

Paragon Banking Group PLC

2018 Annual Report and Accounts



paragon



CAUTIONARY STATEMENT

Sections of this Annual Report, including but not limited to the Directors' Report, the Strategic Report and the Directors' Remuneration Report may contain forward-looking statements with respect to certain of the plans and current goals and expectations relating to the future financial condition, business performance and results of the Group. These have been made by the directors in good faith using information available up to the date on which they approved this report. By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of the Group and depend upon circumstances that may or may not occur in the future. There are a number of factors that could cause actual future financial conditions, business performance, results or developments to differ materially from the plans, goals and expectations expressed or implied by these forward-looking statements and forecasts. Nothing in this document should be construed as a profit forecast.

CONTENTS

Financial Highlights

Results in brief

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

A Strategic Report

The business and its performance in the year

A1	Chairman's statement	Page 10
A2	Business model and strategy	Page 12
A3	Chief Executive's review	Page 21
A4	Future prospects	Page 46
A5	Corporate responsibility	Page 49
A6	Approval of Strategic Report	Page 61

B Corporate Governance

How the business is controlled and how risk is managed

B1	Chairman's statement on corporate governance	Page 64
B2	Board of Directors	Page 66
B3	Corporate governance	Page 70
B4	Audit Committee	Page 78
B5	Directors' remuneration report	Page 86
B6	Risk management	Page 112
B7	Directors' report	Page 127
B8	Statement of directors' responsibilities	Page 131

C Independent Auditor's Report

On the financial statements

C1	Independent Auditor's Report	Page 134
----	------------------------------	----------

D The Accounts

The financial statements of the Group

D1	Primary financial statements	Page 144
D2	Notes to the accounts	Page 150

E Appendices To The Annual Report

Additional financial information

E1	Appendices to the Annual Report	Page 234
----	---------------------------------	----------

F Useful Information

Additional information for shareholders and other users

F1	Glossary	Page 240
F2	Shareholder information	Page 242
F3	Other public reporting	Page 244
F4	Contacts	Page 246

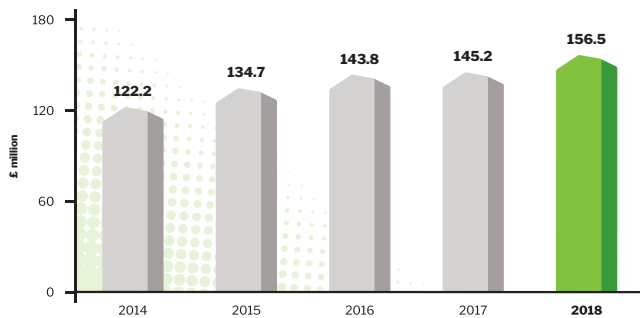
FINANCIAL HIGHLIGHTS

Results in brief

FINANCIAL HIGHLIGHTS

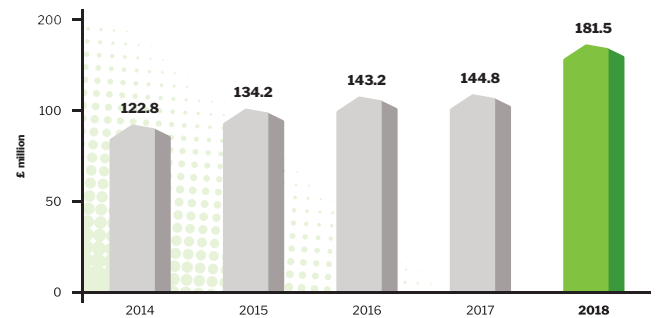
UNDERLYING PROFIT BEFORE TAX **£156.5 million**

7.8% higher (2017: £145.2 million)



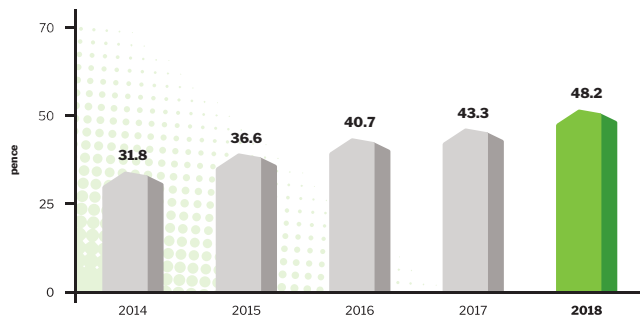
PROFIT BEFORE TAX **£181.5 million**

25.3% higher (2017: £144.8 million)



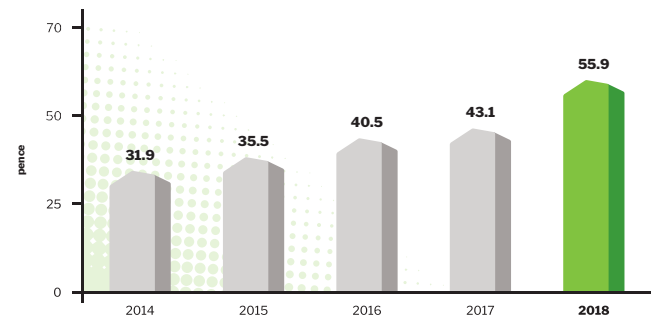
UNDERLYING BASIC EARNINGS PER SHARE **48.2 pence**

11.3% higher (2017: 43.3 pence)



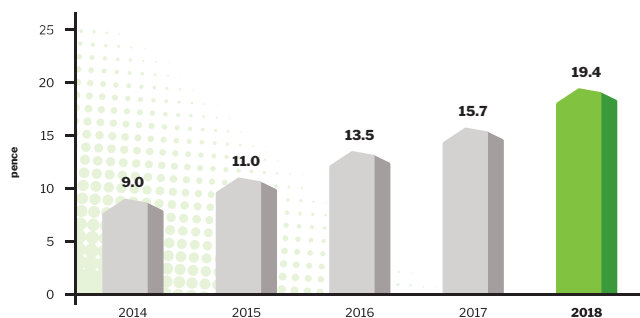
BASIC EARNINGS PER SHARE **55.9 pence**

29.7% higher (2017: 43.1 pence)



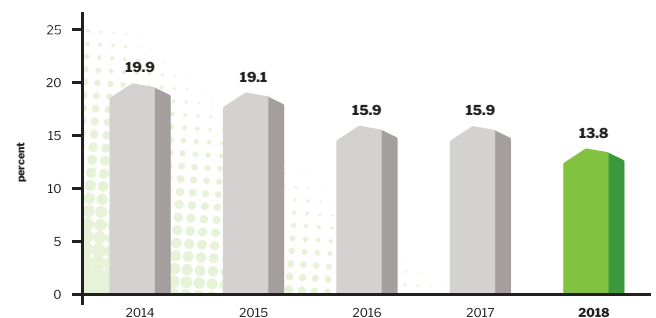
DIVIDEND PER SHARE **19.4 pence**

23.6% higher (2017: 15.7 pence)



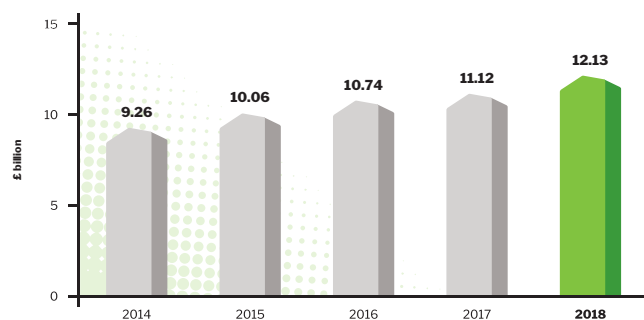
CAPITAL - CET 1 ratio **13.8%**

Remains strong (2017: 15.9%)



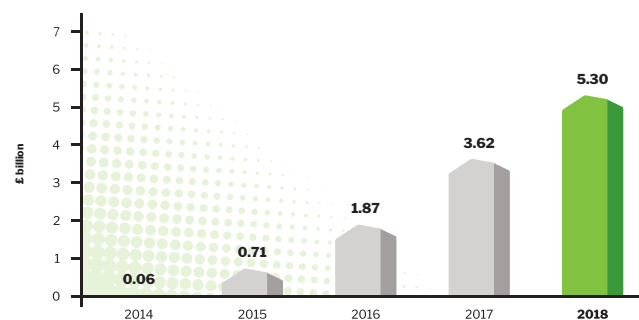
TOTAL LOANS TO CUSTOMERS £12.1 billion

9.0% higher (2017: £11.1 billion)



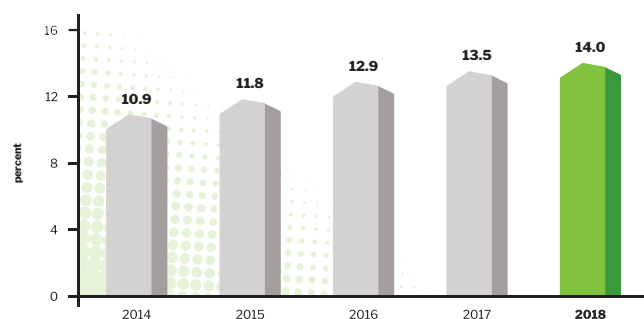
RETAIL DEPOSITS £5.3 billion

46.5% higher (2017: £3.6 billion)



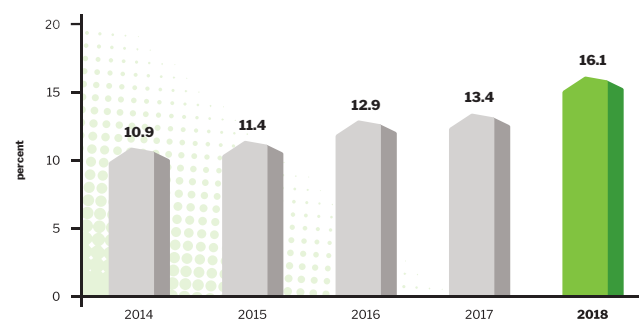
UNDERLYING RETURN ON TANGIBLE EQUITY 14.0%

(2017: 13.5%)



RETURN ON TANGIBLE EQUITY 16.1%

(2017: 13.4%)



Five year performance summary

	2014	2015	2016	2017	2018
	£m	£m	£m	£m	£m
Underlying profit before taxation	122.2	134.7	143.8	145.2	156.5
Profit before taxation	122.8	132.2	143.2	144.8	181.5
Profit after taxation	97.2	107.1	116.0	117.2	145.8
Total loans to customers	9,255.9	10,062.4	10,737.5	11,124.1	12,127.8
Shareholders' funds	947.1	969.5	969.5	1,009.4	1,095.9
	2014	2015	2016	2017	2018
Return on tangible equity	10.9%	11.4%	12.9%	13.4%	16.1%
Earnings per share					
- basic	31.9p	35.5p	40.5p	43.1p	55.9p
- diluted	31.1p	34.8p	39.7p	41.9p	54.2p
Dividend per ordinary share	9.0p	11.0p	13.5p	15.7p	19.4p

The exclusions from underlying results relate principally to acquisitions and a significant asset sale in the period, which do not form part of the day-to-day activities of the Group and which have increased the reported results for the year. The derivation of underlying profit before taxation is described in Appendix A. The calculation of return on tangible equity is shown in note 7.

A.

STRATEGIC REPORT

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

A1	Chairman's statement <i>The year in summary</i>	PAGE 10
A2	Business model and strategy <i>An overview of what the Group does and the significant risks to which it is exposed</i>	PAGE 12
A3	Chief Executive's review <i>The financial and operational performance of the Group in the year</i>	PAGE 21
A4	Future prospects <i>How the Group is placed, looking forward</i>	PAGE 46
A5	Corporate responsibility <i>The Group's impact on its employees, the environment and the community, including non-financial reporting</i>	PAGE 49

A1

CHAIRMAN'S STATEMENT



Fiona Clutterbuck
Chairman

Dear Shareholder

I have the pleasure of introducing my first Annual Report and Accounts as Chairman of Paragon Banking Group PLC, following a year which has seen growth in our major business lines, significant acquisitions and substantial fund-raising transactions. This represents continued progress in the Group's strategic development as a banking group deriving significant funding from retail deposits, while providing finance options for underserved UK customers.

The increasing volume of new business in the Group's Commercial Lending division has also progressed the asset diversification strategy. We continue to target investment and capital to support the Group's medium-term objective of improving net interest margin and cost efficiency, with increasing business volumes.

I hope you find this report useful in understanding our business and our progress in the year.

The business

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

The mortgage division continues to support professional landlords in the private rented sector, which remains an important part of the nation's housing provision.

During the year the acquisition of Titlestone in July accelerated the development of the Group's development finance offering, increasing our ability to provide funding, particularly to small and medium scale residential developers in the UK, an underserved sector of that market. The year has also seen the launch of the Group's first structured lending facilities, providing funding to specialist non-bank lenders.

Significant expenditure has been made in the development of the Group's business lines during 2018 and further investments are anticipated in the coming year.

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

Results

The growth in the Group's new origination flows, up 25.9% to £2,333.2 million, including loans made by the acquired businesses, contributed to an increase in underlying profit by 7.8% to £156.5 million excluding items such as the £28.0 million gain on sale of Idem Capital assets, which do not arise from the underlying operations of the business. Profit before tax on the statutory basis grew by 25.3% to £181.5 million. This led to underlying earnings per share ('EPS') increasing by 11.3% to 48.2 pence (2017: 43.3 pence) and statutory EPS increasing to 55.9 pence (2017: 43.1 pence). Underlying return on tangible equity reached 14.0% (2017: 13.5%), 16.1% on the statutory basis (2017: 13.4%).

Funding was enhanced with the growth of the Group's savings deposit base to £5.3 billion from £3.6 billion a year earlier, further utilisation of Bank of England facilities and a £435.3 million securitisation transaction.

The Group's capital position remains strong, with a regulatory Core Equity Tier 1 ('CET1') ratio of 13.8% (2017: 15.9%), representing a more efficient capital position.

The financial results and operational performance are reviewed in Section A3

Stakeholders

The Group is supportive of efforts across the corporate sector to enhance stakeholder engagement. The Group continues to support the Women in Finance initiative and published its first progress report in January 2018. We have also submitted data to the Hampton-Alexander review team. In March we published our gender pay gap under government rules for the first time and fully support the drive for greater workplace diversity.

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

Social responsibility issues are discussed in Section A5

Governance

I was appointed Chairman in the year, in succession to Bob Dench, after a rigorous and challenging process and am currently enjoying a detailed induction into all aspects of the Group's businesses. Following my appointment as Chairman, Peter Hartill and Hugo Tudor were appointed to replace me as Senior Independent Director and Remuneration Committee Chairman respectively, I look forward to working with the newly structured team going forward.

I would like to extend my personal thanks to my predecessor as Chairman, Bob Dench, for the important part he has played in the evolution of the Group over the last 14 years and the support he has given to me, and I also wish to express my gratitude to Alan Fletcher and Pat Newberry, who will step down from the Board in December.

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

The Group is committed to good corporate governance and we are currently reviewing the updated UK Corporate Governance Code 2018 and are confident that we are well placed for the introduction of the new code for the year ending 30 September 2020.

Corporate governance is discussed in Section B3

Risk

The corporate restructuring in September 2017 enabled the Group to consolidate a number of risk oversight and governance arrangements. The resulting changes have been embedded during the year, resulting in a more efficient and effective framework with which to manage the Group's key risks.

Particular focus has been given in the past year to enhancing the Group's cyber security and operational resilience capabilities, with additional investment in both systems and people. This will continue to be a key priority in future years. Data protection has been another key priority given the significance of the implementation of the General Data Protection Regulation in May 2018. Significant focus also continues to be given to the Group's preparations for the regulatory approval process for its IRB approach for credit risk.

The Risk Management report is set out in Section B6

Shareholder returns

The positive result for the year has enabled the Board to increase its dividend levels, in accordance with the policy previously announced. We have declared a final dividend for the year of 13.9 pence per share, bringing the dividend for the year to 19.4 pence per share, up 23.6% from the 15.7 pence declared for 2017, subject to shareholder approval. £25.0 million (excluding costs) has also been spent on the share buy-back programme. Each of these actions enhances returns for shareholders.

Conclusion

The year has been one of substantial development for the Group. The impact of the group restructuring in September 2017 has continued to work through the business, while the acquisitions and new product launches have contributed to changing the Group's profile. Despite the economic and political uncertainties facing the UK, including the lack of clarity surrounding Brexit, I remain confident that the strength of the Group's existing business, its development plans and its ability to respond to a changing environment, position us well to deliver strong growth and sustainable returns into the future.

Fiona Clutterbuck

Chairman

21 November 2018

A2

BUSINESS MODEL AND STRATEGY

A2.1 PARAGON OVERVIEW

Paragon is a specialist UK banking group. We create points of differentiation through a deep understanding of customer needs in our target markets whilst applying a cautious risk appetite. We have a largely centralised operating model that combines local specialism with central support and expertise and that benefits from a strong mobility of capital. This approach allows us to allocate our resources effectively in order to optimise the relationship between growth, risk and returns.

Following our internal reorganisation in September 2017, where the majority of our operations were brought under our bank subsidiary, we have undertaken two acquisitions within our Commercial Lending division and also disposed of a loan portfolio at a significant capital gain. The widening of the Group's activities, growth in established markets and recycling of capital to support this development will contribute to further diversification of income streams in the years ahead.

Growing

Originally known as one of the country's leading, independent buy-to-let lenders, the Group is growing its business by expanding into broader mortgage, commercial and consumer finance markets, focussed on specialist offerings for small or medium-sized enterprises ('SME') and individuals. Paragon is a significant participant in the UK's loan portfolio purchase market through its Idem Capital division, where it acquires, co-manages and services loan portfolios across a variety of asset classes.

Specialist

Through its long underwriting and account management experience, the Group has developed a deep expertise in broader data analytics, together with advanced risk and credit management capabilities. These strengths are complemented by a highly developed loan servicing function and through the cycle experience in its senior management team. It is this expertise that enables it to tailor lending products for specialist target markets and effectively manage complex loan portfolios.

Simple

The Group has a simple business model, underpinned by a focus on people and a commitment to a single set of values.

Income



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

Assets



To grow its income, the Group focusses on building its asset base by originating new loans, developing new products and acquiring loan portfolios.

Funding



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

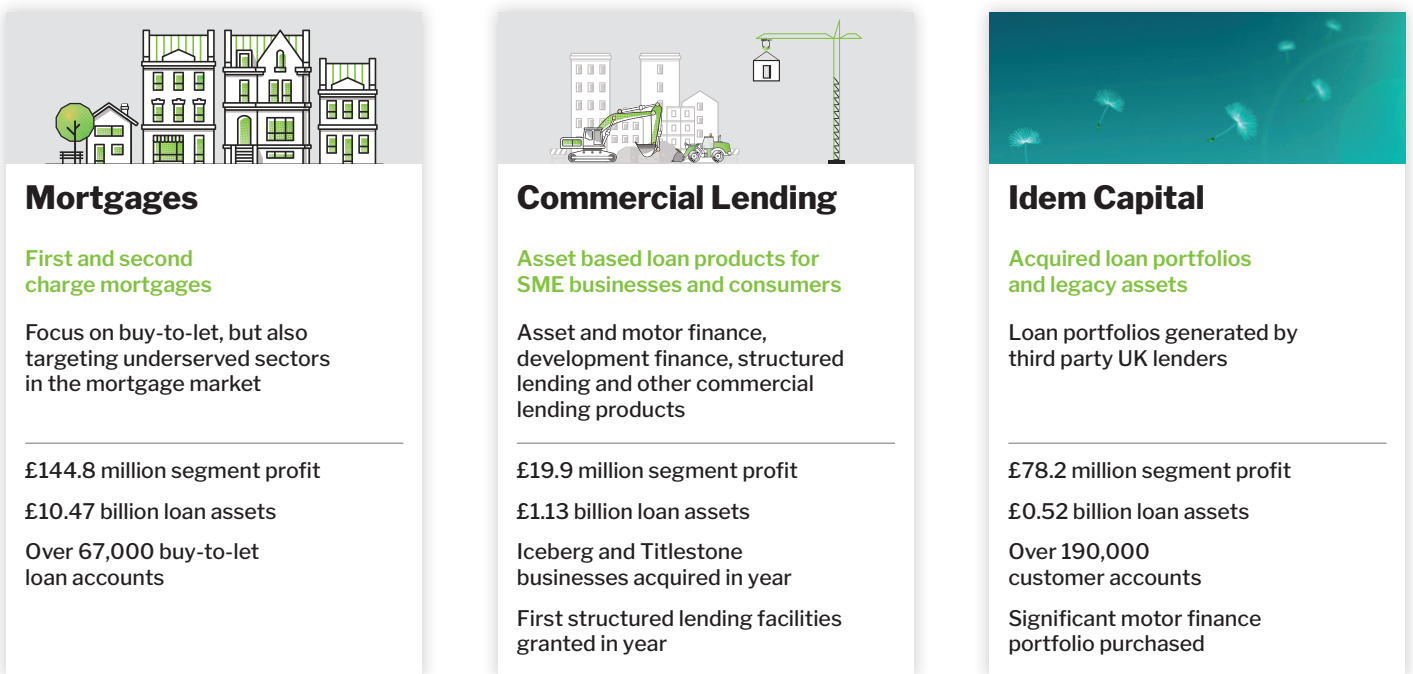
Profitability



Profitability is a key measure of success and the Group manages all aspects of its business closely to deliver sustainable and growing returns to its shareholders.

Operations

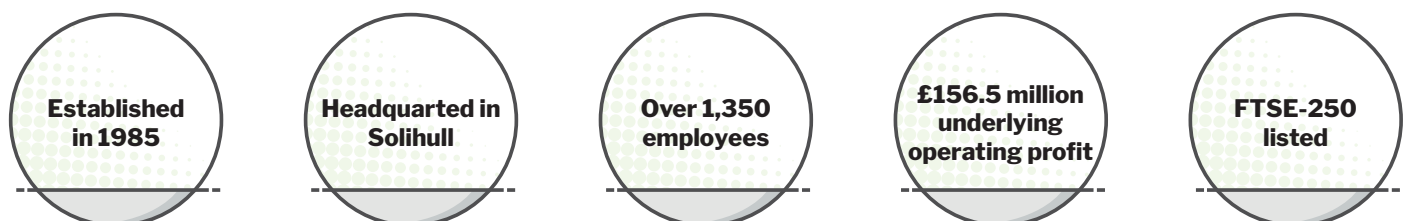
Paragon's operations are organised into three divisions, each with responsibility for achieving asset and profit growth, with new lending funded principally through an online personal savings operation. The three divisions are supported by the Group through the provision of capital to underpin growth and, where appropriate, with central services including loan servicing, marketing, information technology and legal support. The Group's central funding is provided by a mix of equity and corporate and retail bonds.



New lending principally financed from retail savings balances
 Over 135,000 savings customers
 Bank of England funding accessed

Segment profits are before net costs for central items of £61.4 million. Figures at 30 September 2018.

Paragon Banking Group Fast Facts



SUCCESS FACTORS

Key factors affecting the Group's ability to maintain and grow profits and enhance shareholder returns.

1.

Credit quality

Paragon is a conservative lender. When underwriting any new loan or portfolio purchase, the Group makes a detailed credit assessment of the customer and the strength of the underlying loan collateral to help minimise the risk of non-payment and portfolio losses.

Buy-to-let 3 months+ arrears

Paragon

0.11%

Buy-to-let industry average

0.42%

2.

Loan pricing

Paragon prices all new advances and portfolio purchases to be competitive and achieve an appropriate margin over funding costs, relative to risk.

Underlying net interest margin

2.21%

3.

Funding

The Group ensures that its loan assets are financed using appropriately dated and priced funding. It seeks to build a broad and diversified funding mix to underpin the business.

Retail deposit growth

46.5%

Rating upgrade to

BBB

TFS drawings

£944.4 million

Securitisation completed

£435.3 million

4.

Strong financial foundations

Efficient utilisation of the Group's conservative capital and debt positions, which rank among the strongest in the UK, give us material balance sheet capacity for further development.

Underlying RoTE

14.0%

CET1

13.8%

Total regulatory capital ratio

16.2%

UK leverage ratio

6.4%

5.

Diversity and development

The Group's people are at the heart of everything we do, and we understand the significance and value of building strong and diverse teams, with leaders from all backgrounds. Diversity is an important element of the Group's people strategy and we are proud to have signed the Women in Finance Charter as well as supporting the Hampton-Alexander initiative.

Employee attrition rate less than national average

16.1%

Engagement score

85%

Percentage of senior managers which are female

29%

6.

A customer-focussed culture

All the Group's employees share a common culture with a single set of core values. These values: fairness, integrity, respect, professionalism, teamwork, commitment, humour and creativity inform the way that we interact with our customers, our colleagues and our wider stakeholders. Importantly, Paragon's employees agree that customers are at the heart of our business and recognise the value of treating customers fairly.

88%

of employees feel the service we give to customers is improving

91%

of employees feel there are a clear and consistent set of values and behaviours that support the way we do business

84%

of employees feel the customer is at the heart of everything we do

Source : November 2017 employee survey.

7.

Effective loan servicing

Each loan is serviced to optimise retention and minimise the risk of non-payment. We also operate a specialist receiver of rent operation for buy-to-let cases.

465 million

pieces of customer data collected and analysed each month

Behavioural scoring models applied

8.

Cost control

The Group has a low cost:income ratio compared to its competitors and controls costs carefully to maintain this advantage. It operates mainly from a centralised location, maximising the potential for operating leverage. Loan products are distributed principally via third party brokers and savings deposits are collected online.

Underlying cost:income ratio

40.6%

Amounts above at 30 September 2018 (underlying – Appendix A)

MORTGAGES

WHAT WE DO

The Group offers first and second charge mortgage products with buy-to-let mortgage finance for landlords operating in the UK's Private Rented Sector ('PRS') being its largest market. Paragon was one of the first lenders to develop buy-to-let finance and, since 1996 the Group has originated or acquired just over £21.5 billion of buy-to-let accounts. It now provides 4.1% of all new buy-to-let mortgages in the UK.

The Group seeks to serve niche markets where its customer focussed approach to lending and its expertise in property valuation and risk assessment can differentiate it from its competitors.

MARKET DYNAMICS

Renting in the PRS is the second most common housing tenure in the UK today, after owner-occupation. Economic, social and demographic changes, together with the flexibility that renting provides, have all combined to make renting in the PRS an increasingly popular choice. Against a UK backdrop of limited house building, low investment in social housing and mortgage affordability constraints, tenant demand is expected to remain strong.

The owner-occupied mortgage market has become increasingly commoditised, leaving significant customer groups badly underserved.

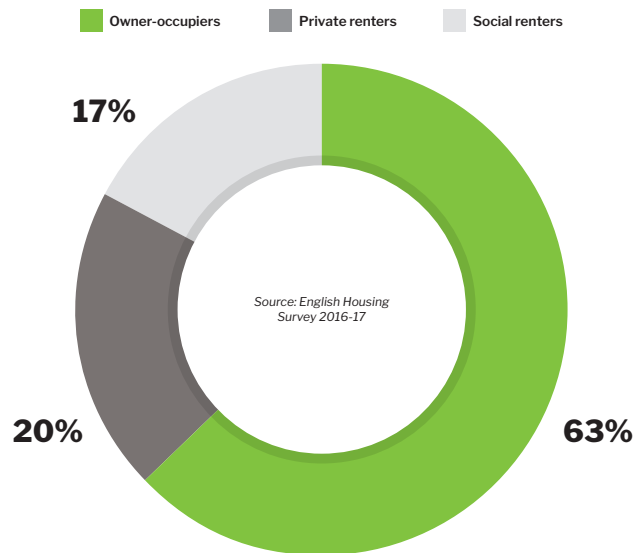
MARKET OUTLOOK

Reforms in the buy-to-let market have led to polarisation between professional landlords and others. The Group's established strength as a buy-to-let specialist has enabled it to establish a significant position in this part of the landlord market.

At the year end 87.8% of the buy-to-let pipeline was either with corporate or other complex landlord customers.

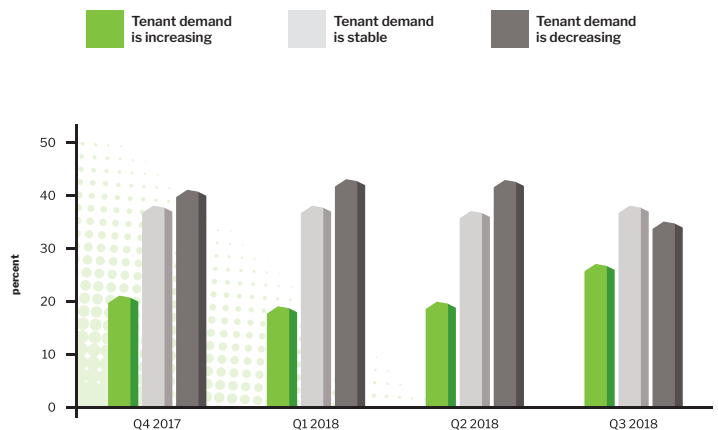
Housing tenure

The PRS makes up 20% of the English housing market



Strong demand for PRS property

Tenant demand - landlord perceptions



COMMERCIAL LENDING

WHAT WE DO

Building on the asset finance business acquired in 2015, the division offers asset and motor lease products to SME and smaller corporate customers and consumers, focussing on specialist assets and underserved markets.

It also funds small-scale property developments and provides structured lending facilities, offering senior debt facilities to non-bank lenders.

MARKET DYNAMICS

The Group aims to bring new competition and choice to UK SMEs and consumers. While the asset finance market is broad, most participants are focussed on specific asset classes or markets, providing the Group with opportunities to increase its presence through either organic growth or acquisition.

Small property developers have been identified as a significantly underserved market. The Group's acquisition of Titlestone in the year increases focus on this market.

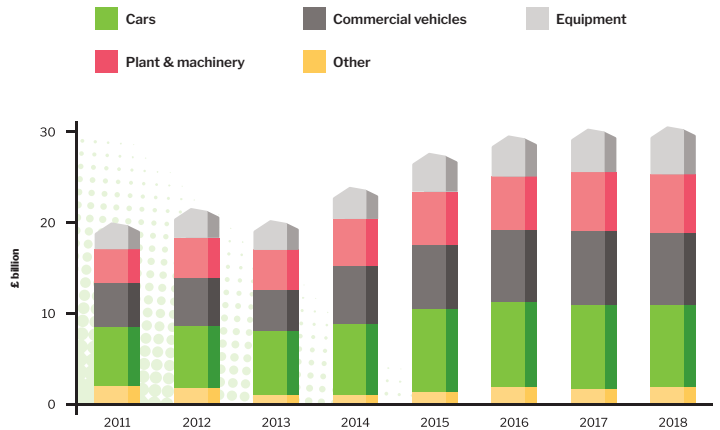
Access to finance for smaller UK corporates has been seen as constrained in recent years and the Group will continue to develop new offerings to address underserved markets.

MARKET OUTLOOK

The UK SME asset finance market is forecast to continue growing strongly while the motor finance market is expected to remain stable.

Housebuilding in England continues to lag behind the Government's target of 300,000 new homes per year. Our development finance proposition is aimed at SME housebuilders in order to fill this gap.

UK asset finance originations

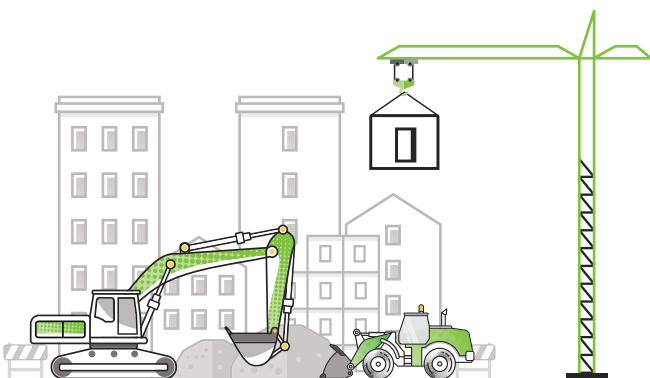


Source: Finance and Leasing Association

New homes completed



Source: MHCLG - House building: permanent dwellings completed



IDEM CAPITAL

WHAT WE DO

Idem Capital is a leading UK loan purchaser, acquiring and servicing portfolios, including finance leases, first and second mortgages as well as unsecured loan assets. In addition, it offers servicing of loan portfolios for clients including banks, private equity houses and specialist lenders.

MARKET DYNAMICS

Idem Capital acquires loan portfolios from banks that are either restructuring or refocussing their activities. It focusses on the acquisition and servicing of paying and semi-performing accounts. Idem Capital does not actively compete to acquire non-paying portfolios.

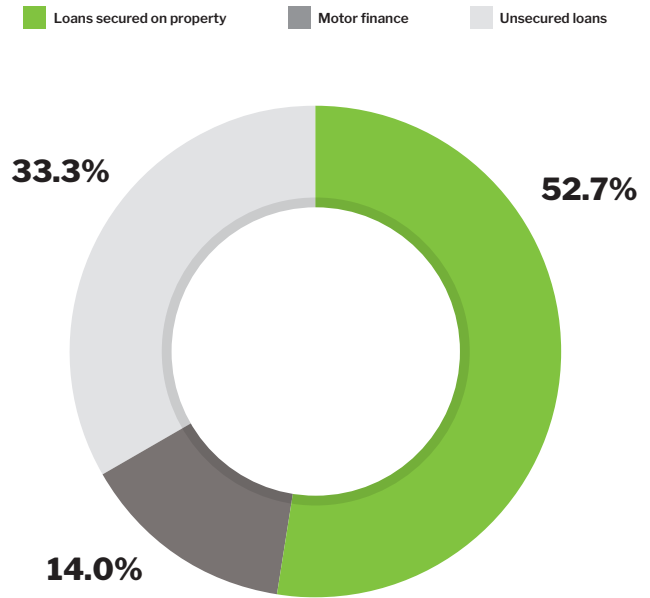
TREATING CUSTOMERS FAIRLY

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

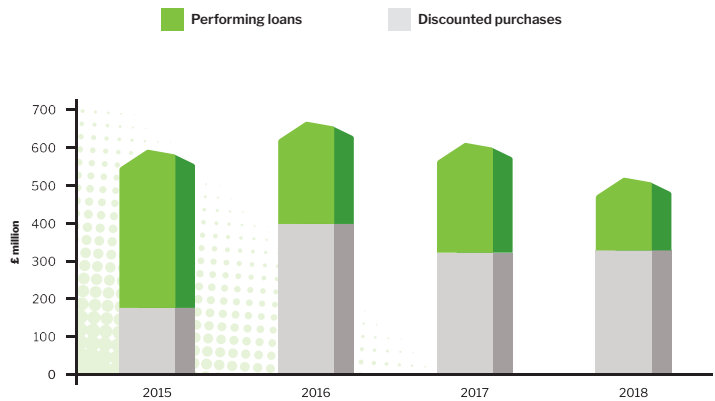
MARKET OUTLOOK

Idem Capital targets those portfolios where it can derive the most benefit from its core credit profiling and administration skills and focusses on disciplined analysis and evaluation of portfolio cash flows on potential acquisitions. It seeks to make purchases which will augment the Group's organic loan originations.

Idem Capital's loan portfolio by value



Shift towards performing loans



FUNDING

WHAT WE DO

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

MARKET DYNAMICS

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

CUSTOMER SATISFACTION

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

CENTRAL BANK FUNDING

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

WHOLESALE FUNDING

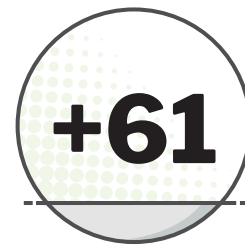
The Group has a core expertise in securitisation and other debt. £435.3 million raised in the year.

OUTLOOK

Retail deposit balances will continue to form the mainstay of the Group's funding, with the capacity to support significant balance sheet growth. Use of Bank of England facilities will be optimised. Securitisation and other wholesale debt markets will be accessed on a tactical basis, when appropriate.



90%
of customers opening a savings account would probably or definitely consider taking out another account



+61
Net promoter score for account opening



£435.3 million
Wholesale funding raised in the year

A2.2 PRINCIPAL RISKS

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

Category	Risk	Description
Business	Economic	The Group could be materially affected by a severe downturn in the UK economy, as its income is wholly derived from activities within the country. The likelihood of this occurring has become more difficult to forecast given the continuing material uncertainties as to the terms on which the UK will leave the European Union ('EU') in March 2019. A material downturn in economic performance could reduce demand for the Group's loan products, increase the number of customers that default on their loans and cause security asset values to fall.
	Concentration	The Group's business plans could be particularly affected by any material change in the operation of the UK private rented sector and / or further regulatory intervention to control buy-to-let lending.
	Transition	Failure to manage major internal reorganisations or integrate acquired businesses, such as Titlestone, safely and effectively could adversely affect the Group's business plans and damage its reputation.
Credit	Customer	Failure to target and underwrite credit decisions effectively could result in customers becoming less able to service debt, exposing the Group to unexpected material losses.
	Counterparty	Failure of an institution holding the Group's cash deposits or providing hedging facilities for risk mitigation could expose the Group to loss or liquidity issues.
Conduct	Fair outcomes	Failure to deliver fair outcomes for its customers could impact on the Group's reputation, its ability to meet its regulatory obligations and its financial performance.
Operational	People	Failure to attract or retain appropriately skilled key employees at all levels could impact upon the Group's ability to deliver its business plans and strategic objectives.
	Systems	The inability of the Group's systems to support its business operations effectively and / or guard against cyber security risks could result in reputational damage and financial loss.
	Regulation	Given the highly regulated sectors in which the Group operates, compliance failures or failures to respond effectively to new and emerging regulatory and legal developments could result in reputational damage and financial loss.
Liquidity and Capital	Funding	If access to funding became restricted, either through market movements or regulatory intervention, this could result in the scaling back or cessation of some business lines.
	Capital	Proposals by the Basel Committee on Banking Supervision ('BCBS') to change capital requirements for lending secured on residential property could have adverse financial implications for the Group.
Market	Interest rates	Reduction in margins between market lending and borrowing rates or mismatches in the Group balance sheet could impact profits.
Pension Obligation	Pensions	The obligation to support the Group's defined benefit pension plan might deplete resources.

The Group has considered and responded to all of these risks, mitigating the exposure as far as is practicable to ensure that its risk profile remains within the Board's stated risk appetite. These risks are discussed in more detail in Section B6.5.

A3

CHIEF EXECUTIVE'S REVIEW

A3.1 Strategy review

The past five years have seen the Group transition from being a monoline centralised lender to a diversified specialist banking group. This process has generated a closer alignment of the Group's cash and capital resources, facilitated growth and diversification, both organically and via acquisition, and accessed a broader and more stable funding base. Across this period the Group has improved returns to its shareholders and optimised its flexibility to recycle capital internally to support the needs of its growth businesses.

The past year has evidenced the strengths of this strategic approach, which will continue to drive the Group's development going forward.

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

We expect growth to remain strong in the future, with a focus on the delivery of our organic strategy being augmented by proposition expansion, where such developments provide an attractive risk profile and shareholder return.

During the year the activities of the Commercial Lending division have been strengthened by two acquisitions. Iceberg, completed in December 2017, expanded the Group's lending to professional firms and Titlestone, completed in July 2018, generated a step-change in the size and scope of the Group's development finance presence. Both acquisitions were funded by a combination of retail deposits and internally generated capital resources. Capital for the Titlestone purchase was also partly provided by a recycling of capital from Idem Capital, where a portfolio of loans was sold during the final quarter of 2018, generating a significant gain that has been separately identified in this year's accounts.

Alongside the strategic progress demonstrated in the year, the Group has delivered strong results for its shareholders. The table below summarises these on both a statutory and an underlying basis, the latter excluding the costs and benefits arising from the acquisitions and asset sales mentioned above which do not form part of the day-to-day activities of the Group. The underlying results, therefore, should provide greater clarity on the Group's operating performance.

	Statutory	Underlying (Appendix A)
Profit before tax	Up 25.3% to £181.5 million (2017: £144.8 million)	Up 7.8% to £156.5 million (2017: £145.2 million)
Basic EPS	Up 12.8 pence to 55.9 pence (2017: 43.1 pence)	Up 4.9 pence to 48.2 pence (2017: 43.3 pence)
RoTE	Up 2.7 pps to 16.1% (2017: 13.4%)	Up 0.5 pps to 14.0% (2017: 13.5%)



Nigel Terrington
Chief Executive

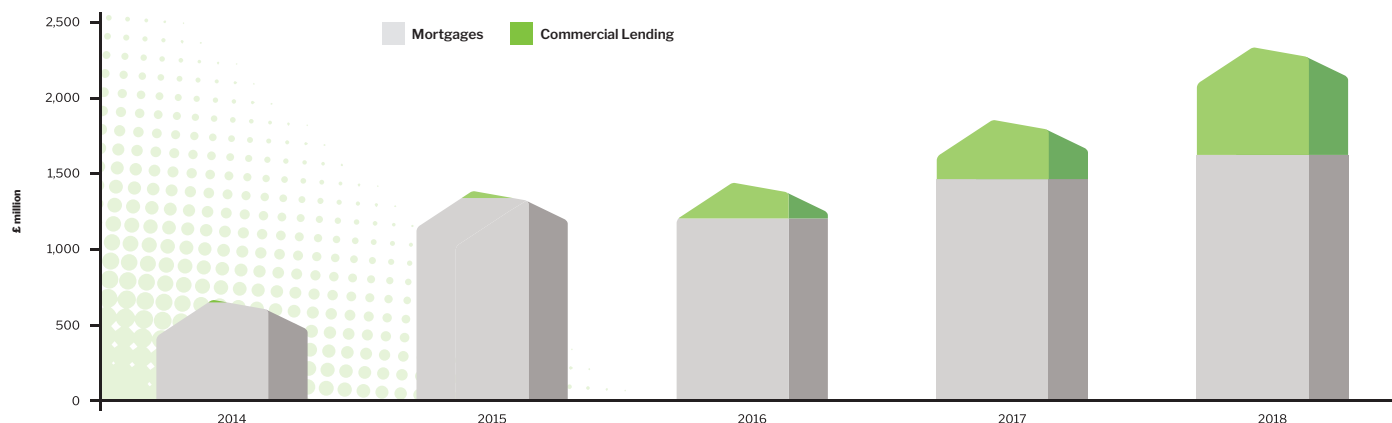
Lending

Strong and targeted growth in organic business volumes has been delivered during 2018. The scale of our Commercial Lending division has been supplemented by business acquisitions, while Idem Capital also completed a loan portfolio purchase transaction of commercial lending assets. Excluding the contribution from the acquired businesses, organic originations grew 18.1% to £2,188.6 million (2017: £1,853.4 million). Including post-acquisition lending from the acquired businesses, total lending increased by 25.9% to £2,333.2 million.

The scale of organic growth and the development of the commercial lending proposition over the past five years is demonstrated in the chart below.

Annual lending volumes by asset class (£m)

Year ended 30 September 2014-2018



The Group's largest business remains its buy-to-let franchise. The UK private rented sector continues to see strong levels of demand from tenants, which is expected to continue for the foreseeable future. The buy-to-let market has experienced a period of disruption following a series of fiscal and regulatory changes aimed at both landlords and lenders. Against this backdrop the Group's performance has remained strong, with over twenty years' experience of servicing the needs of professional landlords differentiating it from other lenders and allowing the business to make market share gains during the year. New buy-to-let origination levels increased by 6.8% from the previous year's level to £1,495.5 million in the year to September 2018 (2017: £1,399.9 million), with the Group's market share, as measured by the figures reported by UK Finance, increasing from 3.93% to 4.11%.

However, survey data suggests that the Group has a more material share of the professional landlord market. With this sector comprising approximately 23% of the market as a whole, the survey results indicate the Group's share of its target market was in the region of 14%.

The most recent regulatory changes in the buy-to-let market require lenders to collect and analyse more information about the landlord's property portfolio and wider business than has previously been common in the market. Consequently, some lenders have restricted their buy-to-let activity as a result of the increased demands of such a complex underwriting process. The Group's expertise in this particular market segment has positioned the business well to benefit from these changes and further increase its market share.

The Group's other mortgage businesses comprise its second mortgage activities, where new origination levels rose 17.3% to £71.2 million during the year (2017: £60.7 million) and a specialist residential lending operation, which remains in its pilot phase with distribution limited to a small number of brokers pending final product reviews and associated systems and process enhancements. New specialist residential volumes totalled £56.5 million during the year (2017: £3.9 million).

Further asset and income diversification is generated by the Group's Commercial Lending division. The division's asset finance activities have been transformed to service a broader mid-market range of SME customers, as opposed to restricting lending solely to the more limited niches originally serviced. Customer credit profiles are generally stronger in this larger sector, with margins commensurately lower. This strategy has resulted in higher new business volumes (up 61.2% on the year ended 2017 to £354.7 million in 2018, including £95.5 million generated by the acquired Iceberg operation).

The motor finance business also saw strong growth in 2018. Operating in the hire and lease purchase segments of the market (with no exposure to personal contract purchase products), new business origination grew by 48.3% to £177.9 million during the year (2017: £120.0 million).

The division's development finance operation was enhanced by the acquisition of Titlestone in the year, accelerating its expansion. This operation provides funding, principally to smaller property developers, and new drawings totalled £136.8 million (2017: £48.9 million), with £49.1 million of this arising in Titlestone.

The Group's structured lending unit, which provides lending solutions to non-bank financial institutions, agreed its first facilities in the year with three arrangements active by the year end. Drawings in the year were £40.6 million with a balance of £38.7 million by the year end. By the end of 2018 the business was operating at breakeven, with a positive contribution to Group profit expected in 2019.

The Group's portfolio purchase business, Idem Capital, is an established purchaser of loan portfolios. Gross purchases in 2018 were £83.4 million (2017: £98.0 million). The sector has proved increasingly popular for both specialist purchasers and credit funds in recent years, with available returns reducing accordingly. Idem Capital has retained its credit and pricing discipline across the past year, but as a consequence, current year activity has been focussed on augmenting the organic asset and motor finance advances made elsewhere in the Group through the purchase of such loans from other lenders.

