London EC2Y 5ET	UBS Limited 5 Broadgate London EC2M 2QS
Remuneration consultants	Deloitte LLP Four Brindleyplace Birmingham B1 2HZ		
Consulting actuaries	Mercer Limited Four Brindleyplace Birmingham B1 2JQ		





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