Funding

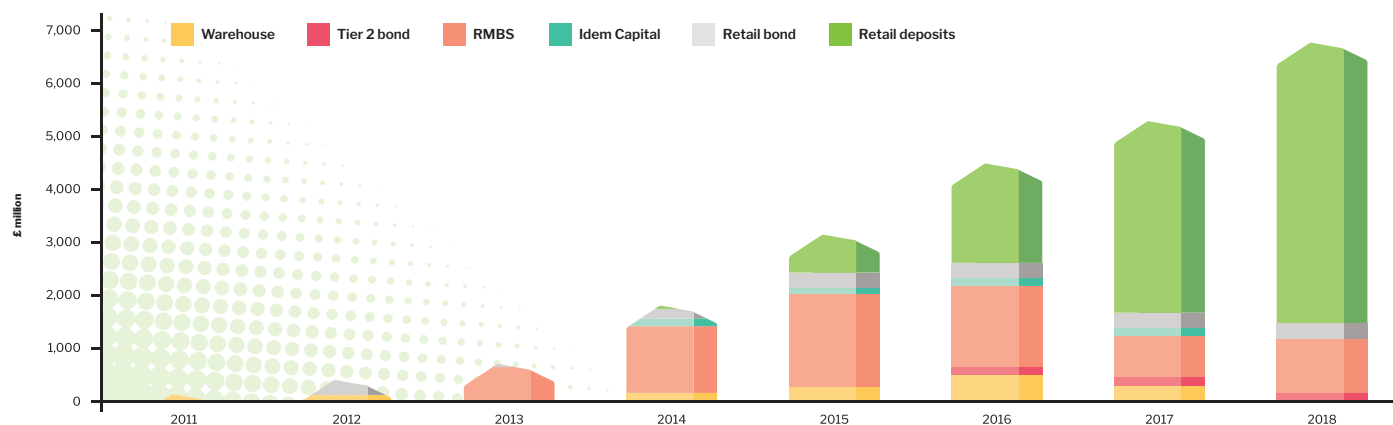
The Group continued to expand its retail deposit funding base and increased its access to Bank of England facilities during the year. At 30 September 2018, retail savings balances were £5.3 billion and the Term Funding Scheme ('TFS') and other central bank drawings totalled £1.0 billion, compared with savings deposits of £3.6 billion and £0.7 billion TFS drawings a year earlier. In addition to funding new advances, the Group refinanced a number of previously securitised or warehoused portfolios using retail deposits. Similar refinancing activity is expected over the coming years.

The Group also launched its first securitisation since 2015, raising £435.3 million through the Paragon Mortgages (No. 25) transaction.

The Group's funding has become increasingly diversified in the years following the financial crisis. This is illustrated by the chart below which shows, for each of the year ends since the Group re-entered the funding markets, the outstanding balance on post-2010 funding lines. Funding for pre-2010 balances is still primarily provided by securitisation funding arranged around the time of advance.

Post-2010 funding by type (£m)

30 September 2011-2018



Retail deposits represent the Group's primary source of funding for new lending, whilst securitisation is used as and when conditions in that market are attractive, as they were during the year, allowing the Group to maintain a diversified approach to its funding.

Capital

The Group's CET1 ratio was managed down to 13.8% in 2018 (2017: 15.9%), reflecting balance sheet growth, product diversification, acquisitions and higher distributions to shareholders through buy-backs and enhanced dividend levels. The Group's total capital ratio was 16.2% at September 2018 (2017: 18.7%).

Enhancing shareholder returns on a sustainable basis is a key objective for the Group and during the year underlying basic EPS increased by 11.3% (29.7% on the statutory basis). Following a reduction to a 2.75 times dividend cover ratio in 2017 the Group targeted a further reduction to 2.5 times in 2018. The dividend for the year of 19.4 pence reflects the new target, based on underlying performance, and has increased by 23.6% (2017: 15.7 pence).

The Group has adopted a formulaic approach to its interim dividend levels going forward, with the interim dividend per share from the 2018 interim being one half of the final dividend declared in the preceding period in normal circumstances.

The Group's share buy-back programme progressed in the year, with £25.2 million having been invested, enhancing shareholder returns, until the programme was suspended to reflect the capital requirements of the Titlestone acquisition. The Group is not anticipating a share buy-back in 2019, but will seek the normal shareholder approvals at its February 2019 Annual General Meeting ('AGM') to allow flexibility if conditions change and surplus capital becomes available.

The business remains well funded, strongly capitalised and effectively placed to continue to deliver long term, sustainable returns through its robust operating model. The Group is positioned to respond quickly to the challenges and to take advantage of the opportunities that will arise given changes in the broader operating environment.

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

Lending review	Funding review	Financial review	Operational review
Lending, performance and markets	Retail deposits, wholesale funding and capital management	Results for the year	People, risk and regulation

A3.2 Lending review

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

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

	Advances and investments in the year		Net loan balances at the year end	
	2018	2017	2018	2017
	£m	£m	£m	£m
Mortgages	1,623.2	1,464.5	10,473.5	9,953.9
Commercial Lending	710.0	388.9	1,133.2	558.8
Idem Capital	83.4	98.0	521.1	611.4
	2,416.6	1,951.4	12,127.8	11,124.1

The Group's loan book increased by 9.0% in the year, with new advances and investments 23.8% higher than in the previous financial year.

A3.2.1 Mortgages

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

Housing and mortgage market

The UK mortgage and housing market remains finely balanced and activity remains subdued, with this position having continued throughout the financial year. New mortgage approvals, reported by the Bank of England, in the year ended 30 September 2018, at £255.4 billion had increased by only 2.1% from the previous year, (2017: £250.1 billion), with remortgaging increasing by 9% and house purchase mortgages declining by 2%. This level of transactions remains some 30% below the 2007 peak in the market.

The Nationwide House Price Index reported annual growth of only 2.0%, similar to the 2.0% seen in 2017, with London seeing a decline in prices, although house prices there remain close to their 2007 peak. Growth has been at this level for the past eighteen months, with expectations of future increases remaining modest. The most recent Nationwide analysis forecasts an increase of only 1.0% over 2018 as a whole.

These market trends were supported by the latest survey data from the Royal Institution of Chartered Surveyors ('RICS') UK Residential Market Survey, which highlighted a lack of market momentum with market confidence drifting downwards, but with a mixed picture on house price expectations across the country.

For the mortgage industry, the interest rate environment, which is still low by historic levels despite recent rises, has led to benign credit conditions, with low arrears and a negligible level of forced sales. Overall the economic environment for the mortgage market currently appears both positive and sustainable.

The impact of a potential economic downturn, whether as a result of the Brexit process or otherwise, remains an area of focus across all lending markets. The Group seeks to mitigate its exposure to such conditions through a robust approach to property valuation, employing an experienced in-house property team who undertake around two thirds of valuations and conduct validation work on 100% of valuations performed by third party surveyors. The internally conducted surveys are subject to regular monitoring and the Risk and Compliance function includes qualified property risk resource. The weighted average loan to value ratio across the Group's first mortgage books at 66.0% (2017: 66.3%) (note 9) provides significant protection in the event of a future downturn.

Buy-to-let

The year has seen the buy-to-let mortgage market continuing to reshape following a period of sustained regulatory intervention. Following changes to tax and stamp duty affecting landlords, the Prudential Regulation Authority ('PRA') introduced new rules on the conduct of buy-to-let underwriting, which came into force partly in the 2017 financial year and partly at the start of the current period.

The regulatory changes were implemented in two phases:

- From 1 January 2017 the PRA imposed common standards for affordability testing in the buy to-let sector, similar, in principle, to the approach adopted by the Financial Conduct Authority ('FCA') for owner-occupied lending under the Mortgage Conduct of Business ('MCOB') rules
- From 1 October 2017, lenders were required to underwrite portfolio buy-to-let cases on a much more specialised basis, differentiating between portfolio and non-portfolio landlords, based on the number of properties owned with buy-to-let finance

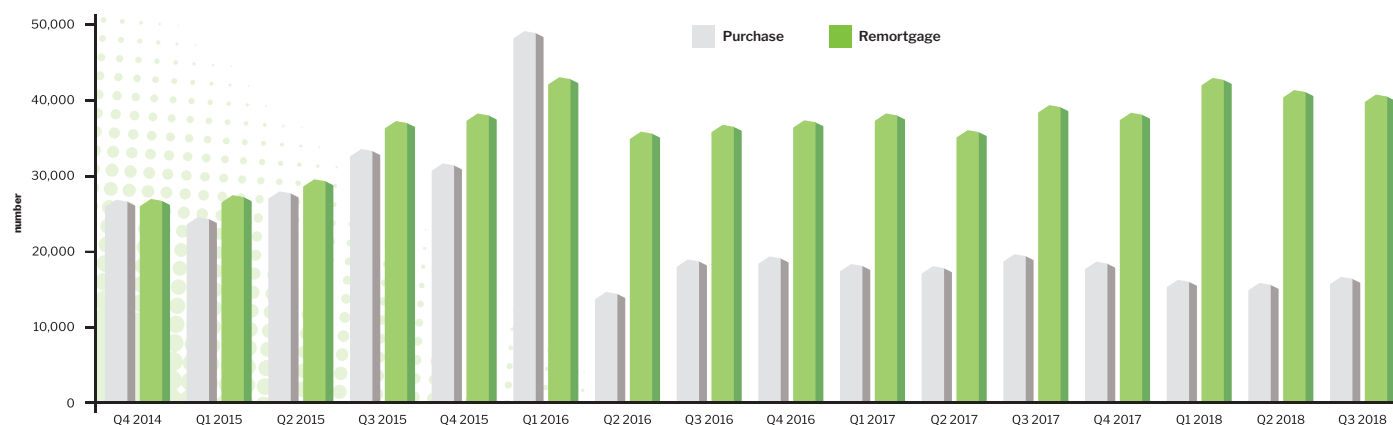
UK Finance ('UKF') reported that completions in the year ended 30 September 2018 were £36.4 billion, compared to £35.7 billion in the same period in 2017. Within this total, new lending for buy-to-let property purchases saw a decrease, from £9.9 billion to £8.8 billion. Remortgaging levels grew, from £24.6 billion in 2017 to £26.1 billion in 2018. However, with more customers choosing longer term fixed rate loans, the potential capacity for remortgage activity is expected to reduce in the medium term.

Almost all new buy-to-let lending continues to be at initially fixed rates, but the preference for longer fixed periods, driven by customer expectations of interest rate rises to come, has been one of the most significant market trends over recent years, with 49% of market-wide completions in September 2018 having a five year fixed term or longer, compared to around 40% of the September 2017 completions and around 20% of completions a year earlier.

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

Number of new buy-to-let mortgages

UKF



Activity in the market supports the Group's analysis of the likely impact of the regulatory changes, with clear evidence of a polarisation of the landlord population between portfolio landlords and those with single properties. The proportion of portfolio landlords operating through corporate structures has also continued to increase.

In response to this, the positions of the lenders active in the market have also become more clearly defined, with some major lenders, including some of the largest, not offering a portfolio landlord proposition, some addressing portfolio landlords only in a limited way and a smaller group of specialised lenders, including the Group, offering a full range of products. This has been driven by the availability of experienced resource, system and process capability.

Overall the Group considers these changes to be positive, with a more sharply focussed class of buy-to-let landlords emerging. These should be motivated to provide a better service to tenants and their funding requirements are a good match for the products offered by the Group, providing an opportunity for the Group to grow its market share, albeit in a potentially smaller market.

The impact of these, and previous, changes on the lettings market is less easy to determine at this stage. The tenure distribution of households remained stable in the latest English Housing Survey 2016-17, with the private rented sector continuing to house 20% of all households. The September 2018 RICS UK Residential Market Survey reports increasing tenant demand against lower levels of landlord instructions, creating upward pressure on rents, which RICS expects will increase by over 2% in the current year, accelerating to a rate of 3.5% per annum over the next five years. This should have a positive impact on affordability for buy-to-let landlords.

Lending activity

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

	2018	2017
	£m	£m
First charge buy-to-let	1,495.5	1,399.9
First charge owner-occupied	56.5	3.9
Second charge	71.2	60.7
	1,623.2	1,464.5

Total mortgage lending in the Group increased by 10.8% in the year. The majority of this increase arose from the division's core buy-to-let products, but other mortgage offerings also contributed.

Buy-to-let

The Group's buy-to-let lending increased by 6.8% year on year, despite the disruption in the market described above and the consequent pressure on volumes. The pipeline of buy-to-let loans in process at the year end was £778.9 million, an increase of 28.9% on the position a year earlier (2017: £604.2 million).

The changes in the way in which buy-to-let landlords are addressing the market, driven by the recent regulatory changes, can be seen in the analysis of the Group's new buy-to-let lending by customer type, compared to the previous year. In the table below corporate customers are those operating through limited companies. Other complex customers are non-corporate customers with portfolios of four properties or more or with specialist properties.

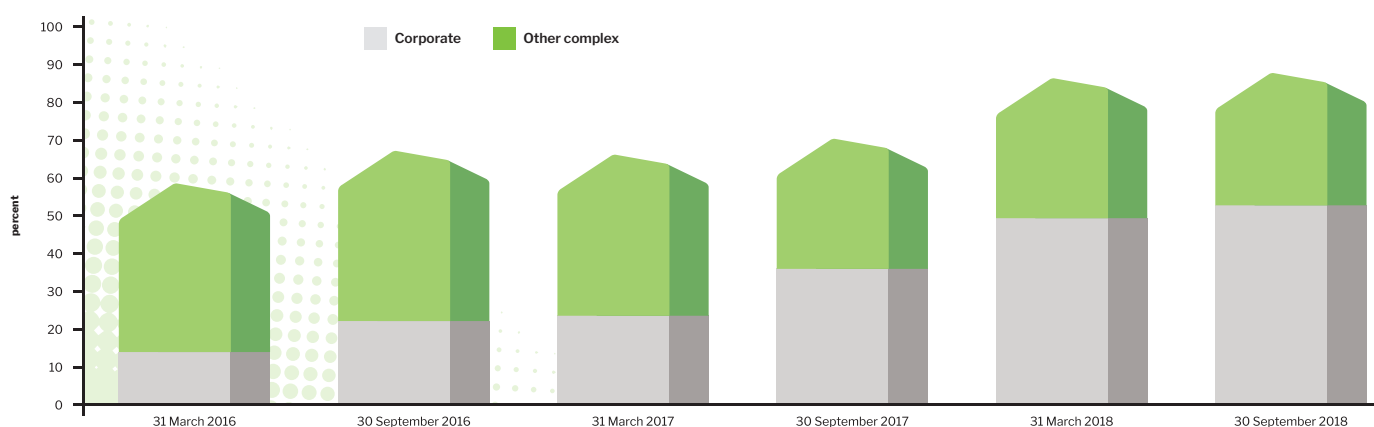
	30 September 2018 £m	30 September 2018 %	30 September 2017 £m	30 September 2017 %
Buy-to-let advances				
Corporate customers	656.7	43.9%	293.5	21.0%
Other complex customers	528.8	35.4%	609.4	43.5%
Total corporate and complex	1,185.5	79.3%	902.9	64.5%
Non-complex customers	310.0	20.7%	497.0	35.5%
	1,495.5	100.0%	1,399.9	100.0%

These advances showed the impact on the Group's business of the concentration of buy-to-let activity among more professional investors, many operating through corporate structures. This trend is set to continue into the next financial year, with 87.8% of pipeline cases being either corporate or complex (2017: 70.4%).

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

Percentage of complex pipeline cases

Number outstanding at date



In common with the wider buy-to-let market, the Group has seen a significant increase in customer preference for new buy-to-let mortgage loans which have an initial fixed rate period of five years, rather than the shorter terms typically chosen previously. The proportion of five-year products, by number, in the Group's new buy-to-let lending, at 72.9% had increased significantly since last year (2017: 50.8%). This should increase the stability of the Group's balance sheet going forward, with longer-dated product maturities supporting higher growth rates in the loan portfolio in the medium term.

Other mortgage lending

The Group's second charge mortgage lending has increased 17.3% during the year, but remains at modest levels. The second charge market is currently not large, with total lending of £1,031 million in the financial year reported by the Finance and Leasing Association ('FLA') little changed from the previous year (2017: £1,003 million). A significant part of this total does not fall within the Group's risk appetite and the Group seeks to target only that population of customers with the strongest credit quality in this area, avoiding any form of sub-prime business, which necessarily limits the addressable market.

The Group continued to develop its offering in specialist sectors of the owner-occupied mortgage market during the period. This lending remains in a pilot phase, with it yet to be established whether a sufficiently large opportunity exists which would generate satisfactory returns at acceptable risk levels.

Performance

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

	30 September 2018	30 September 2017
	£m	£m
<i>Post-2010 assets</i>		
First charge buy-to-let	4,481.8	3,661.1
First charge owner-occupied	59.4	3.9
Second charge	141.3	98.4
	4,682.5	3,763.4
<i>Legacy assets</i>		
First charge buy-to-let	5,779.8	6,175.4
First charge owner-occupied	11.2	15.1
	10,473.5	9,953.9

At 30 September 2018 the balance on the Group's mortgage portfolio was 5.2% higher than a year earlier, with the post-2010 buy-to-let book having grown by 22.4%.

The annualised redemption rate on post-2010 buy-to-let mortgage assets at 16.7% (2017: 22.7%), has reduced from the high level seen in 2017, reflecting both the profile of product maturities and the changing focus towards complex landlord customers. The annualised redemption rate on pre-crisis lending, at 6.0%, is the same as that seen in the year ended 30 September 2017, reflecting the properties of those loans relative to current market offerings.

The redemption rate was also reduced by greater numbers of the Group's customers opting to re-fix their loans during the period, rather than redeem and refinance elsewhere. This affected both customers on products which reached the end of their initial fixed rates and also on those already on reversionary rates. This process was enhanced by systems developments to make the process as easy as possible for customers. While the Group earns a smaller margin on these switch products, the customers should then stay with the Group for a longer period on their new fixed rates, offsetting the reduction in margin over the medium term.

Arrears on the buy-to-let book as a whole have marginally increased in the year to 0.11% (2017: 0.08%), with arrears on post-2010 lending standing at 0.01% (2017: 0.02%). These arrears remain very low compared to the national buy-to-let market, with UKF reporting arrears of 0.42% across the buy-to-let sector at 30 September 2018 (2017: 0.45%). This exemplary performance reflects the Group's focus in underwriting on the credit quality and financial capability of its customers, underpinned by a detailed and thorough assessment of the value and suitability of the property as security.

Second charge arrears increased to 0.21% from 0.06% in the year, as the book began to season, with performance remaining strong, while the new residential lending has yet to see any arrears, although the loans are still comparatively unseasoned.

The Group's receiver of rent process for buy-to-let assets helps to reduce the level of losses by giving direct access to the rental flows from the underlying properties, while allowing tenants to stay in their homes. At the year end 770 properties were managed by a receiver on the customer's behalf, a reduction of 6.2% since 2017 (2017: 821 properties) as cases on the old book resolve and post-2010 cases perform well.

Outlook

Looking forward, the Group's mortgage business is strongly positioned as a specialist participant in a market which is still restructuring following fiscal and regulatory change. Its focus on specific customer requirements is key to growing volumes and enhancing earnings.

An important part of the division's strategy going forward will be to continue to enhance systems to improve the experience of customers and brokers. This will include increasing opportunities for customer 'self-service' and more direct system links to major brokers.

The business is well placed to withstand potential instability in the UK economy, with its strong credit standards and robust assessment of security condition and value affording it a high degree of protection. Average loan-to-value ratios on new buy-to-let lending were 71.8% for the year ended 30 September 2018, with stressed affordability levels in line with or above the PRA requirements. Continued strong rental demand and good affordability suggests the Group's customers will be resilient in the face of anticipated rate rises or broader economic uncertainty. Exposure on owner-occupied lending is low, and the risk position on second charge lending has been carefully managed.

Overall the Group supports the provision of housing in the UK in a controlled and sustainable way, and through its relationships with landlords and trade bodies seeks to promote higher standards in the private rented sector.

A3.2.2 Commercial Lending

The Group's Commercial Lending division brings together a number of streams of mostly asset backed lending to, or through, commercial organisations. The principal customer focus of the division is on lending to SME and mid-sized corporate customers, which is an important differentiator from the rest of the Group's business.

During the year the Commercial Lending division significantly broadened its activities. The acquisition of Titlestone added substantial volume and capacity to the division's development finance unit, the acquisition of Iceberg expanded short-term business lending and the new structured lending offering was launched in the year.

The asset finance market in the UK is substantial, covering some £75.1 billion of outstanding balances at 30 September 2018 (2017: £74.7 billion) and £32.1 billion of advances in the year then ended (2017: £31.2 billion). It is the Group's strategy to target niches within this market where its particular skill sets can be best applied, and its capital effectively deployed to optimise the relationship between growth, risk and return.

Examples of such niches are the financing of waste collection vehicles for local authorities, construction equipment and complex veterinary equipment. Outside the leasing market the division also has niche offerings providing other forms of funding, generally to SME businesses.

Access to customers is generally through specialist brokers, including the Group's in-house brokerage, Premier Asset Finance ('Premier'), or equipment suppliers and the markets in which the division operates tend to be fragmentary, with different brokers focussed on different asset types.

The common themes of these diverse business lines are a reliance on understanding and engaging with the customer and the valuation of any security, together with expertise in collections and security realisation. 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. The division relies heavily on specialist teams to address the separate business lines, either sourced externally or internally developed.

Acquisition of Titlestone

During July 2018 the Group acquired the entire share capital of Titlestone Property Services Limited and a portfolio of loan assets from its related companies (together 'Titlestone'). Titlestone provide development finance loans to smaller property developers, a field in which the Group already had a presence. The acquired loan portfolio was valued at £227.4 million, but there were no other significant tangible assets in the acquired business. The consideration paid was £274.3 million in cash (note 15).

The addition of the Titlestone team to the Group's existing development finance unit offers the opportunity for the Group to reach critical mass in this market much more swiftly than would be possible through purely organic growth, and the team's network of relationships with developers, brokers and other professionals will provide a solid foundation for the further expansion of this business.

Following the acquisition, the Titlestone and Paragon teams were merged and the business rebranded as Paragon Development Finance. The Group's strategic objective is to expand its lending to cover a larger part of the UK as the Titlestone business, in common with the Group's initial development finance offering, was focussed on the South East of England and the Group sees additional promising opportunities outside this area.

The combined operation is focussed primarily on smaller residential developments, where assets are likely to be more liquid and where demand is likely to be more resilient under economic stress. This area has also been identified as one where there is a shortage of available funding. It also aligns with the UK's public policy priority of increasing house building, where the Help to Buy scheme is acting to support prices of completed developments.

A project is currently taking place to integrate the new operation into the Group, which will continue into the new financial year. Progress so far has been encouraging and the acquired business has generated £49.1 million of new lending since acquisition. The Group is confident that this business will form a significant and profitable part of the division's activity in future periods.

Acquisition of Iceberg

During December 2017 the Group acquired the assets and business of Iceberg, a specialist broker and lender, which had previously operated through two limited liability partnerships (note 14). Iceberg focusses principally on short-term unsecured business funding for professionals such as solicitors and accountants and, through solicitors, in lending to parties in inheritance and matrimonial proceedings based upon the strength of their prospects. The consideration paid was £6.8 million in cash, with deferred consideration of up to £13.0 million payable, dependent upon performance.

The combination of the market intelligence and contacts in the Iceberg business with the Group's funding capabilities is expected to create additional value in the asset finance business over time, adding higher lending volumes to this specialist product set.

At acquisition Iceberg was acting as a broker, passing on the majority of its originations for funding by other lenders. Access to Group funding will enable the value of the Iceberg loan portfolio to grow over time with a consequent increase in revenues and contribution.

Loan balances of £2.0 million were acquired with the business and, by 30 September 2018, there were £32.9 million of Iceberg generated assets on the Group's balance sheet. Advances in the nine months since acquisition were £95.5 million.

The process of integrating the Iceberg operations with those of the Group continues. Progress in the first nine months has been good and the prospects for future benefits from the acquisition are encouraging.

Lending activity

The division's SME customer base has had a broadly stable year with no indications of a Brexit impact so far, however recent surveys indicate nervousness going forward, which may start to impact on the investment decisions of small and medium sized firms.

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

	2018	2018	2017
	£m	£m	£m
Asset finance – ongoing operations	259.2		
Asset finance - Iceberg	95.5		
Asset finance		354.7	220.0
Motor finance		177.9	120.0
Development finance - ongoing	87.7		
Development finance - Titlestone	49.1		
Development finance		136.8	48.9
Structured lending		40.6	-
		710.0	388.9

The asset finance business has seen a 17.8% like-for-like growth in the period as the business continues to develop following strategic changes introduced over the past two years. Including Iceberg, the value of new lending in the book was up 61.2%. This result is significantly in excess of the guidance of £0.6 billion given at the half year, even excluding the Titlestone business. Significantly, the developments in the year have led to greater diversity in 2018's advances than was seen in 2017, in line with the Group's strategy.

The asset finance business has remained competitive in its core 'hard asset' (ie construction equipment) market despite pricing pressure from new entrants. It has maintained its focus on margins and sought to support its business levels through good customer relationships and service standards.

Asset finance advances include the Group's first aviation loans, where £12.4 million was outstanding at the year end, and although the operation is still in its early stages, the credit quality of customers is good. This business provides a good example of the niche focus employed by the Group within the wider asset finance space.

The asset finance business also made a significant investment in assets for hire under operating leases, both term and spot, acquiring £19.3 million of assets to generate future income (2017: £12.9 million). Following the last two years of investment, net operating lease income increased by 26.7% to £3.8 million for the year (2017: £3.0 million).

This growth has taken place against a backdrop of aggressive competition in the market and continuing economic nervousness in UK industry, leading to some reluctance by SMEs to take on new finance commitments, especially longer-term arrangements, at least until the UK's future trading relationship with Europe becomes clearer.

The motor finance business continues to develop with a 48.3% increase in new lending. Product offerings remain carefully targeted to avoid riskier and mass market sectors and the Group has no exposure to personal contract purchase and similar product types which have caused concern to commentators and regulators during the year. The business addresses specialist propositions in the motor finance market where distinctive products can generate appealing returns and make effective use of the Group's capital. This includes funding less mainstream vehicle types, such as light commercial vehicles and motorhomes. The current rate of growth is expected to moderate as the business becomes more mature, with the specialist segment of the market always being limited to some degree.

The Group's organically grown development finance business provided funding for small-scale property developments with an average facility size of around £2.0 million, a significantly underserved market. Advances grew by 79.3% in the year as the business expanded into new areas of the country including Yorkshire and the Midlands. This experience served to confirm the viability of the business stream and provided support to the decision to acquire Titlestone in July 2018. Post-acquisition the larger development finance business presents a significant growth opportunity, with undrawn facilities and pipeline commitments of £366.7 million providing a springboard for the start of the new financial year.

During the second half of the year, the first of the Group's structured lending facilities, with Liberis, the business cash flow lender, went live. This was followed by a further two facilities during the year with more scheduled to complete after the year end. Initial returns appear promising, with the team building a good relationship in the market place.

The structured lending unit provides senior debt to the UK non-bank lending market and deploys loans to help support 'best-in-class' businesses working across consumer and commercial lending. Transactions are secured on underlying assets and structured using established robust methodologies. The business addresses certain segments where the Group may be under-weight or has no exposure at all and where working with a recognised industry expert is preferable to organic expansion. Outstanding facilities at 30 September 2018 have reached £52.5 million, of which £38.7 million had been drawn at the year end.

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

Performance

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

	30 September 2018	30 September 2017
	£m	£m
Asset finance	403.4	323.6
Motor finance	256.6	163.0
Development finance	352.8	42.3
Structured lending	38.7	-
Invoice factoring	21.8	14.8
Professions finance	42.6	1.4
Unsecured business lending	13.1	9.0
Other loans	4.2	4.7
	1,133.2	558.8

Professions finance includes Iceberg assets and similar assets generated in the ongoing business.

Margins in the segment have remained strong but have reflected both the changing business mix and the strategic repositioning of the asset finance operations to address the larger, higher quality but lower margin mid-range segment of the asset finance market.

Arrears on the segment's business remain low with arrears in the asset finance business at 0.78% and motor finance at 0.93% (2017: 0.97% and 0.56% respectively), comparable to those in the wider sector, with the FLA reporting average arrears for asset finance at 0.70% and car finance at 2.50% at 30 September 2018 (2017: 0.60% and 2.20%).

Credit quality in both the organic and acquired development finance books has been good, and the overall performance of the projects has been in line with expectations. These accounts are monitored on a case-by-case basis by the Credit Risk function. At 30 September 2018 no accounts had been identified by the monitoring process as being likely to result in a loss, beyond a small number of Titlestone accounts identified on acquisition and allowed for in the purchase price. The average loan to gross development value for the portfolio at the year end, a measure of security cover, was 63.2% (2017: 60.6%). This increase reflects the initially cautious launch of the product in 2017 and the mix effect from the acquired portfolio.

Overall the charge for impairment in the segment was £2.0 million (2017: £0.1 million), which remains low relative to the book size.

Outlook

The Group's intention is to continue to develop its businesses, selectively focussing on those areas where the greatest return can be achieved. This will involve both increasing the reach of its existing offerings and adding further product lines or specialisms, to improve the diversity of its loan book. It will also prioritise maintaining margins and customer relationships in the existing books. The division seeks to be responsive and flexible in addressing the market, but its UK focus means that it is exposed to a downturn in investment amongst UK business as a whole.

The coming year will see the continuation of the integration of the Group's development finance operations and the geographical expansion of the proposition within the UK. The continued growth of the aviation finance and structured lending products is also anticipated. A particular priority will be the on-going integration of the acquired operations into the division.

Overall the division has a good platform on which to build and increasing scale and diversity will enable a better return to be generated from its resources, control framework and investments in systems.

A3.2.3 Idem Capital

The Group's Idem Capital division includes its acquired loan portfolios, together with its pre-2010 legacy consumer accounts.

Idem Capital has a strong capability in loan administration and an ability to self-develop systems, allowing it to respond to regulatory developments and more specialised portfolio requirements. Unlike many market participants, Idem Capital is able to deploy securitisation and particularly retail funding to support its investment.

The division's focus is on acquiring portfolios where it can enhance value through its collections process and access to funding, and which will augment the organic origination activities of the Group. It uses its analytical skills base, which it sees as a core differentiator, to identify and evaluate portfolios brought to market against these criteria. Its principal area of focus over recent years has been on portfolios of UK paying secured and unsecured consumer finance balances, but it has the capability to leverage Group expertise in other asset classes which was used in the year.

It is also willing to consider transactions, deal by deal, on a partnership basis, having acted as a co-investor, servicer or both in various deals in the past. All opportunities are considered.

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

Lending activity

Towards the end of the year the Group completed a £83.4 million portfolio purchase of primarily motor finance receivables. The loans, acquired from a UK bank, were predominantly performing, asset-backed, UK loans and have been successfully migrated on to the Group's systems where they will be managed through their normal contractual lives. This was the sole purchase in the year and represents Idem Capital's first purchase outside its traditional target areas of secured and unsecured consumer loans, providing an excellent example of the division acquiring portfolios of recently originated and performing loans to complement the Group's broader new business flows.

The portfolio purchase market has continued to be busy with a large number of participants bidding on transactions. The operation participated in all of the significant bid processes in its target asset classes, including some very large transactions, but market pricing has generally been aggressive and has driven up bidding on some transactions beyond levels where the Group considers them to be capable of achieving satisfactory return levels within its risk appetite. Activity in the asset sales market tends to be 'lumpy' and the Group's level of investment in any period will reflect the number, type and quality of portfolios offered, together with the levels of return other market participants are willing to accept.

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

The Group completed a disposal of assets with a carrying value of £54.7 million in the final quarter of the year, realising a profit of £28.0 million against book value. The Group took the decision to crystallise the opportunity presented by a strong market price for the assets sold to realise a capital gain and to recycle this capital to support further growth in the commercial lending division, where the acquisition of Titlestone took place in the same quarter.

The sale also enabled the repayment of Idem Capital's external funding facility, incurring exit costs of £1.2 million, including break fees and accelerated amortisation of capital structuring costs.

Performance

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

	30 September	30 September
	2018	2017
	£m	£m
Second charge mortgage loans	274.6	392.3
Unsecured consumer loans	173.7	219.1
Motor finance	72.8	-
	521.1	611.4

The reduction in balances is a result of the scale of realisations from the brought forward consumer loan portfolios, together with the asset disposals in the year. This was offset, partially, by the motor finance portfolio acquisition.

120 month Estimated Remaining Collections ('ERC') on acquired consumer assets reduced from £688.8 million at 30 September 2017 to £489.6 million at the year end, for the same reasons. It should be noted, however, that as the motor finance portfolio acquired during the year was not acquired at a discount and valued on a cash flow basis, its future recoveries are not included in the ERC amounts.

Margins achieved by Idem Capital vary materially by portfolio and are also impacted by the strength of cash generation, particularly when this exceeds expectations for assets acquired at a discount. Where purchases are focussed on performing portfolios, the margin dynamics will more closely resemble those achieved by similar originated assets. The sale of loan balances during September will serve to accelerate this mix-led change in margin profile for the division.

Maintaining a high level of customer service is key to the success of Idem Capital and complaints and compliance issues in the acquired portfolios remained low in the period. Flows of redress cases, where the original lender is required to compensate the customer for conduct issues on acquired accounts, have increased in the period. It should be noted that the terms of loan acquisitions generally leave responsibility for pre-acquisition conduct issues, such as PPI, with the vendor, not the Group. The Group's recorded complaint levels, on the measures published by the Financial Ombudsman Service ('FOS'), remain very low with only 58 new complaints in the six months ended 30 June 2018, while the Group's overturn rate in the same period, where the ombudsman reversed the Group's decision, at 35%, is broadly in line with the 30% average for the industry. Operational improvements have continued to be made in systems, processes and employment patterns which are expected to generate efficiencies in future periods.

Arrears on the segment's secured lending business have improved to 15.8% (2017: 17.5%), the reduction arising from the sale of some of the poorer performing accounts in the year. These arrears levels remain higher than the average for the sector but this reflects the seasoning of the balances, which are mostly more than ten years old and the inclusion of accounts which are currently making full monthly payments, but had missed payments at some point in the past. Average arrears for secured lending of 9.4% at 30 September 2018 were reported by the FLA (2017: 11.2%).

None of the division's remaining portfolios at the year end were regarded as materially underperforming, with strong overall cash generation. The Group monitors actual cash receipts from acquired portfolios against those forecast in the evaluation which informed the purchase price. Up to 30 September 2018 such collections were 109.7% of those forecast to that point (2017: 109.3%).

Overall the segment had a credit for impairment of £0.1 million (2017: £1.5 million charge), representing the stable arrears position and the impact of improving house prices on secured provisioning.

Outlook

While the Group expects that flows of assets for disposal will continue to build, increasing economic uncertainty may restrict the scope for vendors and purchasers to arrive at mutually acceptable pricing, especially for unsecured assets and the flow of completed deals in the market may slow down.

The division's strategy in this market will continue to focus on transactions which are more idiosyncratic in nature and therefore make best use of its core skills in pricing, data, operations and account management in generating value, together with the purchase of portfolios of performing loans similar in nature to those being originated within the Group's Mortgages and Commercial Lending divisions.

The business will continue to maintain its detailed and disciplined approach to evaluating, pricing and bidding on portfolios, not compromising on margins and risk, ensuring that the Group's capital is appropriately deployed and thereby generating appropriate shareholder value.

The division is well placed to manage its assets going forward, and the refocus of the portfolio in the period should reduce credit exposures if economic conditions in the UK deteriorate.

A3.3 Funding review

Over the past five years the Group has transitioned from being entirely wholesale funded to its present broadly diversified funding model, focussed around its retail savings deposit flows.

A3.3.1 Debt and deposit funding

During the year, the Group continued its strategy of focussing its funding on its retail savings capability. However, having also optimised its use of central bank funding at attractive rates to support lending during the early part of the year, the Group completed a securitisation transaction in April 2018, taking advantage of strong investor demand and the attractive rates then available to structure its first deal since 2015. The growth of retail deposit funding flows also allowed the Group to reduce the amount of warehouse funding facilities required to support new lending during the year.

The Group's funding at 30 September 2018 is summarised as follows:

	2018	2017	2016
	£m	£m	£m
Retail deposit balances	5,296.6	3,615.4	1,873.9
Securitised and warehouse funding	6,490.3	7,781.8	9,947.1
Central bank facilities	1,024.4	700.0	-
Tier 2 and retail bonds	445.4	444.8	554.3
Total on balance sheet funding	13,256.7	12,542.0	12,375.3
Off balance sheet central bank facilities	108.7	109.0	108.8
	13,365.4	12,651.0	12,484.1

The Group actively prepares its interest rate exposure position for likely increases in UK interest rates indicated by Bank of England guidance. The risk of a downward movement in rates in recent years has been limited by an apparent absolute lower bound on market rates. This will cease to be the case as rates rise and this is addressed by the Group's treasury policy. The Group's funding and hedging policies are also influenced by the levels of longer-dated fixed rate products now being offered, and it is seeking where possible to increase the levels of maturity matching in its overall balance sheet position.

Retail funding

The Group's savings business provides customers with a range of deposit options, offering value for money and competitive rates, combined with the protection provided by the Financial Services Compensation Scheme ('FSCS'). The business currently sources all deposits through its website, with its strong repeat business and net promoter scores complemented by access to price comparison websites and recommendations from industry savings experts. The business model 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. At the end of the period 74.5% of deposits were term or notice accounts (2017: 83.3%).

Retail deposits continue to represent a reliable, cost-effective and scalable source of finance for the Group. As a consequence of the preference for retail funding in the Group's funding strategy, the volume of retail deposits has continued to grow significantly during the period, with balances at 30 September 2018, at £5,296.6 million, having increased by 46.5% over the year (2017: £3,615.4 million).

However, this represents only a small proportion of the UK savings market, with household savings balances reported by the Bank of England increasing by 4.9% in the year ended 30 September 2018 to £1,174.6 billion (2017: £1,119.2 billion), although these deposits remain overwhelmingly with clearing banks and building societies. The strong supply has helped to maintain the recent trend for low savings rates with the average annual interest on two-year fixed interest bonds, reported by the Bank of England, having increased from 1.26% in September 2017 to 1.42% in September 2018, with rates on one-year bonds increasing from 0.78% in September 2017 to 0.95% in September 2018, the increases being less than the base rate increases in the same period. It does not appear, therefore, that the closure of the TFS to new drawings in February 2018 has had any material impact on rates in the savings market although the trend of rates has been generally upwards.

New entrants to the banking market have adopted similar approaches to the savings market as the Group, and therefore competition for internet-sourced deposits is increasing. The level of competition forces the Group to remain competitive on pricing, products and service. Even so, rates may be influenced by the funding needs of other participants in the market, which are beyond the Group's control.

During the year the savings business has continued to develop to address these competitive challenges, with improvements to customers' ability to access their accounts, improved service from the website and enhanced opening hours of our telephone support group.

Savings balances at the year end are analysed below.

	Average interest rate		Average initial balance		Proportion of deposits	
	2018	2017	2018	2017	2018	2017
	%	%	£000	£000	%	%
Fixed rate deposits	1.94%	1.89%	19	24	68.8%	74.0%
Variable rate deposits	1.36%	1.21%	16	19	31.2%	26.0%
All balances	1.76%	1.71%	18	23	100.0%	100.0%

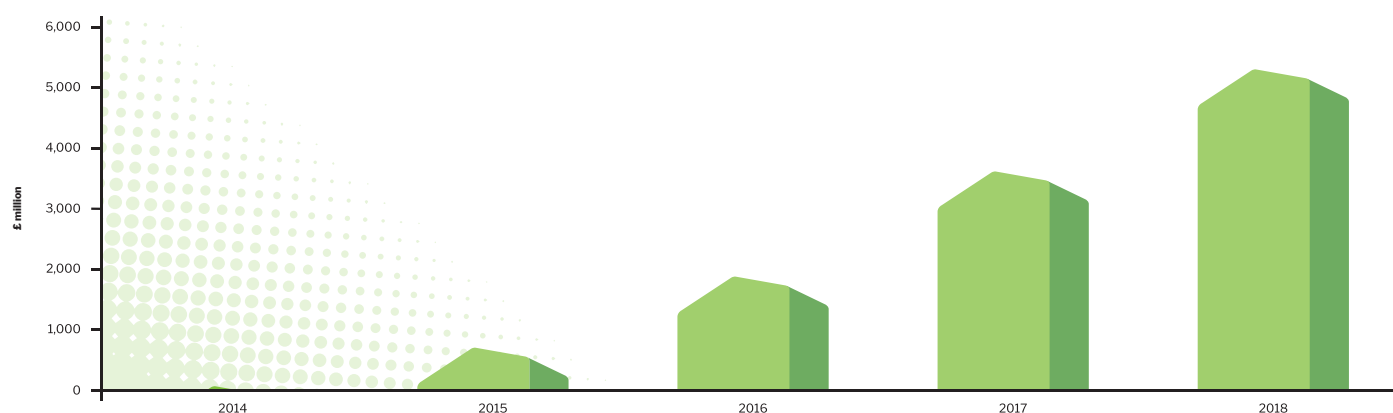
The average initial term of fixed rate deposits was 27 months (2017: 28 months).

The proportion of short term deposits (easy access and those available at three months' notice or less) has increased in the period to 30.3% (2017: 22.6%), representing £1,606.0 million of the balance (2017: £1,035.4 million). This has been driven by market requirements, as customer anticipation of rate rises in the near term leads to a preference for short-dated deposits.

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

Retail deposits (£m)

At 30 September 2014-2018



The Group's products, process and approach have been recognised in the industry and by customers and during the year it won the 'Best Monthly Interest Provider' award in the 2018 MoneyNet awards and was named as the 'Best Long-term Fixed Rate Cash ISA Provider' in the 2018 SavingsChampion.co.uk awards.

In customer feedback 90% 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 (2017: 87%). The net promoter score (the excess of positive over negative feedback per 100 respondents) in the same survey was +61, up from +59 for the 2017 financial year.

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 (2017: 89%) with a net promoter score at maturity of +50, up from +42 for the 2017 financial year. This performance is particularly valuable to the Group, given the benefits of customer, and deposit, retention.

The Group's outsourced administration platform continues to meet its needs and provides a cost-effective, stable and scalable solution in the medium to long term, with a new agreement having been signed in the period to provide longer-term security to this important commercial relationship.

In order to broaden the franchise and reduce dependence on price-comparison websites as a source of customers, the Group has been working to develop alternative routes to market, which are expected to be rolled out during the coming year. This includes the launch of the Group's savings products on the Hargreaves Landsdown Active Savings platform after the year end. It is also investigating potential new savings products and customer groups, in order to mitigate the pressure on rates which is imposed by the competitive market, and to ensure it manages its increasing levels of maturing retail balances effectively.

The size and diversity of the Group's deposit base is expected to continue to expand, forming the principal funding source for new lending activities. The guarantee provided by the FSCS scheme is likely to reduce the potential for an economic downturn to impact liquidity and the profile of the Group's target customers suggests that they are likely to be resilient in those circumstances.

Wholesale funding

The performance of the UK wholesale funding markets over the year has been mixed, with more activity than in recent periods, particularly following the cessation of the TFS. Pricing has, however, been subject to some volatility, being attractive in the early part of the year, while becoming more expensive again towards the end of the period, with increases driven by increasing UK inflation, concerns over international trade, the impact of uncertainty in Italy and a lack of clarity on the terms of the UK's exit from the EU.

The Group's strategic objective of creating a broader-based funding structure, coupled with the availability of attractively priced funding from the Bank of England during the first half of the period, has meant that its use of securitisation and similar funding tools is presently limited to those instances where a particularly compelling case can be made in terms of the tenor, cost and availability of the funding. As a result, the Group did not access the public securitisation market after November 2015 until April 2018, when Paragon Mortgages (No. 25) PLC ('PM25') was launched. This was the largest value and lowest interest margin transaction completed by the Group since 2007.

PM25, backed by a mixture of new and legacy buy-to-let mortgage assets, raised £435.3 million of external funding in sterling Mortgage Backed Floating Rate Notes. The senior notes were rated AAA by Fitch and Aaa by Moodys and bear interest at London Interbank Offered Rate ('LIBOR') plus a margin of 0.65%. The initial average rate on the external notes was 0.72% above LIBOR.

The transaction contained several novel features, which enhanced its value to the Group's funding strategy. It has the capacity to accept further loans, rather than repaying redemption monies immediately. This extends the expected life to five years, rather than four and makes the funding both more cost-effective and more suitable for the five-year fixed rate mortgage products which are becoming increasingly popular in the market. The deal also generated internally held rated notes which may either be sold later or used as collateral for Bank of England facilities, giving the Group significantly enhanced funding and liquidity options.

During the year the Group paid down two securitisation transactions, one funding legacy mortgages and one funding post-2010 mortgages. These assets were refinanced, principally with retail deposits, releasing significant cash balances for use elsewhere in the Group. After the year end notice was given on a further legacy mortgage transaction and the Group's remaining consumer finance transaction. Further such refinancing transactions should be expected over the coming years.

As a consequence of the increased focus on retail deposit funding, the Group's warehouse capacity, which had been used to fund buy-to-let mortgage originations, was rationalised, with the £550.0 million of capacity which existed at 30 September 2017 being closed out in the year. The Group recognises the benefit of wholesale warehouse funding to provide standby capability, particularly in the event of market disruption elsewhere, and as an alternative to retail deposit funding for liquidity purposes. Following the year end a new £200.0 million facility was agreed with Bank of America Merrill Lynch. With an interest rate of LIBOR plus 0.95%, this will provide a source of cost-effective standby funding.

The Group continues to regard wholesale and structured lending as an important part of its funding mix, but these markets will only be accessed where it is appropriate and cost effective to do so.

Central bank facilities

The Group has continued to access the funding facilities offered by the Bank of England, which provide flexible, low-cost collateralised loans designed to reinforce the transmission of low base rates to households and businesses.

The most significant of these facilities for the Group has been the TFS, which was available for new drawings until February 2018 and was used by the Group to support new lending. Drawings on this facility were made against the security of pools of mortgage loans. The interest cost of new TFS funding was very attractive, compared with either retail deposits or securitisation, and repayment is due four years after the drawing, in 2021/22. In common with many UK institutions, the Group made extensive use of the TFS up to its withdrawal and drawings by the scheme's closure had increased to £944.4 million, which remained in place at the year end (2017: £700.0 million), providing 7.1% of the Group's external funding. The Group also has access to the short term Indexed Long-Term Repo scheme ('ILTR'), which gives access to six-month liquidity from the Bank of England, secured against pre-positioned pools of assets.

The Group's liquidity drawdown under the Funding for Lending Scheme ('FLS'), which provides liquidity of £108.7 million (2017: £109.0 million) remained in place throughout the period. The terms of this facility are such that neither the drawing nor the liquidity provided appear on the Group's balance sheet.

The Group has also pre-positioned further mortgage loans and certain other assets with the Bank of England to act as collateral for further drawings on central bank funding lines, if and when required.

The Group will continue to access these facilities in future, as part of its overall funding framework.

Funding for Idem Capital assets

Idem Capital utilised retail deposit financing for its £83.4 million portfolio purchase in July 2018. This was made possible by the quality of the portfolio acquired, with the profile of the loans acquired more closely matching new motor and asset finance originations in the Commercial Lending segment and therefore meeting the Bank's risk appetite.

During the year Idem Capital has had a non-recourse funding facility with Citibank, which was used to fund assets from time to time. This facility was paid down in September 2018, when the loans it had funded were either sold or refinanced, more cost-effectively, with retail deposits. Idem Capital's strategic focus on better quality portfolios, which are more suitable for retail deposit funding, meant that the facility was less relevant to its on-going operations.

Certain legacy assets, principally second charge mortgage balances are also funded through pre-credit crisis securitisation structures.

Corporate funding

While the Group's working capital has been primarily provided by equity since 2008, in recent years it has expanded its use of corporate debt funding, issuing both retail bonds and Tier 2 corporate bonds. All the Group's working capital debt funding has been raised since the credit crisis and therefore there are no legacy issues relating to these borrowings.

The Group is rated by Fitch Ratings, which reviewed its rating in the light of the Group's 2017 reorganisation and, on 6 April 2018, upgraded its Long-Term Issuer Default Rating to BBB from BBB- with a stable outlook. The BB+ rating on the Group's £150.0 million Tier 2 Bond was also upgraded to BBB- at the same time.

Although no corporate debt was issued in the period, such borrowings continue to form part of the Group's long-term funding strategy and the enhanced rating will support further long-dated corporate debt issuance in both scale and pricing terms.

Summary

The Group's overall funding position remains strong. Retail deposit flows represent the core element in the funding programme, however the successful securitisation in the year demonstrates the continuing benefits delivered by a diversified funding base.

Further information on all the above borrowings is given in notes 47 to 51.

A3.3.2 Capital management

The Group's funding model places primary reliance on retail deposit funding, which has fundamentally changed the working capital cycle of the Group, reducing the variability in working capital demand and hence enabling an on-going reduction in working capital levels relative to the size of the balance sheet.

Dividend and dividend policy

In its 2017 results announcement the Company announced a policy of targeting a dividend cover ratio of 2.75 times in 2017 and 2.50 times in the current financial year and thereafter, subject to the requirements of the business and the availability of cash resources. The final dividend for the year ended 30 September 2017, paid in the year, was declared in accordance with that policy.

To provide greater transparency, the Company also indicated that its interim dividend per share will normally be 50% of the previous final dividend, in the absence of any indicators which might make such a level of payment inappropriate and an interim dividend for the year of 5.5 pence per share was paid in July 2018 in accordance with this policy.

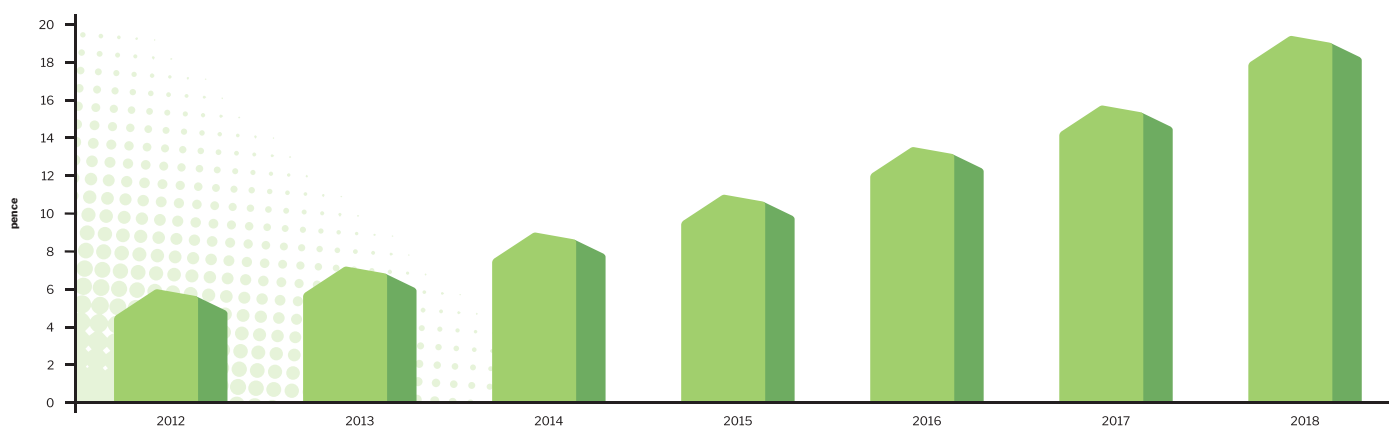
In determining the level of dividend for the year, the Board has considered the dividend policy, but has also taken into account the Group's strategy, capital requirements, principal risks, the level of available retained earnings in the Company, its cash resources and the objective of enhancing shareholder value. In particular the Board considered the capital requirements of the businesses acquired in the year and the nature of the significant one-off items of cost and income included in the result for the year. The Board determined that the existing policy remained appropriate, but that the one-off items, which do not relate to ongoing earnings generation would be excluded from the earnings used to derive the dividend.

On this basis, the Board is proposing, subject to approval at the Annual General Meeting on 14 February 2019, a final dividend of 13.9 pence per share which, when added to the interim dividend, gives a total dividend of 19.4 pence per share for the year. This represents an increase of 23.6% from 2017, bringing the dividend cover to 2.5 times, based on earnings excluding one-off items (2017: 2.75 times) (note 7(a)).

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

Dividend for the year (pence)

In respect of the years 2012-2018



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 individual capital guidance setting an amount of regulatory capital, defined under the international Basel III rules, implemented through the Capital Requirements Regulation and Directive ('CRD IV'), which the Group is required to hold relative to its risk weighted assets in order to safeguard depositors in the event of severe losses being incurred by the Group. During the year the PRA determined that the amount of the regulatory capital required should be disclosed by firms in their public reporting.

The Group maintains extremely strong capital and leverage ratios, with a total capital ratio of 16.2% at 30 September 2018 (2017: 18.7%) and a UK leverage ratio at 6.4% (2017: 6.6%) (note 7(d)). The CET1 ratio, 13.8% at 30 September 2018, reduced during the period (2017: 15.9%), reflecting the growth in the balance sheet, acquisition of goodwill and distributions to shareholders through buy-backs and dividends. The Group's medium term CET1 target remains at 13.0%.

The Group's total regulatory capital at 30 September 2018 was £1,045.7 million (2017: £1,030.5 million), a level in excess of the amount required by the PRA guidance, including the £727.7 million required in respect of Pillar 1 and Pillar 2a. This amount includes variable and fixed components and further capital buffers, either specific to the Group or applicable across the sector, may also be required.

In December 2017, the BCBS published its final proposals regarding amendments to the assessment of institutions' capital adequacy, in its document 'Basel III: Finalising post-crisis reforms'. This addresses both the Standardised Approach ('SA') for credit risk, presently used by the Group and the Internal Ratings Basis ('IRB'), which is based on firms' own internal calculations and subject to supervisory approval.

The new BCBS rules are scheduled to take effect from 1 January 2021 and the most material change for the Group relates to an increase in the risk weightings applicable to buy-to-let lending assets. The proposals may also serve to limit the comparative advantage available to IRB users over SA users through the use of floors, setting minimum capital requirements where the IRB is used. The final proposals are much less severe in their treatment of buy-to-let, amongst other asset classes, than the proposals published two years earlier, but would still require the Group to carry increased capital. The final version of the framework still needs to be enacted into EU law to take effect and there are important areas where discretion is given to national supervisors or other competent bodies. Therefore, the full impact of the reforms will not be certain until the legislative process is complete and the appropriate bodies have made their intended use of their discretions clear. The Group will be closely monitoring developments as this process progresses.

The Group also notes the steps taken by the PRA towards using its assessment of Pillar 2 capital to reduce the perceived capital disadvantage of banks using the SA compared to IRB banks, which the regulator regards as distortive to the market. The PRA published its final policy statement on this in October 2017, and the Group is considering its potential impact, when taken with the Basel reforms described above.

IRB approach

The Group continues to develop its own IRB approach to credit risk, notwithstanding the outcome of the CRD and PRA processes. It has substantial performance data, excellent credit metrics and core competence in credit risk and analytics to support the adoption of an IRB approach for determining appropriate risk weightings for its assets.

In addition to the potential capital advantages from adopting the IRB approach, the Group sees broader business benefits from adopting the disciplines required by IRB as a core part of its risk management structure, which should lead to further enhancements in the internal risk governance framework.

Other UK institutions currently using an IRB approach for their buy-to-let portfolios achieve materially lower risk weightings than the 35% required by the present SA, with PRA benchmark figures, most recently updated in October 2017, being typically in the low to mid-teen percentages.

The Group expects to be in a position to apply formally to the PRA for IRB authorisation for its buy-to-let and development finance portfolios in early 2019. These will be the first portfolio for which authorisation is sought, with development work continuing for further asset classes which will be added on a phased basis to achieve the coverage required by the IRB rules.

Liquidity

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

Indicator	2018	2017	Regulatory minimum
LCR – Liquidity cover ratio	144%	246%	100%
NSFR – Net stable funding requirement	113%	118%	100% [‡]

[‡] From 1 January 2019

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

Gearing and share buy-backs

The Group's reorganisation completed in 2017, coupled with the strong capital base and low leverage, provide the opportunity for the business to reduce its over-reliance on equity capital, improving returns for shareholders. The future requirement to raise debt for liquidity purposes has been reduced by its access to retail deposit funding and the Group is able to take a long term view of opportunities available to it in the corporate debt markets to optimise its funding, working capital and regulatory capital position over time.

At the same time the Group will carefully monitor any excess equity position and consider whether any adjustment is required, either through further changes in the dividend policy or through share buy-backs.

In November 2014 the Company announced a share buy-back programme, which had been extended to £215.0 million by November 2017. During the year the Group bought back 5.1 million of its ordinary shares at a cost of £25.2 million, including stamp duty and transaction expenses (note 59); these shares being held in treasury. Treasury shares may subsequently be cancelled.

Since the programme commenced in 2014 the issued share capital has reduced from 306.6 million shares to 260.7 million shares, a decrease of 15.0%. The size and timing of the programme is reviewed periodically to take account of anticipated investment opportunities and the balance of the Group's debt and equity capital resources.

As a result of the potential capital requirements of the Titlestone acquisition the programme was suspended during the year and no further buy-backs are proposed in the short term.

Capital outlook

The appropriate level of capital for the business to meet its operational requirements and strategic development objectives is kept under review by the Board, in particular when major acquisitions or other significant changes take place. The strength of the Group's business lines, the diversification which has been achieved in the funding base in recent years and the further opportunities for growth and sustainability opened up by the group reorganisation in 2017, provide the foundations for the capital base to sustain the Group going forward.

A3.4 Financial review

The financial year ended 30 September 2018 saw the Group's underlying profit (appendix A) increase by 7.8% to £156.5 million (30 September 2017: £145.2 million) while on the statutory basis profit before tax increased by 25.3% to £181.5 million (30 September 2017: £144.8 million) including a gain on the sale of financial assets of £28.0 million. Earnings per share increased by 29.7% to 55.9 pence on the statutory basis (30 September 2017: 43.1 pence) and by 11.3% to 48.2 pence on an underlying basis (30 September 2017: 43.3 pence).

A3.4.1 Results for the year

CONSOLIDATED RESULTS

For the year ended 30 September 2018

	2018	2018	2018	2017
	Underlying	Adjustments (Appendix A)	Total	
	£m	£m	£m	£m
Interest receivable	451.7	0.2	451.9	409.2
Interest payable and similar charges	(195.2)	(2.1)	(197.3)	(176.6)
Net interest income	256.5	(1.9)	254.6	232.6
Net leasing income	3.8	-	3.8	3.0
Gain on disposal of financial assets	-	28.0	28.0	-
Other income	15.5	-	15.5	17.2
Total operating income	275.8	26.1	301.9	252.8
Operating expenses	(111.9)	(2.3)	(114.2)	(102.3)
Provisions for losses	(7.4)	-	(7.4)	(5.3)
	156.5	23.8	180.3	145.2
Fair value net gains / (losses)	-	1.2	1.2	(0.4)
Operating profit being profit on ordinary activities before taxation	156.5	25.0	181.5	144.8
Tax charge on profit on ordinary activities			(35.7)	(27.6)
Profit on ordinary activities after taxation			145.8	117.2
			2018	2017
Dividend – rate per share for the year			19.4p	15.7p
Basic earnings per share			55.9p	43.1p
Diluted earnings per share			54.2p	41.9p

The exclusions from underlying results above (appendix A) relate principally to the acquisitions and asset sales in the period which do not form part of the day-to-day activities of the Group. The adjustments reduce earnings and related measures but have been made to provide greater clarity to users on the operating performance of the business.

The acquired Iceberg and Titlestone businesses contributed £4.1 million to underlying profits and £1.9 million to statutory profits. This contribution is expected to increase going forward.

Total underlying operating income increased by 9.1% to £275.8 million (2017: £252.8 million). Total operating income on the statutory basis, at £301.9 million (2017: £252.8 million) also included the £28.0 million one off gain on Idem Capital asset disposals arising in the year. Net interest income increased by 9.5% to £254.6 million from the £232.6 million recorded in the year ended 30 September 2017. The increase reflects growth in the size of the average loan book, which rose by 6.4% to £11,626.0 million over the year (2017: £10,930.8 million) (appendix B).

Underlying net interest margin ('NIM') in the year ended 30 September 2018 increased to 2.21% compared to the 2.13% in the previous year (appendix B). On the statutory basis, which includes the costs of building up the cash balances required for the Titlestone acquisition and the break costs of the Idem funding facility, the NIM was 2.19% (2017: 2.13%) (appendix C). The increase in NIM is in line with guidance given at the half year.

During the year, a gain of £28.0 million, was realised on the sale of long-standing Idem Capital consumer loan assets where the EIR based accounting, coupled with movements in the debt purchase market caused the carry and market values to diverge markedly. After costs incurred on the settlement of related funding arrangements the net gain was £26.8 million. This disposal represents a major refocus of the Idem Capital operation and included assets purchased in a large number of different transactions. It also supports the redistribution of capital to the Group's growth businesses, with the Titlestone acquisition occurring in the same quarter. As such, this gain is unlikely to be repeated in future periods.

Excluding the gain on disposal, other operating income was little changed at £19.3 million for the year, compared with £20.2 million in 2017.

Underlying operating expenses increased by 9.4% to £111.9 million from £102.3 million reported in the previous year, partly reflecting the increase in the average number of employees to 1,349, a 2.4% rise (2017: 1,317) and the level of employees joining the payroll in the period, which saw employment costs increase by 13.3% year on year (note 24). The year has also seen significant investments in systems and personnel in order to support the development, launch and start up phases of new product lines such as development finance, structured lending and aviation finance. Further investment was made to support the expansion of existing business lines, to enhance the Group's operational resilience, to improve its cyber security and to meet its General Data Protection Regulation ('GDPR') requirements. Despite this, the overall underlying cost:income ratio remained stable at 40.6% (2017: 40.5%) (appendix C) and remains significantly below the industry average.

The Board remains focussed on controlling operating costs through the application of rigorous budgeting and monitoring procedures and the underlying costs for the period are in line with guidance given to the market. The Group expects the overall cost:income ratio to improve over time as acquired and start-up operations are integrated into the Group and it starts to see the benefits of income growth from its new and expanded operations.

Total operating expenses, which included the costs of the Iceberg and Titlestone acquisition transactions, increased by 11.6% to £114.2 million (2017: £102.3 million), giving a cost:income ratio on a statutory basis of 37.8% (appendix C).

The charge of £7.4 million for loan impairment has increased from that for 2017 (2017: £5.3 million). As a percentage of average loans to customers (appendix B) the impairment charge remains broadly stable at 0.06% compared to 0.05% in 2017. The Group has seen favourable trends in arrears performance over the period, both in terms of new cases reducing and customers correcting past arrears, whilst increasing property values have served to reduce overall exposure to losses on enforcement of security. The loan books continue to be carefully managed and the credit performance of the buy-to-let book remains exemplary.

Yield curve movements during the period resulted in hedging instrument fair value net gains of £1.2 million (2017: £0.4 million net losses), which do not affect cash flow. The fair value movements of hedged assets or liabilities are expected to trend to zero over time, as such this item represents a timing difference. The Group remains economically and appropriately hedged.

Corporation tax has been charged at the rate of 19.6%, increased from 19.1% for the previous year. The reduction in the underlying rate of UK corporation tax applying to the Group in the year, from 19.5% to 19.0%, has been offset by the increased proportion of the Group's profit to which the 8.0% Bank Tax Surcharge applies.

Profits after taxation of £145.8 million (2017: £117.2 million) have been transferred to consolidated equity, which totalled £1,095.9 million at the year end (2017: £1,009.4 million), representing a tangible net asset value of £3.59 per share (2017: £3.45 per share) and an unadjusted net asset value of £4.25 per share (2017: £3.84 per share) (appendix D).

A3.4.2 Segmental results

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

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

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

The underlying operating profits of these business segments are detailed fully in note 16 to the accounts and are summarised below.

	2018 Segment £m	2018 One off £m	2018 Total £m	2017 £m
Segmental profit				
Mortgages	144.8	-	144.8	143.3
Commercial Lending	19.9	(0.1)	19.8	14.1
Idem Capital	78.2	26.8	105.0	75.9
	242.9	26.7	269.6	233.3
Unallocated central costs	(86.4)	(2.9)	(89.3)	(88.1)
	156.5	23.8	180.3	145.2

Mortgages

Trading activity during the year in the Mortgages division delivered further growth during the year, with the segmental profit at £144.8 million, up 1.0% from the previous year (2017: £143.3 million). Net interest income increased by 4.3% to £157.6 million (2017: £151.1 million), broadly in line with the growth in the loan book of 5.2%. The costs of the division increased as a result of higher activity levels while other income reduced during the period, in part reflecting an increasing trend for borrowers to choose fee-free loan products. The overall result was also affected by a £1.8 million increase in impairment provision in the year, with the variance arising on a small number of legacy loans.

Commercial Lending

Segmental profit in Commercial Lending increased 41.1% in the year to £19.9 million (2017: £14.1 million). The operations acquired in the year, Iceberg and Titlestone contributed £4.1 million to the divisional operating result. Excluding the £229.3 million of acquired assets, the loan book grew 61.8% in the year, and reached £1,133.2 million at 30 September 2018, driving the increase in net interest income.

A number of business units within the Commercial Lending segment remain in start-up phase, including the structured lending area, which made a loss during the period and is expected to make a positive contribution during 2019.

Idem Capital

The Idem Capital division's portfolios continued to perform well in the year to 30 September 2018. Strong cash performance in the year supported an increase in segmental profit of 3.0% to £78.2 million (2017: £75.9 million).

In September a sale of some non-core low-quality balances from the division's older portfolios realised a net gain of £26.8 million, after allowing for break costs in associated funding arrangements.

A3.4.3 Assets and liabilities

SUMMARY BALANCE SHEET

30 September 2018

	2018	2017
	£m	£m
Intangible assets	169.3	104.4
Investment in customer loans	12,127.8	11,124.1
Derivative financial assets	855.7	906.6
Free cash	238.0	305.5
Other cash	1,072.6	1,191.4
Other assets	51.7	50.2
Total assets	14,515.1	13,682.2
Equity	1,095.9	1,009.4
Retail deposits	5,296.6	3,615.4
Borrowings	7,961.2	8,927.2
Pension deficit	19.5	29.8
Other liabilities	141.9	100.4
Total equity and liabilities	14,515.1	13,682.2

The increase in intangible assets results from £65.5 million of intangible assets and goodwill recognised on the Iceberg and Titlestone acquisitions in the year. The valuation of these assets was reconsidered at the year end and is presently considered to be appropriate.

The Group's loan assets include:

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

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

	2018	2017
	£m	£m
Mortgages	10,473.5	9,953.9
Commercial Lending	1,133.2	558.8
Idem Capital	521.1	611.4
	12,127.8	11,124.1

An analysis of the Group's financial assets by type is shown in note 35. Movements in the Group's loan asset balances are discussed in the lending review section (Section A3.2).

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

Cash flows from the Group's loan portfolios remained strong during 2018. These flows, together with an increased deposit base, financed the expansion of the Group's loan book, supported portfolio and business acquisitions and underpinned an increased dividend payment to the Group's shareholders. Cash was also utilised in the share buy-back programme, which commenced during December 2014 and where £25.2 million (including costs) was deployed in the year. Free cash balances were £238.0 million at 30 September 2018 (2017: £305.5 million) following the acquisitions towards the end of the period (note 33).

Movements in the Group's funding are discussed in the funding review section (Section A3.3).

The accounting value of the deficit in the Group's defined benefit pension plan has reduced significantly over the year ended 30 September 2018. Gilt yields increased over the year and more recent market mortality assumptions were adopted and together these resulted in the deficit under International Accounting Standard ('IAS') 19 falling to £19.5 million (2017: £29.8 million). A corresponding actuarial gain of £8.9 million before tax was recognised in other comprehensive income (2017: gain of £29.0 million).

During the year a Pension Funding Partnership ('PFP') arrangement was agreed with the Trustee, effectively granting The Paragon Pension Plan ('the Plan') a charge over the Group's head office building as security for its agreed contributions and thereby reducing the Plan's funding risk.

While the valuation under IAS 19 is that which is required to be disclosed in the accounts, pension trustees generally use the technical provisions basis as provided in the Pensions Act 2004 to measure scheme liabilities. On this basis, the deficit at the triennial valuation date was £18.0 million and this had reduced to £15.2 million at 30 September 2018 excluding the benefit to the Plan of the PFP (30 September 2017: £14.9 million), representing an 87% funding level (30 September 2017: 87%). Including the benefit of the PFP the deficit was £3.7 million, a 97% funding level.

A3.4.4 Accounting changes

On 1 October 2018 the Group adopted the provisions of International Financial Reporting Standard ('IFRS') 9, which will require loss provisions on financial assets to be calculated on the basis of expected rather than incurred losses. This will result in the Group's impairment provisions increasing by approximately £27 million at that date and its equity reducing by £22 million after tax.

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

It should be noted that this movement represents principally an acceleration of the impairment charge and is therefore a timing difference, rather than an additional loss.

The Group continues to develop, test and validate its IFRS 9 approach and therefore these estimates are provisional and may be revised on the basis of this further analysis.

A3.5 Operational review

A3.5.1 Management and people

The Group's people are both its most significant cost and the key to its future growth and development. Over 1,300 people worked for the Group throughout the period, at its Solihull headquarters and other locations across the UK. The training and development of these people together with a rigorous recruitment and selection process are a key part of the Group's organic growth strategy and underpin the strong progress made and the Group's Investors in People Champion status.

Governance and management

As had been announced during February 2018, on 10 May 2018 Robert Dench resigned as both Chairman and director after fourteen years on the Board, having become Chairman in 2007. His tenure has seen major challenges and changes for the Group, covering the credit crisis, the Group's return to lending, the launch of Paragon Bank and most recently the transition to a specialist banking group. Throughout these events Bob has chaired the Board in a collegiate, but challenging way and has been a supportive Chairman to the management team, with his wealth of banking experience being an invaluable asset to the Group. He left the Group in a strong strategic position and excellent financial health.

Bob left to take up a new challenge as Chairman of The Co-operative Bank p.l.c. and departed with the sincere thanks and good wishes of his fellow directors and other colleagues.

Fiona Clutterbuck succeeded Bob as Chairman on 10 May 2018, having previously been Senior Independent Director and an independent non-executive director of the Group. She also succeeded Bob as Chairman of the Nomination Committee.

This appointment was the result of a thorough and independent recruitment process, involving both internal and external candidates, during which it became clear that Fiona was the best candidate to become Chairman. She has a strong knowledge of the Group, having served on the Board since 2012 and has a wealth of financial services experience, having held senior positions at leading UK and international banks. She was most recently Head of Strategy, Corporate Development and Communications at the Phoenix Group, until March 2018, while also serving as a non-executive director at a number of prominent listed companies.

Following Fiona's appointment, Peter Hartill, an independent non-executive director since 2011, was appointed to succeed her as Senior Independent Director, in addition to his responsibilities as Chairman of the Audit Committee, while Hugo Tudor, an independent non-executive director since 2014, succeeded Fiona as Chairman of the Remuneration Committee.

On 31 December 2018 Alan Fletcher and Patrick Newberry will step down from the Board. Alan has served as a director since 2009, including a lengthy term as Chairman of the Remuneration Committee, ceasing to be independent for corporate governance purposes in February 2018. Pat served first as an independent director of Paragon Bank PLC from its earliest months of operation in 2014, serving as chairman of its audit committee, and joined the Board of Paragon Banking Group in 2017. They will leave with the thanks of the Group and their fellow directors for their support and dedication in the development of both the Group and Paragon Bank PLC, and the best wishes of their colleagues for the future.

The Group's second annual statement under the Modern Slavery Act 2015 was published on its website in March 2018. Relevant policies have been reviewed and updated as appropriate. All employees have completed an annual e-learning module on this subject to raise awareness and understanding.

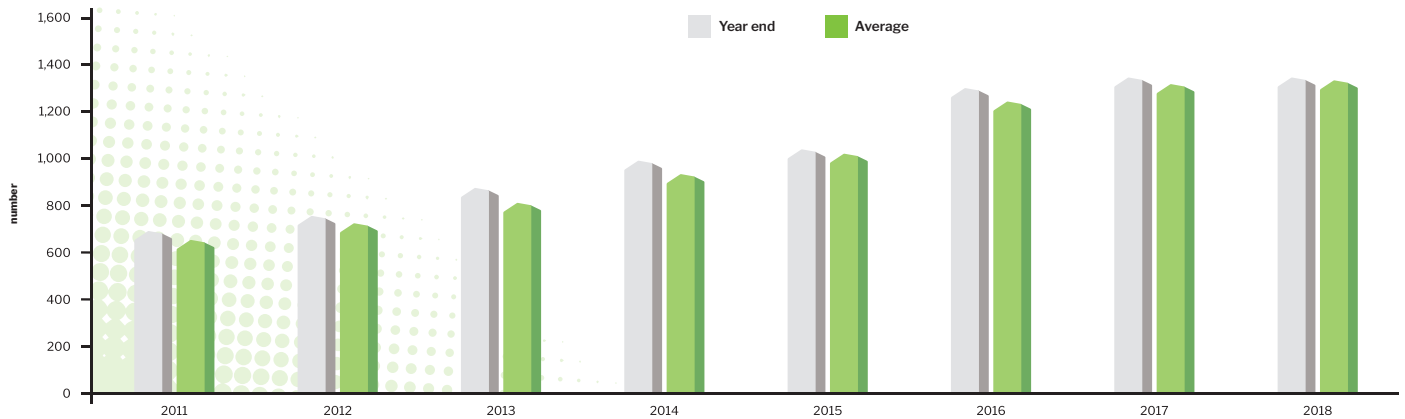
People and development

The Group continues to focus on maintaining an efficient and effective workforce, increasing employee numbers by 1.7% over the year. This increase includes those who joined the Group as a result of the Iceberg and Titlestone acquisitions and bringing these people into the Group has been an important priority during the year. The Group maintains its accreditation from the UK Living Wage Foundation and minimum pay continues to meet the levels set by the Foundation.

The Group prides itself on the fact that its people remain with it for a long time. Its annual employee attrition rate of 16.1% is below the national average and 26.8% of its people have over ten years service, with 10.9% having achieved over 20 years with the Group. We believe this is due to providing quality development opportunities and creating a place where people want to work, which has meant that knowledge and experience have been retained in each of our specialist areas. We believe our people are well positioned to support the Group's future growth strategy.

Employee numbers

At 30 September and average for the year



The Group was proud to have signed the Women in Finance Charter, sponsored by HM Treasury, in 2017. The Charter's objectives reflect the Group's own aspirations in the field of gender diversity and in January 2017, the Group published its first set of internal targets under the Charter.

The Group published an interim update in January 2018 and the latest update at 30 September 2018 confirms the Group is making good progress towards its targets:

- 52.3% of employees receiving management career development/leadership training are female (target 50%)
- 58.4% of the workforce are on flexible working contracts (target 10%)
- 32.3% of the flexible working available is on a part time basis (target 50%)

The Group notes the publication of the Hampton-Alexander ('HA') review on gender diversity during the year. The Group believes that its Women in Finance primary objective is consistent with the review's recommendation and notes that its proportion of female senior managers at the year end, as defined by HA, was 29.1% (2017: 31.4%).

The Group has calculated its gender pay gap at April 2018, as required by law. This calculation shows that median female pay in the Group was 30.8% less than the median male pay. This is broadly in line with the results reported by other financial services companies and narrower than the 39.8% gap for the sector reported by the Office of National Statistics in their Annual Survey of Hours and Earnings published in October 2018.

The Group will be analysing its gender pay gap data as part of its Women in Finance initiative to determine if there are areas where urgent action is required, but preliminary results suggest where groups of similar positions exist, there is no evidence of systematic gender bias on pay.

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

A3.5.2 Risk

The effective management of risk is crucial to the achievement of the Group's strategic objectives. To ensure this is achieved the Group operates a risk governance framework, structured around a formal three lines of defence model (business areas, Risk and Compliance function and Internal Audit) supervised at Board level.

During the year the Group's risk governance framework has worked effectively to manage and mitigate the risks to which the Group is exposed from its various operational activities, while continuing to enhance its ability to manage all categories of risk. In particular this has been focussed on:

- The continuing evolution of the Group's risk appetite statements and embedding them in the processes of the businesses
- The embedding of a new operational risk management system in business areas for use on a day-to-day basis
- The review of cyber security controls and the evaluation of ongoing investments in systems resilience and security
- Support for the integration of acquired operations and the development of new businesses and product types, to ensure they are fully captured by the risk management framework

The principal challenges in the risk environment faced by the Group during the year included:

- The potential impact of the proposals on capital regulation from the BCBS
- Execution and transitional risks arising from recent acquisitions, particularly the acquisitions of Titlestone and Iceberg in the period
- The impact of continuing uncertainty as to the terms on which the UK will leave the EU in March 2019
- The impact of fiscal changes over recent years on the demand for buy-to-let mortgages in the UK
- Changes in the regulatory environment relating to the underwriting of buy-to-let mortgages
- Heightened cyber-security risks as a result of the increasing sophistication and frequency of cyber-attacks affecting the financial services sector
- Major regulatory developments including the implementation of the GDPR
- The level of business change required in respect of a move away from LIBOR linked products

The Group continues to closely monitor its exposure to current and emerging risks as they develop, and a particular focus continues to be the risks arising from the present uncertainties surrounding the UK's future relationship with the European Union. At this point the Group considers itself well placed to mitigate the impact of the risks to which it is exposed.

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 B6 of this annual report.

A3.5.3 Regulation

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

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

- In March 2017, the FCA issued a policy statement to complete the consultation process regarding PPI that it began in 2015. This included setting a deadline of 29 August 2019 by which consumers will need to make PPI complaints and new rules and guidance on the handling of such complaints. Impacts from this process have, so far, been minimal and this is expected to remain the case
- The impacts of the Second Payment Services Directive ('PSD2') have been evaluated with the support of external advice. It was determined that the Group is compliant with the regulations based on the current product suite. Consideration of PSD2 will form part of all future product development
- The Senior Managers and Certification Regime ('SMCR') will be extended to cover a wider section of persons employed in the financial services sector during 2019. This will increase the number of the Group's employees within the SMCR and the oversight activities required to ensure compliance with the extended rules. These systems have been developed in the period and training modules for all impacted people have been delivered across the Group
- The development of proposals, led by the Bank of England and the FCA, to establish SONIA (the Sterling Overnight Index Average) administered by the Bank of England as the primary sterling interest rate benchmark by the end of 2021, in place of LIBOR, continues to be monitored to assess any potential impact on the Group. In November 2017 the regulators announced that the latest stage of this process would commence in January 2018, with consultations taking place during the year
- In December 2017 the BCBS published its 'Basel III: Finalising post-crisis reforms' document. This has clarified the proposed increase to the capital risk weights for buy-to-let lending under the revised standardised approach and the introduction of a capital output floor based on the revised standardised approach. The proposed changes had been anticipated within the Group's IRB project
- GDPR came into force with effect from May 2018, representing the most significant revision to data protection legislation for several decades. The Group continues to take appropriate steps to ensure that it is compliant with the new legislation

Whilst the Group, along with the rest of the UK corporate sector, does not have clear visibility on potential regulatory changes that may be introduced following the UK's decision to leave the EU, it does not have any EU passporting issues that need to be considered.

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

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

A3.6 Conclusion

The Group intends to maintain its current strategic approach moving forward, focussing on using its extensive credit experience to enable it to operate effectively and with a low-risk appetite in its chosen range of specialist markets. The deep understanding in these sectors, combined with the flexibility of the operating model, enables the Group to focus resources to optimise the relationship between growth, risk and reward. The diversification delivered by a series of organic and acquisitive developments over the past five years, combined with a broadly-based funding approach leaves the business well placed to deliver further value to its stakeholders over the coming years.

The Group enters 2019 with a strong new business pipeline, is well positioned in its chosen markets and equipped with high levels of liquidity. Despite the potential for economic uncertainties arising from Brexit and elsewhere, the Group remains confident of its future prospects.

NIGEL TERRINGTON

Chief Executive

21 November 2018

A4

FUTURE PROSPECTS

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

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

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

The business activities of the Group, its current operations and those factors likely to affect its future results and development, together with a description of its financial position and funding position, are described in the Chairman's Statement in Section A1 and Chief Executive's review in Section A3. The principal risks and uncertainties affecting the Group, and the steps taken to mitigate these risks are described in Section B6.5.

Section B6 of this annual report describes the Group's risk management system and the three lines of defence model which it is based upon.

Note 7 to the accounts includes an analysis of the Group's working and regulatory capital position and policies, while notes 9 to 11 include a detailed description of its funding structures, its use of financial instruments, its financial risk management objectives and policies and its exposure to credit, interest rate and liquidity risk. Critical accounting estimates affecting the results and financial position disclosed in this annual report are discussed in note 6.

Financial forecasts

As described under 'Accountability' in Section B3.1, the Group has a formalised process of budgeting, reporting and review. The Group's planning procedures forecast its profitability, capital position, funding requirement and cash flows. Detailed annual plans are produced for two-year periods with longer term forecasts covering a five-year period, which include detailed income forecasts. These plans provide information to the directors which is used to ensure the adequacy of resources available for the Group to meet its business objectives, both on a short term and strategic basis.

The plans for the period commencing on 1 October 2018 have been approved by the Board and have been compiled taking into consideration the Group's cash flow, dividend cover, encumbrance, liquidity and capital requirements as well as other key financial ratios throughout the period.

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

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

Risk assessment

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

- Consideration of the principal risks facing the Group
- Consideration and challenge of the ratings applied to the various risk categories to which the Group is exposed
- Consideration of performance against the Board risk appetite measures, with particular focus on any measures outside agreed target ranges
- Consideration of the continuing appropriateness of the Board risk appetite measures
- Consideration of key regulatory developments

During the year the directors also carried out a high-level exercise to identify the most significant emerging risks facing the Group. The results of this exercise were fed back into the Group's risk management process.

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 and Resolution Plan ('RRP').

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 B6.5 of the Risk Management Report.

Availability of funding and liquidity

The Group's retail deposits of £5,296.6 million (note 46), accepted through Paragon Bank, are repayable within five years, with 68.5% of this balance (£3,630.7 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 ('ALCO'). The Group is required to hold liquid assets in Paragon Bank to mitigate this liquidity risk. At 30 September 2018 Paragon Bank held £724.9 million of balance sheet assets for liquidity purposes, in the form of central bank deposits (note 33). A further £108.7 million of liquidity was provided by the Bank of England FLS, bringing the total to £833.6 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 £716.0 million.

The Group's securitisation funding structures, described in note 10, ensure that a substantial proportion of its originated loan portfolio is match-funded. This proportion was increased by the issue of the Paragon Mortgages (No. 25) PLC securitisation in April 2018. Repayment of the securitisation borrowings is restricted to funds generated by the underlying assets and there is limited recourse to the Group's general funds. Recent and current loan originations are financed through retail deposits and may be refinanced through securitisation where this is appropriate and cost effective.

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

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

The Group has demonstrated its ability to raise retail and corporate bond debt when required through its Euro Medium Term Note Programme and other programmes. The Group's access to debt is also enhanced by its corporate BBB rating, upgraded from BBB- by Fitch Ratings in April 2018, and its status as an issuer is evidenced by the BBB- rating of its £150.0 million Tier-2 bond issue (upgraded from BB+ in April 2018).

As described in note 7 the Group's capital base is subject to consolidated supervision by the PRA. Its capital at 30 September 2018 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 2018. This aligns with the horizons used in the Group's analysis of risk and only includes one year of the less detailed forecasting period.

The directors considered:

- The Group's financial and business position at the year end, described in section A3
- The Group forecasts, and the assumptions on which they were based
- The Group's prospective access to future funding
- Stress testing carried out as part of the Group's ICAAP process
- The activities of the Group's risk management process throughout the period
- Risk monitoring activities carried out by the Risk and Compliance Committee
- Internal audit activities 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 2018.

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 Financial Reporting Council ('FRC') in September 2014.

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

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

A5

CORPORATE RESPONSIBILITY

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

A5.1 Non-Financial Information Statement

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

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

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

A5.2 People

The welfare, development and engagement of the Group's employees are central to developing a strong culture, with employee capability and motivation acknowledged as being central to the delivery of the Group's strategy. Engagement levels are monitored through employee surveys. The most recent survey returned a response rate of 85% (previous survey: 91%) and an overall engagement score of 85% (previous survey: 86%) which compares favourably to the average of 82% in the financial services sector.

Remuneration packages across the business are compliant with the UK's national minimum wage rates. In addition, the Group is an accredited employer with the Living Wage Foundation and first met this standard in June 2016. The independent Living Wage Foundation sets an hourly rate calculated according to the cost of living in the UK which is updated annually. This is a higher rate than the government's National Living Wage. The Group supports the Living Wage Foundation's principle of a living wage being good for business, good for the individual and good for society and this is an important part of the Group's values and people strategy.

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.

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

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

Equality and diversity

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

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

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

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

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

Women in Finance

The Group's people are at the heart of everything it does, and we understand 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 we are proud to have signed the Women in Finance Charter.

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

The definition of senior management used in the Group's 'Women in Finance' targets is the same as that used by the Hampton-Alexander Review. The percentage of female senior managers on this basis at 30 September 2018 was 29.1% (2017: 31.4%).

Gender Pay

As required by legislation, the Group has calculated its gender pay gap as at April 2018. The results will be published on the government website and on the Group's own website and are summarised below.

	April 2018	April 2017
Median gender pay gap	30.8%	30.4%
Mean gender pay gap	36.8%	36.2%
Median bonus pay gap	1.2%	2.2%
Mean bonus pay gap	84.6%	87.8%

The median and mean pay gaps are in line with the 39.8% median pay gap and 34.7% mean pay gap in the financial services sector reported by the Office of National Statistics in their Annual Survey of Hours and Earnings published in October 2018. They are also broadly in line with those for other businesses in the sector.

83.4% of male employees and 87.9% of female employees received a bonus (2017: 74.5% and 85.2%), 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 continues to analyse the gender pay gap data as part of the Women in Finance initiative, to 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.

Composition of the workforce

During the year the workforce has grown by 2.0% to 1,345 people (2017: 1,318). Information on the composition of the workforce at the year end is summarised below:

	2018 Females	2018 Males	2017 Females	2017 Males
Employees				
Number	711	634	693	625
Percentage	52.9%	47.1%	52.6%	47.4%
Management grade employees				
Number	98	187	113	187
Percentage	34.4%	65.6%	37.7%	62.3%
Senior managers				
Number	5	22	5	21
Percentage	18.5%	81.5%	19.2%	80.8%
Directors				
Number	2	9	2	10
Percentage	18.2%	81.8%	16.7%	83.3%

Of these employees, ethnic minority employees comprised 11.6% of the workforce (2017: 11.4%) and 1.2% of management grade employees (2017: 3.0%). 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.

Employees on temporary or short-term contracts accounted for 0.9% of the workforce (2017: 0.1%).

The Group's annual employee turnover for the year was 16.1% (2017: 13.2%).

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 2018 the Group conducted its second annual diversity survey to obtain anonymous feedback from employees on their age, gender, ethnicity, sexual orientation, religious beliefs and disability. We received a positive response rate of 72% (2017: 78%) and as expected, the survey illustrated our workforce is diverse. The results were reviewed at executive level and a number of actions were agreed in line with the Group's commitment to the Women in Finance Charter, including requiring improved diversity from our external recruitment partners and providing more flexible working opportunities and mentoring support for individuals.

Training and development

The Group has been accredited under the 'Investors in People' scheme since 1997 and its Gold status was confirmed once again in February 2016. The reaccreditation review process will take place in February 2019. This demonstrates the Group's commitment to the training and development of all its employees.

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

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

The Group's in-house development team deliver leadership development programmes, externally accredited by the Chartered Management Institute ('CMI'), to support managers. During the year work has continued to embed the internal mentoring programme accredited by the CMI, helping to support succession planning strategy and develop future leaders. In addition, during the year, the Group joined the Women Ahead 30% Club cross-company mentoring scheme, providing 10 trained mentors to support female mentees from other companies, whilst nominating 10 female mentees to receive external mentoring support at the same time.

The Group provides financial support for professional development and approximately 10% of employees are undertaking professional qualifications at any one time. During the year the Group has also introduced a number of apprenticeship schemes with 2.2% of employees registered as apprentices across specialist and operational roles including IT, finance, underwriting and first line management.

The corporate training and development strategy focuses on providing opportunities to develop all employees and is central to the achievement of the Group's business objectives. On average, employees received 7.5 days training in the year (2017: 9.0 days), which is significantly higher than the average figure quoted by the Chartered Institute of Personnel and Development ('CIPD') of between 2.8 and 3.3 days for the private sector. This included online training undertaken by all employees on various matters including regulatory requirements.

Recruitment

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

We also run a successful 'refer a friend' scheme whereby employees receive a referral fee if an individual they refer for a role passes probation. This year 55 individuals were successfully recruited through this scheme (2017: 52).

Employees' involvement

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

During the year, the People Forum was refreshed following feedback from the Group's latest engagement survey. The purpose of the People Forum was updated to encourage and develop an employee voice to support effective decision making and continual business improvement, to protect the Group's strong culture and to deliver good customer outcomes. The role profile for representatives was redefined, a number of open sessions took place for those potentially interested in becoming involved, an application and selection process was completed and this resulted in the number of representatives increasing to cover all areas and geographical locations.

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

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

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

Involvement in industry initiatives on employment standards

This year the business has provided support to external working groups focussing on employment standards organised by industry bodies such as UKF and, in particular, contributing to the Banking Standards Board's survey on culture.

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

Health and Safety policy

The Group strives towards continual improvement of health, safety and welfare in the working environment for its employees and has a published health and safety policy which sets out objectives regarding the health and safety of employees, contractors and visitors, and its application throughout the business.

All employees are made aware of their individual responsibilities. These include taking care of the health and safety of themselves and others, following health and safety policies and standards and reporting incidents. The health, safety and environmental induction programme is rolled out to newly acquired sites, as well as being given to new employees. Information, training and supervision is provided to all employees, in line with the Group's objective of maintaining a consistent approach towards health and safety policies and procedures. Job specific safety training is delivered as required.

The Group continues to provide information, training and supervision to visitors and contractors. Including our resident mechanical and electrical contractor on key training topics has had a positive impact on health and safety performance, through risk reduction, with the frequency of incidents/near misses significantly reduced.

The Group has an Occupational Health and Safety Management System ('OHSMS') including a dedicated health and safety manager. The OHSMS is certified to BS 18001:2007 and is kept under review and revised as appropriate. It includes:

- A health and safety policy
- A register of risk assessments and health and safety legislation relevant to the Group's business activities
- Regular internal and external audits to evaluate performance
- Regular health and safety management meetings which monitor and revise current performance, objectives and targets

The number of fire marshals, first aiders and other qualified personnel is monitored and continues to be sufficient, with training and adequate cover provided in all offices. During the year, defibrillator machines were installed at all sites.

All incidents, regardless of severity are reported internally and attributed to either the work activity or the building environment, providing a clear focus when determining any corrective actions that may be required. The appropriate level of investigation, based on the incident or injury is then progressed through to closure, with any statutory reporting obligations considered.

Health and safety incidents are classified as operational risk incidents for the purposes of the Group's risk management system and monitored through the Risk and Compliance function and the Operational Risk Committee ('ORC').

The Group's principal source of health and safety related risk is in the vehicle maintenance operation of Specialist Fleet Services ('SFS') undertaken at either directly controlled premises or any contracted sites. SFS has an OHSMS that is certificated to BS 18001 and continues to maintain a high standard of compliance with all legislation associated with its industry. SFS has a dedicated health and safety manager who will investigate any incidents locally, utilising Group resources as required.

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 2018 there were no prosecutions or any enforcement action from visits by the authorities for non-compliance in respect of health and safety matters. In May 2018 there was one lost time incident reported under the Reporting of Incidents, Disease and Dangerous Occurrences Regulations 2013 ('RIDDOR'). This was the Group's first notification since August 2017 and the only such incident in the period.

The Group's principal objectives for the next period are to transition to the new ISO 45001 standard which was released in May 2018 and to ensure health and safety practise is maintained and updated in line with current legislation and regulations.

A5.3 Environmental issues

Impact

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

SFS, a division of Paragon Asset Finance ('PAF'), 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. It operates a Green Charter to raise employees' awareness of recycling and campaigns are also run to reduce various forms of waste such as food, consumables or energy.

The Group's Green Charter, which is kept under regular review:

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

The Group is committed to identifying, targeting and addressing inefficiencies within its supply chain. It will work with key suppliers to identify solutions to continue to reduce environmental impacts.

Risk management

The Group's environmental commitment is included within the Health, Safety and Environmental policy that is approved by the CEO and the People Director and which is publicly displayed in its buildings. Energy data is collated by Group Services, the division responsible for managing the Group's properties. Consumption figures for all the premises occupied whether directly owned or tenanted are actively monitored. This is reported to the business 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 their own workshop activities. These are effectively managed under an environmental management system that is certificated to an International Standard – ISO14001:2015. SFS has a dedicated health and safety manager with direct responsibility for environmental issues at all of its sites.

Environmental risk is considered within the Group's operational risk management framework and is monitored by the second line Operational Risk function and the ORC.

The Group complies with the Energy Savings and Opportunities Scheme ('ESOS'). This is a UK Government initiative, under an EU Directive, and requires the Group to identify and reduce its energy consumption. The Group is actively engaged in the data collection phase for the next Environment Agency compliance submission under ESOS due in 2019. The Group has implemented an Energy Working Group which reports to the Property Steering Group to prioritise and drive forward key recommendations for the more efficient use of energy.

Environmental initiatives

The Group's current environmental programmes include:

- A programme to upgrade the lighting at the Group's head office which is ongoing. LED sensor controlled lighting units are being installed in areas of the site that remain lit all day, effectively reducing consumption in infrequently used areas by dimming, then turning lights off, until further movement is detected
- Paper-based stationery is procured from Forest Stewardship Council ('FSC') certified suppliers
- Redundant equipment is collected by an accredited third-party who achieve the maximum amount of plastic and metals recycling possible for this WEEE waste
- A Cycle to Work scheme is operated, enabling employees to obtain cycles at preferential rates for commuting purposes, thereby reducing the carbon footprint of travel to work and its impact on the local community

The Group's principal objectives for the next financial year are to identify, target and address inefficiencies in the supply chain. A supplier relationship manager has been recruited to work with key suppliers to identify innovative solutions which will continue to reduce environmental impacts.

Performance indicators

The environmental key performance indicators for the Group, determined having regard to the Reporting Guidelines published by the Department for Environment, Food and Rural Affairs ('DEFRA') in June 2013, 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 £273.9 million (2017: £252.8 million), excluding the £28.0 million gain on financial asset sales.

Greenhouse gas ('GHG') emissions

	2018	2017
	Tonnes CO ₂	Tonnes CO ₂
Scope 1 (Direct emissions)		
Combustion of fuel:		
Operation of gas heating boilers	653	588
Petrol and diesel used by company cars	641	769
Operation of facilities:		
Air conditioning systems	20	21
	1,314	1,378
Scope 2 (Energy indirect emissions)		
Directly purchased electricity	1,163	1,420
Total scope 1 and 2	2,477	2,798
Normalised tonnes - scope 1 and 2 CO₂ per £m income	9.0	11.1
Scope 3 (Other indirect emissions)		
Fuel and energy related activities not included in scope 1 or 2	637	829
Water consumption	11	11
Waste generated in operations	20	23
Total scope 3	668	863
Total scopes 1, 2 and 3	3,145	3,661
Normalised tonnes scope 1, 2 and 3 CO₂ per £m income	11.5	14.5

CO₂ values above are calculated based on the DEFRA / Department for Business, Energy and Industrial Strategy ('BEIS') guidelines published in August 2018. CO₂ values for the year ended 30 September 2017 have been restated for the revised conversion factors published by DEFRA / BEIS.

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

Vehicle fuel usage is based upon expense claims and recorded mileage.

The Group's business is growing which creates a need for new buildings, increased use of digital technology and associated facilities. Despite these challenges the Group's energy consumption and GHG emissions remain broadly comparable year-on-year.

The Group has not been involved in any prosecutions, accidents or similar non-compliances in respect of environmental 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. The amount of power used in the year ended 30 September 2018 is shown below.

	2018	2017
	MWh	MWh
Electricity	4,107.5	4,040.1
Natural gas	3,547.6	3,192.4
Total	7,655.1	7,232.5
Normalised MWh per £m income	27.9	28.6

Consumption levels have increased as the Group's workforce has grown. However the normalised usage remains broadly in line with previous performance.

Gas and electricity usage is based on consumption recorded on purchase invoices.

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 2018 was 10,155m³ (2017: 10,802 m³), based upon consumption recorded on purchase invoices, a normalised amount of 37.1m³ per £m income (2017: 42.7m³ per £m income). This reduction has taken place despite the Group's expansion over the period. A water saving initiative is in place which is intended to reduce year on year water usage across the sites where the Group has full responsibility for the premises occupied.

Waste

SFS are the Group's primary waste producers. Their vehicle servicing activities generate a variety of different waste streams – including various grades of oil, and a range of metals and plastics. These wastes are managed responsibly in accordance with an ISO 14001:2015 certificated management system. Waste streams generated by SFS are disposed of appropriately. Waste is transferred to approved waste transfer stations under contract and consignment notes obtained.

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

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

Amounts of waste generated in the year ended 30 September 2018 together with the methods of disposal are shown below.

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

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

A5.4 Social and community matters

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

Commitment to our customers

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

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

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

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

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

Complaint handling

We understand that we do not always get things right first time and all complaints from our customers are taken very seriously. We acknowledge each complaint promptly and then work with customers to understand their feedback, investigating fully and responding swiftly in a fair and open manner.

Where possible we aim to resolve complaints at the first point of contact, but acknowledge some complaints will require further specialist investigation and time to resolve. Where further investigation is needed, we will stay in regular contact with the customer to keep them informed of what is happening with their complaint. If we need to contact previous service providers, we have established contacts within these companies to ensure any 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, the FLA and the Credit Services Association. Where customers feel the need to appeal we co-operate fully and promptly with any settlements and awards made by these parties.

We genuinely view every complaint as an opportunity to improve our business, an opportunity to identify where we are going wrong and, most importantly, an opportunity to put things right for our customers. As a result, we complete root cause analysis on complaints to ensure appropriate corrective actions are taken to address the issue and minimise the risk of re-occurrence for other customers.

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

Supporting the community

The Group contributes to registered charities relating to financial services or serving the local communities in which it operates. Contributions of £1,950,000 (2017: £1,882,000) were made by the Group during the year to the work of the Foundation for Credit Counselling which operates the StepChange Debt Charity. The Group also contributed to charities throughout the year by way of single donations.

Other charitable contributions made in the year totalled £25,300 (2017: £25,000). The Group's main objective is to support children's and local charities, although no charity request is overlooked. During the last year the Group has helped many and varied charities and causes such as: Kids Cancer Charity, 3H Fund - Helping Hands for Holidays, NSPCC, Multiple Sclerosis Society, Chicks, Soroptimist International Solihull and District, WellChild, Kids in Action and Strongbones Children's Charitable Trust.

Employees have also been making a difference to the local community in many ways. This year our employees have:

- Delivered workshops in local schools and colleges focussing on financial awareness and employability skills
- Donated over 100 shoeboxes for local Samaritans project 'Operation Christmas Purse'

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 2017, £17,024 was raised for Marie Curie Hospice Solihull, while in the first nine months of 2018, £8,204 has been raised for Birmingham Children's Hospital and Solihull Mind. All our employees are given the opportunity to nominate a charity each year and a vote is carried out amongst the employees to select the charity or charities to benefit from the following year's fundraising activities.

Taxation policy and payments

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 second 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 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:

	2018	2017
	£m	£m
Corporation tax	32.0	28.9
PAYE and NI	28.0	24.3
VAT	1.6	0.3
Stamp duty	0.2	0.5
Total national taxation	61.8	54.0
Business rates	1.1	1.2
	62.9	55.2

A5.5 Human rights

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

The Group 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 area, authorised in accordance with the Group's governance procedures and are communicated to all employees and included in the Human Resources Policies Manual.

The Group 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.

The statement 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.

A5.6 Business practices

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

The Group has carried out the risk assessment required by the Bribery Act 2010 and concluded that it is not a company with a high risk of bribery. The Group conducts all of its business within the UK and its only significant outsourcing arrangement relates to the administration of its savings operations by the outsourcing arm of a major UK building society. However, the Group takes its responsibilities seriously and will not tolerate bribery 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.

All employees are required to read the Group's anti-bribery and corruption policy and sign to confirm their acknowledgement, understanding and acceptance of its requirements. 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 2018.

The CRO, in conjunction with the Head of Financial Crime, who is part of the 'second line' Risk and Compliance function, is 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.

The Internal Audit Director is responsible for providing assurance that business heads have the appropriate controls in place to ensure all employees adhere to the anti-bribery and corruption policies and procedures at all times.

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 and corruption.

A6

APPROVAL OF STRATEGIC REPORT

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

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

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

Pandora Sharp

Company Secretary

21 November 2018

B.

CORPORATE GOVERNANCE

How the Group is run and how risk is managed

B1	Chairman's statement <i>An overview of governance in the year</i>	PAGE 64
B2	The Board <i>The directors and their experience</i>	PAGE 66
B3	Corporate governance <i>The system of governance, how the Board operates and how the Group complies with the Code</i>	PAGE 70
B4	Audit Committee <i>How the Group controls its external and internal audit processes and its financial reporting systems</i>	PAGE 78
B5	Remuneration <i>Policies and procedures determining how directors are remunerated</i>	PAGE 86
B6	Risk management <i>How the Group identifies and manages risk in its businesses</i>	PAGE 112
B7	Directors' report <i>Other information about the structure of the Group required by legislation</i>	PAGE 127
B8	Directors' responsibilities <i>Statement of the responsibilities of the directors in relation to the preparation of the financial statements</i>	PAGE 131

B1

CHAIRMAN'S STATEMENT ON CORPORATE GOVERNANCE



Fiona Clutterbuck
Chairman

Dear Shareholder

I am delighted to introduce the Corporate Governance section of the Annual Report and Accounts for the first time. As you know, I have been a member of the Board since 2012 and appreciate Paragon's values generally and in respect of corporate governance specifically. My intention is to continue to uphold the strong tradition of good corporate governance that was operated by my predecessor and, where necessary, introduce evolutionary not revolutionary change. This includes responding appropriately to regulatory or legislative requirements, including, potentially, those of the new UK Corporate Governance Code 2018 (the '2018 Code').

I would very much like to thank Bob Dench for his support to me personally over the years and for his excellent leadership of the Board since 2007. I would also like to thank Alan Fletcher and Patrick Newberry, as they step down from the Board, for their support and dedication in the development of both Paragon Banking Group PLC and Paragon Bank PLC, Alan since 2009 and Pat since 2014, and I wish them well in their future endeavours.

I would also like to thank the Nomination Committee for their clear and transparent process in respect of my appointment and I appreciated the robustness of the process.

During the upcoming year work will be undertaken to ensure that the Company complies, as appropriate, with the new 2018 Code from the year ending 30 September 2020 and with other upcoming regulatory and legislative changes in respect of corporate governance which are due to come into force for the Company and its subsidiaries over the next couple of years.

I am very pleased to state that the Board has adopted the Hampton-Alexander Review target that a third of the directors on the Board will be female by the end of 2020 and I look forward to managing this future development.

An overarching learning and development framework has been adopted during the year and I fully endorse the Group's emphasis on training, including induction for all the Board. I am currently in the process of an induction tailored to my new position as Chairman which will be ongoing for the next year and which has been thorough, detailed and enjoyable. A programme of induction for the directors appointed on 20 September 2017 was undertaken during the year which included meetings with members of senior management and heads of business areas as well the opportunity to meet with the auditors.

During the year ended 30 September 2018 in addition to its regular business items the Board has:

- Discussed, considered and approved the Group's acquisitions of Iceberg and Titlestone, and the disposal by Idem Capital of a portfolio of wholesale funded assets
- Monitored the integration of acquired businesses
- Reviewed the Group's funding strategy and position in the light of changes in the business and market conditions
- With the Nomination Committee, considered the appointment of a new Chairman and other changes to the Board structure
- With the Nomination Committee, reviewed the targets for gender and ethnic diversity and other statements in relation to the Group's commitment to the Women in Finance charter and considered gender pay reporting and relevant next steps
- Begun to address the impact of the new 2018 Code and other governance regulation changes
- Kept under review potential new business opportunities
- Considered the potential impact of Brexit and other macro-economic uncertainties on the Group

I intend to regularly meet with shareholders to discuss general matters affecting the Group and, on an annual basis, the Chairman of the Remuneration Committee and I meet investors to discuss governance and remuneration matters. These meetings assist in the development of governance within the organisation and ensure proper account is taken of shareholders' views. I would like to thank shareholders for their continued interest in the Group and the challenges they raise at these discussions.

The Company will be holding its AGM on 14 February 2019 and I look forward to welcoming all shareholders.

Fiona Clutterbuck

Chairman

21 November 2018

B2

BOARD OF DIRECTORS

The directors of the Company at the year end were:



Fiona J Clutterbuck (Age 60)

Chairman

Appointed to the Board as a non-executive director in 2012 and became Chairman 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.

COMMITTEE MEMBERSHIP

Chairman: Nomination Committee (from 10 May 2018)

Member: Risk and Compliance and Remuneration Committee

CURRENT EXTERNAL APPOINTMENTS

Non-executive director of Hargreaves Lansdown PLC, Chairman of its Remuneration Committee and member of its Audit, Risk and Nomination Committees



Nigel S Terrington (Age 58)

Chief Executive

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

EXPERIENCE

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, shortly becoming Treasurer, before being appointed as Finance Director and then Chief Executive.

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

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

COMMITTEE MEMBERSHIP

None

CURRENT EXTERNAL APPOINTMENTS

Member of HM Treasury's Home Finance Forum

Member of Bank of England's Residential Property Forum



Richard J Woodman (Age 53)

Chief Financial Officer

Appointed to the Board as Director of Corporate Development in 2012 and became Group Finance Director in June 2014

EXPERIENCE

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.

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

COMMITTEE MEMBERSHIP

None

CURRENT EXTERNAL APPOINTMENTS

None



John A Heron (Age 59)

Managing Director, Mortgages

Appointed to the Board in 2003

EXPERIENCE

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

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

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

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

He is a fellow of the Chartered Institute of Bankers.

COMMITTEE MEMBERSHIP

None

CURRENT EXTERNAL APPOINTMENTS

Member of UKF Mortgages Product Board



Peter J N Hartill (Age 69)

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

Appointed in 2011 – seven years served

EXPERIENCE

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

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

COMMITTEE MEMBERSHIP

Chairman: Audit Committee
Member: Risk and Compliance, Remuneration and Nomination Committees

CURRENT EXTERNAL APPOINTMENTS

Chairman of Deeley Group Limited
Non-executive director of A&J Mucklow Group PLC and Chairman of its Audit Committee.
Non-executive director of Scott Bader Limited



Hugo R Tudor (Age 55)

Non-executive director

Appointed in 2014 – four years served

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 and brings an investor perspective to the Board.

COMMITTEE MEMBERSHIP

Chairman: Remuneration Committee (from 19 June 2018)

Member: Audit, Risk and Compliance, and Nomination Committees

CURRENT EXTERNAL APPOINTMENTS

Director of Damus Capital Limited
Director of Vitec Global Limited

B2

BOARD OF DIRECTORS

The directors of the Company at the year end were:



Patrick J Newberry (Age 62)

Non-executive director

Appointed in 2017 – one year served

EXPERIENCE

Patrick Newberry spent 25 years as a consulting and regulatory partner with PricewaterhouseCoopers (PwC) until his retirement in 2013, concentrating on the Financial Services industry. He was a member of PwC's Supervisory Board, Chair of the Strategy, Governance and International Sub-Committee and a member of the Audit and Risk Committee. Patrick was a board member and past president (2010/11) of the Management Consultancies Association Ltd ('MCA') and sits on the judging panel for the MCA 2014 awards, a benchmark for quality in the consulting industry.

He was appointed to the Board of Paragon Bank PLC in May 2014 and was Chairman of its Audit Committee until 20 September 2017.

Patrick is a Chartered Accountant.

COMMITTEE MEMBERSHIP

Member: Audit, Nomination, Risk and Compliance and Remuneration Committees

CURRENT EXTERNAL APPOINTMENTS

Non-executive director of Shepherd and Wedderburn and Chairman of its Audit Committee

Historic England Commissioner and Chair of its Audit and Risk Assurance Committee

Adviser to Unipart Expert Practices



Barbara A Ridpath (Age 62)

Non-executive director

Appointed in 2017 – one year served

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 JP Morgan.

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.

Until May 2018, she was Director of St Paul's Institute which examines moral and ethical aspects of finance and economics.

COMMITTEE MEMBERSHIP

Member: Audit and Risk and Compliance Committees

CURRENT EXTERNAL APPOINTMENTS

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

Member of Council and the Executive Committee at Chatham House, the Royal Institute of International Affairs and commissioner of the Marshall Aid Commemoration Commission



Finlay F Williamson (Age 59)

Non-executive director

Appointed in 2017 – one year served

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 Chairman 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.

COMMITTEE MEMBERSHIP

Chairman: Risk and Compliance Committee

Member: Audit Committee

CURRENT EXTERNAL APPOINTMENTS

None



Graeme H Yorston (Age 61)

Non-executive director

Appointed in 2017 – one year served

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, including IT Director for its retail bank, Regional Director and ran a number of significant change programmes. He also led its call centre operations.

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.

COMMITTEE MEMBERSHIP

Member: Audit, Risk and Compliance Committees

CURRENT EXTERNAL APPOINTMENTS

None



Alan K Fletcher (Age 68)

Non-executive director

Appointed in 2009 – nine years served

EXPERIENCE

Alan Fletcher has considerable experience in financial services, including pension fund trusteeship and investment fund management. He was Chairman of Neville James Holdings prior to its acquisition by Challenger International of Australia, following which he was Sales and Marketing Director of Challenger Group Services and a director of Challenger Life (UK) between 2002 and 2003.

He was Chairman of the professional training company, Fresh Professional Development, between 2003 and 2010 and was a Director of CEPB Mortgages Limited between 2010 and 2017. He was a member of the General Synod of the Church of England between 2007 and 2010.

Alan has also served as director of Paragon Pension Trustees Limited, the Corporate Trustee of the Group's pension plan, since 2011.

COMMITTEE MEMBERSHIP

None

CURRENT EXTERNAL APPOINTMENTS

Trustee of the Church of England Pensions Board, member of its Pensions Committee, Chairman of its Investment Committee and member of its Ethical Investment Advisory Group

Chairman of the Diocese of Leicester Investment Committee and member of the Finance Committee of Leicester Cathedral

B3

CORPORATE GOVERNANCE

B3.1 Governance framework

The Board of Directors is responsible for overall Group strategy and for the delivery of that strategy within a robust corporate governance and corporate responsibility framework. That framework is described in the following pages.

The Board is committed to the principles of corporate governance contained in the UK Corporate Governance Code issued by the FRC in April 2016 ('the Code') and which is publicly available at www.frc.org.uk. Throughout the year ended 30 September 2018 the Company complied with the principles and provisions of the Code (except for a short period, as noted below, while awaiting regulatory approvals). The Board has considered the new edition of the Code, published in July 2018, which is applicable to the Company from 1 October 2019 and will make any necessary and appropriate amendments to its practices and procedures.

Stakeholders

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

The People Director, and the executive directors, report to the Board regularly on the views of the Group's employees and the impact of new projects on the workforce is taken into account.

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

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

The Group also endeavours to maintain an open and transparent relationship with its various regulators, including the PRA and FCA. Its relationship with HMRC and the principles it applies to its tax affairs are described in Section A5.4.

The Group maintains a whistleblowing process to enable employees or other stakeholders to raise concerns anonymously. This is described further in section B4.6.

Leadership

The schedule of matters reserved for the Board, which was reviewed during the year, details the key matters for which the Board is responsible including:

- The Group's values and standards
- Its strategic aims and objectives
- Approval of major capital projects and material acquisitions and disposals
- Approval of annual operational and capital expenditure budgets
- Approval of the Company's dividend and corporate governance policies
- Agreeing the Group's risk appetite
- Determining the remuneration policy for the executive directors

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

Currently the Board consists of the Chairman, three executive directors, six independent non-executive directors and one non-independent non-executive director. At the start of the year the Board included seven independent non-executive directors, however, Alan Fletcher ceased to be considered independent in February 2018 on the ninth anniversary of his appointment and consequently ceased to be a member of any board committees. All the directors bring a broad and valuable range of experience to the Company and further details of this together with other biographical details are set out in Section B2. Throughout the year the independent non-executive directors have formed the majority of the Board and consequently, the balance between independent and non-independent directors has been appropriate.

The division of responsibilities between the Chairman and CEO is clearly established, set out in writing, regularly revised and agreed by the Board.

There is a strong non-executive representation on the Board, including the Senior Independent Director (Fiona Clutterbuck until June 2018 and subsequently Peter Hartill). This provides effective balance and challenge.

The Chairman’s other business commitments are set out in the biographical details in Section B2.

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

Code compliance

During the year under review there was a short period when the Company was not fully in compliance with the provisions of the Code. This occurred while regulatory approvals for various appointments were awaited. The provisions which the Company did not comply with, and the periods of non-compliance were:

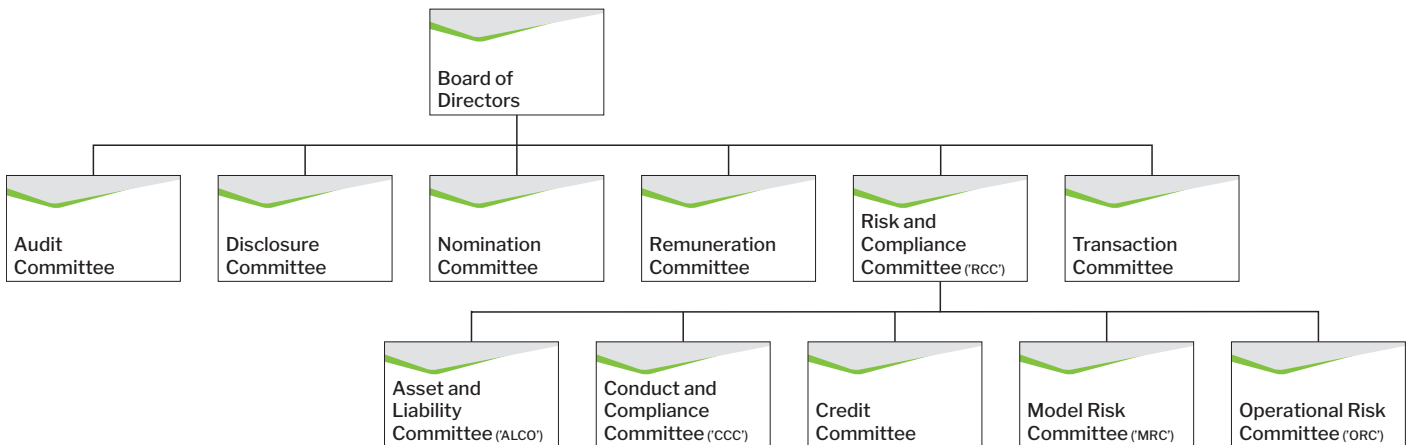
- From 10 May 2018 until 5 June 2018 there was no Senior Independent Director (Code provision A.4.1)
- From 10 May 2018 until 19 June 2018 the Chairman of the Board was also Chairman of Remuneration Committee (Code provision D.2.1) and
- From 10 May 2018 until 5 June 2018 there were only two independent non-executive directors on the Remuneration Committee (Code provision D.2.1)

During the period when the Company was not in compliance with the Code provisions relating to remuneration committees, no meetings of the Remuneration Committee were scheduled or held.

Board Committees

The Board operates through a number of committees covering certain specific matters, illustrated in the chart below.

Board Committee structure



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

Committee		Audit	Remuneration	Risk and Compliance	Nomination
Chair	From 1 October 2017	P J N Hartill	F J Clutterbuck	F F Williamson	R G Dench
	To / from		19 June 2018		10 May 2018
	To 30 September 2018	P J N Hartill	H R Tudor	F F Williamson	F J Clutterbuck
Minimum number of meetings		3	3	4	2
Further information		Section B4	Section B5	Section B6	Section B3.2

Members	Independent non-executive	Audit	Remuneration	Risk and Compliance	Nomination
F J Clutterbuck	Until 10 May 2018	Until 10 May 2018	Yes	Yes	Yes
R G Dench	No	No	Until 10 May 2018	Until 10 May 2018	Until 10 May 2018
N S Terrington	No	No	No	No	Until 20 September 2018
A K Fletcher	Until 24 February 2018	Until 24 February 2018	Until 24 February 2018	Until 24 February 2018	Until 24 February 2018
P J N Hartill	Yes	Yes	Yes	Yes	Yes
H R Tudor	Yes	Yes	Yes	Yes	Yes
P J Newberry	Yes	Yes	From 5 June 2018	Yes	Yes
B A Ridpath	Yes	Yes	No	Yes	No
F F Williamson	Yes	Yes	No	Yes	No
G H Yorston	Yes	Yes	No	Yes	No

The Board has considered the requirements of the Code with respect to the composition of audit committees and is satisfied that all members of the Audit Committee have recent and relevant financial experience and that the Committee as a whole has competence relevant to the sector in which the Group operates.

The Disclosure Committee assists in the design, implementation and evaluation of disclosure controls and procedures; monitors compliance with the Company's disclosure controls; considers the requirements for announcement; and overall determines the disclosure treatment of material market information. The Committee's members are the Chairman, CEO and CFO, of which any two can form a quorum.

Executive committees

Five main executive committees, the Asset and Liability Committee ('ALCO'), the Credit Committee, the Model Risk Committee ('MRC'), the Operational Risk Committee ('ORC') and the Conduct and Compliance Committee ('CCC'), consisting of executive directors and appropriate senior employees, report to the Risk and Compliance Committee. The Operational Risk and Compliance Committee was split during the year to ensure that a greater focus could be put into both areas. All of these committees are described further in the Risk Management Section B6.

In addition, the Transaction Committee, which reports directly to the Board, has been established for a number of years, but meetings are called as and when required and have occurred more frequently this year due to the establishment of the Group's Structured Lending business. The Committee consists of the CEO and the CFO, the Director of Treasury and Structured Finance and the CRO, any two of which can form a quorum, but that quorum should include either the CEO or CFO. The Committee meets to consider potential acquisitions or disposals of loan assets by the 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.

All board committees operate within defined terms of reference and sufficient resources are made available to them to undertake their duties. The terms of reference of the committees are available on request from the Company Secretary.

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

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

* The Nomination Committee held a number of meetings to discuss the appointment of a new chairman and other changes to the Board. These meetings were not attended by Bob Dench and Fiona Clutterbuck either in part or in full (as appropriate) and have not been included in the potential number of meetings they could have attended.

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

The Board regularly receives, reviews and considers reports on the following matters:

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

Subsidiary governance

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

Since the completion of the strategic reorganisation in September 2017 the directors of the Company have also comprised the Board of Paragon Bank PLC. The boards of both companies meet jointly in most circumstances and the meetings noted above (with the exception of the meetings of the Nomination Committee) were joint meetings. Oversight of Paragon Bank PLC, consequently, forms an intrinsic part of the board and committee meetings of the Company.

Effectiveness

A majority of the non-executive directors are independent of management. They are kept fully informed of all relevant operational and strategic issues and bring a strongly independent and experienced judgement to bear on these issues. The non-executive directors meet with the Chairman, from time to time, without the presence of the executive directors. All non-executive directors are appointed for fixed terms.

All of the directors holding office at 30 September 2018 were reappointed at the AGM on 15 February 2018, and all of them, excluding Alan Fletcher and Pat Newberry who are stepping down from the Board on 31 December 2018, have submitted themselves for re-election at the forthcoming AGM.

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

All directors are able to take independent professional advice in the furtherance of their duties whenever it is considered appropriate to do so and have access to such continuing professional development opportunities as are identified as appropriate in the Board appraisal process.

The Board considers that a majority of the non-executive directors are independent of the Group and free from any business or other relationship which could materially interfere with the exercise of their independent judgement. Alan Fletcher ceased to be an independent non-executive director, in accordance with the Code, in February 2018 when he had served on the Board for nine years. Nevertheless, there were at all times during the year no less than six independent non-executive directors on the Board, therefore throughout the year the majority of the Board has been independent.

The composition of the Board and its committees is kept under review, with the aim of ensuring that there is an appropriate balance of power and authority between executive and non-executive directors and that the directors collectively possess the skills and experience necessary to direct the Company's and the Group's business activities. The directors review actual or potential conflicts of interest in respect of any director at each meeting of the Board and its committees.

There is an established process for external appointments through the Nomination Committee. Ultimately, the appointment of any new director is a matter for the Board. Executive director appointments are based upon merit and business need. Non-executive appointments are based upon the candidates' profiles matching those agreed by the Nomination Committee. In all cases the Board approves the appointment only after careful consideration.

Succession planning for the Board is in place with emergency cover available for the executive directors. Further detail is provided in the Nomination Committee section B3.2.

Learning and development

At the end of September 2018, a Learning and Development framework was endorsed for the Board. As this is embedded during the year ending 30 September 2019, learning and development plans for each board member based on an agreed skills matrix will be fully established and enhanced. The matrix considers the competency level for each director based on a broad range of skills, scoring the skills and then building a tailored development programme. The skills that form the matrix include helping to develop strategy; ensuring that the Group is acting in a prudent manner; and for a director who is chairman of a committee, fostering an open, inclusive and challenging discussion as well as facilitating independent oversight. This framework will support the work of the Nomination Committee and the Chairman in developing the future structure of the Board.

All of the non-executive directors have received presentations during the year on various aspects of the Group's activities. In addition, training has been provided by external advisors on topics such as the economy, and the markets and regulatory environments which the Group operates or is considering operating in.

As part of its development programme the Board has agreed a dedicated day and a half for training in each financial year and such days are scheduled into the ongoing board calendar. During the year the Board, including at the dedicated training days, has received presentations on the macro-economy, the GDPR, various regulatory and reporting matters including IRB and IFRS 9, and the housing market.

A training schedule is maintained by the Human Resources department.

The directors appointed in September 2017 have received appropriately tailored induction training during the financial year to develop their understanding of the Group and its operations. The Chairman is in the process of an extensive and tailored induction programme and has had deep dives into areas including Mortgages and Savings, covering the full customer life-cycle. The Chairman's next area of focus will be Asset Finance and operational resilience, specifically IT and cyber security management. Hugo Tudor is also undergoing a specific development programme for his new role as Chairman of the Remuneration Committee.

Board evaluation

The effectiveness of the Board, individual directors and the Board's main committees are reviewed annually, with an externally facilitated review every three years as required by the Code (previously completed during the year ended 30 September 2016).

This year's annual board and committee review was internally facilitated. No issues that were of concern arose from that review.

Individual performance

The performance of the CEO is appraised by the Chairman. The performance of the other executive directors is appraised by the CEO in conjunction with the Chairman. The results of these appraisals are presented to the Remuneration Committee for consideration and determination of remuneration.

The Chairman appraises the performance of the non-executive directors, identifying any development opportunities or training needs. The Senior Independent Director leads the review of the performance of the Chairman with the other non-executive directors, taking into account the views of the executive directors.

At the AGM the Chairman 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.

Accountability

Detailed reviews of the performance of the Group's main business lines are included within the Strategic Report (Section A). The Board uses this to present a fair, balanced and understandable assessment of the Company's position and prospects.

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

An on-going process for identifying, evaluating and managing the significant risks faced by the Group, which is regularly reviewed by the Board, was in place for the year ended 30 September 2018 and to the date of these financial statements. An overview of this process, and its part in the directors' consideration of the Group's viability is given in Section A4.

The directors are responsible for the system of internal control throughout the Group, including the system of internal control over financial reporting, and for reviewing its effectiveness. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can provide reasonable, but not absolute, assurance against the risk of material misstatement or loss and that assets are safeguarded against unauthorised use or disposition. In assessing what constitutes reasonable assurance, the directors have regard to the relationship between the cost and benefits from particular aspects of the control system.

The system of internal control includes documented procedures covering accounting, compliance, risk management, personnel matters and operations, clear reporting lines, delegation of authority through a formal structure of mandates, a formalised budgeting, management reporting and review process, the use of key performance indicators throughout the Group and regular meetings of the Executive Committee, ALCO, CCC, Credit Committee, MRC and ORC.

Internal control over financial reporting within the Group is provided by a process designed, under the supervision of the CFO and senior financial management of the Group, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes, including the process of preparing the Group's consolidated financial statements.

Internal control over financial reporting includes policies and procedures intended to ensure that records are maintained that fairly, and in reasonable detail, reflect transactions and dispositions of assets, to provide reasonable assurance that transactions are recorded as necessary to permit the preparation of the financial statements, to ensure that receipts and expenditures are only being made in accordance with management authorisation and to provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use or disposition of assets that could have a material effect on the financial statements.

Internal control systems, no matter how well designed, have inherent limitations and may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that internal controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may reduce.

The Board receives regular reports setting out key performance and risk indicators. In addition, the Board operates a formal risk management process, described in more detail in Section B6, from which the key risks facing the business are identified. The process results in reports to the Board, through its Risk and Compliance Committee, on how these risks are being managed. The Board has a programme of regular presentations from senior management to enable the Board to review the operation of internal controls in relation to the risks associated with their specific areas.

The system of internal control is monitored by management and by an internal audit function that concentrates on the areas of greater risk and reports its conclusions regularly to management and the Audit Committee. The internal audit work plan is approved annually by the Audit Committee, which reviews the effectiveness of the system of internal control annually and reports its conclusions to the Board. Further details of the role and activities of the Audit Committee and its relationship with the internal and external auditors are set out in Section B4. The Risk and Compliance Committee is responsible for reviewing the Group's risk management framework and the effectiveness of the Group's systems and controls. Further details of the role and activities of the Risk and Compliance Committee and the Group's risk management system are set out in Section B6. There is some overlap between the work of the Audit Committee and that of the Risk and Compliance Committee and the Board monitors these areas to ensure that no gaps develop in the system of internal control.

The directors confirm that they have reviewed the effectiveness of the Group's system of internal control for the period and that these procedures accord with the 'Guidance on Risk Management, Internal Control and Related Financial and Business reporting' published by the FRC.

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 B5.

Relations with 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 chairmen are available for questions. The AGM is held in London during business hours and provides an opportunity for directors to report to investors on the Group's activities, to answer their questions and receive their views. At all general meetings shareholders have an opportunity to vote separately on each resolution and all proxy votes lodged are counted and the balances for, against and directed to be withheld in respect of each resolution are announced.

The Chairman, CEO and CFO have a full programme of meetings with institutional investors during the course of the year and investors' comments are communicated to all members of the Board, enabling them to develop an understanding of major shareholders' views of the Group. During the year ended 30 September 2018 meetings were held with investors from the UK, Europe and North America. From time to time other presentations are made to institutional investors and analysts to enable them to gain a greater understanding of important aspects of the Group's business.

The Chairman, the Chairman of the Remuneration Committee, People Director and the Company Secretary hold annual meetings, generally in October, with leading shareholders to discuss remuneration policies and other corporate governance matters and the comments received are reported to the Board and considered by the Remuneration Committee in determining or varying the Group's approach to executive compensation.

The results of all of these meetings are reported to the Board so that all directors are aware of shareholder views.

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

The Company's website at www.paragonbankinggroup.co.uk provides access to information on the Group and its businesses.

B3.2 Nomination Committee

During the year the Nomination Committee consisted of the Chairman of the Company, (Robert Dench until 10 May 2018 and Fiona Clutterbuck from 10 May 2018), who chaired the Committee, Nigel Terrington, the Chief Executive (until 20 September 2018) and Alan Fletcher (until 24 February 2018), Peter Hartill, Patrick Newberry and Hugo Tudor, all independent non-executive directors. The majority of the Committee's members during the year were, therefore, independent non-executive directors and the Chairman who was considered independent on appointment. At the year end the Committee consisted only of independent non-executive directors and the Chairman, and it is intended that this composition will be maintained in future.

During the year the Committee reviewed its terms of reference (which were adopted by the Board in October 2016) to ensure that its remit continues to align with best practice. No changes were proposed. The Committee's purpose has been defined to include:

- Ensuring that there is a formal, rigorous and transparent procedure for the appointment of new directors to the Board
- Leading the process for Board appointments
- Making recommendations to the Board on those appointments
- Assisting the Board in ensuring its composition is regularly reviewed and refreshed so that it is effective and able to operate in the best interests of shareholders

Ultimate responsibility for any appointment remains with the Board. The Committee also considers re-appointment of directors, re-election of directors and the independence of non-executive directors, and makes recommendations regarding these matters to the Board.

The Committee keeps under review the structure, size and composition of the Board (including its skills, experience, independence, knowledge and diversity) and makes any recommendations that it deems necessary.

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

The Committee also has a general responsibility for oversight of the Group's senior management succession policy and its initiatives on workforce and management diversity, with a particular focus on its participation in external programmes, such as Women in Finance.

Appointment of the Chairman

The process leading to the appointment of the new Chairman was undertaken in conjunction with Andrew Simpson of Korn Ferry (a management consulting company) who has no other connection to the Group.

A description of the role and capabilities required by a chairman of the board was approved by the Committee and a search was conducted against these objective criteria with due regard for the benefits of diversity on the Board including gender. The search was led by Peter Hartill as it could not be led, in accordance with the Code, by the outgoing Chairman, Bob Dench, and nor could it be led by the then Senior Independent Director, Fiona Clutterbuck, as she was a candidate for the post.

The role description was considered in the light of the skills (both hard and soft skills), experience and knowledge on the Board. Initial conversations were undertaken by Andrew Simpson on an anonymised basis, with more detailed conversations held, once candidates had indicated their interest, with Peter Hartill and Nigel Terrington. First formal interviews were held with a combination of Peter, Nigel, the People Director and other members of the Committee. Final interviews were conducted by the full Committee with the People Director and Company Secretary in attendance. The Committee ensured not only culture fit, but that the candidates could devote sufficient time to the appointment.

The shortlisted candidates were referenced at a level commensurate with the potential role, including discussions with the PRA, and they also underwent pre-employment screening, as do all potential Group employees. Once the Committee had made a recommendation to the Board an application was submitted to the PRA for their approval. The PRA's approval process included the submission not only of the job description and the CV of the candidate but also a proposed learning and development programme. The regulator also conducted a formal interview with the candidate.

As part of this process the Committee also considered the consequential changes required to the Board and its committees following the appointment of the new Chairman. It proposed that Peter Hartill and Hugo Tudor, both having been on the Board for a number of years, be appointed as Senior Independent Director and Chairman of the Remuneration Committee respectively.

Diversity

The Group recognises the importance of diversity, including gender diversity, at all levels of the organisation. The Group recognises the importance of diversity on the Board, not only of gender, but also of experience and background, and the valuable contribution which such diversity can make towards achieving the appropriate balance of skills and knowledge which an effective board of directors requires. The Board is committed to ensuring, in line with the Hampton-Alexander Review recommendations, that female directors will comprise 33% of the Board by the end of 2020.

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 and agreed targets in respect of gender diversity amongst the Group's senior management.

As is clear from the existence of the Women in Finance initiative, obtaining full diversification of gender in the financial services sector is particularly challenging given the size of the female talent pool across the industry. Similar issues apply to advancing diversity of ethnicity in the sector. The targets adopted reflect the Board's commitment to ensuring that diversity considerations throughout the Group are wider than gender.

The Group's diversity policies are described in Section A5.2 of the, where information on the composition of the workforce is also given, together with further information on the Group's Women in Finance targets and its progress since initial adoption of the targets in 2017. The Group also reported on gender pay during the period and this information, together with updated comparisons is also discussed in Section A5.2.

Succession planning

The succession plans for the Board were reviewed during the current financial year following the Group's strategic reorganisation at the end of September 2017. The tenure of the 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. This data has been considered against internally identified individuals with high potential and the capability to fulfil those roles as they become vacant, to ensure that succession requirements can be met. Internal individuals will be developed for future senior roles and this will be complemented with external recruitment at a senior level where necessary, to balance the required skills and experience of the senior management team and ensure continuing success in the future. Following review work in 2016, which considered approximately 100 roles, internal development has been undertaken to enhance succession planning with consideration given to possible 'at risk' roles as well as to the development of potential future senior management candidates.

A review of the effectiveness of this approach took place during the year which concluded that whilst there was a robust method to identify the risk and impact of a particular role becoming vacant, the identification of potential internal successors could be quite subjective and consequently a revised methodology will be adopted going forward including the introduction of a formal assessment and development cycle for senior and critical roles.

Risk mitigation will continue to include the ongoing development of employees, as well as work to further validate potential candidates for senior positions. Development work on potential candidates occurs with those employees remaining in their current roles, as this training is undertaken so as to minimise business impact while ensuring that candidates are enabled to undertake a more senior role in due course. The Group's preference, where possible, is that internal candidates are developed and supported to undertake senior roles as this assists in the ongoing maintenance of its strong cultural focus on its people.

B4

AUDIT COMMITTEE



Peter Hartill
Chairman of the
Audit Committee

B4.1 Statement by the Chairman of the Audit Committee

Dear Shareholder

The year ended 30 September 2018 has been a busy one for the Committee. The Group reorganisation in September 2017 increased the Committee's membership and extended its regulatory duties, and these changes were bedded in throughout the year.

There was also substantial change in the Group, with the Committee having to consider the accounting and reporting implications of two acquisitions as well as the preparations for the introduction of IFRS 9 in the coming financial year, which will have a major impact on the Group's accounting, both internally and externally.

This has all taken place against a background of constantly evolving accounting and regulatory requirements and organic developments within the business, all of which impact on the Committee's workload.

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

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

- The review of the annual and half-yearly financial statements to ensure these properly present the Group's activities in accordance with accounting standards, law, regulations and market practice
- In particular, the consideration 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
- The supervision of the process to appoint a new Internal Audit Director
- The supervision of the internal audit function as its role changes as the business evolves and best practice develops
- Overseeing the Group's preparations for the introduction of IFRS 9, which was implemented with effect from 1 October 2018 and, with the Risk and Compliance Committee, the Group's IRB project
- Overseeing the integration of the Titlestone and Iceberg operations acquired in the year into the Group's financial reporting and control framework
- Considering the Group's readiness to address other forthcoming accounting changes which will affect it, such as IFRS 15 and IFRS 16
- Receiving and considering the results of the Audit Quality Review carried out by the Financial Reporting Council ('FRC') of KPMG's audit of the 2017 accounts

During the year, I also received notice of the retirement of Steve Powell, the Group's Internal Audit Director. I would like to take this opportunity to record the thanks of the Committee and myself for all Steve's hard work, especially in ensuring that the Internal Audit function remained fit for purpose as the Group transitioned into a bank.

I was pleased to take part in the selection process for the Group's new Internal Audit Director, who was approved by the Committee during the year. She took up her new position after the year end and I look forward to working with her in the future.

In the financial year ending 30 September 2019 the Committee's main priorities will include:

- Continued monitoring of the Group's IFRS 9 implementation programme following transition and as the first reporting is generated
- Maintaining oversight of the integration of the acquired businesses into the Group's control and reporting framework
- Ensuring that the Group's control processes evolve alongside developments in the business

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 2019.

Peter Hartill

Chairman of the Audit Committee

21 November 2018

B4.2 Operations of the Committee

The Audit Committee comprises all of the independent non-executive directors of the Company whose relevant experience is set out in Section B2 and its terms of reference include all matters indicated by Disclosure and Transparency Rule 7.1 and the Code. The Committee's responsibilities include:

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

It also provides a forum through which the Group's external and internal audit functions report to the non executive directors.

The Internal Audit Director reports ultimately to the Chairman of the Audit Committee. They attend all meetings of the Audit Committee and also report regularly to the Risk and Compliance Committee.

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

The Committee meets at least three 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 Chairman, the executive directors, 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.

At each meeting the Committee receives reports of reviews conducted throughout the Group by the Internal Audit and, from time to time, Compliance functions.

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

Details on the Committee members' attendance at meetings and the Board's evaluation of the Committee's effectiveness are given in Section B3.1.

B4.3 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 2018 the Committee considered particularly:

- The calculation of interest income under the Effective Interest Rate ('EIR') method for both internally originated and purchased loan assets and the Group's borrowings
- The levels of impairment provision against loan assets
- The accounting for the acquisitions of Iceberg and Titlestone which took place in the year
- 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

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

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

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

Matter	Particular areas of focus
<p>Interest income and expense recognition</p>	<p>As required by IAS 39, the Group recognises income from loan balances on an EIR basis, which is intended to produce a constant yield throughout the behavioural life of the loan, taking account of such matters as costs of procurement, and initially fixed or discounted interest rates. The calculation therefore rests on assumptions about the future behaviour of the Group's customers. A similar approach is taken to assessing interest on borrowings, where redemption profiles and anticipated refinancing dates influence expense recognition.</p> <p>The Committee assessed the appropriateness of the assumptions made, considering performance of the portfolios against expectations and the impact of changes in product specifications. 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>The Committee also paid particular attention to the accounting for new Idem portfolio purchases, which are generally made at a discount to the gross balance owed by customers on the accounts purchased, and where portfolio performance is a major driver of the EIR calculation.</p> <p><i>Further information on these estimates can be found in note 6b to the accounts, and the interest income and expense recognised on this basis is shown in notes 18 and 19</i></p>
<p>Loan impairment</p>	<p>IAS 39 requires that companies provide for any financial assets, held at amortised cost, considered to be impaired at the balance sheet date, to the extent that the carrying value might not be recovered.</p> <p>The Group's calculation of impairment provision relies on assumptions to determine when an account might require provision and how large that provision would need to be.</p> <p>In order to satisfy itself that this calculation resulted in appropriate provisioning, the Committee considered actual out-turns against historical impairment provision amounts calculated by the Group's models and the continued relevance of historical cash flow experience to the current loan book, based on present economic conditions and account administration practices.</p> <p>This included an assessment of the impact of the Group's receiver of rent processes on cash flows and ultimate impairment levels, consideration of the likely effects of movements in property prices on security values and an examination of exposure on large portfolios.</p> <p><i>Further information on these estimates can be found in note 6a to the accounts, the impairment charge for the year is shown in note 28 and movements in provision for impairment are shown in note 38.</i></p> <p><i>The Group's exposure to credit risk is discussed in note 9</i></p>
<p>Acquisition accounting</p>	<p>During the year the Group completed the acquisitions of Iceberg and Titlestone and was required, in accordance with IFRS 3, to determine fair values for all of the assets and liabilities acquired, including intangible assets and therefore to determine the amount of goodwill arising in each transaction.</p> <p>In considering whether the fair values of assets and liabilities had been properly determined the Committee considered the nature of the assets acquired, their historic credit performance, the due diligence exercises carried out before acquisition, and in the case of Titlestone, considered a detailed review of the loan book carried out as part of the acquisition process.</p> <p><i>Further information on these estimates and policies can be found in notes 14 and 15 to the accounts</i></p>
<p>Goodwill impairment</p>	<p>The Group is required to assess, at the end of the year, whether the carrying value of the acquired goodwill balance in its accounts, which is not subject to amortisation under IFRS, remains appropriate or whether any impairment has occurred. This includes both newly acquired goodwill and goodwill arising from previous acquisitions.</p> <p>In considering whether any impairment of goodwill had occurred the Committee considered particularly the Group's forecasts for the cash flows to be generated by the acquired businesses and their reasonableness in the light of current trading performance and the Group's strategy for these operations.</p> <p><i>The potential impairment of goodwill is discussed in notes 6c and 44</i></p>

Matter	Particular areas of focus
<p>Pension deficit</p>	<p>The deficit on the Group's defined benefit pension plan is valued in accordance with IAS 19, which requires an actuarial valuation of the plan liabilities. Such a valuation is based on assumptions including market interest rates, inflation and mortality rates in the Plan.</p> <p>In order to satisfy itself as to the appropriateness of these assumptions, the Committee considered their derivation and the market data underlying them. These were compared to market benchmarks and advice from the Group's actuarial advisers. The Committee also considered benchmarking data provided by the external auditor.</p> <p><i>Further information on the Plan deficit, the basis of valuation and the assumptions underlying it can be found in note 56 to the accounts, along with an analysis of sensitivities to the more significant assumptions</i></p>
<p>Viability statement</p>	<p>The Board is required by the Code and the Listing Rules to make a viability statement in the Annual Report. The Committee has been asked to express an opinion to the Board as to whether this statement could properly be made.</p> <p>The Committee considered aspects of the work of the Board and its various committees which addressed the Group's business model, risk profile, access to funds and future strategy, they also considered guidance issued by the FRC and stress testing which had been carried out in the year.</p> <p><i>A fuller discussion of the directors' consideration of the viability statement is set out in Section A4</i></p>
<p>Capital and funding</p>	<p>The Board is required by the Code and the Listing Rules to make a going concern statement in the Annual Report. The Committee has been asked to express an opinion to the Board as to whether this statement could properly be made.</p> <p>The Committee considered the Group's detailed forecasts and the implicit cash and capital requirements. The Committee discussed availability of funding, potential stress events and the impact of the economic environment.</p> <p><i>A fuller discussion of the directors' consideration of the going concern statement is set out in Section A4</i></p>
<p>Fair, balanced and understandable</p>	<p>The Board is required by the Code to state whether, in its view, the Annual Report is fair, balanced and understandable. The Committee has been asked to express an opinion to the Board as to whether this statement could properly be made.</p> <p>The Committee considered the draft Annual Report for the financial year, as a whole, satisfying itself that the process for the preparation and review of its various sections, was appropriate. The Committee especially focussed on areas where disclosure requirements had changed or where new activities were to be reported on. Based on this exercise, and the Committees own understanding of the business in the year, it determined whether the Annual Report, overall, portrayed the Group's activities, position and results properly.</p>

The discussion of future accounting changes required by IAS 8 (note 3) is an output of the ongoing IFRS 9 implementation project which the Committee has supervised throughout the period and the Committee reflected upon whether the disclosure made in the accounts was appropriate.

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

Earlier in the year the Committee had considered each of these areas, where applicable, in the same manner in concluding that it could commend the Group's half-yearly financial report for the six months ended 31 March 2018 to the Board for approval.

B4.4 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.

Audit tendering

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

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

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

Other than the legal requirements of the Order, the Committee has not identified any factors which might restrict its choice of external auditor.

Audit Quality Review

The audit of the Group's financial statements for the year ended 30 September 2017 by KPMG was reviewed by the FRC during the year. The results of this review were received by the Committee and they were discussed with the Auditors. Additionally, the Chairman of the Committee met with the FRC's representatives to discuss their findings.

The Committee also noted the results of the FRC's overall review of KPMG for the year published in July 2018 and, in view of its adverse findings, considered whether these had any implications for the Group's audit.

KPMG presented their action plan to address the FRC's recommendations to the Committee, which discussed the appropriateness of these responses.

Having considered the FRC reports and the representations made by KPMG, the Committee concluded that these matters would not prevent KPMG's reappointment as auditors at this stage.

Audit effectiveness

The Committee has considered the effectiveness of the external audit for the year ended 30 September 2018 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 2017 audit, undertaken at the time of approval of the 2017 Group accounts was updated once the external audit process for all Group companies had been completed and affirmed the original conclusion, that the external audit was independent and objective and that the audit process was effective for that financial year.

In conjunction with the effectiveness review the Committee considered whether KPMG remained able to provide the required quality of service and were independent of the Group. More specifically 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 Auditor and the FRC's most recent audit inspection review on the audit firm.

As a result of these exercises the Committee concluded that it would recommend to the Board that a resolution to reappoint KPMG as auditors for the year ending 30 September 2019 should be proposed at the forthcoming AGM.

Independence policy

Both the Committee and the external auditor have safeguards in place to avoid any compromise of the independence and objectivity of the external auditor. The Committee considers the independence of the external auditor annually and the Group has a formal policy for the engagement of its external auditor to supply non-audit services, reviewed, most recently, in September 2018. The policy is designed to ensure that neither the nature of the service to be provided nor the level of reliance placed on the services could impact the objectivity of the external auditor's opinion on the Group's financial statements.

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

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

Fees paid to the external auditor

Fees paid to the external auditor are shown in note 27 to the Accounts. Other than services required to be provided by external auditors by legislation or regulation, non-audit services provided by KPMG related to assurance in respect of transactions, where such assurance is customarily given by a company's auditors (shown as 'other assurance services' in note 27).

Audit fees of Group entities for the year have increased by 37.4% to £1,161,000 (2017: £845,000). This was a result of an increase in scope as a result of acquisitions and additional work related to the introduction of IFRS 9.

The fees paid to KPMG, the Group's external auditor, for non-audit services (excluding VAT), were £68,000 (2017: £52,000), which is equivalent to 5.2% of the total fees paid to them.

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 Auditor's firm and considers discrete projects on a case-by-case basis. The Group has engaged with a number of firms, including some outside the 'big four' largest audit firms for assignments during the year, assessing each firm's appropriateness for the particular assignment before an appointment was made. Fees paid to audit firms (excluding VAT), excluding the Group audit and related fees can be analysed as shown below:

	2018	2017
	£000	£000
Auditors – KPMG	68	52
Other big four firms	926	673
Other firms	3	33
	997	758

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

B4.5 Internal Audit

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

Operations

During the year, the Committee considered and approved the annual internal audit plan, which is based on an assessment of the key risks faced by the Group. Progress in respect of the plan is monitored throughout the year and an assessment made of whether the internal audit function has sufficient resource to complete the plan. 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.

The Internal Audit Director met regularly throughout the year with the Chairman of the Committee to discuss progress against plan, outstanding agreed actions, and departmental resourcing. Ahead of finalisation of the audit plan for the year ending 30 September 2019, the Chairman of the Committee met with the Internal Audit Director and his managers to discuss audit planning priorities, key business risks and assess current resourcing. The Chairman then took the opportunity to meet informally with all the internal audit team members to enhance understanding on both sides.

The Group's Internal Audit Director informed the Committee of his intention to retire during the year and the Committee supervised the transitional arrangement to ensure the ongoing effectiveness of the internal audit function. The Committee was also responsible for the selection process for a new Internal Audit Director, with the Chairman interviewing all shortlisted candidates and discussing them with the Committee, who approved the final selection. The successful candidate took up her appointment in November.

At the request of the PRA, as part of a market-wide review, during the year ended 30 September 2018 internal audit has undertaken specific review work to assess the effectiveness of the firm's processes and controls in place in relation to the PRA Certification Regime. Additionally, other assurance has been provided to the regulator with treasury and funding reviews in the Bank. These reviews were co-sourced under the agreement with a third-party accounting firm on a subject matter expertise basis. Certain other technical or specialist reviews of the first and second line have also been undertaken including an element of co-sourced input where it was deemed by the Internal Audit Director that such skills would complement those of the internal team.

All internal audit reports are circulated to the full Board. Main findings of reports graded high or above are discussed by the Committee. Overdue actions graded medium or above are challenged at both the Committee and the Risk and Compliance Committee.

The results of this work, together with the Committee's engagement with the management information of the Group and the executive directors, have enabled them to conclude that the statements given in Section B3 relating to the Group's systems of internal control and its management of risk are appropriate.

Effectiveness

In line with the Chartered Institute of Internal Auditors standards, the Committee commissioned an external quality assessment ('EQA') in January 2018 to benchmark internal audit activities against best practice and peers. The EQA concluded:

"Overall we have been impressed with the professional and stakeholder-focussed approach taken by Paragon Internal Audit and this is reflected in the positive feedback from both the Audit Committee and from senior management, who see a good level of value being delivered on a consistent basis. This is further supported by a strong level of conformance with the IIA's Standards."

B4.6 Whistleblowing

There is 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. This process is supervised by the Committee and any amendments to the policy require the approval of the Chairman of the Committee. There is a right of appeal to the Chairman where the employee is dissatisfied with the outcome and his decision is final in all cases.

To ensure that the policy is embedded in the operations of the Group all employees received training on the requirements of PIDA and the Group's policy during the year and were tested to ensure their understanding.

During the year ended 30 September 2018 no reports were made through the Group's whistleblowing process which necessitated action being taken.

B5

REMUNERATION REPORT

This report covers the activities of the Remuneration Committee for the year ended 30 September 2018 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 in August 2013, and the principles of the Code.

This report consists of the Statement by the Chairman of the Committee (B5.1) and the Annual Report on Remuneration (B5.2). The policy summary tables extracted from the detailed Remuneration Policy are reproduced for reference as Section B5.3. The full Remuneration Policy is set out in the Annual Report and Accounts for the year ended 30 September 2016, a copy of which can be found at www.paragonbankinggroup.co.uk.



Hugo Tudor
Chairman of the
Audit Committee

B5.1 Statement by the Chairman of the Remuneration Committee

Dear Shareholder

Introduction

Following my appointment as Remuneration Committee Chairman on 19 June 2018, I am pleased to present the Company's remuneration report for the year ended 30 September 2018.

I have been a member of the Remuneration Committee since my appointment to the Board in November 2014 and I recognise and support the philosophy the Group has adopted towards pay throughout the organisation; seeking to recognise fairly and equitably the contributions to the Group of all employees. For executive directors, the aim is to ensure that their rewards are aligned with the interests of shareholders through the achievement of the Group's strategic objectives and with a focus on appropriate risk management. The Committee and I are pleased and encouraged by the continued high level of shareholder support illustrated by a vote of above 98% in favour of the Annual Report on Remuneration at the 2018 AGM.

An active dialogue with shareholders has been maintained throughout the year. As part of our annual governance review myself, the Chairman, the People Director and the Company Secretary met with a number of major shareholders in October 2018. These meetings were positive in tone whilst appropriately challenging.

Business performance

The year saw growth in the Group's loan books, with new lending up 25.9% to £2,333.2 million, including loans made by the acquired businesses, which contributed to an increase in underlying profit by 7.8% to £156.5 million. Profit before tax on the statutory basis grew by 25.3% to £181.5 million after including a £28.0 million gain on sale of Idem Capital assets. This led to underlying EPS increasing by 11.3% to 48.2 pence (2017: 43.3 pence) and statutory EPS increasing to 55.9 pence (2017: 43.1 pence).

Funding was enhanced with the growth of the Group's savings deposit base to £5.3 billion from £3.6 billion a year earlier. The Group's capital position remains strong, with a regulatory CET1 ratio of 13.8% (2017: 15.9%), representing a more efficient capital position.

Remuneration outcomes for the year

The Committee recommended salary increases for the executive directors of 3%, in line with the average increase for the wider workforce. This came into effect from 1 October 2018. Strong financial performance and risk management resulted in bonus out-turns of 90% of maximum opportunity for all of the executive directors. Details of the performance relating to these bonuses are provided in Section B5.2.2. In assessing personal performance, the Committee took into account the continued excellent growth and focus on an expanding portfolio at a time when a major Group legal and regulatory re-structuring was also taking place.

Full retrospective disclosure of the target range for the bonuses for the year ended 30 September 2018 will be included in the 2019 Annual Report on Remuneration.

Awards granted under the Performance Share Plan ('PSP') in 2015 and which vested in respect of performance in the three years ended 30 September 2018 were subject to a Total Shareholder Return ('TSR') performance condition, measured against the FTSE 250 index (50% of the award), and an EPS growth condition (50% of the award). Awards vested at 72.47% of maximum.

Changes proposed for 2019

Changes proposed for the coming financial year are minimal. The TSR comparator group has been reviewed to reflect the changes in the financial services sector over the last few months and consequently constituents have been amended slightly. Details are in Section B5.2.3. The Chairman's fees and non-executive directors' fees are unchanged. We have broadened the 'trigger' events which permit the application of malus and clawback to the bonus and PSP awards to include significant failure of risk management.

During the coming year the Committee will be reviewing the current remuneration policy and preparing for the next binding vote on remuneration at the 2020 AGM. As part of this review we will be taking into account the Group's regulatory journey as it grows in size. We will also be addressing the impact of the new 2018 Code to ensure that our new policy is fit for purpose in light of those changes, including the provisions governing holding periods for long term incentives and guidelines on post-employment shareholdings. We will be consulting with shareholders over the course of the coming year before finalising our proposals.

The Committee will continue to engage with shareholders and hopes that it can rely on your continuing support at the AGM on 14 February 2019.

Hugo Tudor

Chairman of the Remuneration Committee

21 November 2018

B5.2 Annual report on remuneration

Remuneration summary

The information provided in this section is not subject to audit

Aligning our pay principles to our strategy:

The success factors on which the Group's strategic priorities are based	Translation into reward principles and structure	
	Bonus	Performance share plan
Credit quality	Risk measures and future value of new business	Risk assessment
Loan pricing	Future value of new business and financial performance	EPS growth and TSR
Funding	Risk measure and financial performance	EPS growth, TSR and risk assessment
Strong financial foundations	Financial performance	TSR and risk assessment
Efficient utilisation of the Group's capital base	Risk measures	TSR and risk assessment
Cost control	Profit measures and personal objectives	EPS growth
A customer focused culture	Personal objectives	Risk assessment includes customer engagement measures
These success factors deliver enhancement of shareholder value and align with the Group's reward structure		

At a glance summary of remuneration during the year ended 30 September 2018:

	Salary increase	Salary £000	Bonus earned as % of maximum	PSP vesting
N S Terrington	3%	489	90%	72.47%
R J Woodman	3%	308	90%	72.47%
J A Heron	3%	260	90%	72.47%

The annual report on remuneration comprises:

- The Remuneration Committee, key responsibilities and advisers (B5.2.1)
- The remuneration of the directors for the year ended 30 September 2018 (B5.2.2)
- How the remuneration policy will be applied to the directors in the year ending 30 September 2019 (B5.2.3)
- Other disclosures required by the Regulations (B5.2.4)
- Policy summary for executive and non-executive directors approved at the AGM in 2017 (B5.3)

The remuneration policy was approved at the Company's AGM on 9 February 2017 and became effective for three years from the close of that meeting. The remuneration policy is set out in full in the Annual Report and Accounts for the year ended 30 September 2016.

B5.2.1 The Remuneration Committee, key responsibilities and advisers

The information provided in this section is not subject to audit

Committee membership during the year ended 30 September 2018

The members of the Committee during the year were:

Hugo Tudor	Chairman from 19 June 2018
Fiona Clutterbuck	Chairman until 19 June 2018
Peter Hartill	Member all year
Patrick Newberry	From 5 June 2018
Bob Dench	Until 10 May 2018
Alan Fletcher	Until 24 February 2018

None of the non-executive directors who sit on the Committee has any personal financial interest (other than as a shareholder or debt holder) or conflict of interest arising from cross-directorships or day-to-day involvement in running the business.

Key responsibilities

The Committee determines the Company's policy on executive remuneration and specific compensation packages for each of the executive directors and the Chairman. No director contributes to any discussion about his or her own remuneration.

The Committee also reviews the level and structure of remuneration of senior management.

The terms of reference for the Committee are available from the Company Secretary.

Attendees

The CEO, People Director and external remuneration advisers attend by invitation.

Advisors

During the year, the Committee considered advice from:

- Deloitte LLP ('Deloitte') who were appointed as the Committee's independent advisor in February 2016 following a review process. Deloitte is a founder member of the Remuneration Consultants Group and as such voluntarily operates under its Code of Conduct in relation to executive remuneration in the UK. This supports the Committee's view that all advice received during the year was objective and independent

The total fees paid to Deloitte for advice to the Committee during the year amounted to £61,000 (including VAT). Deloitte provided other professional services to the Group during the year including share scheme advice, M&A support, corporate tax advice, pension structuring advice, regulatory advice, co-sourced internal audit services and advice relating to the Group's structured finance business

- The CEO and the People Director in determining remuneration for the year for directors and senior management

Statement of voting at Annual General Meeting

The table below sets out actual voting in respect of the resolutions to approve the Annual Report on Remuneration at the Company's AGM on 15 February 2018 and the Remuneration Policy at the AGM on 9 February 2017.

Resolution	Votes for	% for	Votes against	% against	Total votes cast	Votes withheld
Annual Report on Remuneration	194,583,324	98.36	3,234,726	1.64	197,818,050	430,854
Remuneration Policy	195,090,537	95.06	10,145,210	4.94	205,235,747	4,242

B5.2.2 Directors' remuneration for the year ended 30 September 2018

The information provided in this section has been audited

Single total figure of remuneration for executive directors

Year ended 30 September 2018	N S Terrington £000	R J Woodman £000	J A Heron £000	Total £000
Fixed remuneration				
Salaries and fees	489	308	260	1,057
Allowances and benefits ¹	14	12	12	38
Benefits in kind from the performance of duties ²	7	-	20	27
Pension allowance	220	138	117	475
Variable remuneration				
Cash bonus	672	428	364	1,464
Deferred bonus	207	126	105	438
Dividend on vested deferred bonus ³	-	16	-	16
Share awards	998	628	532	2,158
Total	2,607	1,656	1,410	5,673

Year ended 30 September 2017	N S Terrington £000	R J Woodman £000	J A Heron £000	Total £000
Fixed remuneration				
Salaries and fees	474	299	253	1,026
Allowances and benefits ¹	14	12	12	38
Pension allowance	197	142	105	444
Variable remuneration				
Cash bonus	653	416	325	1,394
Deferred bonus	201	122	92	415
Dividend on vested deferred bonus ³	-	-	17	17
Share awards ⁴	766	482	408	1,656
Total before pension settlement	2,305	1,473	1,212	4,990
Pension settlement ⁵	-	1,006	-	1,006
Total	2,305	2,479	1,212	5,996

1. "Allowances and benefits" includes private health cover, fuel benefit and company car provision or company car allowance (£10,000 to £12,000).
2. "Benefits in kind from the performance of duties" – the Company reimburses executive directors in respect of certain travel costs incurred in connection with the performance of their duties. The Company has been advised that the reimbursement of some of these costs constitutes a taxable benefit in kind. The Company has agreed to provide an allowance to these directors to cover the tax liability. The amounts shown represent the payments HMRC treats as taxable together with an allowance to cover the tax.
3. Dividend on vested bonus is the accrued dividends to the date of exercise paid on deferred bonuses which were exercised during the year. Under the policy which was adopted at the 2017 AGM, dividends will accrue to the point of vesting on deferred share awards made in respect of the year ended 30 September 2016 and thereafter.
4. The share awards value for the year ended 30 September 2017 has been restated to reflect the market value of the shares under the PSP that vested on 18 December 2017 as at that date.
5. The pension settlement relates to a legacy payment due to Richard Woodman for past service. Further detail is provided in the pensions note below.

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. They had no further entitlement under the Plan as at 30 September 2018 or 30 September 2017.

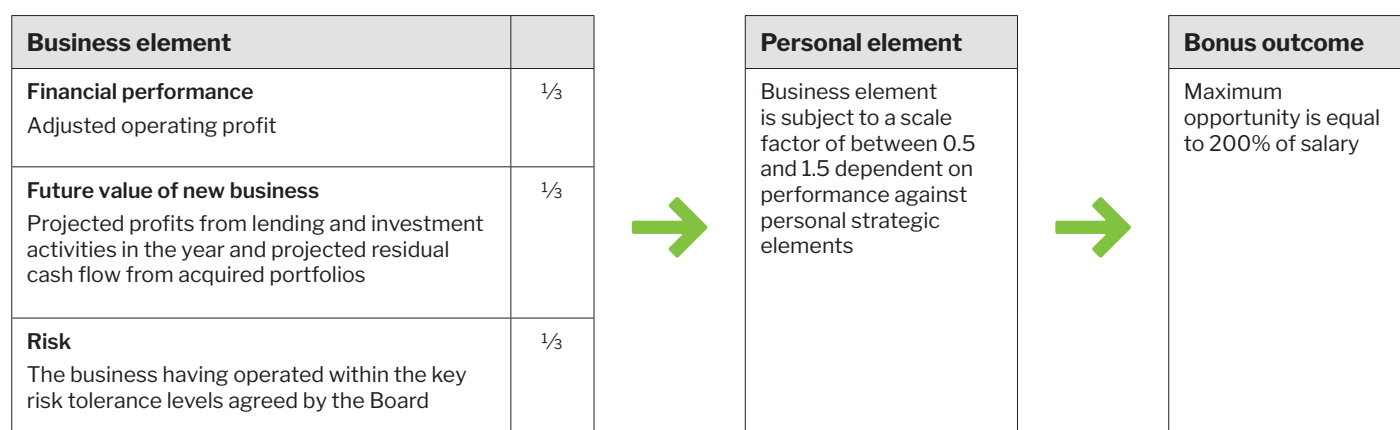
The executive directors had previously ceased pension accrual under the Plan in return for a cash supplement calculated, as a percentage of salary, to equate to the cost of the Group's contributions towards future service benefits had each individual stayed within the Plan for their future service accrual. This supplement was assessed every three years and was last assessed by the Group's actuaries during 2017. Following this assessment, recognising the substantial cost to the Group of meeting these obligations, the Committee asked the executive directors to agree to fix this cash supplement at 45% of base salary so that the Group would have known costs associated with pension provision. For all three directors, the fixed percentage was a lower amount than their actual contractual entitlement based on the most recent figures presented by the Group's actuaries.

These contributions in respect of further pension provision for each of the directors are shown as 'pension allowance' in the single total figure of remuneration table. The change to 45% was made with effect from 1 April 2017, and no compensation was paid or payable to the executive directors in respect of this change.

In assessing these values, the percentage due to Richard Woodman was higher due to an outstanding amount owed which related to past service (i.e. what the Group would legally be required to pay him if he left the Group). This was paid to him during 2017 and is shown in the single figure table above as 'pension settlement'. The consequence of settling this legacy contractual liability, which related to past not future service, was to reduce the calculated pension supplement to 63% from the original 103%. As explained above, Richard Woodman agreed to reduce this supplement to 45% without compensation.

Annual bonus

The annual bonus for the year ended 30 September 2018 was based on performance against business, financial and risk measures and personal strategic objectives.



Business element assessment

Performance for the year and the resulting award levels in respect of the business element were as follows:

Measure	Weighting	Target performance	Actual performance	Bonus outcome
Financial performance	1/3			16.5%
Adjusted operating profit		£156.8m	£156.5m	
Future value of new business	1/3			Individual ranges between 20.0% and 22.0%
Lending		£2,338.72m	£2,333.2m All business written in line with required return and risk appetite	
Debt purchase investments		£60.0m	£83.4m	
Risk	1/3	Operating within the risk tolerance levels set by the Board	Met all risk targets, excellent credit performance of loan book, no material risk events, successful integration of the risk management framework across the banking group following the legal restructure	Individual ranges between 26.5% and 28.0%

Full disclosure of the threshold and maximum ranges for the bonus earned in respect of the year ended 30 September 2018 will be given in the Annual Report on Remuneration for the year ending 30 September 2019, by which time it is anticipated that this information will no longer be considered commercially sensitive.

Personal element assessment

Performance against objectives is assessed by the Committee at the end of the year (with input from the CEO as appropriate). A scale factor is determined based on performance as set out in the table below.

Performance	Personal assessment	Scale factor
Poor	0	0.50
Below target	1	0.75
Target	2	1.00
Above target	3	1.25
Exceptionally good	4	1.50

The following overarching objectives were applicable to all executive directors:

- Provide strategic leadership to deliver the business plan aligned to the Group's strategy
- Deliver the planned financial performance within the parameters of the Group's risk appetite
- Safeguard fair outcomes for customers to ensure they are at the heart of everything we do
- Ensure secure and stable platforms are in place to deliver longer term strategic goals
- Embed the legal restructure across processes, systems and ways of working to maximum value
- Ensure the Group meets all risk, compliance and regulatory requirements
- Comply with the Senior Managers and Certification Regime and ensure it is embedded
- Protect the Group's strong culture with capable and motivated employees

The directors' individual objectives and the assessments made are set out below:

Executive director	Individual targets	Actual performance	Personal assessment
N S Terrington	In addition to strong leadership, delivery of the Group's business plan and financial performance, upholding our corporate values, ensuring our customers are at the heart of everything we do and extending the Paragon brand and all within the Group's risk management framework, the following annual personal objectives were agreed:		3-4
	Broaden the Group's presence as a leading UK specialist lender	Total non-buy-to-let lending £837.7m (2017: £453.5m)	
	Deliver strong organic new business generation	Growing maturity complemented by M&A activity	
	Actively assess M&A opportunities to broaden the Group's diversification strategy	Titlestone and Iceberg acquisitions accelerated the Group's diversification strategy	
	Drive the business towards the optimisation of RoTE on a sustainable basis over the medium term	M&A activity, volume and margin management, the funding programme and financial risk management has positioned the Group for future growth	
	Develop an increased awareness of conduct risk to appropriately control and monitor inherent and residual risks	Formal external and internal mentoring and conduct courses	

Executive director	Individual targets	Actual performance	Personal assessment
R J Woodman	In addition to strong leadership, delivery of the Group's business plan and financial performance, upholding our corporate values, ensuring our customers are at the heart of everything we do and extending the Paragon brand and all within the Group's risk management framework, the following annual personal objectives were agreed:		3-4
	Optimise the Group's funding costs to support lending activities	Retail funding from customers' deposits now exceeds £5.3bn Achieved Fitch upgrade and delivered the largest and cheapest securitisation deal post-crisis	
	Continue to advance the Group's application for IRB authorisation	Annual validation of buy-to-let first generation models and models for other products progressed	
	Ensure actions progress to support the Women in Finance Charter targets	First annual targets published, confirming five of the seven targets achieved	
	Increase oversight and management of the investor relations programme including equity analysts	Strong engagement with analyst community including facilitating initiation of coverage by new firms	

Executive director	Individual targets	Actual performance	Personal assessment
J A Heron	In addition to strong leadership, delivery of the Group's business plan and financial performance, upholding our corporate values, ensuring our customers are at the heart of everything we do, management of all buy to let activities, lending controls and customer engagement, all within the Group's risk management framework, the following annual personal objectives were agreed:		3-4
	Achieve £1,758.7m of buy-to-let and second charge mortgage originations	Lending in line with the levels indicated to the market with margins and risk appetite maintained	
	Increase the Group's specialist buy-to-let products and lending to corporate landlords	Cemented position and now almost exclusively serves the professional / complex end of the market	
	Develop bespoke commercial underwriting offering with individual terms and pricing	Adapted well to regulatory changes, leading to a more favourable business mix than originally planned	

Annual bonus outcome

The resulting bonuses for the year ended 30 September 2018, after applying the personal element scale factors to the business element award levels, were as follows:

Executive director	Financial performance	Future value of new business	Risk	Scale factor times	Total	Total £000	Cash £000	Share value £000
N S Terrington	16.5%	22.0%	26.5%	1.38	90%	879	672	207
R J Woodman	16.5%	21.0%	28.0%	1.37	90%	554	428	126
J A Heron	16.5%	20.0%	28.0%	1.39	90%	469	364	105

25% of amounts awarded in excess of £50,000 are deferred into nil cost options under the Deferred Share Bonus Plan ('DSBP') which can be exercised after three years. No further performance conditions apply to the deferred shares.

Retrospective disclosure of business element targets for the year ended 30 September 2017

The threshold and maximum performance targets in relation to the business element performance conditions are no longer considered commercially sensitive and are therefore disclosed below. Actual performance has also been provided for reference.

Measure	Threshold performance	Target	Maximum	Actual
Financial performance				
Adjusted operating profit	£129.2m	£143.5m	£157.9m	£145.2m
Future value of new business				
Lending	£1,269.7m	£1,587.1m	£1,904.5m	£1,853.4m
Debt purchase investments	£75.0m	£100.0m	£125.0m	£98.0m
Risk	The future value of new business was written in line with the Group's required return and risk appetite. The Group operated within the risk tolerance levels set by the Board for capital ratios, liquidity positions, new business and operational and regulatory risk. It also developed its plan to mitigate longer term strategic risk			

Performance Share Plan

Awards vesting in respect of the year ended 30 September 2018

Awards granted in December 2015 under the Group's PSP are subject to performance conditions measured over the three financial years ended 30 September 2018.

Performance condition	Weighting	Threshold vesting for 25% of maximum award	Maximum vesting	Actual performance	Vesting outcome
Relative TSR against the FTSE 250	50%	Median performance	Upper quartile performance	Between median and upper quartile	46.04%
EPS growth	50%	RPI plus 3% p.a.	RPI plus 13% p.a.	RPI plus 12.85% p.a.	98.90%
Total as a % of salary at grant					144.94%
Total as a % of maximum award					72.47%

There is straight-line vesting between the points and no reward below threshold performance.

The vesting percentage has been reviewed by the Committee and details of the estimated vesting outcome are set out below. This is subject to the Committee's final determination, in accordance with the financial underpin, that the level of vesting reflected the overall financial performance of the Group.

	Total shares granted	Vesting outcome	Total shares awarded ¹	Share price ²	PSP value £000
N S Terrington	259,944	72.47	188,381	487.6p	998
R J Woodman	163,708	72.47	118,639	487.6p	628
J A Heron	138,596	72.47	100,440	487.6p	532

1. In accordance with the rules of the PSP, participants are entitled on exercise to additional value equal to the dividends that would have been paid on vested shares in respect of dividend record dates between the grant date and vesting date. Accordingly, the share award values also include 42.1 pence per vested share in respect of such dividends.
2. The PSP value has been determined using the average closing share price for the three months ended 30 September 2018 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 2018.

Awards granted during the year ended 30 September 2018

During the year ended 30 September 2018 the following awards were granted under the PSP on 8 December 2017, each with a face value of 200% of salary.

Executive director	Salary £000	Percentage grant	Face value of grant £000	Share price ² £	Number of shares ¹
N S Terrington	489	200%	977	4.7614	205,192
R J Woodman	308	200%	615	4.7614	129,227
J A Heron	260	200%	520	4.7614	109,401

1. On the same date, as part of the above PSP award, each executive director was granted a tax qualifying option under the Company Share Option Plan ('CSOP') over 6,279 shares at an exercise price of £4.7776 per share. The CSOP options are subject to performance conditions described below. 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 over the number of shares stated in the table above, and the CSOP options may be disregarded in determining award value.
2. Based on the average closing mid-market price of the Company's shares on each of the five dealing days following the announcement of the Company's results for the financial year ended 30 September 2017, being the price used to determine the number of shares in accordance with the Directors' Remuneration Policy.

The PSP awards are subject to the following performance conditions*, with a performance period of the three years ending 30 September 2020:

Performance measure	Weighting	Threshold vesting at 25% of maximum award	Maximum vesting
Relative TSR	50%	Median performance	Upper quartile performance
EPS growth	25%	RPI plus 3% p.a.	RPI plus 7% p.a.
Risk	25%	Based on an assessment of a balanced scorecard of risk and compliance factors (see below)	

There is straight-line vesting between the points and no reward below threshold performance.

In addition, prior to any awards vesting under any element, the Committee must be satisfied that the requirements of a financial underpin test have been met.

* In line with the applicable tax legislation, the CSOP options are not subject to:

- (1) the risk performance condition (and accordingly, two thirds of each CSOP option is subject to the relative TSR condition and one third to the EPS growth condition); or
- (2) the underpin.

They will only deliver value to the extent the share price increases between grant and exercise.

Relative TSR measure

The comparator group for the purposes of the relative TSR condition is:

Aldermore Group PLC	Arrow Global Group PLC	Barclays PLC	Charter Court Financial Services Group PLC
Close Brothers Group PLC	CYBG PLC	Lloyds Banking Group PLC	Metro Bank PLC
OneSavings Bank PLC	Provident Financial PLC	Royal Bank of Scotland Group PLC	Secure Trust Bank PLC
S&U PLC	Virgin Money Holdings (UK) PLC		

Risk measure

The risk management performance condition is assessed by reference to risk management performance and the application of a strong risk culture across the Group taking into account:

Material regulatory breaches	Customer service	Management of liquidity and capital risk
Credit losses against risk appetite	Management of conduct risk	Material risk events over the performance period

Disclosure of assessment against performance of the risk element will be made in the Annual Report on Remuneration when the awards vest.

Chairman and non-executive director fees

	Year ended 30 September 2018			Year ended 30 September 2017		
	Fees £000	Benefits £000	Total £000	Fees £000	Benefits £000	Total £000
Chairman						
F J Clutterbuck ¹	159	5	164	90	-	90
R G Dench ²	158	7	165	240	15	255
Non-executive directors						
A K Fletcher ³	65	-	65	70	-	70
P J N Hartill	88	-	88	70	-	70
P J Newberry ⁴	65	-	65	2	-	2
B A Ridpath ⁴	65	-	65	2	-	2
H R Tudor	70	-	70	50	-	50
F F Williamson ⁴	85	-	85	2	-	2
G H Yorston ⁴	65	-	65	2	-	2
Total	820	12	832	528	15	543

1. Appointed as Chairman on 10 May 2018. Previously a non-executive director until appointment as Chairman. Fees as Chairman and as a non-executive director are therefore each for a part year.
2. Stepped down as Chairman and ceased to be a director on 10 May 2018; the figures above reflect his remuneration until his departure. No termination payment was made.
3. In addition to fees earned as a non-executive director, A K Fletcher serves as a director of the Corporate Trustee of the Plan and receives £15,000 (2017: £10,000) per annum in respect of that appointment from Paragon Finance PLC, the sponsoring company of the Plan and a subsidiary of the Company. The Plan is a trust which is independent of the Company and, as a director of its corporate trustee, A K Fletcher has a fiduciary duty to act in the best interests of the trust and the Plan's beneficiaries.
4. Appointed to the Board on 20 September 2017.

Directors' share interests

The interests of the executive directors in the shares of the Company at 30 September 2018 (including those held by their connected persons) were:

	N S Terrington Number	R J Woodman Number	J A Heron Number
Unvested awards subject to performance conditions			
PSP ^{1,2}	467,306	294,301	249,154
Unvested awards not subject to performance conditions			
DSBP	146,590	88,776	58,967
Sharesave	12,026	12,026	7,216
Total unvested awards	625,922	395,103	315,337
Vested but unexercised awards			
PSP ²	291,929	279,672	100,400
DSBP	108,190	26,965	19,249
Total vested but unexercised awards	400,119	306,637	119,689
Shares beneficially held	781,269	226,051	267,507
Total interest in shares	1,807,310	927,791	702,533
Awards exercised in the year			
PSP	250,000	574,424	146,986
DSBP	-	36,906	-
Total awards exercised in the year	250,000	611,330	146,986

1. In addition to the unvested PSP awards in the table, each executive director holds a CSOP option over 6,279 shares, at an exercise price of £4.7776 per share, as part of the awards granted on 8 December 2017, as described above.
2. For the purposes of the table above the awards granted in December 2015 are assumed to be vested but unexercised in respect of the percentage which it is estimated will vest (72.47%) as referred to previously and to have lapsed in respect of the balance.

The interests of the Chairman and the non-executive directors at 30 September 2018, which consist entirely of ordinary shares, beneficially held, were as follows:

	2018
F J Clutterbuck	8,372
A K Fletcher	30,000
P J N Hartill	7,000
P J Newberry	-
B A Ridpath	-
H R Tudor	225,000
F F Williamson	-
G H Yorston	-

As at 31 October 2018, the last practicable date prior to approving this Report, the Company has not been advised of any changes to the interests of the directors and their connected persons as set out in the tables above.

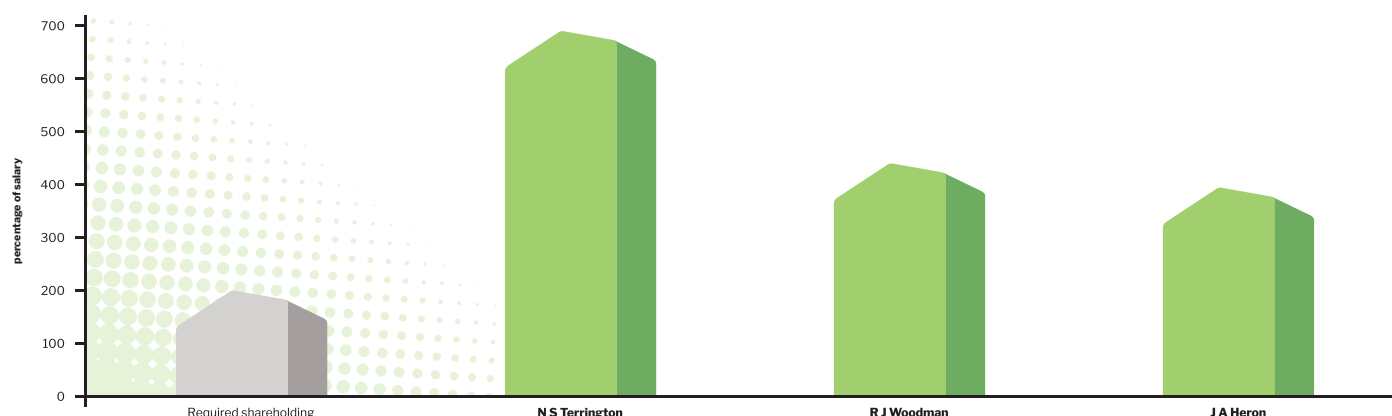
Share ownership guidelines

All executive directors are encouraged to hold a minimum number of shares in the Company with a value of 200% of their salary, calculated at 31 December each year. The valuation for shares held before 1 January 2017, is based on the average price of the Company's shares over a rolling three-year period. For shares acquired after that date the valuation is based on the market value of the shares at the date of acquisition. The value, net of income tax and national insurance, of vested but unexercised shares granted under the DSBP and under the PSP count towards the aggregate shares held by each director in respect of the policy.

The chart below compares the executive directors' holdings at 30 September 2018 to those required by the guidelines, expressed in value terms as a percentage of salary at 30 September 2018.

Directors' shareholding guidelines

30 September 2018



At 30 September 2018, all of the executive directors' holdings were in accordance with guideline levels. Due to the high level of personal shareholdings and the length of tenure of the three executive directors, the Committee decided, for the present, not to mandate that executives hold awards granted under the PSP for an additional period after the vesting date. For any new external appointment, however, the Committee has introduced a holding period of two years to encourage share participation.

B5.2.3 Application of remuneration policy for the year ending 30 September 2019

The information provided in this section of the Directors' Remuneration Report is not subject to audit

Executive directors

Base salary

The salaries of Nigel Terrington, Richard Woodman and John Heron were increased by 3% from 1 October 2018. This is in line with the level of increases for the Group's wider workforce.

	Salary with effect from	
	1 October 2018	1 October 2017
	£	£
N S Terrington	503,150	488,500
R J Woodman	316,875	307,650
J A Heron	268,275	260,450

Allowances and benefits and pension contributions

No changes from the stated policy.

Annual bonus

The annual bonus structure, maximum opportunity, metrics and deferral arrangements will be unchanged.

The Committee has chosen not to disclose, in advance, the performance targets for the forthcoming year as these are felt to be commercially sensitive. Retrospective disclosure of the targets and performance against them will be set out in next year's Annual Report on Remuneration except to the extent that any measure/target remains commercially sensitive.

The maximum award remains unchanged at 200% of salary and executive directors will be required to defer 25% of amounts awarded in excess of £50,000 in shares. The Committee may require higher levels of deferral or the executive may elect to defer a greater proportion.

PSP awards

Award levels for executive directors are unchanged at 200% of base salary. The performance conditions and targets are summarised below:

Performance measure	Weighting	Threshold vesting at 25% of maximum award	Maximum vesting
Relative TSR	50%	Median performance	Upper quartile performance
EPS growth	25%	RPI plus 3% p.a.	RPI plus 7% p.a.
Risk	25%	Based on an assessment of a balanced scorecard of risk and compliance factors	

There is straight-line vesting between the points and no reward below threshold performance.

In addition, prior to any awards vesting under any element, the Committee must be satisfied that the requirements of a financial underpin test have been met.

Relative TSR test

The comparator group for the purposes of the relative TSR test for the 2018 grant will be:

Amigo Holdings PLC	Arrow Global Group PLC	Barclays PLC	Charter Court Financial Services Group PLC
Close Brothers Group PLC	Funding Circle Holdings PLC	CYBG PLC	Lloyds Banking Group PLC
Metro Bank PLC	OneSavings Bank PLC	Provident Financial PLC	Royal Bank of Scotland Group PLC
Secure Trust Bank PLC	S&U PLC		

Risk test

Risk will be assessed against the same factors outlined in Section B5.2.2 in respect of the PSP awards made in the year ended 30 September 2018.

Chairman's and non-executive directors' fees

	Fee with effect from	
	1 October 2018	1 October 2017
	£000	£000
Chairman's fee	255	255
Base fee for non-executive directors	65	65
Additional fee for Senior Independent Director	10	10
Additional fee for chairmen of committees ¹	20	20

1. The additional fee for chairmen of committees is currently payable to the Chairmen of the Remuneration, Audit and Risk and Compliance Committees, but would be payable for the chairmanship of such additional committees as might be authorised by the Board.

B5.2.4 Other information

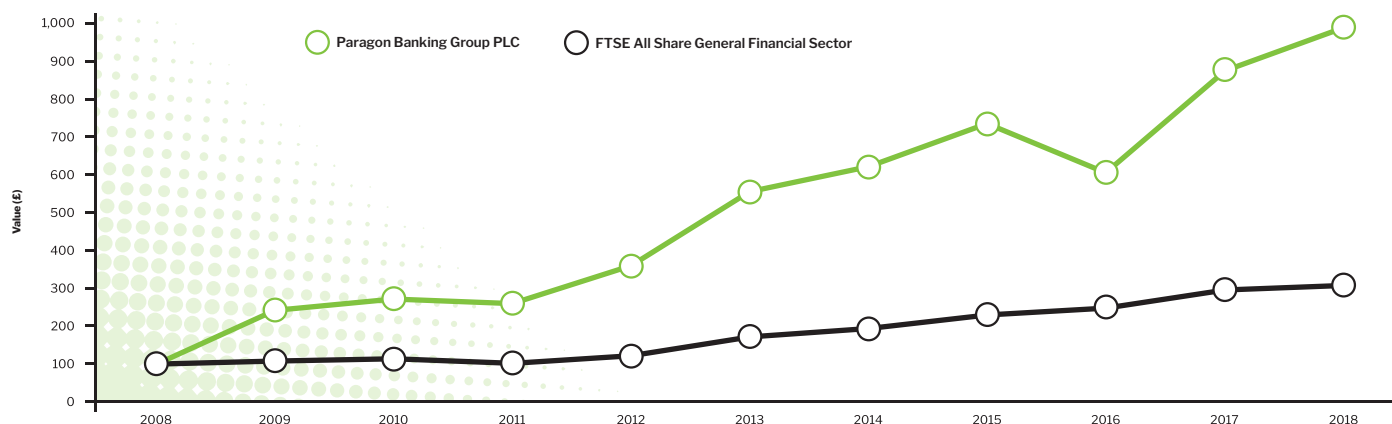
The information provided in this section of the Directors' Remuneration Report is not subject to audit

Performance graph and table

The following graph shows the Company's TSR performance compared with the performance of the FTSE All Share General Financial sector index. This graph shows the value, by 30 September 2018, of £100 invested in Paragon Banking Group PLC on 30 September 2008, compared with £100 invested in the FTSE General Financial sector index. The General Financial sector has been selected for this comparison because it is the sub-sector index that contains the Company's shares.

Ten-year return index for the FTSE All Share General Financial Sector

Ten years ended 30 September 2018



The following table shows the total remuneration, as defined by the Regulations, 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 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	%	%
2018	2,607	90.0	72.47
2017	2,305	90.0	63.51
2016	1,956	75.0	50.00
2015	2,546	100.0	100.00
2014	3,113	100.0	100.00
2013	2,655	85.0	100.00
2012	2,565	87.5	100.00
2011	2,382	87.5	58.60 and 85.10
2010	1,209	75.0	58.60
2009	932	50.0	-

Percentage change

The following table shows the change in certain aspects of the remuneration of the CEO, Nigel Terrington:

Component	2018	2017	Change
	£000	£000	%
Salary	489	474	3.2
Benefits ¹	14	14	-
Benefits in kind in performance of duties ²	7	-	-
Bonus	879	854	2.9

1. "Benefits" includes private health cover, fuel benefit and company car provision or company car allowance.

2. "Benefits in kind from the performance of duties" is where the Company reimburses executive directors in respect of certain travel costs incurred in connection with the performance of their duties. The Company has been advised that the reimbursement of some of these costs constitutes a taxable benefit in kind. The Company has agreed to provide an allowance to Mr Terrington to cover the tax liability. The amount shown represents the payments HMRC treats as taxable together with an allowance to cover the tax.

The Group's pay review taking effect on 1 October 2017 awarded average percentage increases in wages and salaries to employees as a whole of 3.21%.

The nature and level of benefits available to employees in the year ended 30 September 2018 was broadly similar to that in the previous year.

Relative importance of spend on pay

Set out below is a summary of the Group's levels of expenditure on pay and other significant cash outflows.

	Note	2018 £m	2017 £m	Change £m
Wages and salaries	24	57.2	51.4	5.8
Dividend paid	60	43.1	38.0	5.1
Loan advances and investment in portfolios		2,416.6	1,951.4	465.2
Corporation tax paid	61	32.0	28.9	3.1

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.

Current service contracts and terms of engagement

Chairman and executive directors

The current letter of appointment of the Chairman and service contracts for the executive directors are dated as follows:

	Contract date
F J Clutterbuck	10 May 2018
N S Terrington	1 September 1990 (amended 7 January 1993, 16 February 1993, 30 October 2001 and 10 March 2010)
R J Woodman	8 February 1996 (amended 10 March 2010)
J A Heron	1 September 1990 (amended 14 January 1993, 8 February 1993 and 10 March 2010)

Executive directors may accept an external non-executive appointment with the approval of the Board. Any fees earned are retained by the executive. None of the executive directors currently earns remuneration from external non-executive appointments.

Non-executive directors

Current terms of engagement for the non-executive directors apply for the following periods:

	Period of engagement
A K Fletcher	25 February 2018 to 24 February 2021
P J N Hartill	11 February 2017 to 10 February 2020
P J Newberry	20 September 2017 to 19 September 2020
B A Ridpath	20 September 2017 to 19 September 2020
H R Tudor	24 November 2017 to 23 November 2020
F F Williamson	20 September 2017 to 19 September 2020
G H Yorston	20 September 2017 to 19 September 2020

Non-executive director appointments are for three years unless terminated earlier by, and at the discretion of, the director or the Company upon three months' notice.

Executive directors' share interests

The individual interests of the executive directors under the PSP are as follows:

	Award date	Market price	At 1 October 2017 Number	Awarded Number	Lapsed Number	Exercised Number	At 30 September 2018 Number	Exercisable from
N S Terrington	28/02/2013	321.20p	77,840	-	-	77,840	-	28/02/2016
	10/12/2013	345.30p	130,419	-	-	130,419	-	10/12/2016
	18/12/2014	409.60p	145,289	-	-	41,741	103,548	18/12/2017
	22/12/2015 [†]	362.70p	259,944	-	71,563	-	188,381	22/12/2018
	01/12/2016	369.40p	262,114	-	-	-	262,114	01/12/2019
	08/12/2017	483.20p	-	205,192	-	-	205,192	08/12/2020
R J Woodman	17/12/2010	182.00p	205,886	-	-	205,886	-	17/12/2013
	21/12/2011	176.90p	219,943	-	-	219,943	-	21/12/2014
	28/02/2013	321.20p	148,595	-	-	148,595	-	28/02/2016
	10/12/2013	345.30p	69,525	-	-	-	69,525	10/12/2016
	18/12/2014	409.60p	91,508	-	-	-	91,508	18/12/2017
	22/12/2015 [†]	362.70p	163,708	-	45,069	-	118,639	22/12/2018
	01/12/2016	369.40p	165,074	-	-	-	165,074	01/12/2019
	08/12/2017 [*]	483.20p	-	129,227	-	-	129,227	08/12/2020
J A Heron	10/12/2013	345.30p	69,525	-	-	69,525	-	10/12/2016
	18/12/2014	409.60p	77,461	-	-	77,461	-	18/12/2017
	22/12/2015 [†]	362.70p	138,596	-	38,156	-	100,440	22/12/2018
	01/12/2016	369.40p	139,753	-	-	-	139,753	01/12/2019
	08/12/2017 [*]	483.20p	-	109,401	-	-	109,401	08/12/2020

[†] For the purpose of the table above, these awards are assumed to be vested in respect of the percentage which it is assumed will vest (72.47%) and to have lapsed in respect of the balance.

^{*} On 8 December 2017 each executive director was granted CSOP options over 6,279 shares, at an exercise price of £4.7776 per share, as part of his PSP award. If a CSOP option is exercised at a gain, the number of shares that may be delivered under the PSP will be reduced at exercise by the same value to ensure that the total pre-tax benefit is not increased by the grant of the CSOP options.

The individual interests of the executive directors under the DSBP are as follows:

	Award date	Market price	At 1 October 2017	Awarded	Exercised	At 30 September 2018	Exercisable from
			Number	Number	Number	Number	
N S Terrington	10/12/2013	345.30p	55,302	-	-	55,302	10/12/2016
	18/12/2014	409.60p	52,888	-	-	52,888	18/12/2017
	22/12/2015	362.70p	60,042	-	-	60,042	22/12/2018
	01/12/2016	369.40p	-	-	-	44,493	01/12/2019
	08/12/2017	483.20p	-	42,055	-	42,055	08/12/2020
R J Woodman	10/12/2013	345.30p	36,906	-	36,906	-	10/12/2016
	18/12/2014	409.60p	26,965	-	-	26,965	18/12/2017
	22/12/2015	362.70p	36,517	-	-	36,517	22/12/2018
	01/12/2016	369.40p	26,742	-	-	26,742	01/12/2019
	08/12/2017	483.20p	-	25,517	-	25,517	08/12/2020
J A Heron	18/12/2014	409.60p	19,249	-	-	19,249	18/12/2017
	22/12/2015	362.70p	21,901	-	-	21,901	22/12/2018
	01/12/2016	369.40p	17,849	-	-	17,849	01/12/2019
	08/12/2017	483.20p	-	19,217	-	19,217	08/12/2020

The individual interests of the executive directors under the Sharesave Plan are as follows:

	Award date	Option price	At 1 October 2017	Awarded	Vested	Exercised	At 30 September 2018	Exercisable from
			Number	Number	Number	Number	Number	
N S Terrington	20/06/2016	249.44p	12,026	-	-	-	12,026	01/08/2021
R J Woodman	20/06/2016	249.44p	12,026	-	-	-	12,026	01/08/2021
J A Heron	20/06/2016	249.44p	7,216	-	-	-	7,216	01/08/2019

B5.3 Policy summary

For ease of reference of this Report the remuneration policy tables for the executive and non-executive directors, as adopted following the AGM in 2017, are detailed below. However, these are summaries only and do not constitute a Policy Statement in accordance with the Regulations. For the full Policy Statement please refer to the Annual Report and Accounts for the year ended 30 September 2016 available at www.paragonbankinggroup.co.uk.

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 and pension scheme contributions or alternative retirement benefit provision. Performance-related remuneration consists of participation in the annual bonus plan and the award of shares under the PSP. The performance-related elements of remuneration are intended to provide a significant 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 remuneration levels in the Group as a whole, individual and business performance and objective research into comparable companies.</p>	<p>While there is no maximum salary, if the Committee is satisfied with the individual's performance increases will normally broadly follow those awarded for the rest of the organisation, in percentage of salary terms.</p> <p>Increases above the level awarded for the rest of the organisation may be awarded in appropriate circumstances which may include, but are not limited to:</p> <ul style="list-style-type: none"> • Changes in the scope or responsibilities of a director's role • Development or performance in role • A change in the size and/or complexity of the business • Change in market practice or a director's salary substantially falling behind a market competitive rate 	None.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Benefits			
To provide market levels of benefits on a cost-effective basis.	<p>Private health cover for the executive and their family, life insurance cover of up to seven times salary and company car or cash alternative.</p> <p>Other benefits may be offered from time to time taking into account individual circumstances.</p>	<p>Private health care benefits are provided through third party providers and therefore the cost to the company and the value to the director may vary from year-to-year.</p> <p>Whilst no absolute maximum level of benefits has been set, it is intended the maximum value of benefits offered will remain broadly in line with market practice.</p>	None.
Retirement benefits			
To provide competitive post-retirement benefits (or an appropriate cash allowance).	<p>1/37.5 of basic annual salary for each year of eligible service.</p> <p>A cash alternative is offered in lieu of pension accrual, equating to the approximate cost to the Company of defined benefit provision, normally reviewed every five years.*</p> <p>For new external appointments, a cash allowance or company pension contribution may be awarded.</p>	<p>Maximum pension 2/3 of salary at retirement or the value of the annual cash alternative calculated by the Company's actuary.</p> <p>The maximum pension contribution (or cash allowance) for new external appointments will be up to 25% of salary.</p>	None.

* The existing directors have agreed that this payment will be capped at 45% of salary.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Annual bonus			
<p>To incentivise executives to achieve specific, predetermined goals that drive delivery of the Company's operational objectives.</p> <p>To reward individual performance.</p> <p>To encourage retention and alignment with shareholders' interests through a three-year deferral of a proportion of bonus, awarded in shares.</p>	<p>Each executive director's annual bonus is based on a challenging mix of performance measures.</p> <p>25% of amounts awarded in excess of £50,000 are deferred under the DSBP, to be satisfied in shares, for three years. Higher levels of deferral may be required by the Committee or, with the approval of the Committee, may be elected for by the director. The Committee retains discretion to pay the whole of the bonus in cash in circumstances where the amount to be deferred would, in the opinion of the Committee, be so small as to make operation of the DSBP unduly administratively burdensome.</p> <p>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.</p> <p>Awards may include the right to receive a benefit of a value determined by reference to dividends that would have been paid on shares in respect of dividend record dates between grant and, except as described in the 'legacy arrangements' section of this policy, vesting. The benefit may assume the reinvestment of dividends and may be delivered in shares or in cash.</p> <p>The annual bonus is non-pensionable. 'Malus' and 'clawback' apply to the annual bonus.</p>	<p>Maximum annual bonus potential is 200% of salary.</p> <p>For target performance a bonus of 100% of salary will be awarded, with additional amounts being awarded for exceptional performance.</p> <p>If a bonus is awarded the minimum that could be paid is 8.25% of salary.</p> <p>For performance below threshold, no bonus is payable.</p>	<p>The performance targets are set by the Committee at the start of the year with input, as appropriate, from the Chairman and Chief Executive.</p> <p>Performance measures and their weightings are reviewed annually to maintain appropriateness and relevance.</p> <p>The bonus is calculated as follows:</p> <ul style="list-style-type: none"> • Performance against a range of measures, with at least 50% relating to financial metrics and any balance reflecting risk-related measures; and • Each element is then subject to a scale factor that can reduce or increase the bonus (subject to the overall cap of 200% of salary) according to performance against personal and strategic objectives.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Performance Share Plan ('PSP')			
<p>To incentivise executives to achieve enhanced returns for shareholders.</p> <p>To encourage long-term retention of key executives.</p> <p>To align the interests of executives and shareholders.</p>	<p>An annual award of shares subject to continued service and performance conditions assessed over a three-year performance period.</p> <p>The performance conditions used are reviewed on an annual basis to ensure they remain appropriate.</p> <p>Awards are structured as nil cost options with a ten-year life, a conditional award of shares or an award of forfeitable shares.</p> <p>Awards may include the right to receive a benefit of a value determined by reference to dividends that would have been paid on vested shares in respect of dividend record dates between grant and vesting. The benefit may assume the reinvestment of dividends and may be delivered in shares or in cash.</p> <p>For any externally appointed executive director, awards under the PSP will be subject to an additional holding period of two years following the date of vesting before they are released to the participant.</p> <p>The Committee may at its discretion structure awards as 'Qualifying PSP Awards' comprising both an HMRC tax qualifying option and a standard PSP award, with the extent to which the standard PSP award may be exercised being scaled back to take account of any gain made on exercise of the tax-qualifying option.</p> <p>'Malus' and 'clawback' apply to the PSP.</p>	<p>Maximum award is 200% of salary in any year. Where a 'Qualifying PSP Award' is granted, the shares subject to the HMRC tax qualifying option part of the award are not taken into account for the purposes of this limit, reflecting the 'scale back' referred to in the 'Operation' column.</p> <p>In determining the number of shares subject to an award, the market value of a share shall, unless the Committee determines otherwise, be assumed to be the average share price for the five days following the announcement of the Company's results for the previous financial year.</p>	<p>Granted subject to challenging performance measures that reflect the Company's strategic priorities. Performance conditions may include financial measures (eg adjusted EPS and / or relative TSR), and / or risk-based measures and / or strategic measures. Performance measures and their weightings, where multiple measures are used, are reviewed annually to maintain appropriateness and relevance.</p> <p>25% of the awards will vest for threshold performance, with full vesting taking place for equalling or exceeding the maximum performance target.</p>

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Sharesave Plan			
<p>To provide all employees with the opportunity to become shareholders on similar terms.</p>	<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 Plan provides tax benefits in the UK subject to satisfying certain HMRC requirements and is operated on an 'all employee' basis.</p>	<p>HMRC monthly savings limits apply.</p>	<p>None.</p>

Elements of the remuneration policy for the Chairman and non-executive directors

The Chairman receives a salary, a company car or cash alternative and is eligible for private health cover for herself and her family in the same way as the executive directors. Non-executive directors are remunerated solely by fees. Neither the Chairman nor the non-executive directors are eligible to participate in any of the Company's 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 (e.g. travel and hospitality).

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Salary and fees			
<p>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>	<p>Non-executive director fees are reviewed on a periodic basis and are subject to the Articles of Association. The Chairman'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 procure 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 the roles of Senior Independent Director and / or chairman of a board committee.</p>	<p>Increases above those awarded for the rest of the organisation may be made to reflect the periodic nature of any review.</p> <p>Changes in the scope or responsibilities of a director's role, or the time commitment required, may require an adjustment to the level of their fee.</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>None.</p>

B5.4 Approval

This Directors' Remuneration Report, Section B5 of the Annual Report and Accounts, including the Statement by the Chairman 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

Chairman of the Remuneration Committee

21 November 2018

B6

RISK MANAGEMENT



Finlay Williamson
Chairman of the
Risk and Compliance
Committee

B6.1 Risk and Compliance Committee Chairman's Report

Dear Shareholder

I am pleased to write to you again as Chairman of the Risk and Compliance Committee to explain how we as a committee have discharged our responsibilities in the last year.

Following the major corporate restructuring in 2017, the decision was taken to combine the meetings of the previously separate Bank and Group Risk and Compliance Committees for practical reasons and all required changes arising from this were fully embedded early in the year. I am pleased to report that this has resulted in a simpler and more effective governance structure.

As a Committee, our primary responsibility has continued to be the maintenance of oversight of the effectiveness of the Group's risk management framework and of the Group's systems and controls for compliance with its statutory and regulatory obligations. The Committee also oversees the risk culture within the Group to ensure that this is adequately embedded and is supportive of the overall risk appetite set by the Board.

The Committee has maintained an agenda that has balanced standing review items with coverage of new or materially heightened risks and deeper dives into areas considered worthy of greater focus.

Standing items covered in each meeting have included:

- Reviews of the principal risks facing the Group
- Consideration of new or emerging risks
- Consideration of the potential impact of key regulatory developments
- Consideration and challenge of management's rating of the various risk categories to which the Group is exposed
- Consideration of the root causes and impact of material risk events and the adequacy of actions undertaken by management to address them

In addition, during the last year, the Committee:

- Reviewed the Group's risk appetite to ensure it remained consistent with the delivery of the Group's strategic objectives, proposing any required changes to the Board
- Considered regular focussed reviews of key risk areas including credit risk, capital risk, liquidity and market risk and conduct risk
- Considered reviews on specific areas of focus including cyber security and operational resilience
- Reviewed, challenged and approved the Management Responsibilities Map
- Monitored the management of any residual transition risk following the Group's corporate reorganisation
- Reviewed, challenged and approved the terms of reference of each of the executive risk committees
- Monitored developments in the buy-to-let market in light of the implementation of regulatory changes in 2017
- 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 RRP recommending approval to the Board
- Monitored and reviewed progress in the development of policies and procedures to enable the Group to comply with the General Data Protection Regulation
- Monitored and reviewed the potential impacts on the Group of the UK's decision to withdraw from the EU
- Monitored progress with regard to the Group's strategic decision to seek regulatory approval to enhance credit risk management by implementing an IRB approach
- Challenged and approved various key risk policies

During the coming year, the Committee's priorities will include:

- Reviewing the Group's risk appetite to ensure it remains consistent with delivery of the Group's strategic objectives and proposing any required changes in risk appetites to the Board
- Continuing to review the potential impacts on the Group of the UK's decision to withdraw from the EU as details of the terms of exit and the basis of the future relationship become clearer
- Reviewing the management of any residual transition risk following the Group's acquisition of the Titlestone development finance business
- Reviewing and challenging the Group's submissions to the PRA, ahead of approval by the Board, in relation to its strategic decision to seek regulatory approval to implement an IRB approach for credit risk
- Reviewing and challenging reports in relation to ICAAP, ILAAP and RRP ahead of approval by the Board
- Monitoring the Group's adherence to the FCA and PRA requirements in relation to the Senior Managers and Certification Regimes as they are expanded across the financial services sector
- Monitoring the impact on the Group of proposals to replace LIBOR as the primary sterling interest rate benchmark
- Undertaking deep dives in relation to specific risk categories and business areas on both a rolling and ad hoc basis

Overall, I am pleased to confirm that in the last year the Committee has again, in my view, met its key objectives and carried out its role effectively.

As I look to the year ahead, it is clear that the economic, political and regulatory environment within which the Group operates will remain challenging. In particular, the level of uncertainty surrounding the basis of the UK's departure from the EU in March 2019 and the status of its future trading relationships remains extremely unclear. Whilst I remain confident that the Group has the skills and experience to manage the risks it is likely to encounter in the year ahead, we remain vigilant to the need to reinforce these should circumstances change materially.

Finlay Williamson

Chairman of the Risk and Compliance Committee

21 November 2018

B6.2 Risk governance

The Risk and Compliance Committee assists the Board in fulfilling its responsibilities for risk management and comprises the independent non-executive directors and the Chairman of the Company. Its terms of reference, which were reviewed and approved by the Board in October 2018, include all matters indicated by the Code.

The Committee's responsibilities include reviewing:

- The effectiveness of the Group's risk management framework and the extent to which risks inherent in the Group's business activities are controlled within the risk appetite established by the Board
- The effectiveness of the Group's systems and controls for compliance with statutory and regulatory obligations, as well as its obligations under significant contracts
- The oversight of the timely completion of any remedial actions found to be necessary
- The appropriateness of the Group's risk culture, to ensure it supports the Group's stated risk appetite
- The effectiveness of the Group in addressing issues requiring remedial attention to ensure actions are completed in a timely manner and minimise the potential for risk appetite thresholds to be exceeded

The Risk and Compliance Committee provides oversight and challenge to the Group's enterprise-wide risk management arrangements. The Committee is supported by an executive level Asset and Liability Committee, Conduct and Compliance Committee, Credit Committee, Model Risk Committee and Operational Risk Committee.

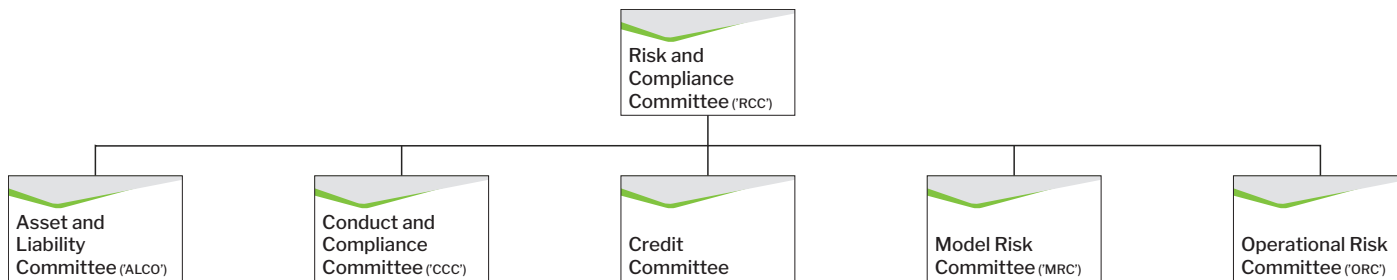
The Committee meets at least four times a year and normally invites the executive directors, Chief Risk Officer ('CRO'), Chief Operating Officer and Internal Audit Director to attend its meetings. However, it reserves the right to request any of these individuals to withdraw or to request the attendance of any other Group employee. The Committee meets with the CRO at least once a year, without the presence of executive management, to discuss his remit and any issues arising from it.

The Committee also has the opportunity to meet with the Internal Audit Director and/or the external auditor without the presence of executive management to discuss any matters that any of these parties believe should be discussed privately.

Agenda items for regular meetings of the Committee include:

- Reviewing the Group's principal risks
- Receiving and considering reports relating to the Group's consolidated risk profile
- Receiving and considering reports relating to the Group's performance against the Board's risk appetite and the progress of any resulting management actions to restore performance within approved target ranges
- Reviewing any proposed material changes to the Group's risk appetite prior to approval by the Board
- Reviewing and approving the Compliance Plan and the proposed management actions to address any adverse reports
- Receiving reports relating to key regulatory developments affecting the Group
- Reviewing the Group's conduct strategy and receiving reports from management on conduct risk
- Receiving reports from the Money Laundering Reporting Officer on compliance with Anti Money Laundering requirements
- Reviewing material operational risk events to assess the effectiveness of the Group risk and control assessment framework
- Reviewing the timeliness, effectiveness and progress of any executive management actions required to remediate issues identified
- Reviewing the Group's capital and liquidity adequacy assessments and stress testing analysis
- Considering the minutes of its executive sub-committees

The structure of the executive committees reporting to the Committee and their reporting lines is illustrated below:



Each of the executive committees operates within terms of reference formally approved by the Risk and Compliance Committee. The primary functions of each of these committees are described below.

Asset and Liability Committee ('ALCO')

ALCO comprises heads of relevant functions and is chaired by the CFO.

The principal purpose of ALCO is to monitor and review the financial risk management of the Group's balance sheet. As such, it is responsible for overseeing all aspects of market risk, liquidity risk and capital management as well as the treasury control framework. ALCO operates within clearly delegated authorities, monitoring exposures and providing recommendations on actions required. It also monitors performance against appetite on an on-going basis and makes recommendations for revisions to risk appetites to the Risk and Compliance Committee.

Conduct and Compliance Committee ('CCC')

The CCC comprises heads of relevant functions and is chaired by the Deputy CRO.

The CCC is responsible for overseeing the Group's conduct risk and compliance arrangements. The Committee considers conduct risk information such as details of conduct breaches; systems and procedure for delivering fair outcomes to customers; the product governance framework; monitoring reports; and employee incentive schemes. It also considers product reviews from a customer perspective. With respect to compliance, the CCC is responsible for overseeing the maintenance of effective systems and controls to meet conduct related regulatory obligations. It is also responsible for reviewing the quality, adequacy, resources, scope and nature of the work of the Compliance function, including the annual Compliance Plan.

Credit Committee

The Credit Committee comprises senior managers from the risk, finance and collections functions and is chaired by the CRO.

The Credit Committee approves credit risk policies and defines risk grading and underwriting criteria for the Group. It also provides guidance and makes recommendations in order to implement the Group's strategic plans for credit. The committee oversees the management of the credit portfolios, the post origination risk management processes and the management of past due or impaired credit accounts. It also monitors performance against appetite on an on-going basis and makes recommendations for revisions to the credit risk appetites to the Risk and Compliance Committee. The Committee also operates the Group's most senior lending mandate.

Model Risk Committee ('MRC')

The MRC comprises senior managers from risk, finance and the main business areas and is chaired by the CRO.

The role of the MRC is to review and make recommendations on all material aspects of the rating and estimation processes in relation to key credit and finance models.

Operational Risk Committee ('ORC')

The ORC comprises heads of relevant functions and is chaired by the CRO.

The ORC is responsible for overseeing the Group's operational risk and business risk management arrangements, including those systems and controls intended to counter the risk that the Group might be used to further financial crime. The Committee considers key operational risk information such as key risk indicators, themes within risk registers, emerging risks, loss events, control failures, and operational resilience measures.

It also monitors performance against appetite on an on-going basis and makes recommendations for revisions to the Risk and Compliance Committee.

B6.3 Risk management culture

The Board is committed to maintaining an effective risk management framework that is consistent and commensurate with the nature, complexity and risk profile of the business and is responsive to both internal and external events. The Group's inherently risk-averse approach to its business is expressed through the culture promoted by the Board and senior management. This has resulted in historically low levels of credit and operational losses and the absence of any material conduct issues affecting customers. The Group aims to help its customers by offering financial options which meet individual needs and achieve fair customer outcomes in a well-controlled environment.

The following risk principles are designed to support and protect the Group's strategic goals:

- Risk management is used to protect the Group's customers, shareholders, creditors and its reputation
- The fair treatment of customers and the delivery of fair outcomes, particularly for those customers considered to be vulnerable, is central to the Group's risk management approach
- The Group encourages a risk culture that has robust risk management at the heart of all decision-making within an open and transparent environment
- The Group only carries out business where the potential risk to itself and its customers has been considered together with the potential reward and where the residual risk exposure is within its defined risk appetite
- The Group utilises appropriate risk management processes to ensure that risks are identified, assessed, prioritised and managed in a consistent way
- Appropriate, timely and accurate risk management information is maintained and developed to support business decisions and to ensure the Group operates within its agreed risk appetite

An independent Risk and Compliance function provides an effective second line oversight capability together with a source of specialist support and advice for business areas in relation to the management of risk.

B6.4 Risk management framework

Introduction

The Group's risk management framework is designed to enable management to identify and focus attention on the risks most significant to its objectives and to provide an early warning of events that put those objectives at risk. The framework includes:

- The Risk and Compliance Committee and its sub-committees as described in B6.2
- A suite of risk policies, which include policies addressing:
 - o Conduct risk (including dealing with vulnerable customers and handling complaints)
 - o Credit risk
 - o Treasury risk
 - o Operational risk
 - o Data protection
 - o Information security
 - o Health and safety
 - o Business continuity
 - o Anti-money laundering
 - o Anti-bribery and corruption
 - o Market abuse
 - o Whistleblowing
 - o Conflicts of interest

- Dedicated teams within the Risk and Compliance function covering particular risk areas, as described below
- Risk Champions appointed within all business areas to support the embedding of an effective risk culture across the Group
- A well-established and experienced Internal Audit function, supported by ongoing co-source arrangements with external providers when specific specialist skills are required

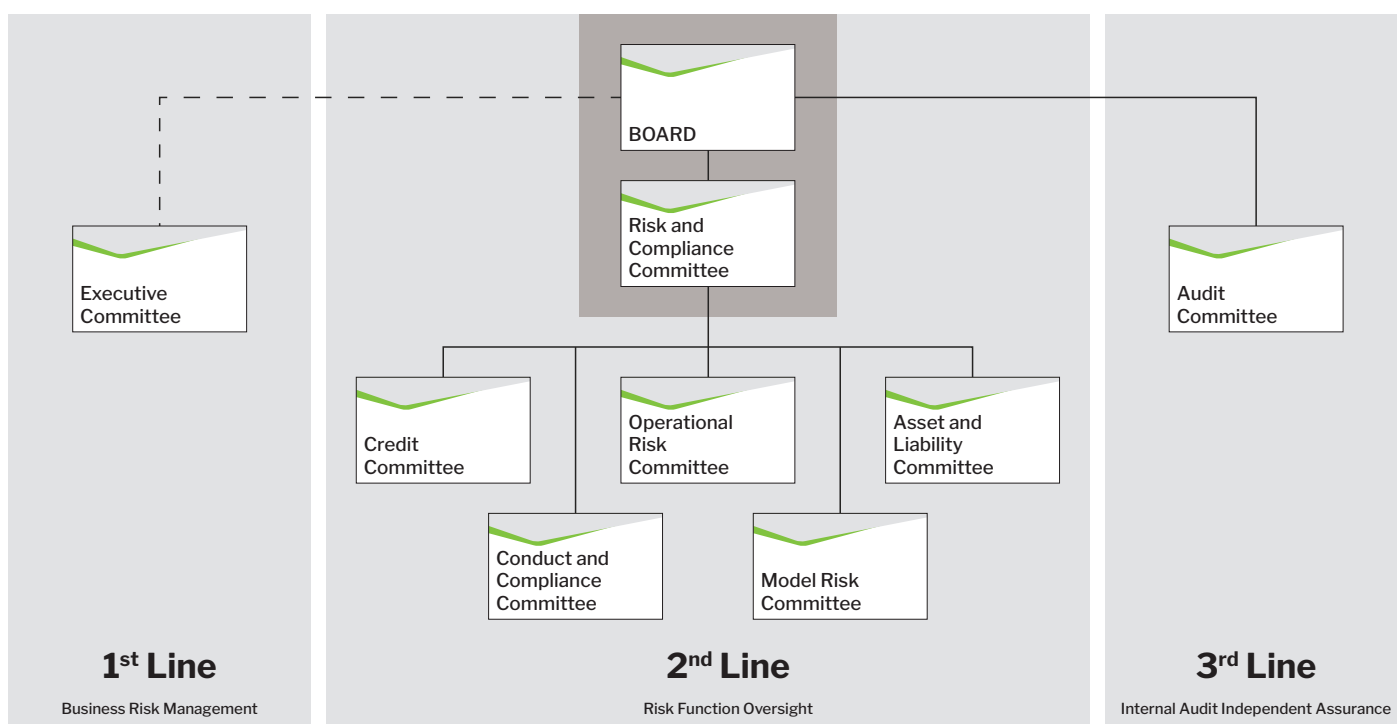
Three lines of defence model

The committee structures outlined above form the cornerstone for the governance of risk in a management framework organised within a three lines of defence model as follows:

- *The first line of defence*, comprising executive directors, managers and employees, holds primary responsibility for designing, operating and monitoring risk management and control processes
- *The second line of defence* is provided by the Risk and Compliance function which is responsible for providing risk oversight and guidance to the first line. The function is overseen by the Risk and Compliance Committee and its supporting executive committees
- *The third line of defence* is provided by the Internal Audit function which is responsible for reviewing the effectiveness of the first and second lines of defence. This function is overseen by the Audit Committee

In addition, there are further external levels of control that complement the three internal layers, provided by the external audit process and the monitoring activities of regulatory bodies.

The way in which the three lines of defence model aligns with the wider governance framework is illustrated below:



The risk management framework is intended to provide a structured and disciplined approach to the management of risk within agreed appetites thereby supporting the achievement of the Group's strategic objectives. The key objectives of the risk management framework are to:

- Establish standards for the consistent identification, measurement, monitoring, management and reporting of risk exposure and loss experience
- Outline the approach that will be taken in respect of setting and defining risk appetite and risk tolerances
- Promote risk management and the proactive reduction of the frequency and severity of risk events
- Facilitate adherence to regulatory requirements, including threshold conditions, capital standards and to support the regulatory requirements associated with the ICAAP, ILAAP and RRP
- Provide senior management and relevant committees with risk reporting that will be relevant and appropriate, enabling timely action to be taken in response to the information included within these reports
- Promote an appropriate risk culture across the Group

The Group publishes further information on its risk management system and risk profile in its Pillar III report, which can be found on the investor relations section of the Group's website at www.paragonbankinggroup.co.uk.

Risk management function

The Group's Risk and Compliance function is headed by the CRO, who reports directly to the CEO. The key responsibilities of the CRO are to:

- Develop and maintain the risk management framework covering all areas of the Group
- Develop and maintain risk policies within that framework, ensuring these are consistent with the Board's risk appetite
- Ensure that risks generated by the business are measured, monitored, controlled and reported on a timely basis
- Ensure compliance with all new and existing regulatory requirements
- Maintain open and constructive engagement with the regulatory authorities

The CRO is also responsible for the effective day-to-day running of the Risk and Compliance function and its relationship with the Board, its committees and senior management as well as for championing the Group's risk culture, providing support and advice to employees in the discharge of their risk responsibilities.

Following the major corporate restructuring in the previous year, the consolidation of the previously separate Group and Bank functions has been completed to good effect. During the course of the year additional focus and resource has been given to ensuring the structure and resources within the Risk and Compliance function are sufficient to meet the requirements of the restructured Group. The current function includes the following dedicated specialist second line areas which ultimately report to the CRO:

- Credit Risk
- Liquidity and Market Risk
- Compliance
- Operational Risk
- IT and Cyber Security Risk
- Data Protection
- Property Risk
- Financial Crime
- IRB Development

B6.5 Principal risks and mitigation

The Group is exposed to a number of principal risks and uncertainties that arise from the operation of its business model and strategy. A summary of those risks and uncertainties which could prevent the achievement of the Group's strategic objectives, how the Group seeks to mitigate those risks and the change in the perceived level of each risk in the last financial year are described below. These risks are discussed in more granular detail in the Group's Pillar III report, published on the Group website.


This analysis represents the Group's gross risk position as presented to, and discussed by, the Risk and Compliance Committee as part of its ongoing monitoring of the Group's risk profile.



This summary should not be regarded as a complete statement of all potential risks and uncertainties faced by the Group but rather those which the Group believes have the potential to have a significant impact on its financial performance and future prospects.

To identify and control the risks to which it is exposed, the Group employs a risk management framework. As part of this framework, principal risks are identified and assessed within the key categories of Business Risk, Credit Risk, Conduct Risk, Operational Risk, Liquidity and Capital Risk, Market Risk, and Pension Obligation Risk.

The changes in the perceived level of each risk in the last financial year are indicated using the symbols shown below:

 Risk Increasing	 Risk Decreasing	 Risk Stable
---	---	---


BUSINESS RISK		
Economic risk		
Description	Mitigation	
<p>The potential for a deterioration in the UK's economic conditions is harder to forecast given the continuing material uncertainties as to the terms on which the UK will leave the EU in March 2019.</p> <p>Given that its income is wholly derived from activities within the UK, the Group could be materially affected by a severe downturn in the UK economy, which could reduce demand for the Group's loan products, increase the number of customers that default on their loans and cause security asset values to fall.</p>	<p>The Group closely monitors economic developments in the UK and overseas, with support from leading independent macro-economic advisors. This information supports the senior management's review of objectives each year and helps inform business plans for each of the Group's principal trading operations.</p> <p>As a lender and acquirer of credit portfolios, exposure to any material deterioration in economic conditions is inevitable. The Board's defined strategy is to limit this risk by operating as a specialist lender in carefully chosen markets where its employees have significant levels of experience and expertise.</p> <p>The Group also uses stress testing to assess its expected performance under a range of operating conditions. This provides the Board with an informed understanding and appreciation of the Group's capacity to withstand shocks of varying severities. In addition to considering the credit implications of such economic stress, the board also considers the operational and liquidity implications of such scenarios, which would include the potential to increase liquidity coverage ratios, access contingent liquidity and further strengthen key risk and servicing functions as and when required.</p>	
Change	<p>Whilst UK economic performance has again been broadly stable in the last financial year, the near-term outlook has continued to remain uncertain given a lack of clarity as to the basis of the UK's withdrawal from and future relationship with the EU. This continuing uncertainty has led to the overall risk assessment being considered to have increased further in the last year.</p>	

BUSINESS RISK		
Concentration risk		
Description	Mitigation	
<p>Lending to customers investing in the UK private rented sector forms a substantial part of the Group's advances and assets.</p> <p>It is therefore exposed to any systemic deterioration in performance of the sector, which will be influenced by underlying factors such as house prices, supply of rental property, and demographic changes.</p> <p>The buy-to-let sector has been subject to a high level of fiscal and regulatory intervention in recent years, where such changes make buy-to-let less attractive or viable to customers' businesses, the Group is exposed to adverse consequences.</p>	<p>The Group has a very deep understanding of the private rented sector built up over many years of successful operations in the buy-to-let market. This includes a long history of performance data through several economic cycles together with regular independently conducted research commissioned over many years.</p> <p>The Group seeks to use this expertise constructively by playing an active role in shaping the development of policy for the private rented sector.</p> <p>Given its specialist knowledge of the sector and its historically prudent approach to underwriting, the Group has been well placed to respond effectively to the various regulatory changes introduced in recent years in relation to buy-to-let lending.</p> <p>The Group also continues to exploit opportunities to diversify the range of its activities and income streams, such as the acquisitions of the Iceberg and Titlestone businesses in the year. This is consistent with its strategic objective of operating as a prudent, risk focussed specialist lender that delivers fair outcomes for its customers.</p>	
Change	<p>The Group continues to have significant exposure to buy-to-let lending but, due to its specialist knowledge of the sector, it has been able to respond positively to recent regulatory changes.</p> <p>In the longer term, changes to the UK taxation regime and greater regulatory intervention in the sector may reduce demand and availability of buy-to-let lending products. However, the Group continues to be confident in its ability to operate successfully in this evolving environment.</p>	
Transition risk		
Description	Mitigation	
<p>Any failure to manage effectively the transition and implementation risks resulting from material corporate acquisitions such as those of Iceberg and Titlestone in the last financial year could impact adversely on the Group's financial performance and its reputation.</p>	<p>The Board's M&A strategy is that the Group will only consider acquisitions in areas of business that it understands, and which are complementary to its existing activities.</p> <p>Extensive pre-acquisition due diligence is always undertaken with support from respected, high quality advisors. Formal governance arrangements are applied to any proposed acquisition and to subsequent integration projects, with regular progress reporting to the executive team and the Board.</p> <p>Where necessary, enhancements are made to the risk and control frameworks of acquired businesses to ensure these are aligned to those within the wider Group.</p>	
Change	<p>Whilst acquisition of new businesses inevitably creates the potential for greater transition risk, the integration of the Iceberg and Titlestone businesses has progressed entirely satisfactorily. The Group remains confident that any residual risks in this area can be managed effectively.</p>	

CREDIT RISK


Customer risk


Description	Mitigation
<p>Failure to screen potential borrowers, underwrite and manage repayments effectively could expose the Group to the risk of unexpected material losses.</p> <p>Recoverable amounts on loans may also be affected by adverse movements in security values such as house and commercial asset prices.</p>	<p>The Group has comprehensive policies in place that set out detailed criteria which must be met before loans are approved.</p> <p>Credit policies incorporate limits for concentration risks arising from factors such as large exposures to counterparties, geographical areas or types of lending.</p> <p>The Group uses a range of sources to inform expectations of key external factors such as interest rate movements, house price inflation, property rental inflation and asset depreciation which are in turn used to guide policy and underwriting.</p> <p>The Group's approach to the management of credit risk and the systems in place to mitigate that risk on both originated and purchased assets are further described in note 9 to the Group Accounts.</p>

Change	<p>The Group's impairment rate has remained very low, reflecting the maintenance of robust, proven credit disciplines, generally stable economic conditions and the credit quality of its borrowers. The potential for any credit deterioration due to changing economic conditions, particularly given current uncertainties regarding the UK's future relationship with the EU, is being monitored closely across all Group portfolios.</p>	
---------------	---	---

Counterparty risk


Description	Mitigation
<p>The Group is exposed to the failure of counterparties with which it places deposits or which provide hedging agreements to mitigate interest rate and foreign exchange risk.</p>	<p>The Group has a strictly controlled number of approved treasury counterparties. To be approved, counterparties must meet specific credit rating criteria.</p> <p>Exposure to approved counterparties is monitored intra-day by senior management within the Group's Treasury function with all trading performed within approved limits.</p> <p>The credit quality of all treasury counterparties and the Group's exposure to them is reported monthly to ALCO.</p> <p>Treasury counterparties are typically highly rated banks and, for all cash deposits and derivative positions held within the Group's securitisation structures, they must comply with criteria set out in the financing arrangements, which are monitored externally.</p> <p>Where a counterparty to the Group's cross-currency basis swaps fails to meet the required credit criteria they are obliged under the terms of the instruments to set aside a cash collateral deposit.</p>



Change	<p>The credit quality of the treasury counterparties, with whom the Group transacts has been maintained during the year and this risk is therefore considered to have remained stable.</p>	
---------------	--	---

CONDUCT RISK		
Customer fair outcomes		
Description	Mitigation	
<p>The Group provides a broad range of financial services products across a number of brands to consumers and small business customers.</p> <p>As a result, the Group is exposed to potential conduct risk should it fail to deliver fair outcomes for its customers.</p> <p>Systemic poor customer treatment may lead to regulatory censure, reputational damage and resulting reductions in profitability.</p>	<p>The Group has a formal Conduct Risk Management framework which includes a number of detailed policies and standards addressing the fair treatment of customers. At the centre of these is the Conduct Risk Policy, underpinned by additional policies and standards. This sets out the Group's overarching approach to the management of conduct risk as part of a framework within which business areas are required to develop systems and processes to identify, measure, manage, monitor and report risks in accordance with stated risk appetites.</p> <p>The management of conduct risk within the Group is tailored to the specific product and customer type concerned. Business areas dealing with consumers have dedicated quality and control teams which validate process adherence and the delivery of fair treatment for customers. This may also include a dedicated customer support team to manage customers deemed to be vulnerable.</p> <p>During the last financial year, the Group has further strengthened its governance in relation to conduct risk by the introduction of a dedicated Conduct and Compliance Committee ('CCC'). The CCC has a remit which includes overseeing the fair treatment of customers.</p> <p>The CCC also receives items for review and / or approval, such as product governance submissions, conduct risk related policies and standards, business area incentive schemes, compliance monitoring outputs and regulatory communications.</p> <p>The Compliance function has a formal monitoring plan which is focussed on conduct risk and the fair treatment of customers, particularly those that are defined as vulnerable, or in financial difficulty. The plan is reviewed and approved on at least an annual basis by the RCC.</p> <p>Management actions to address any adverse compliance monitoring or Internal Audit reports are overseen at the CCC, ORC and RCC.</p> <p>The Group's approach to employee remuneration means that very few staff are included in financial incentive schemes. All schemes are required to be approved by the CCC before implementation and then reviewed by the CCC at least annually.</p>	
Change	<p>The Group operates in areas which are highly regulated and where continuing changes to the regulatory conduct landscape heighten the potential risk of financial losses or censure. In response to this, the Group has continued to develop and embed its conduct risk management framework during the year.</p>	

OPERATIONAL RISK

People risk


Description	Mitigation	
<p>The Group is exposed to the risk that it is unable to recruit and retain skilled senior management and key personnel at all levels.</p> <p>Failure to maintain the necessary skill base within its workforce could have a material impact on the Group's ability to deliver its business plan and strategic objectives.</p> <p>This is a particular risk in respect of key specialist and executive positions, where the institutional knowledge of the incumbents would be very difficult to replicate in the short term.</p>	<p>The Group manages and controls its key person dependency risk through effective succession planning, recruitment, development and retention strategies.</p> <p>External remuneration and reward structures are monitored to ensure the Group remains competitive and is able to recruit and retain key personnel.</p> <p>A range of employee benefits are offered in addition to base salaries including a defined contribution pension scheme, Sharesave Plan and an annual profit related pay scheme for most employees.</p> <p>Manager and Team Leader Academies have been created to develop pools of strong, capable individuals with the potential to fill future managerial and specialist roles within the business.</p> <p>The Group has been accredited under the 'Investors in People' scheme since 1997 and achieved Champion status in May 2014. This accreditation is awarded to a very small proportion of organisations who are seen as pioneers in people management practices and role models in strategic leadership.</p>	
<p>Change</p>	<p>A strong employment market and particularly buoyant demand for skilled financial services staff has again been a feature of the last financial year. This has led to continued strong competition to recruit and retain employees. Despite the increasingly competitive external environment, the Group remains confident in its ability to manage this risk.</p>	

OPERATIONAL RISK		
Systems risk		
Description	Mitigation	
<p>The Group is exposed to the risk that its IT infrastructure and systems are unable to support its operational needs and fail to offer adequate protection against the threat of cyber-crime.</p> <p>Failure in these systems, either in terms of capacity or security, could result in detriment to customers, regulatory censure and reputational damage, all of which could materially impact income and profitability.</p> <p>This risk also includes the potential that the Group's key outsourcing arrangements with third parties could expose it to material loss or reputational damage.</p>	<p>The Group has continued to strengthen its capabilities in relation to operational resilience and in particular its information technology infrastructure management and security.</p> <p>The Group has a formally agreed IT strategy which ensures that priority is given to those areas which are most critical to the delivery of the Group's strategy and business plan. It maintains an ongoing programme of investment in IT infrastructure and systems. This includes increased investment in security solutions to counteract cyber security threats and the recruitment of specialist resource.</p> <p>A formal Cyber Incident Response Plan is in place and reviewed with the RCC to ensure the Group is well placed to deal with any issues or events.</p> <p>There is ongoing focus on the information security management system (ISO 27001) to which the Group is certified, to ensure that controls, testing and user awareness are maintained and improved.</p> <p>Change programmes are closely managed with robust control and testing processes to ensure that system developments meet operational requirements and are effectively implemented.</p>	
Change	<p>The Group has continued to invest significantly in order to further enhance its operational resilience. This has included ensuring that it maintains a robust and secure IT infrastructure that supports its operational needs. However, the level and sophistication of cyber-crime continues to increase, heightening the risk that this may impact on the Group's operations and strategic objectives.</p>	
Regulatory risk		
Description	Mitigation	
<p>The Group is exposed to the risk that its financial performance and reputation could suffer significantly if it fails to identify, interpret and comply with relevant regulatory and legal obligations.</p> <p>The customers and market sectors to which the Group supplies products, and the capital markets from which it obtains some of its funding, have been subject to increasing legislative and regulatory intervention over recent years.</p>	<p>The Group has Risk and Compliance and Legal teams who review key regulatory and legal developments to assess the impact on the Group's operations. These teams then work with business areas to provide advice on the implementation of appropriate measures to meet identified requirements. Expert external advice is also sought where necessary. Major regulatory or legal change initiatives are subject to formal change governance with progress reporting to the RCC.</p> <p>All employees are required to undertake regulatory training and testing to ensure appropriate levels of competence are maintained. Those in relevant specialist roles are also required to adhere to formal regulatory training and competence regimes.</p> <p>The Compliance and Financial Crime functions maintain formal second line monitoring plans. Progress against the plan and the issues identified within individual reviews are reported to the CCC and the RCC to ensure that regulatory requirements have been satisfactorily embedded, and any lessons learnt are applied across all relevant areas of the Group.</p> <p>In order to ensure the Group responded effectively to the requirements of the Data Protection Act 2018, which covered the requirements of the EU General Data Protection Regulation, a formal programme was initiated under the sponsorship of the CRO. This included the delivery of comprehensive training and communications to all staff, the establishment of a Data Protection Office within the second line with appropriate supporting resource and a programme of oversight reviews.</p>	
Change	<p>The increasingly regulated nature of the Group's operations heightens the potential risk arising from any failure to comply with current regulations or to respond effectively to new and emerging regulations. The Group therefore continues to ensure it has robust arrangements in place to enable it to respond effectively to new and emerging regulatory developments.</p>	

LIQUIDITY AND CAPITAL RISK


Funding risk


Description	Mitigation
<p>The Group relies on its access to various sources of funding to finance the origination of new business, portfolio acquisitions and working capital. If access to funding became restricted, either through market movements or regulatory intervention, this might result in the scaling back or cessation of some business lines.</p> <p>Retail deposit taking is central to the Group's funding plans and therefore changes in market conditions could impact the ability of the business to maintain the level of liquidity required to sustain normal business activity.</p>	<p>The Group maintains a diversified range of both retail and wholesale medium and long-term funding sources to cover future business requirements and liquidity to cover shorter term funding needs. Comprehensive treasury policies are in place to ensure sufficient liquid assets are maintained and that all financial obligations can be met as they fall due.</p> <p>Paragon Bank is authorised to accept retail deposits. As such, it is subject to regulation by the PRA, which aims to ensure that sufficient liquid assets are held, at all times, to mitigate the liquidity risk inherent in deposit taking.</p> <p>During the financial year, further prudent use was made of the Bank of England's TFS to support ongoing lending activities. The drawings made under the Scheme were well phased to minimise the risks to the Group as they fall due over the coming years.</p> <p>In April 2018, the Company's credit rating from Fitch was increased from BBB- to BBB. This investment grade credit rating helps to support maintenance of access to funding markets.</p>

Change	<p>Following last year's corporate reorganisation, the Group is better placed to access funding from a wide range of sources to meet its future funding requirements. However, despite this, there has been continued strong competition for retail deposits amongst an increasing number of challenger banks during the year.</p>	
---------------	--	---

Capital risk

Description	Mitigation	
<p>Proposals made by the BCBS regarding potential changes to minimum capital requirements from 2021 could impact on the Group.</p> <p>The BCBS final proposals include increases in risk weights for residential real estate exposures where repayment is materially dependant on cash flows generated by the property, which may include certain categories of buy-to-let lending. The Group's capital requirements would, therefore, be increased to some extent.</p>	<p>In order to further enhance its existing robust credit management capabilities and to mitigate the risks of the proposed BCBS changes, the Group took a strategic decision in 2016 to seek the necessary regulatory approval to implement an IRB approach for credit risk.</p> <p>In support of this, the Group appointed an experienced director of IRB to lead this initiative. A formal IRB project has since been initiated with support from respected external specialist advisors to enable the Group to commence its application process with the relevant regulatory authorities during the first half of the new financial year.</p> <p>In June 2017, the PRA published an updated approach to IRB applications. The process is now modular, with each element covering a different aspect of a firm's plan for IRB implementation. This new application process is now embedded in the Group's IRB project plan.</p>	
Change	<p>In December 2017, the BCBS published its 'Basel III: Finalising Post-Crisis Reforms' document. This has clarified the proposed increase to the capital risk weights for buy-to-let lending under the revised standardised approach and the introduction of a capital output floor based on the revised standardised approach. The proposed changes had been anticipated within the Group's IRB project.</p> <p>Further information on the Group's management of capital risk is given in note 7 to the Group Accounts.</p>	

MARKET RISK		
Interest rate risk		
Description	Mitigation	
<p>The Group is exposed to the risk that changes in interest rates may adversely affect its net income and profitability.</p> <p>In particular, the Group's profitability is determined by the difference between the interest rates at which it lends and those at which it borrows.</p> <p>Changes in market interest rates could therefore materially impact the Group's profits as a result of significant mismatches between its assets and liabilities.</p>	<p>This risk is managed through Board approved risk appetite limits with comprehensive treasury policies in place to ensure that the risk posed by changes and mismatches in interest rates are effectively managed.</p> <p>The Board's risk management framework for Interest Rate Risk in the Banking Book ('IRRBB') continues to evolve in line with updates in regulatory guidance on methods expected to be used by banks for controlling such risks.</p> <p>Day-to-day management of interest rate risk within Board approved limits is the responsibility of Treasury with control and oversight provided by ALCO which reports to the RCC.</p> <p>The Group seeks to match the structure of assets and liabilities by using appropriate financial instruments, such as interest rate swaps or cap agreements and fixed rate retail liabilities.</p>	
Change	<p>The Group's interest risk exposure profile, relative to its balance sheet has remained broadly similar and therefore associated risk levels remain generally stable compared to previous periods. The approach to managing the risks has, however, been enhanced to reflect the BCBS principles.</p> <p>Further information regarding the Group's management of interest rate risk is given in note 11 to the Group Accounts.</p>	

PENSION OBLIGATION RISK		
Pension obligation risk		
Description	Mitigation	
<p>The Group operates a defined benefit pension scheme and defined contribution pension schemes in the UK.</p> <p>There is a risk that the Group's commitments under its defined benefit scheme expose it to the risk that the assets of the scheme may be insufficient to meet its liabilities, either due to adverse investment performance or inaccurate assumptions, including future inflation levels, members' salaries or mortality rates.</p>	<p>The Group's defined benefit scheme ('the Plan') was closed to new members with effect from February 2002. Since that time, new employees have been invited to join the Group's defined contribution pension scheme which carries no investment or mortality risk for the Group.</p> <p>To mitigate the risks inherent in its exposure to the Plan, the Group conducts regular asset-liability reviews in conjunction with the Trustee. These reviews are used to assist the Trustee and the Group to determine the optimal long-term asset allocation with regard to the structure of liabilities within the Plan.</p> <p>The results of the reviews also assist the Trustee in managing the volatility in the underlying investment performance and the risk of a significant increase in the scheme deficit by providing information used in investment strategy decisions.</p> <p>The Plan is subject to triennial formal valuation by the Plan actuary. The most recent valuation process, as at 31 March 2016 included the agreement of a recovery plan which aims to clear the deficit in the Plan by January 2023.</p>	
Change	<p>During the last year, changes in bond yields, equity prices, interest rates, mortality assumptions and inflation rates have all impacted favourably on the Group's exposure in relation to its pension obligations.</p> <p>Further details of the Group's exposure to the Plan are given in note 56 to the Group Accounts.</p>	

B7

DIRECTORS' REPORT

The directors of Paragon Banking Group PLC (registered number 2336032) submit their Report prepared in accordance with Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ('Schedule 7'), which also includes additional disclosures made in accordance with the requirements of the UK Listing Authority.

Directors and their interests

The directors of the Company during the year were:

F J Clutterbuck

R G Dench (resigned 10 May 2018)

N S Terrington

R J Woodman

J A Heron

A K Fletcher*

P J N Hartill*

H R Tudor*

P J Newberry*

B A Ridpath*

F F Williamson*

G H Yorston*

* Non-executive directors throughout the year

The directors' interests in the shares of the Company are disclosed in the Directors' Remuneration Report in Section B5. There have been no changes in the directors' interests in the share capital of the Company since 30 September 2018.

Mr H R Tudor additionally has an interest in £300,000 of the Company's 6.00% sterling denominated notes due 2020.

Other than as stated above, the directors had no interests in securities issued by the Company. The directors have no interests in the shares or debentures of the Company's subsidiary companies.

The appointment and replacement of the Company's directors is governed by the Articles of Association of the Company (the 'Articles'), the Code, the Companies Act 2006 and related legislation, and the individual service contracts and terms of appointment of the directors. The powers of the directors, and their service contracts and terms of appointment, are described in the Corporate Governance section, Section B3.1. The Articles may only be amended by the Company's shareholders in general meeting.

Under Article 161 of the Articles, the Company has qualifying third party indemnity provisions for the benefit of its directors, which were in place throughout the year and which remain in force at the date of this report, in the form of directors' and officers' liability insurance. The directors' and officers' liability insurance covers directors of all the Company's subsidiary entities.

Under Article 85 of the Articles certain directors are required to submit themselves for reappointment. In accordance with the Code, however, the Board has decided that it is appropriate for all directors to submit themselves for reappointment on an annual basis. Accordingly, all current directors, other than Mr Fletcher and Mr Newberry, who have announced their intention to step down from the Board before the meeting, will retire and seek reappointment at the AGM.

None of the directors has a service contract with the Company requiring more than 12 months' notice of termination to be given.

A director has a statutory duty to avoid a situation in which he or she has, or can have, an interest that conflicts or possibly may conflict with the interests of the Company. A director will not be in breach of that duty if the relevant matter has been authorised in accordance with the Articles by the other directors. The Articles include the relevant authorisation for directors to approve such conflicts.

None of the directors had, either during or at the end of the year, any material interest in any contract of significance with the Company or its subsidiaries.

Capital structure

Details of the issued share capital of the Company, together with details of movements in its issued share capital in the year, are given in note 57 to the accounts. The Company has one class of ordinary shares which carries no right to fixed income. Each ordinary share carries the right to one vote at general meetings of the Company. The rights and obligations attaching to ordinary shares are set out in the Articles.

There are no specific restrictions on the size of a member's holding or on the transfer of shares. Both of these matters are governed by the general provisions of the Articles and prevailing legislation. The Articles may be amended by special resolution of the shareholders. The directors are not aware of any agreements between holders of the Company's shares in respect of voting rights or which might result in restrictions on the transfer of securities.

Details of employee share schemes are set out in note 26 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 £88.5 million and to make market purchases of up to 26,500,000 £1 ordinary shares, granted at the AGM on 15 February 2018. These authorities expire at the conclusion of the forthcoming AGM on 14 February 2019 and resolutions will be put to that meeting proposing that they be renewed.

Purchase of own shares

On 25 November 2014 the Group announced a share buy-back programme, which had been extended to £165.0 million by the start of the year. On 23 November 2017 the programme was extended by £50.0 million. During the year 5,106,641 £1 ordinary shares (2017: 15,344,929) having an aggregate nominal value of £5,106,641 (2017: £15,344,929), were purchased under this programme. The reasons for this purchase were set out in Section A3.3 of the Annual Report for the year ended 30 September 2017. Total consideration paid in the year was £25.2 million, including costs (2017: £65.5 million).

All of the shares acquired under this programme were held initially as treasury shares.

The programme was suspended during the year and the Company has no current intention to make further buy-backs. Should this policy change, an announcement will be made to the market.

The number of treasury shares held at 30 September 2018 was 20,800,284 (2017: 15,693,643), representing 7.98% of the issued share capital excluding treasury shares (2017: 5.90%). The maximum holding of treasury shares during the year was 20,800,284 (2017: 24,251,153) representing 7.98% of the issued share capital excluding treasury shares at that time (2017: 8.91%).

Dividends

The directors recommend a final dividend of 13.9p per share (2017: 11.0p per share) which, taken with the interim dividend of 5.5p per share (2017: 4.7p per share) paid on 27 July 2018, would give a total dividend for the year of 19.4p per share (2017: 15.7p per share).

Major shareholdings

Notifications of the following major voting interests, comprising over 3%, in the Company's ordinary share capital, notifiable in accordance with Chapter 5 of the FCA's Disclosure and Transparency Rules or section 793 of the Companies Act 2006, had been received by the Company as at 30 September 2018 and at 31 October 2018, being a date not more than one month before the date of the notice convening the forthcoming AGM.

Shareholder	31 October 2018		30 September 2017	
	Ordinary Shares	% Held	Ordinary Shares	% Held
Royal London Asset Management Limited	19,263,761	7.39%	19,263,761	7.39%
Prudential plc group of companies	18,012,554	6.91%	18,012,554	6.91%
J O Hambro Capital Management Limited	13,090,008	5.02%	13,090,008	5.02%
Norges Bank	11,007,893	4.22%	11,007,893	4.22%

Significant agreements

The Company is not party to any significant agreements that would take effect, alter or terminate following a change of control of the company.

The Company does not have any agreements with any director or employee that would provide compensation for loss of office or employment resulting from a takeover of the Company, except that provisions of the Company's share based remuneration arrangements may cause awards granted to employees under such plans to vest in such circumstances.

Research and development

During the year, the Group undertook certain projects to develop its IT capabilities which met the definition of research and development set out in the guidelines issued by the Department of Business Innovation and Skills in 2010. Claims in respect of these activities were made in the Group's tax returns. The amounts involved were modest in the context of the Group accounts.

Political expenditure

Company law requires the disclosure of political donations and political expenditure by any Group company. During the year ended 30 September 2018 no such payments were made (2017: £nil).

Auditors

The directors have taken all reasonable steps to make themselves and the Company's auditors, KPMG LLP ('KPMG'), aware of any information needed in preparing the audit of the Annual Report and Financial Statements for the year, and, as far as each of the directors is aware, there is no relevant audit information of which the auditors are unaware.

The directors, having considered the requirements for rotation of auditors, the length of service of KPMG and the conduct of the audit concluded there was no present need to retender the audit. Therefore, a resolution for the reappointment of KPMG, who have expressed their willingness to continue in office, as the auditors of the Company is to be proposed at the forthcoming AGM. The evaluation process is described more fully in the Audit Committee Section B4.

Annual General Meeting

The Annual General Meeting of the Company will take place on 14 February 2019 in London. A notice convening the AGM is being circulated to shareholders with this Annual Report and Accounts.

Listing Rule LR9.8.4

There are no matters which the Company is required to report under Listing Rule LR9.8.4, other than the fact that the trustees of its employee share ownership trust (note 59) have waived their right to receive dividends on any shares held from time to time. As these shares are held on the consolidated balance sheet, this has no effect on the amounts reported by the Group.

Information presented in other sections

Certain information required to be included in a directors' report by Schedule 7 can be found in the other sections of the Annual Report, as described below. All of the information presented in these sections is incorporated by reference into this Directors' Report and is deemed to form part of this report.

- Commentary on the likely future developments in the business of the Group is included in the Strategic Report (Section A)
- A description of the Group's financial risk management objectives and policies, and its exposure to risks arising from its use of financial instruments are set out in note 8 to the accounts and related notes
- Information concerning directors' contractual arrangements and entitlements under share based remuneration arrangements is given in Section B5, the Directors' Remuneration Report
- Information concerning the employment of disabled persons and the involvement of employees in the business is given in Section A5.2 – 'People'
- Disclosures concerning greenhouse gas emissions are given in Section A5.3 – 'Environmental issues'
- Disclosures concerning events taking place after the balance sheet date, are set out in notes 47, 48 and 56 to the accounts

Rule DTR7.2.1 of the Disclosure Guidance and Transparency Rules requires the Group's disclosures on Corporate Governance to be included in the Directors' Report. This information is presented in Sections B3, B4, B5 and B6 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 2018, for the purposes of the Disclosure Guidance and Transparency Rules.

Section B7 of this Annual Report, together with the other sections of the Annual Report incorporated by reference, comprise a directors' report for the Company which has been drawn up and presented in accordance with, and in reliance upon, applicable English company law and the liabilities of the directors in connection with this report shall be subject to the limitations and restrictions provided by such law.

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

Pandora Sharp

Company Secretary

21 November 2018

B8

STATEMENT OF DIRECTORS' RESPONSIBILITIES

in respect of Financial Statements

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations. The directors are required to prepare accounts for the Group in accordance with IFRS and have also elected to prepare company financial statements in accordance with IFRS. In respect of the financial statements for the year ended 30 September 2018, company law requires the directors to prepare such financial statements in accordance with IFRS, the Companies Act 2006 and Article 4 of the IAS Regulation.

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. In preparing each of the Group and Company financial statements the directors are also required to:

- Properly select and apply suitable accounting policies consistently
- Make an assessment of the Group's and the Company's ability to continue as a going concern
- 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

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.

The directors are responsible for keeping adequate accounting records which disclose with reasonable accuracy at any time the financial position of the Company, for safeguarding the assets, for the Group's systems of Internal Control, as described in Section B3.1, and for taking reasonable steps for the prevention and detection of fraud and other irregularities. They are also responsible for the preparation of a strategic report, directors' report, directors' remuneration report and corporate governance statement which comply with the applicable requirements of the Companies Act 2006.

The directors are responsible for the maintenance and integrity of the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

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, which includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face
- The 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

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

Pandora Sharp
Company Secretary

21 November 2018

C.

INDEPENDENT AUDITOR'S REPORT

Report by the independent auditor of the Company, KPMG LLP on the
financial statements

C

INDEPENDENT AUDITOR'S REPORT

To the members of Paragon Banking Group PLC

1. Our opinion on the financial statements is unmodified

We have audited the financial statements of Paragon Banking Group PLC ('the Company') for the year ended 30 September 2018 which comprise the:

- Consolidated Income Statement
- Consolidated Statement of Comprehensive Income
- Consolidated and Company Balance Sheets
- Consolidated and Company Cash Flow Statements
- Consolidated and Company Statements of Movements in Equity
- related notes, including the accounting policies in note 4, other than the disclosures labelled as unaudited in note 7.

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 2018 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU);
- the Parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ('ISAs (UK)') and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the audit committee.

We were first appointed as auditor by the shareholders on 9 February 2016. The period of total uninterrupted engagement is for the three financial years ended 30 September 2018. 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.

We combined our knowledge and understanding gained through the audit of the Group in previous years with a consideration of external and internal developments and the risks they present to the Group's business model and how these risks are mitigated. These have been continually reassessed through the audit process. That consideration includes discussions not only with the Group, and ongoing knowledge gained through reading pertinent information, but also reflected the views of the Prudential Regulatory Authority, market analysts, specialists within our firm, and peer comparisons.

The final result of our risk consideration is shown in the table below, where we have continued to show the segments of the Group in which each of the risks arise and the movements in those risks compared with the prior year. We have identified eight areas of significant risk at Group level, but we are of the view that three of these – revenue recognition on loans and advances, impairment of loans and receivables and recoverability of goodwill – represent the greatest significance. We have also identified one key audit matter for the parent company only, being investment in subsidiaries risk. These key audit matters are detailed within Section 2 of our report.

The factors that have caused the greatest impact on the changes in audit risk arising from significant risks are:

- ↑ Increased audit risk due to the acquisitions by the Group of the Iceberg and Titlestone businesses during the year, resulting in the recognition of goodwill on acquisition.
- ↓ The increased historical experience of asset backed loan notes and the availability of alternative sources of funding by the Group, have together decreased the audit risk of the recognition of interest payable on asset backed loan notes.
- ↓ Audit risk regarding the retirement benefit obligation valuation reducing compared to the prior period as the prior year included significant transfers out of the scheme.
- ↓ A fall in conduct and regulatory redress due to the settlement by the Group of historic litigation cases.

Audit Risk	GROUP					
	Segments		Mortgages	Commercial Lending	Idem Capital	Unallocated
	Revenue recognition on loans and advances	↔	●	●	●	
	Impairment of loans and receivables	↔	●	●	●	
	Recoverability of goodwill	↑				●
	Interest payable on asset backed loan notes	↓				●
	Retirement benefit obligation valuation	↓				●
	Hedge accounting and valuation of derivatives	↔				●
	Conduct and regulatory redress	↓	●	●	●	●
	Disclosure – impact of new IFRSs <i>New Risk</i>		●	●	●	
	Accounting for one-off transactions					●
	Share option scheme					●
	Financial reporting		●	●	●	●
	Taxation risk		●	●	●	●
	Going concern		●	●	●	●
	Financial control process		●	●	●	●
	Consolidation adjustments		●	●	●	●
	PARENT COMPANY ONLY					
	Investments in subsidiaries	↔				●
Key:						
●	Key audit matter					
●	Significant risk not considered to be key audit matter					
●	Other area of audit focus					
↑ ↓	Movement in risk compared to prior year					

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 (which do not include two items reported in 2017), 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.

Revenue recognition on loans and advances

(£408.9 million; 2017: £375.1 million)

Refer to page 81 (Audit Committee Report), page 154 (accounting policy) and page 186 (financial disclosures).

The risk

Subjective estimate:

The recognition of revenue (interest receivable) on loans and advances to customers 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.

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 level of estimation uncertainty and subjects the judgement to future market changes. The Group makes its expected life assumptions based on its forecasting process which incorporates both historical experience and judgemental overlays by management.

The cohorts of loans and advances which require the most judgement are buy-to-let products which were originated by the Group post-2010. Following recent developments in regulation and tax on buy-to-let products, the future expected lives of these loans are likely to be impacted by the availability to customers of re-mortgages or alternative funding from other providers, which has increased the level of judgement required over expected lives. There is also less historical experience for the newer lending in this segment due to their relatively unseasoned nature.

The Group's developing customer retention strategies also require management to make judgements in respect of the accounting for customers who have switched to a new fixed rate product rather than moving onto a variable reversionary interest rate, specifically in terms of the reforecasting of cash flows and the expectations of future customer behaviour.

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.

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 assessing the appropriateness of the revised cohort segmentation and the treatment of product switches; and
- **Sensitivity analysis:** We performed sensitivity analysis over the repayment profiles by applying alternative profiles based upon the above procedures.

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.

Both portfolios:

- **Assessing transparency:** We critically assessed the adequacy of the Group's disclosures about the sensitivity of the revenue recognition on loans and advances to changes in key assumptions reflected in the inherent risk;
- **Controls:** We tested management review controls over the approval of the Group's repayment profiles; and
- **Accounting standards compliance:** We critically assessed the reasonableness of the Group's approach with reference to the requirements under IAS 39.

Our results

We found the resulting estimate of the revenue recognition on loans and advances to be acceptable (2017: acceptable).

Impairment of loans and receivables

(£107.4 million; 2017: £110.6 million)

Refer to page 81 (Audit Committee Report), page 154 (accounting policy) and page 193 (financial disclosures).

The risk

Subjective estimate:

The impairment provision relating to the Group's loan portfolios requires the directors to make significant judgements and assumptions over the recoverability of loans and receivables. Impairment provisions are assessed on an individual and collective basis and we consider the key assumptions and risks for each in turn.

Individual impairment:

A critical assumption is the appropriate identification of the impairment trigger. The individual provision model uses arrears as the primary impairment trigger and for buy-to-let properties in receivership of rent, the property status (vacant, held for sale or let) and the cure from impaired to non-impaired.

There is a risk that other impairment triggers are not identified on a timely basis or that cured accounts remain impaired.

The other key assumption used within the model is the estimation of the quantum and timing of future cash flows on impaired loans. This estimation includes past payment behaviour, the expected collections approach, including net rental income from the receivership of rent arrangement through its subsidiary Redbrick, and the likely collateral valuation. Where the expected collections approach is through net rental income, a key estimate is the expected future rental period.

Collective impairment:

For the purposes of the collective provision assessment, the Group calculates an emergence provision based on the previous loss experience for loans that have become individually impaired, overlaid with management judgement. There is a risk that the overall provision is not reflective of the incurred losses at the end of the period due to the period of time assumed that it takes for incurred losses to emerge, changes in customer credit quality or other market factors not sufficiently incorporated into the model, such as the tax position of borrowers, changes in rental income on buy-to-let properties, and house prices.

Our response

Our procedures included:

- **Controls:** We tested the key controls over the acceptance, monitoring and reporting of credit risk, including testing of IT controls over the identification and measurement of accounts in arrears;
- **Historical comparisons:** We critically assessed the Group's assumptions on past payment behaviour, including net rental income and growth, collateral valuations and growth, the rental periods, the proportion of properties that are vacant, and emergence provisions by comparing them to the Group's historical experience;
- **Benchmarking assumptions:** We compared the Group's key assumptions on emergence period to comparable peer group organisations;
- **Our sector experience:** We challenged the Group's key assumptions on impairment triggers, net rental income and emergence provisions by applying our own expectations based upon our knowledge of the Group and experience of the industry in which it operates;
- **Sensitivity analysis:** We performed sensitivity analysis over the Group's key assumptions on rental periods, likely collateral valuations and emergence provisions based upon our findings from the above procedures; and
- **Assessing transparency:** We critically assessed the adequacy of the Group's disclosures about the sensitivity of the impairment of loans and receivables to changes in key assumptions reflected in the inherent risk.

Our results

We found the resulting estimate of the impairment of loans and receivables to be acceptable (2017: acceptable).

Recoverability of goodwill
(£162.2 million; 2017: £98.1 million) Refer to page 81 (Audit Committee Report), page 153 (accounting policy) and page 206 financial disclosures).
The risk
<p>Forecast-based valuation:</p> <p>Goodwill is significant and at risk of irrecoverability due to changes in market factors since acquisition. The estimated recoverable amount is subjective due to the inherent uncertainty involved in forecasting future cash flows and deriving an appropriate discount rate to reflect the time value of money.</p> <p>In calculating the recoverable amount, the directors made assumptions over the following key inputs; profitability growth, the discount rate and the long-term growth rate.</p>
Our response
<p>Our procedures included:</p> <ul style="list-style-type: none"> • Historical comparisons: We compared the Group's previous forecasting with actual results; • Benchmarking assumptions: We compared the Group's assumptions to externally derived data in relation to key inputs such as projected economic growth and discount rates, and challenged management on the forecast business performance; • Sensitivity analysis: We performed breakeven analysis and applied alternative scenarios based on the assumptions noted above; • Assessing transparency: We critically assessed whether the Group's disclosures about the sensitivity of the outcome of the impairment assessment to changes in key assumptions reflected the risks inherent in the valuation of goodwill. <p>Our results</p> <p>We found the resulting estimate of the recoverable amount of goodwill to be acceptable (2017: acceptable).</p>

Recoverability of parent company's investment in subsidiaries
(£984.4 million; 2017: £819.1 million) Refer to page 155 (accounting policy) and page 208 (financial disclosures).
The risk
<p>Low risk, high value</p> <p>The carrying amount of the parent company's investments in subsidiaries represents 80.3% (2017: 70.9%) of the company's total assets. Their recoverability is not at a high risk of significant misstatement or subject to significant judgement. However, due to their materiality in the context of the parent company financial statements, this is considered to be the area that had the greatest effect on our overall parent company audit.</p>
Our response
<p>Our procedures included:</p> <ul style="list-style-type: none"> • Tests of detail: Comparing the carrying amount of 100% of investments with the relevant subsidiaries' draft balance 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. <p>Our results</p> <p>We found the resulting estimate of the impairment of investments in subsidiaries to be acceptable (2017: acceptable).</p>

We continue to perform procedures over interest payable on asset backed loan notes. However, as a result of the increased information about the future expected lives of the asset backed notes, we have not assessed this as one of the most significant risks in our current year audit and, therefore, it is not separately identified in our report this year.

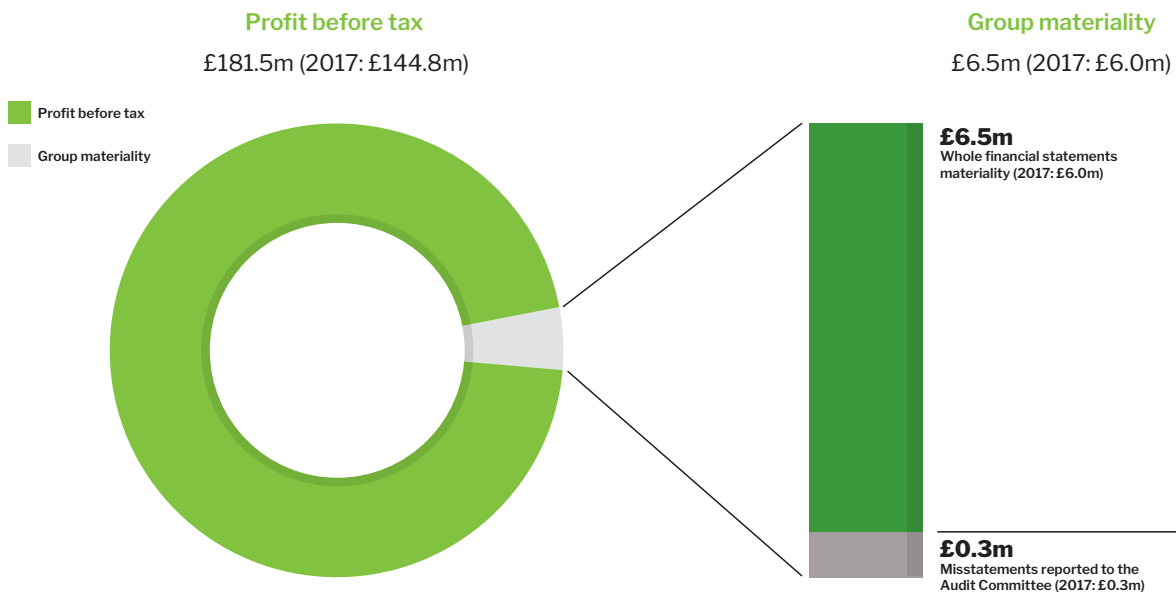
We also continue to perform procedures over the retirement benefit obligation valuation. However, as there have been no transfers out of the defined benefit pension scheme in the year (2017: 3), the risk of inappropriate accounting treatment is lower than in prior year and we have not assessed this as one of the most significant risks in our current year audit and, therefore, it is not separately identified in our report this year.

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 £6.5m (2017: £6.0m), determined with reference to a benchmark of Group profit before tax from continuing operations, of £181.5m, of which it represents 3.6% (2017: 4.1%).

Materiality for the Parent Company financial statements as a whole was set at £3.9m (2017: £3.9m), determined with reference to a benchmark of company net assets, of which it represents 0.6% (2017: 0.6%).

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.3m (2017: £0.3m), in addition to other identified misstatements that warranted reporting on qualitative grounds.



In 2018, the Group audit team performed the audit of Group as if it was a single aggregated set of financial information. The audit was performed using the materiality level set above. In 2017 we identified two components both of which were subjected to audits for group reporting purposes and audited to component materiality.

IFRS 9

The Group is adopting IFRS 9 Financial Instruments from 1 October 2018 and has included an estimate of the financial impact of the change in accounting standard in accordance with IAS 8 Changes in Accounting Estimates and Errors as set out in note 3. This disclosure notes that the Group continues to refine its expected credit loss model and embed its operational processes which may change the actual impact on adoption. While further testing of the financial impact will be performed as part of our 2019 year-end audit, we have performed sufficient audit procedures for the purposes of assessing the disclosures made in accordance with IAS 8. Specifically we have:

- Considered the appropriateness of key technical decisions, judgements, assumptions and elections made by management;
- Considered key classification and measurement decisions, including business model assessments and solely payment of principal and interest outcomes;
- Involved credit risk modelling and economic specialists in the consideration of credit risk modelling decisions and macroeconomic variables, including forward economic guidance and generation of multiple economic scenarios; and
- Considered transitional controls and governance processes related to the approval of the estimated transitional impact.

4. We have nothing to report on going concern

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 4 to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Group and Company's use of that basis for a period of at least twelve months from the date of approval of the financial statements; or
- the related statement under the Listing Rules set out on page 48 is materially inconsistent with our audit knowledge.

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 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 the 'Future prospects' section, Section A4, 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, in Section B6.5, 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.

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 on page 131, the directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; and assessing the Group and Parent Company's ability to continue as a going concern. Additionally, they are responsible for: 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; 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 sector experience, and through discussion with the directors and other management (as required by auditing standards), and from inspection of the Group's regulatory and legal correspondence.

We had regard to laws and regulations in areas that directly affect the financial statements including financial reporting (including related company legislation) and taxation legislation. We considered the extent of compliance with those laws and regulations as part of our procedures on the related financial statement items.

In addition we considered the impact of laws and regulations in the specific areas of regulatory capital and liquidity and certain aspects of company legislation recognising the financial and regulated nature of the Group's activities. With the exception of any known or possible non-compliance, and as required by auditing standards, our work in respect of these was limited to enquiry of the directors and other management and inspection of regulatory and legal correspondence.

We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

As with any audit, there remained a higher risk of non-detection of non-compliance with relevant laws and regulations, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.

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

21 November 2018

D.

THE ACCOUNTS

Showing the financial position, results and cash flows of the Group and the Company prepared in accordance with IFRS and UK law

D1	Primary Financial Statements	PAGE 144
	<i>D1.1 Consolidated Income Statement</i>	<i>PAGE 144</i>
	<i>D1.2 Consolidated Statement of Comprehensive Income</i>	<i>PAGE 144</i>
	<i>D1.3 Consolidated Balance Sheet</i>	<i>PAGE 145</i>
	<i>D1.4 Company Balance Sheet</i>	<i>PAGE 146</i>
	<i>D1.5 Consolidated Cash Flow Statement</i>	<i>PAGE 147</i>
	<i>D1.6 Company Cash Flow Statement</i>	<i>PAGE 147</i>
	<i>D1.7 Consolidated Statement of Movements in Equity</i>	<i>PAGE 148</i>
	<i>D1.8 Company Statement of Movements in Equity</i>	<i>PAGE 149</i>
D2	Notes to the Accounts	PAGE 150

D1.1 Consolidated Income Statement

For the year ended 30 September 2018

	Note	2018 £m	2018 £m	2017 £m	2017 £m
Interest receivable	18		451.9		409.2
Interest payable and similar charges	19		(197.3)		(176.6)
Net interest income			254.6		232.6
Other leasing income	20	16.3		14.4	
Related costs	20	(12.5)		(11.4)	
Net leasing income		3.8		3.0	
Gain on disposal of financial assets	21	28.0		-	
Other income	22	15.5		17.2	
Other operating income			47.3		20.2
Total operating income			301.9		252.8
Operating expenses	23		(114.2)		(102.3)
Provisions for losses	28		(7.4)		(5.3)
Operating profit before fair value items			180.3		145.2
Fair value net gains / (losses)	29		1.2		(0.4)
Operating profit being profit on ordinary activities before taxation			181.5		144.8
Tax charge on profit on ordinary activities	30		(35.7)		(27.6)
Profit on ordinary activities after taxation for the financial year			145.8		117.2

	Note	2018	2017
Earnings per share			
- basic	32	55.9p	43.1p
- diluted	32	54.2p	41.9p

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 2018

	Note	2018 £m	2018 £m	2017 £m	2017 £m
Profit for the year			145.8		117.2
Other comprehensive income					
<i>Items that will not be reclassified subsequently to profit or loss</i>					
Actuarial gain on pension scheme	56	8.9		29.0	
Tax thereon		(1.7)		(5.5)	
			7.2		23.5
<i>Items that may be reclassified subsequently to profit or loss</i>					
Cash flow hedge gains taken to equity		1.0		0.5	
Tax thereon		(0.2)		(0.1)	
			0.8		0.4
Other comprehensive income for the year net of tax			8.0		23.9
Total comprehensive income for the year			153.8		141.1

D1.3 Consolidated Balance Sheet

30 September 2018

	Note	2018 £m	2017 £m	2016 £m
Assets				
Cash – central banks	33	895.9	615.0	315.0
Cash – retail banks	33	414.7	881.9	922.6
Short term investments	34	-	-	7.1
Loans to customers	35	12,103.7	11,115.4	10,750.0
Derivative financial assets	40	855.7	906.6	1,366.4
Sundry assets	41	19.0	12.7	12.7
Property, plant and equipment	42	56.8	46.2	39.2
Intangible assets	43	169.3	104.4	105.4
Total assets		14,515.1	13,682.2	13,518.4
Liabilities				
Short term bank borrowings		1.1	0.6	1.2
Retail deposits	46	5,292.4	3,611.9	1,874.7
Derivative financial liabilities	40	4.7	7.1	15.8
Asset backed loan notes	47	5,554.7	6,475.8	8,374.1
Secured bank borrowings	48	935.6	1,306.0	1,573.0
Retail bond issuance	49	296.1	295.7	295.3
Corporate bond issuance	50	149.3	149.1	259.0
Central bank facilities	51	1,024.4	700.0	-
Sundry liabilities	52	114.4	74.6	78.7
Current tax liabilities	54	21.4	17.4	16.7
Deferred tax liabilities	55	5.6	4.8	2.0
Retirement benefit obligations	56	19.5	29.8	58.4
Total liabilities		13,419.2	12,672.8	12,548.9
Called up share capital	57	281.6	281.5	295.9
Reserves	58	918.3	811.0	736.1
Own shares	59	(104.0)	(83.1)	(62.5)
Total equity		1,095.9	1,009.4	969.5
Total liabilities and equity		14,515.1	13,682.2	13,518.4

Approved by the Board of Directors on 21 November 2018.
Signed of behalf of the Board of Directors

N S Terrington
Chief Executive

R J Woodman
Chief Financial Officer

D1.4 Company Balance Sheet

30 September 2018

	Note	2018 £m	2017 £m	2016 £m
Assets				
Cash – retail banks	33	24.9	277.6	361.3
Sundry assets	41	217.0	40.1	84.6
Property, plant and equipment	42	-	18.6	18.9
Investment in subsidiary undertakings	45	984.4	819.1	984.8
Total assets		1,226.3	1,155.4	1,449.6
Liabilities				
Retail bond issuance	49	296.1	295.7	295.3
Corporate bond issuance	50	149.3	149.1	259.0
Sundry liabilities	52	128.5	39.4	173.2
Current tax liabilities	54	-	-	0.4
Deferred tax liabilities	55	1.8	1.8	1.9
Total liabilities		575.7	486.0	729.8
Called up share capital	57	281.6	281.5	295.9
Reserves	58	460.8	454.5	470.1
Own shares	59	(91.8)	(66.6)	(46.2)
Total equity		650.6	669.4	719.8
		1,226.3	1,155.4	1,449.6

Approved by the Board of Directors on 21 November 2018.
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 2018

	Note	2018 £m	2017 £m
Net cash generated by operating activities	61	1,074.4	1,474.7
Net cash (utilised) / generated by investing activities	62	(282.8)	3.2
Net cash (utilised) by financing activities	63	(978.4)	(1,218.0)
Net (decrease) / increase in cash and cash equivalents		(186.8)	259.9
Opening cash and cash equivalents		1,496.3	1,236.4
Closing cash and cash equivalents		1,309.5	1,496.3
Represented by balances within:			
Cash	33	1,310.6	1,496.9
Short term bank borrowing		(1.1)	(0.6)
		1,309.5	1,496.3

D1.6 Company Cash Flow Statement

For the year ended 30 September 2018

	Note	2018 £m	2017 £m
Net cash (utilised) by operating activities	61	(30.5)	(44.5)
Net cash (utilised) / generated by investing activities	62	(154.3)	172.8
Net cash (utilised) by financing activities	63	(67.9)	(212.0)
Net (decrease) in cash and cash equivalents		(252.7)	(83.7)
Opening cash and cash equivalents		277.6	361.3
Closing cash and cash equivalents		24.9	277.6
Represented by balances within:			
Cash	33	24.9	277.6
Short term bank borrowings		-	-
		24.9	277.6

D1.7 Consolidated Statement of Movements in Equity

For the year ended 30 September 2018

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Cash flow hedging reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m
Transactions arising from								
Profit for the year	-	-	-	-	-	145.8	-	145.8
Other comprehensive income	-	-	-	-	0.8	7.2	-	8.0
Total comprehensive income	-	-	-	-	0.8	153.0	-	153.8
Transactions with owners								
Dividends paid (note 60)	-	-	-	-	-	(43.1)	-	(43.1)
Shares cancelled	-	-	-	-	-	-	-	-
Own shares purchased	-	-	-	-	-	-	(31.4)	(31.4)
Exercise of share awards	0.1	0.3	-	-	-	(10.9)	10.5	-
Charge for share based remuneration (note 24)	-	-	-	-	-	6.1	-	6.1
Tax on share based remuneration	-	-	-	-	-	1.1	-	1.1
Net movement in equity in the year	0.1	0.3	-	-	0.8	106.2	(20.9)	86.5
Opening equity	281.5	65.5	28.7	(70.2)	2.5	784.5	(83.1)	1,009.4
Closing equity	281.6	65.8	28.7	(70.2)	3.3	890.7	(104.0)	1,095.9

For the year ended 30 September 2017

	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	-	-	-	-	-	117.2	-	117.2
Other comprehensive income	-	-	-	-	0.4	23.5	-	23.9
Total comprehensive income	-	-	-	-	0.4	140.7	-	141.1
Transactions with owners								
Dividends paid (note 60)	-	-	-	-	-	(38.0)	-	(38.0)
Shares cancelled	(15.0)	-	15.0	-	-	(45.1)	45.1	-
Own shares purchased	-	-	-	-	-	-	(69.7)	(69.7)
Exercise of share awards	0.6	0.9	-	-	-	(4.0)	4.0	1.5
Charge for share based remuneration (note 24)	-	-	-	-	-	4.2	-	4.2
Tax on share based remuneration	-	-	-	-	-	0.8	-	0.8
Net movement in equity in the year	(14.4)	0.9	15.0	-	0.4	58.6	(20.6)	39.9
Opening equity	295.9	64.6	13.7	(70.2)	2.1	725.9	(62.5)	969.5
Closing equity	281.5	65.5	28.7	(70.2)	2.5	784.5	(83.1)	1,009.4

D1.8 Company Statement of Movements in Equity

For the year ended 30 September 2018

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m
Transactions arising from							
Profit for the year	-	-	-	-	43.0	-	43.0
Other comprehensive income	-	-	-	-	-	-	-
Total comprehensive income	-	-	-	-	43.0	-	43.0
Transactions with owners							
Dividends paid (note 60)	-	-	-	-	(43.1)	-	(43.1)
Shares cancelled	-	-	-	-	-	-	-
Own shares purchased	-	-	-	-	-	(25.2)	(25.2)
Exercise of share awards	0.1	0.3	-	-	-	-	0.4
Charge for share based remuneration (note 24)	-	-	-	-	6.1	-	6.1
Net movement in equity in the year	0.1	0.3	-	-	6.0	(25.2)	(18.8)
Opening equity	281.5	65.5	28.7	(23.7)	384.0	(66.6)	669.4
Closing equity	281.6	65.8	28.7	(23.7)	390.0	(91.8)	650.6

For the year ended 30 September 2017

	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	-	-	-	-	47.4	-	47.4
Other comprehensive income	-	-	-	-	-	-	-
Total comprehensive income	-	-	-	-	47.4	-	47.4
Transactions with owners							
Dividends paid (note 60)	-	-	-	-	(38.0)	-	(38.0)
Shares cancelled	(15.0)	-	15.0	-	(45.1)	45.1	-
Own shares purchased	-	-	-	-	-	(65.5)	(65.5)
Exercise of share awards	0.6	0.9	-	-	-	-	1.5
Charge for share based remuneration (note 24)	-	-	-	-	4.2	-	4.2
Net movement in equity in the year	(14.4)	0.9	15.0	-	(31.5)	(20.4)	(50.4)
Opening equity	295.9	64.6	13.7	(23.7)	415.5	(46.2)	719.8
Closing equity	281.5	65.5	28.7	(23.7)	384.0	(66.6)	669.4

D2 NOTES TO THE ACCOUNTS

For the year ended 30 September 2018

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

2. ADOPTION OF NEW AND REVISED REPORTING STANDARDS

In the preparation of these financial statements, the 'Disclosure Initiative' amendments to IAS 7 are being applied for the first time.

(a) IAS 7 – 'Disclosure Initiative' amendments

The Disclosure Initiative amendments to IAS 7 – 'Statement of Cash Flows', came into force with effect from the Group's financial year ended 30 September 2018 and requires entities to present a note to the accounts describing movements in liabilities arising from financing cash flows. The Group already presented such a note on a voluntary basis and the minor amendments to note 64 required by the standard have been made in the preparation of these accounts. The introduction of the new standard has no impact on reported profits, assets, liabilities or equity.

(b) Standards not yet adopted

At the date of authorisation of these financial statements the following International Financial Reporting Standards and Interpretations, which have not been applied in these financial statements, were in issue but not yet effective:

- IFRS 9 – 'Financial Instruments'
- IFRS 15 – 'Revenue from Contracts with Customers'
- IFRS 16 – 'Leases'

Other standards and interpretations in issue but not effective do not address matters relevant to the Group's accounting and reporting.

IFRS 9

IFRS 9 largely replaces the requirements of the existing financial instruments standard, IAS 39: 'Financial Instruments: Recognition and Measurement'. It addresses the areas of recognition, bases of valuation, income recognition methods, impairment and hedging for financial instruments and will become the standard governing the Group's accounting for Loans to Customers, Borrowings and Derivative Financial Assets and Liabilities. Only the rules relating to the Group's portfolio hedging arrangements will remain subject to IAS 39.

This standard will come into force with effect from the Group's financial statements for the year ending 30 September 2019 and work is well progressed to assess its impact and develop new procedures. Many of the current rules applying to the Group are repeated in broadly similar form in the new standard. In particular, the amortised cost basis of valuation and the related EIR method of income recognition remain largely unchanged. The greatest impact from the new standard is likely to be on impairment provisions, but the requirements addressing classification and measurement and hedging also change.

The application of this new standard is discussed in detail in note 3 below.

IFRS 15

IFRS 15 will replace the standards currently governing the recognition of that part of the Group's income which does not derive directly from financial assets, that is the amounts shown as 'maintenance income' in note 20 and the amounts shown in note 22. It affects the timing of recognition of revenue items, but not generally the overall amount recognised. The standard will come into force with effect from the Group's financial statements for the year ending 30 September 2019. A preliminary review exercise has taken place and the Group has concluded that the introduction of the new standard will not have a material impact on its results or financial position.

IFRS 16

IFRS 16 will replace the standards currently governing the accounting for operating and finance leases and will come in to force with effect from the Group's financial statements for the year ending 30 September 2020, unless the Group decides to adopt it early.

The standard will address accounting by lessees and lessors, but the provisions for lessor accounting are little changed from those in IAS 17 and so the accounting for the Group's finance lease receivables will be largely unaffected.

Accounting by lessees will be changed significantly, with a right of use asset recognised on the balance sheet for all leases, based on discounted future commitments. This includes leases presently treated as operating leases and not recognised on the balance sheet. The Group's commitments under such leases are described in note 65(b) and a preliminary review of the standard indicates the changes are unlikely to have a material impact on the Group's results or financial position.

3. IMPLEMENTATION OF IFRS 9

IFRS 9 – 'Financial Instruments' applies to the Group from 1 October 2018. Its principal provisions applying to the Group and their impacts are set out below.

Impairment of financial assets

Requirements

IFRS 9 changes the basis of recognition of impairment of financial assets from an incurred loss to an expected credit loss ('ECL') approach for financial assets held at amortised cost. This introduces a number of new concepts and changes to the approach to provisioning set out in IAS 39.

ECLs are based on an assessment of the probability of default ('PD') and loss given default ('LGD'), discounted to give a net present value. The estimation of ECL should be unbiased and probability weighted, considering all reasonable and supportable information, including forward looking economic assumptions and a range of possible outcomes. This has the effect of recognising losses on loans earlier than at present, as IAS 39 requires provisions to be made only at the point where there is objective evidence of credit impairment.

IFRS 9 also requires that companies calculate impairment under a variety of differing economic scenarios and calculate a weighted average provision, rather than base calculations on a central forecast, as is generally the case under IAS 39.

IFRS 9 divides loans into three classes: those where there has been no significant increase in credit risk since advance or acquisition; those where there has been a significant increase in credit risk ('SICR'); and loans which are impaired. It is an important feature of the standard that SICR is not defined solely by the performance of the account, but also by other information available about the customer, such as credit bureau information.

- On initial recognition, and for assets where there has not been an SICR, provisions will be made to the level of expected credit default events within the next year. These accounts would be largely unprovided for under IAS 39, although some cases with adverse qualitative indicators might attract an emergence provision
- Where a loan has experienced an SICR, even though this may not lead to a conclusion that the loan is credit impaired, provisions will be made based on the expected credit losses over the full life of the loan. This is likely to lead to an increase in provision in general, though the IAS 39 emergence provision would also address some of this risk
- For credit impaired assets, provisions will be made on the basis of lifetime expected credit losses, taking account of forward looking economic assumptions and a range of possible outcomes. Under IAS 39 provisions are based on the asset's carrying value and the present value of the estimated future cash flows. Despite IAS 39 not explicitly taking account of alternative economic scenarios, it is likely that provisions for loans in this condition will be broadly similar to their existing values
- For assets which were purchased or originated credit impaired ('POCI') accounts (i.e. considered as credit impaired at the point of first recognition), such as certain of the Group's acquired assets in Idem Capital, the required treatment is largely similar under IAS 39 and IFRS 9

Overall, the introduction of IFRS 9 is likely to result in companies carrying a larger provision balance and recognising losses earlier. However, the profit and loss effect is broadly one of timing, with the same amount of provision per case ultimately charged to profit.

Impact on the Group

The most significant elements of the Group's provision calculation for any given asset will be:

- Definition of default, which is used in PD modelling. This has been selected to ensure alignment with internal operational procedures and to be capable of objective modelling and analysis in the model build process. The standard provides a rebuttable presumption of default where an account is more than 90 days overdue, which 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 variety of quantitative and qualitative measures was considered in the process
- The PD, both on a twelve month and a lifetime basis, where default is defined as above, which the Group intends to base on statistical models for its most significant asset classes. The PD calculation is a function of future economic assumptions. The economic variables used were derived through analysis of correlation in historic data. They include such measures as UK gross domestic product and consumer and house price inflation
- The LGD for each account, which is calculated in a similar fashion to the present calculations under IAS 39. This includes consideration of future account movements, costs and security values together with the Group's potential case management activities

- The economic inputs to the model, where the central forecast represents the scenario used in the Group's planning process and the alternative scenarios are based on versions of this forecast flexed upwards and downwards and the Bank of England's stress scenario
- The identification of SICR, which is based primarily on changes in the calculated PD, 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

In certain asset classes a full modelled approach is not possible, normally 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. In these cases, which represent a small part of the total portfolio, alternative approaches, which rely on internal credit monitoring practices and professional credit judgement, are adopted.

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.

Implementation project

During the year, the Group has continued its project to ensure compliance with the new requirements. The project includes finance, analysis and credit risk personnel, is sponsored by the Chief Financial Officer and reports regularly to the Audit Committee. Model builds and ongoing validation are subject to the oversight of the Model Risk Committee.

Project workflows have included analysis of historic internal and external credit performance metrics, prototype model design and consideration of how external economic factors should affect IFRS 9 impairments. This has made use of the Group's substantial data history and data handling capabilities. External consultants and the Group's auditors have been engaged with as appropriate. The project team have also engaged with external initiatives to gauge best practice and participated in dialogue with regulators.

Base PD and LGD models have been completed for all of the Group's most material asset classes and indicative outputs have been provided to Credit Committee on a business as usual basis during the year.

Where a modelled approach is not being applied, detailed proposals for the provisioning approach have been developed and the appropriate provisions evaluated.

Work will continue to evaluate, test and revise these models and other approaches though business as usual running in the coming financial year. This will include the updating of historical analysis to reflect the latest available data as it becomes available.

The process of testing, updating, validating and refreshing models, inputs and other approaches will continue as part of the accounting process going forward.

The Audit Committee has received regular presentations throughout the process, alongside training sessions on specific aspects of the IFRS 9 provisioning approach.

Classification and measurement

The classification of financial assets under IFRS 9 is based on the objectives of a company's business model and the contractual cash flow characteristics of the instruments. Financial assets are classified as held at amortised cost, at fair value through other comprehensive income, or at fair value through profit or 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'). The Group has considered its products and concluded that, as standard lending products, they will fall within the SPPI criteria.

Therefore, the changes from the classification under IAS 39 are not expected to be significant for the Group.

Hedge accounting

The hedge accounting requirements of IFRS 9 are designed to create a stronger link with financial risk management, however these provisions do not cover macro hedge accounting (including portfolio hedges of interest rate risk). A separate financial reporting standard is to be developed in this area. IFRS 9 allows the option to continue to apply the existing hedge accounting requirements of IAS 39 until this is implemented.

As the Group's hedging arrangements are either macro hedges, which are not included in the new standard or bespoke cash flow hedges which would not be affected by the change of standard, the Group has decided to defer application of these rules until the full new hedge accounting regime is in place.

Impact

It is estimated that the Group's new IFRS 9 provisioning approach will result in an increase in provisions of approximately £27m. The total impact on equity, net of tax is expected to be a reduction of £22m. This estimate is provisional and may be subsequently changed as the Group continues to further develop, calibrate and test its provisioning models, as described above.

Transition arrangements

The Group will not restate comparatives on its adoption of IFRS 9, but will issue a separate transition report. The report will be published before the publication of the half yearly report for the six months ending 31 March 2019.

The Group intends to take advantage of the transitional relief on regulatory capital, which will spread the impact of the introduction of IFRS 9 on capital over a five year period.

4. ACCOUNTING POLICIES

The financial statements have been prepared in accordance with International Financial Reporting Standards 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 policies applied are described below.

(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 2018. Subsidiaries comprise all those entities over which the Group has control and are listed in note 67. The results of businesses acquired are dealt with in the consolidated accounts from the date of acquisition.

In accordance with IFRS 10 – 'Consolidated Financial Statements' 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, 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.

(c) Going concern

The consolidated financial statements have been prepared on the going concern basis.

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

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

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

(d) Acquisitions and goodwill

Goodwill arising from the purchase of subsidiary undertakings, representing the excess of the fair value of the purchase consideration over the fair values of acquired assets, including intangible assets, is held on the balance sheet and reviewed annually to determine whether any impairment has occurred.

As permitted by IFRS 1, the Group has elected not to apply IFRS 3 – 'Business Combinations' to combinations taking place before its transition date to IFRS (1 October 2004). Therefore any goodwill which was written off to reserves under UK GAAP will not be charged or credited to the profit and loss account on any future disposal of the business to which it relates.

Contingent consideration arising on acquisitions is first recognised in the accounts at its fair value at the acquisition date and subsequently revalued at each accounting date until it falls due for payment or the final amount is otherwise determined.

(e) Cash and cash equivalents

Balances shown as cash and cash equivalents in the balance sheet comprise demand deposits and short-term deposits with banks with initial maturities of not more than 90 days.

(f) Short term investments

Short term investments are held as part of the liquidity requirement of Paragon Bank PLC. As such they are designated as 'Available for Sale', as defined by IAS 39 - 'Financial Instruments: Recognition and Measurement' and are consequently measured at their fair value which corresponds to their market value at the balance sheet date.

(g) Leases

Leases are accounted for as operating or finance leases in accordance with IAS 17 - 'Leases'. A finance lease is deemed to be one which transfers substantially all of the risks and rewards of the ownership of the asset concerned. Any other lease is an operating lease.

Rental income and costs under operating leases are credited or charged to the profit and loss account on a straight line basis over the period of the leases.

(h) Loans to customers

Loans to customers are considered to be 'loans and receivables' as defined by IAS 39 - 'Financial Instruments: Recognition and Measurement'. They are therefore accounted for on the amortised cost basis.

Loans advanced are valued at inception at the initial advance amount, which is the fair value at that time, inclusive of procurement fees paid to brokers or other business providers and less initial fees paid by the customer. Loans acquired from third parties are initially valued at the purchase consideration paid or payable. Thereafter, all loans to customers are valued at this initial amount less the cumulative amortisation calculated using the EIR method. The loan balances are then reduced where necessary by a provision for balances which are considered to be impaired.

The EIR method spreads the expected net income arising from a loan over its expected life. The EIR is that rate of interest which, at inception, exactly discounts the future cash payments and receipts arising from the loan to the initial carrying amount.

(i) Finance lease receivables

Finance lease receivables are included within 'Loans to Customers' at the total amount receivable less interest not yet accrued, unamortised commissions and provision for impairment.

Income from finance lease contracts is accounted for on the actuarial basis.

(j) Impairment of loans and receivables

Loans and receivables are reviewed for indications of possible impairment throughout the year and at each balance sheet date in accordance with IAS 39. Where loans exhibit objective evidence of impairment (a 'loss event') the carrying value of the loans is reduced to the net present value of their expected future cash flows, including the value of the potential realisation of any security (net of sales costs) discounted at the original EIR.

Within its buy-to-let portfolio the Group utilises a receiver of rent process, whereby the receiver stands between the landlord and tenant and will determine an appropriate strategy for dealing with any delinquency. This strategy may involve the immediate sale of any underlying security or the short or long term letting of the property to cover arrears and principal shortfalls. Where a letting strategy is adopted by the receiver, a tenant is in place and arrears are reduced or cleared, the account will not necessarily attract an impairment provision. Properties in receivership are eventually either returned to their landlord owners or sold.

Loss events reflect both loans that display delinquency in contractual payments of principal or interest or, for buy-to-let loans in receivership but up to date at the balance sheet date, properties where the receiver adopts a sale strategy, where a shortfall may or may not arise.

In addition to loans where loss events are evident, loans are also assessed collectively, grouped by risk characteristics and account is taken of any impairment arising due to events which are believed to have taken place but have not been specifically identified at the balance sheet date. Collective impairment provisions are calculated for each key portfolio based on recent historical performance, with adjustments for expected changes in losses based on management's judgement. In the receiver of rent portfolio collective provisions are also established for cases where the present strategy might not be sustainable.

For loan portfolios acquired at a discount, the discounts take account of future expected impairments. An impairment charge is only recognised in the income statement if the total receipts from an acquired portfolio are below the original purchase price. Changes to expected cash flows from acquired portfolios are reflected by discounting the future expected cash flows by the original effective interest rate, with any change from the prevailing carrying value being recognised in the income statement.

For financial accounting purposes provisions for impairments of loans to customers when first recognised in the income statement are held in an allowance account. These balances are released to offset against the gross value of the loan when it is written off to profit and loss on the administration system. After this point a salvage balance may be held in respect of any further recoveries expected on the loan.

(k) Amounts owed by or to group companies

In the accounts of the Company, balances owed by or to other group companies are carried at the current amount outstanding less any provision. Where balances owing between group companies fall within the definition of either financial assets or financial liabilities given in IAS 32 – ‘Financial Instruments: Presentation’ they are classified as ‘Loans and Receivables’ or ‘Other financial liabilities’, respectively.

(l) Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation.

Assets held for letting under operating leases are depreciated in equal annual instalments to their estimated residual value over the life of the related lease. This depreciation is deducted in arriving at net lease income and is shown in note 20.

The assets’ residual values and useful lives are reviewed by management and adjusted, if appropriate, at each balance sheet date.

Depreciation on operating assets is provided on cost in equal annual instalments over the lives of the assets. Land is not depreciated. The rates of depreciation are as follows:

Freehold premises	2% per annum
Short leasehold premises	over the term of the lease
Computer hardware	25% per annum
Furniture, fixtures and office equipment	15% per annum
Company motor vehicles	25% per annum

(m) Intangible assets

Intangible assets comprise purchased computer software and other intangible assets acquired in business combinations.

Purchased computer software is capitalised where it has a sufficiently enduring nature and is stated at cost less accumulated amortisation. Amortisation is provided in equal instalments at a rate of 25% per annum.

Other intangible assets acquired in business combinations include brands and business networks and are capitalised in accordance with the requirements of IFRS 3 – ‘Business Combinations’. Such assets are stated at attributed cost less accumulated amortisation. Amortisation is provided in equal instalments at a rate determined at the point of acquisition.

(n) Investments in subsidiaries

The Company’s investments in subsidiary undertakings are valued at cost less provision for impairment.

(o) Own shares

Shares in Paragon Banking Group PLC held in treasury or by the trustee of the Group’s employee share ownership plan are shown on the balance sheet as a deduction in arriving at total equity. Own shares are stated at cost.

(p) Retail deposits

Retail deposits are carried in the balance sheet on the amortised cost basis. The initial fair value recognised represents the cash amount received from the customer.

Interest payable to the customer is expensed to the income statement as interest payable over the deposit term on an EIR basis.

(q) Borrowings

Borrowings are carried in the balance sheet on the amortised cost basis. The initial value recognised includes the principal amount received less any discount on issue or costs of issuance.

Interest and all other costs of the funding are expensed to the income statement as interest payable over the term of the borrowing on an EIR basis.

(r) Central bank facilities

Where central bank facilities are provided at a below market rate of interest, and therefore fall within the definition of government assistance as defined by IAS 20 – ‘Accounting for Government Grants and Disclosure of Government Assistance’ the liability is initially recognised at the value of its expected cash flows discounted at a market rate of interest for a comparable commercial borrowing. Interest is recognised on this liability on an EIR basis, using the imputed market rate to determine the EIR.

The remaining amount of the advance is recognised as deferred government assistance and released to the profit and loss account through interest payable over the periods during which the arrangement affects profit.

(s) Derivative financial instruments

All derivative financial instruments are carried in the balance sheet at fair value, as assets where the value is positive or as liabilities where the value is negative. Fair value is based on market prices, where a market exists. If there is no active market, fair value is calculated using present value models which incorporate assumptions based on market conditions and are consistent with accepted economic methodologies for pricing financial instruments. Changes in the fair value of derivatives are recognised in the income statement, except where such amounts are permitted to be taken to equity as part of the accounting for a cash flow hedge.

(t) Hedging

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 highly probable.

(u) Taxation

The charge for taxation represents the expected UK corporation tax (including the Bank Corporation Tax surcharge where applicable) and other income taxes arising from the Group’s profit for the year. This consists of the current tax which will be shown in tax returns for the year and tax deferred because of temporary differences. This in general, represents the tax impact of items recorded in the current year but which will impact tax returns for periods other than the one in which they are included in the financial statements.

The Group holds a provision for uncertain tax positions at the balance sheet date based on a global assessment of the expected amount that will ultimately be payable.

Tax relating to items taken directly to equity is also taken directly to equity.

(v) Deferred taxation

Deferred taxation is provided in full on temporary differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Deferred tax assets are recognised to the extent that it is regarded as probable that they will be recovered. As required by IAS 12 – ‘Income Taxes’, deferred tax assets and liabilities are not discounted to take account of the expected timing of realisation.

(w) Retirement benefit obligations

The expected cost of providing pensions within the funded defined benefit scheme, determined on the basis of annual valuations by professionally qualified actuaries using the projected unit method, is charged to the income statement. Actuarial gains and losses are recognised in full in the period in which they occur and do not form part of the result for the period, being recognised in the Statement of Comprehensive Income.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation, as reduced by the fair value of scheme assets at the balance sheet date.

The expected financing cost of the deficit, as estimated at the beginning of the period is recognised in the result for the period within interest payable. Any variances against the estimated amount in the year form part of the actuarial gain or loss.

The charge to the income statement for providing pensions under defined contribution pension schemes is equal to the contributions payable to such schemes for the year.

(x) Revenue

The revenue of the Group comprises interest receivable and similar charges and other income. The accounting policy for the recognition of each element of revenue is described separately within these accounting policies.

(y) Fee and commission income

Other income includes:

- 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, 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, which are taken to profit at the point of completion of the related loan

(z) Share based payments

In accordance with IFRS 2 – 'Share-based Payments', the fair value at the date of grant of awards to be made in respect of options and shares granted under the terms of the Group's various share based employee incentive arrangements is charged to the profit and loss account over the period between the date of grant and the vesting date.

National Insurance on share based payments is accrued over the vesting period, based on the share price at the balance sheet date.

Where the allowable cost of share based awards for tax purposes is greater than the cost determined in accordance with IFRS 2, the tax effect of the excess is taken to reserves.

(aa) Dividends

In accordance with IAS 10 – 'Events after the balance sheet date', dividends payable on ordinary shares are recognised in equity once they are appropriately authorised and are no longer at the discretion of the Company. Dividends declared after the balance sheet date, but before the authorisation of the financial statements remain within shareholders' funds.

However, such dividends are deducted from regulatory capital from the point at which they are announced, and capital disclosures are prepared on this basis.

(bb) Foreign currency

Foreign currency transactions, assets and liabilities are accounted for in accordance with IAS 21 – 'The Effects of Changes in Foreign Exchange Rates'. The functional currency of the Group is the pound sterling. Transactions which are not denominated in sterling are translated into sterling at the spot rate of exchange on the date of transaction. Monetary assets and liabilities which are not denominated in sterling are translated at the closing rate on the balance sheet date.

Gains and losses on retranslation are included in interest payable or interest receivable depending on whether the underlying instrument is an asset or a liability, except where deferred in equity in accordance with the cash flow hedging provisions of IAS 39.

(cc) Segmental reporting

The accounting policies of the segments are the same as those described above for the Group as a whole. Interest payable by each segment includes directly attributable funding and the allocated cost of retail deposit funds utilised. Costs attributed to each segment represent the direct costs incurred by the segment operations.

5. FAIR VALUES OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

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 2018 or the year ended 30 September 2017 carried at fair value and valued using level 3 measurements, other than contingent consideration amounts (note 52).

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

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 benchmark interest rates for the currencies in which the instruments are denominated, being sterling, euros and dollars. The cross-currency basis swaps have a notional principal related to the outstanding currency borrowings and therefore the estimated rate of repayment of these notes also affects the valuation of the swaps. 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 40.

Contingent consideration

The value of the contingent considerations shown in note 52 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 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 the businesses or individuals concerned, 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.

Short term investments

The short term investments described in note 34 are freely traded securities for which a market price quotation is available and are classified as level 1 measurements.

b) Assets and liabilities carried at amortised cost

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.

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.

Loan assets

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.

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 thereafter.

The Group has reviewed its classification of the level of valuations for retail deposits and loan assets, where valuations are derived from a mixture of observable and non-observable outputs, and concluded it is more in line with market practice to classify them as level 3 measurements rather than, as previously, level 2.

The fair values for financial assets and liabilities held at amortised cost, other than those where carrying values are so low that any difference would be immaterial, determined in accordance with the methodologies set out above are summarised below.

	2018 Carrying amount £m	2018 Fair value £m	2017 Carrying amount £m	2017 Fair value £m
The Group				
Financial assets				
Loans and receivables				
Loans to customers	12,127.8	12,222.9	11,124.1	11,191.9
Cash	1,310.6	1,310.6	1,496.9	1,496.9
	13,438.4	13,533.5	12,621.0	12,688.8
Financial liabilities				
Other liabilities				
Asset backed loan notes	5,554.7	5,554.7	6,475.8	6,475.8
Corporate and retail bonds	445.4	478.3	444.8	480.4
Retail deposits	5,296.6	5,301.7	3,615.4	3,615.1
Secured bank borrowings	935.6	935.6	1,306.0	1,306.0
	12,232.3	12,270.3	11,842.0	11,877.3
The Company				
Financial assets				
Loans and receivables				
Loans to group companies	213.7	213.7	59.7	59.7
Cash	24.9	24.9	277.6	277.6
	238.6	238.6	337.3	337.3
Financial liabilities				
Other liabilities				
Corporate and retail bonds	445.4	478.3	444.8	480.4
	445.4	478.3	444.8	480.4

The fair value of retail deposits shown above will include amounts for the related accrued interest.

6. 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 indicate cases for which a specific provision might be required.

Indicators will include number of months arrears, qualitative information, such as possession by a first charge holder on a second charge mortgage or where a buy-to-let case is under the control of a receiver of rent, the receiver's present and likely future strategy for the property (e.g. keeping current tenants in place, refurbish and relet, immediate sale etc).

Where a letting strategy has been adopted for a buy-to-let case in receivership, with a tenant in place, arrears reduced or cleared and the capital balance potentially reducing, the account will not necessarily attract an impairment provision, dependant on the management strategy adopted.

The key 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 conditions.

The accuracy of the impairment calculations would therefore be affected by unexpected changes to the economic situation, variances between the models used and the actual results, or assumptions which differ from the actual outcomes. In particular, if the impact of economic factors such as employment levels on customers is worse than is implicit in the model then the number of accounts requiring provision might be greater than suggested by the model, while falls in house prices, over and above any assumed by the model might increase the provision required in respect of accounts currently provided. Similarly, if the account management approach assumed in the modelling cannot be adopted the provision required may be different.

To illustrate this the impairment provisions were recalculated by changing one factor in the calculation and keeping all others at their current levels. This exercise indicated that:

- Adopting a sale strategy for 5% of currently let buy-to-let properties with a receiver of rent in place would increase impairment provisions by £2.1m (2017: £2.3m).
- 5% of receiver of rent properties currently vacant or for sale becoming fully performing would reduce impairment provisions by £0.3m (2017: £0.3m).
- A 10% reduction in house prices would increase impairment provisions across the first mortgage assets by £1.7m (2017: £2.0m), while a 10% increase would reduce these impairment provisions by £1.5m (2017: £1.5m).
- A reduction in cash flows from receiver of rent properties of 10% would increase impairment provision by £0.1m (2017: £0.1m).

It should be noted that all of these changes would, in reality be interrelated so examining them in isolation may not give reliable guidance as to future outcomes.

(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. 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 that predicted, which in turn would depend directly or indirectly (in the case of borrowings) on customer behaviour.

To illustrate this the amortised cost values were recalculated by changing one factor in the EIR calculation and keeping all others at their current levels. This exercise indicated that:

- A reduction (or increase) of the assumed average lives of loans secured on residential property by three months would reduce (or increase) balance sheet assets by £4.0m (2017: £2.0m)
- A reduction (or increase) in estimated cash flows from purchased loan assets of 5% would reduce (or increase) balance sheet assets by £10.3m (2017: £15.3m)

As any of these changes would, in reality, be accompanied by movements in other factors, actual outcomes may differ from these estimates.

(c) Impairment of goodwill

The carrying value of goodwill recognised on acquisitions is verified by use of an impairment test based on the projected cash flows for the cash generating unit, based on management forecasts and other assumptions described in note 44, including a discount factor.

The accuracy of this impairment calculation would therefore be compromised by any differences between these forecasts and the levels of business activity that the cash generating unit is able to achieve in practice. This test will also be affected by the accuracy of the discount factor used.

The sensitivity of the impairment test to reasonably possible movements in these assumptions is discussed in note 44.

(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 56. 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 56.

7. CAPITAL MANAGEMENT

The Group's objectives in managing capital are:

- To ensure that the Group has sufficient capital to meet its operational requirements and strategic objectives
- To safeguard the Group's ability to continue as a going concern, so that it can continue to provide returns to shareholders and benefits for other stakeholders
- To provide an adequate return to shareholders by pricing products and services commensurately with the level of risk
- To ensure that sufficient regulatory capital is available to meet any externally imposed requirements

The Group sets its target amount of capital in proportion to risk, availability, regulatory requirements and cost. The Group manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets, having particular regard to the relative costs and availability of debt and equity finance at any given time. In order to maintain or adjust the capital structure the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares, issue or redeem other capital instruments, such as retail or corporate bonds, or sell assets to reduce debt.

The Group is subject to regulatory capital rules imposed by the PRA on a consolidated basis as a group containing an authorised bank. This is discussed further below.

(a) Dividend policy

The Company is committed to a long term sustainable dividend policy. Ordinarily, dividends will increase in line with earnings, subject to the requirements of the business and the availability of cash resources. The Board reviews the policy at least twice a year in advance of announcing its results, taking into account the Group's strategy, capital requirements, principal risks and the objective of enhancing shareholder value. In determining the level of dividend for any year, the Board expects to follow the dividend policy, but will also take into account the level of available retained earnings in the Company, its cash resources and the cash and capital requirements inherent in its business plans.

The distributable reserves of the Company comprise its profit and loss account balance (note 58) and, other than the requirement for the Bank to retain an appropriate level of capital, there are no restrictions preventing profits elsewhere in the Group from being distributed to the parent.

The Board reviewed its dividend policy following Group reorganisation in September 2017, concluding that the changes made would make the Group's use of working capital more efficient and that there was, therefore, less need to retain earnings to support future growth. It therefore determined that the targeted dividend cover ratio (on the basis set out below) would be reduced from 3.00 times, initially to 2.75 times for the year ended 30 September 2017 and then, subject to the requirements of the business, to 2.50 times for the current year. The Company considers it has access to sufficient cash resources to pay dividends at this level and that its distributable reserves are abundant for this purpose.

To provide greater transparency, the Company has also indicated that in future its interim dividend per share will normally be 50% of the previous final dividend, in the absence of any indicators which might make such a level of payment inappropriate.

The most recent review, in September 2018, confirmed this policy but concluded that the significant one-off income and costs arising in the year, principally relating to asset sales and acquisitions should be excluded from earnings for this purpose. The interim and final dividends for the year ended 30 September 2018 have been declared in accordance with the policy, as amended.

For the purposes of dividend policy the Group defines dividend cover based on earnings per share, adjusted where considered appropriate and dividend per share. This is the most common measure used by financial analysts.

The derivation of the dividend for the year, which is subject to approval at the forthcoming AGM is set out below.

	Note	2018	2017
Earnings per share (p)	32	55.9	43.1
Adjustment for one off items (p)		(7.3)	-
Adjusted earnings per share (p)		48.6	43.1
Dividend cover (times)		2.50	2.75
Proposed dividend per share in respect of the year (p)	60	19.4	15.7

(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.

The Group's consolidated RoTE for the year ended 30 September 2018 is derived as follows:

	Note	2018	2017
		£m	£m
Profit for the year after tax		145.8	117.2
Amortisation of intangible assets	23	2.1	1.6
Adjusted profit		147.9	118.8
Divided by			
Opening equity		1,009.4	969.5
Opening intangible assets	43	(104.4)	(105.4)
Opening tangible equity		905.0	864.1
Closing equity		1,095.9	1,009.4
Closing intangible assets	43	(169.3)	(104.4)
Closing tangible equity		926.6	905.0
Average tangible equity		915.8	884.5
Return on Tangible Equity		16.1%	13.4%

This table is not subject to audit

(c) Gearing

The Board regularly review the proportion of working capital represented by debt and equity. Net debt is calculated as total debt, other than securitised and warehouse debt, valued at principal value, less free cash up to a maximum of the total debt. Adjusted equity comprises all components of equity (share capital, share premium, capital redemption reserve, retained earnings, and revaluation surplus) other than amounts recognised in equity relating to cash flow hedges.

The debt and equity amounts at 30 September 2018 and at 30 September 2017 were as follows:

	Note	2018 £m	2017 £m
Debt			
Retail bonds	49	297.5	297.5
Corporate bonds	50	150.0	150.0
Bank overdraft		1.1	0.6
Less: Applicable free cash	33	(238.0)	(305.5)
Net debt		210.6	142.6
Equity			
Total equity		1,095.9	1,009.4
Less: cash flow hedging reserve	58	(3.3)	(2.5)
Adjusted equity		1,092.6	1,006.9
Total working capital		1,303.2	1,149.5
Debt		16.2%	12.4%
Equity		83.8%	87.6%
Total working capital		100.0%	100.0%

The movements in the proportion of working capital represented by debt and equity during the year ended 30 September 2018 resulted primarily from the operation of the policy described above.

(d) 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 individual capital guidance setting an amount of regulatory capital, which the Group is required to hold relative to its risk weighted assets in order to safeguard depositors from loss in the event of severe losses being incurred by the Group. This is defined by the international Basel III rules, set by the Basel Committee on Banking Supervision ('BCBS') and currently implemented in UK law by EU Regulation 575/2013, referred to as the Capital Requirements Regulation ('CRR').

The Group's regulatory capital is monitored by the Board, its Risk and Compliance Committee and the Asset and Liability Committee, who ensure that appropriate action is taken to ensure compliance with the regulator's requirements. The future regulatory capital requirement is also considered as part of the Group's forecasting and strategic planning process.

The tables below demonstrate that at 30 September 2018 the Group's regulatory capital of £1,045.7m (2017: £1,030.5m) was comfortably in excess of the amounts required by the regulator, including £727.7m in respect of Pillar 1 and Pillar 2a capital (unaudited), which is comprised of fixed and variable elements. The CRR also requires firms to hold additional capital buffers, including a Capital Conservation Buffer of 1.875% of risk weighted assets (at 30 September 2018) and a Counter-Cyclical Buffer, currently 0.5% of risk weighted assets. 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 2018 is set out below.

	Note	2018 £m	2017 £m
Total equity		1,095.9	1,009.4
Deductions			
Proposed final dividend	60	(35.8)	(28.9)
Intangible assets	43	(169.3)	(104.4)
Common Equity Tier 1 ('CET1') capital		890.8	876.1
Other Tier 1 capital		-	-
Total Tier 1 capital		890.8	876.1
Corporate bond	50	150.0	150.0
Less: amortisation adjustment	†	-	-
		150.0	150.0
Collectively assessed credit impairment allowances		4.9	4.4
Total Tier 2 capital		154.9	154.4
Total regulatory capital		1,045.7	1,030.5

† When tier 2 capital instruments have less than five years to maturity the amount eligible as regulatory capital reduces by 20% per annum. No such adjustment is required in respect of the Corporate Bond issued in the year ended 30 September 2016, which matures in 2026

The total exposure amount calculated under the CRD IV framework against which this capital is held, and the proportion of these assets it represents, are calculated as shown below.

	2018 £m	2017 £m
Credit risk		
Balance sheet assets	5,767.3	4,907.7
Off balance sheet	87.8	68.3
Total credit risk	5,855.1	4,976.0
Operational risk	485.1	464.9
Market risk	-	-
Other	105.1	67.8
Total exposure amount	6,445.3	5,508.7
Solvency ratios	%	%
CET1	13.8	15.9
Total regulatory capital	16.2	18.7

This table is not subject to Audit

The CRD IV risk weightings for credit risk exposures are calculated using the Standardised Approach. The Basic Indicator Approach is used for operational risk.

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	2018 £m	2017 £m
Total balance sheet assets		14,515.1	13,682.2
Add: Credit fair value adjustments on loans to customers	35	24.1	8.7
Debit fair value adjustments on retail deposits	46	4.2	3.5
Adjusted balance sheet assets		14,543.4	13,694.4
Less: Derivative assets	40	(855.7)	(906.6)
Central bank deposits	33	(895.9)	(615.0)
CRDs	41	(6.2)	(1.6)
Accrued interest on sovereign exposures		(0.4)	-
On-balance sheet items		12,785.2	12,171.2
Less: Intangible assets	43	(169.3)	(104.4)
Total on balance sheet exposures		12,615.9	12,066.8
Derivative assets	40	855.7	906.6
Potential future exposure on derivatives		172.1	191.3
Total derivative exposures		1,027.8	1,097.9
Post offer pipeline at gross notional amount		817.7	417.9
Adjustment to convert to credit equivalent amounts		(569.2)	(208.9)
Off balance sheet items		248.5	209.0
Tier 1 capital		890.8	876.1
Total leverage exposure		13,892.2	13,373.7
UK leverage ratio		6.4%	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.

8. 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 9 to 12 respectively. The Board has a Risk and Compliance Committee, consisting of the Chairman and the non-executive directors which is responsible for providing oversight and challenge to the Group's risk management arrangements. The Credit Committee and ALCO are executive sub-committees of the Risk and Compliance Committee which monitor performance against the risk appetites set by the Board and make recommendations for changes in risk appetite where appropriate. They also review and, where authorised to do so, agree or amend policies for managing each of these risks, which are summarised in the relevant note. The Corporate Governance Statement in Section B3 (which is not subject to audit) provides further detail on the operations of these committees.

The financial risk management policies have remained unchanged throughout the year and since the year end. The position discussed in notes 9 to 12 is materially similar to that existing throughout the year.

9. CREDIT RISK

The Group's 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 credit risk management across the Group lies with the Credit Committee. The Credit Committee is made up of senior employees, drawn from financial and risk functions independent of the underwriting process. It is chaired by the Chief Risk Officer. Its key responsibilities include setting and reviewing credit policy, controlling applicant quality, tracking account performance against targets, agreeing product criteria and lending guidelines and monitoring performance and trends.

The assets of the Group and the Company which are subject to credit risk are set out below:

	Note	The Group		The Company	
		2018 £m	2017 £m	2018 £m	2017 £m
Loans to customers	35	12,127.8	11,124.1	-	-
Trade receivables	41	2.2	4.2	-	-
Derivative financial assets	40	855.7	906.6	-	-
Amounts owed by Group companies	41	-	-	216.3	40.1
CSA assets	41	3.8	2.0	-	-
CRDs	41	6.2	1.6	-	-
Cash	33	1,310.6	1,496.9	24.9	277.6
Accrued interest income	41	0.6	0.2	0.7	-
Maximum exposure to credit risk		14,306.9	13,535.6	241.9	317.7

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 10, 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.

Loans to customers

The Group's credit risk is primarily attributable to its loans to customers. There are no significant concentrations of credit risk to individual counterparties due to the large number of customers included in the portfolios.

The Group's balance sheet loan assets at 30 September 2018 are analysed as follows:

	2018 £m	2018 %	2017 £m	2017 %
Buy-to-let mortgages	10,261.6	84.6%	9,836.5	88.4%
Owner-occupied mortgages	70.6	0.6%	19.0	0.2%
Total first charge residential mortgages	10,332.2	85.2%	9,855.5	88.6%
Second charge mortgage loans	415.9	3.5%	490.7	4.4%
Loans secured on residential property	10,748.1	88.7%	10,346.2	93.0%
Development finance	352.8	2.9%	42.3	0.4%
Loans secured on property	11,100.9	91.6%	10,388.5	93.4%
Motor finance loans	329.4	2.7%	163.0	1.5%
Other consumer loans	173.7	1.4%	219.1	2.0%
Asset finance loans	403.4	3.3%	323.6	2.9%
Factoring and discounting balances	34.9	0.3%	23.8	0.2%
Professions finance	42.6	0.4%	1.4	-
Structured lending	38.7	0.3%	-	-
Other commercial loans	4.2	-	4.7	-
Total loans to customers	12,127.8	100.0%	11,124.1	100.0%

Other consumer loans include unsecured loans either advanced by Group companies or acquired from their originators at a discount.

Professions finance includes loans originated by the acquired Iceberg business (note 14). These are generally short term unsecured loans made to lawyers and accountants for working capital purposes.

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.

First mortgages and secured loans are secured by charges over residential properties in England and Wales, or similar Scottish or Northern Irish securities. Motor finance loans and asset finance loans are effectively secured by the financed asset.

Development finance loans are secured by the development property and various charges over the build.

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).

An analysis of the indexed loan to value ratio ('LTV') for those loan accounts secured on residential property by value at 30 September 2018 is set out below. LTVs for second charge mortgages are calculated allowing for the interest of the first charge holder, while for acquired accounts the effect of any discount on purchase is allowed for.

	2018	2018	2017	2017
	First mortgages	Secured loans	First mortgages	Secured loans
	%	%	%	%
Loan to value ratio				
Less than 70%	60.6	66.1	62.1	56.7
70% to 80%	29.7	17.4	25.0	17.5
80% to 90%	7.1	9.3	9.5	11.5
90% to 100%	0.8	3.5	1.3	7.1
Over 100%	1.8	3.7	2.1	7.2
	100.0	100.0	100.0	100.0
Average loan to value ratio	66.0	65.9	66.3	70.0
<i>of which</i>				
Buy-to-let	66.1		66.4	
Owner-occupied	51.3		30.9	

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 2.0% in the year ended 30 September 2018 (2017: 2.0%).

The increase in the LTV ratio for the owner-occupied accounts relates to the greater number of new lending accounts, which have higher LTV levels than legacy cases.

The 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 2018 and 30 September 2017, compared to the industry averages at those dates published by UK Finance ('UKF') and the FLA, was:

	2018	2017
	%	%
First mortgages		
Accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	0.11	0.08
Buy-to-let accounts excluding receiver of rent cases	0.03	0.02
Owner-occupied accounts	3.15	3.55
UKF data for mortgage accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	0.42	0.45
Buy-to-let accounts excluding receiver of rent cases	0.38	0.41
Owner-occupied accounts	0.86	0.95
All mortgages	0.78	0.86
Second charge mortgage loans		
Accounts more than 2 months in arrears		
All accounts	13.64	17.55
Post-2010 originations	0.21	0.06
Legacy cases (Pre-2010 originations)	17.91	16.75
Purchased assets	14.81	19.69
FLA data for secured loans	9.40	11.20
Car loans		
Accounts more than 2 months in arrears	3.91	0.67
FLA data for point of sale hire purchase	2.50	2.20
Asset finance loans		
Accounts more than 2 months in arrears	0.78	0.97
FLA data for business lease / hire purchase loans	0.70	0.60

No published industry data for asset classes comparable to the Group's other books has been identified. Where revised data at 30 September 2017 has been published by the FLA or UKF, the comparative industry figures above have been amended.

Arrears information is not given for development finance or factoring activities as the structure of the products means that such a measure is not relevant.

The Group calculates its headline arrears measure for buy-to-let mortgages, shown above, based on the numbers of accounts three months or more in arrears, including purchased 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.

The payment status of the carrying balances of the Group's live loan assets, at 30 September 2018 and at 30 September 2017, split between those accounts considered as performing and those included in the population for impairment testing, is shown below. Balances for immaterial asset classes are not shown. 'Asset finance loans' below includes other related loan balances. Fully provided non-live accounts shown in note 38 are excluded from the tables below.

Days past due is not a relevant measure for the development finance, structured lending or invoice discounting businesses, due to their particular contractual arrangements.

First mortgages

	2018	2017
	£m	£m
Not past due	10,211.1	9,724.2
Arrears less than 3 months	101.7	112.6
Performing accounts	10,312.8	9,836.8
Arrears 3 to 6 months	3.0	1.1
Arrears 6 to 12 months	2.2	1.9
Arrears over 12 months	5.7	7.7
Possessions and similar cases	22.1	22.5
Impairment population	33.0	33.2
Total gross balances	10,345.8	9,870.0
Impairment provision on live cases	(12.7)	(12.7)
Timing adjustments	(0.9)	(1.8)
Carrying balance	10,332.2	9,855.5

Consumer and asset finance

	Second charge mortgage loans	Motor finance loans	Asset finance loans	Total
	£m	£m	£m	£m
30 September 2018				
Not past due	350.7	310.8	388.6	1,050.1
Arrears less than 2 months	19.4	13.2	13.8	46.4
Performing accounts	370.1	324.0	402.4	1,096.5
Arrears 2 to 6 months	11.0	3.2	1.3	15.5
Arrears 6 to 9 months	4.1	0.9	0.7	5.7
Arrears 9 to 12 months	3.3	0.6	-	3.9
Arrears over 12 months	29.9	2.1	0.6	32.6
Specifically impaired asset finance cases	-	-	0.5	0.5
Impairment population	48.3	6.8	3.1	58.2
Total gross balances	418.4	330.8	405.5	1,154.7
Impairment provision on live cases	(1.5)	(1.7)	(1.7)	(4.9)
Timing adjustments	(1.0)	0.3	(0.4)	(1.1)
Carrying balance	415.9	329.4	403.4	1,148.7

30 September 2017

Not past due	400.8	158.0	315.3	874.1
Arrears less than 2 months	20.5	5.0	10.0	35.5
Performing accounts	421.3	163.0	325.3	909.6
Arrears 2 to 6 months	14.9	0.7	0.5	16.1
Arrears 6 to 9 months	7.1	0.2	0.7	8.0
Arrears 9 to 12 months	5.4	0.1	-	5.5
Arrears over 12 months	46.2	0.3	0.1	46.6
Specifically impaired asset finance cases	-	-	2.7	2.7
Impairment population	73.6	1.3	4.0	78.9
Total gross balances	494.9	164.3	329.3	988.5
Impairment provision on live cases	(2.1)	(1.2)	(3.1)	(6.4)
Timing adjustments	(2.1)	(0.1)	(1.2)	(3.4)
Carrying balance	490.7	163.0	325.0	978.7

Arrears in the tables above are based on the contractual payment status of the customers concerned. Where assets have been purchased by the Group, customers may already have been in arrears at the time of acquisition and an appropriate adjustment made to the consideration paid.

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. Collections on purchased accounts have been comfortably in excess of those implicit in the purchase prices.

In the debt purchase industry, Estimated Remaining Collections ('ERCs') is commonly used as a measure of the value of a portfolio. This is defined as the sum of the undiscounted cash flows expected to be received over a specified future period. In the Group's view, this measure may be suitable for heavily discounted, unsecured, distressed portfolios, but is less applicable for the types of portfolio in which the Group has invested, where cash flows are higher on acquisition, loans may be secured on property and customers may not be in default. In such cases, the IAS 39 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, but the differing bases of calculation lead to different outcomes.

	2018	2018	2018	2017	2017	2017
	Carrying value	84 month ERC	120 month ERC	Carrying value	84 month ERC	120 month ERC
	£m	£m	£m	£m	£m	£m
Loans to customers	364.2	434.9	489.6	503.5	608.9	688.8

Amounts shown as loans to customers above include loans disclosed as first mortgages and other loans (note 35) and are included in the aging tables above at their carrying values.

Buy-to-let receiver of rent cases

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 Group's outstanding exposure to buy-to-let loans with an appointed receiver is set out below.

	2018	2018	2018	2017	2017	2017
	Gross	Provision	Net	Gross	Provision	Net
	£m	£m	£m	£m	£m	£m
Performing loans						
Let with less than 3 months arrears	106.6	(1.1)	105.5	113.3	-	113.3
Impaired loans						
Let with over 3 months arrears	5.9	(2.5)	3.4	7.0	(2.7)	4.3
Vacant or on sale	20.7	(6.4)	14.3	21.7	(6.8)	14.9
Impairment population	26.6	(8.9)	17.7	28.7	(9.5)	19.2
Total gross balances	133.2	(10.0)	123.2	142.0	(9.5)	132.5

Development finance

Development finance cases include both originated accounts and accounts recognised on the Titlestone acquisition (note 15).

Development finance loans do not require customers to make payments during the life of the loan, therefore 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.

	2018 By value %	2018 By number %	2017 By value %	2017 By number %
LTGDV				
50% or less	3.4	4.4	4.2	7.3
50% to 60%	18.9	22.8	36.6	39.0
60% to 65%	63.3	59.6	42.6	41.5
65% to 70%	7.1	9.6	16.6	12.2
70% to 75%	0.7	0.7	-	-
Over 75%	6.6	2.9	-	-
	100.0	100.0	100.0	100.0

The average LTGDV cover at the year end was 63.2% (2017: 60.6%).

LTGDV is calculated by comparing the current expected end of term exposure with the latest estimate of the value of the completed development based on surveyors' reports.

At 30 September 2018 the development finance portfolio comprised 136 accounts (2017: 41) with a total carrying value of £352.8m (2017: £42.3m). Of these accounts only four were considered at risk of loss (2017: none). These accounts had been acquired in the Titlestone purchase where an allowance for losses was made in the IFRS 3 fair value calculation. There was, therefore, no impairment provision under IAS 39 (2017: £nil).

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

	2018	2017
Number of transactions	3	-
Total facilities (£m)	52.5	-
Carrying value (£m)	38.7	-

The maximum advance under these facilities was 70% to 75% of the underlying assets and the Group's Credit Risk function monitors compliance with agreed covenants relating to both the customer and the asset pool.

At 30 September 2018 there were no significant concerns regarding the credit performance of these facilities and no provisions for impairment had been made.

Institutional exposures

In order to control credit risk relating to counterparties to the Group's derivative financial instruments and cash deposits, 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 cash deposits and 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. The amounts of these cash collateral deposits, which do not form part of the Group's cash position, are given in note 40.

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.

	2018	2017
	£m	£m
Carrying value of derivative financial assets		
Counterparties rated		
AA	7.9	-
AA-	169.7	213.3
A+	5.4	41.8
A	630.2	615.4
BBB+	42.5	36.1
Gross exposure (note 40)	855.7	906.6
Collateral amounts posted	(77.8)	(723.6)
Net exposure	777.9	183.0

The reduction in collateral cover is the result of a major counterparty to the Group's cross-currency basis swaps no longer being required to post collateral due to the improved credit position of the institution, as determined by the independent trustees of the related note issues.

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. Credit risk on these balances, and the interest accrued thereon, is considered to be minimal.

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.

10. LIQUIDITY RISK

Liquidity risk is the risk that the Group might be unable meet its liabilities as they fall due.

The Group's principal source of liquidity risk is from its retail deposit funding. Deposit balances raised are typically used to support lending activities where maturity is over a longer period than that of the deposits. This maturity transformation exposes the Group to liquidity risk.

Further liquidity risk arises:

- In the medium term from the Group's corporate and retail bonds which are used to support its general operations and from its participation in central bank funding schemes
- From the Group's derivatives portfolio which gives rise to liquidity risk due to the collateral requirements to cover adverse changes in valuation
- From the Group's participation in the SPVs where sufficient funding must be available

Liquidity is also required to provide capital support for new loans and working capital for the Group.

Where assets are funded by non-recourse arrangements, through the securitisation process, liquidity risk is effectively eliminated.

The responsibility for managing liquidity risk rests with ALCO which makes recommendations for the Group's liquidity policy for Board approval and uses detailed cash flow projections to ensure that an adequate level of liquidity is available at all times. The Group's liquidity position is managed on a day to day basis by the treasury function, under the supervision of ALCO.

Retail deposits

The Group's retail funding strategy is focussed on building a stable mix of deposit products. A high proportion of balances, 97.9%, are protected by the Financial Services Compensation Scheme ('FSCS') which mitigates against the possibility of a retail run.

The cash outflows, including principal and estimated interest contractually required by the Group's retail deposit balances analysed by the earliest date at which repayment can be demanded are set out below:

	2018 £m	2017 £m
Payable on demand	1,294.3	606.6
Payable in less than one year	2,380.5	1,652.5
Payable in less than one year or on demand	3,674.8	2,259.1
Payable in one to two years	1,068.8	795.5
Payable in two to five years	720.8	687.4
	5,464.4	3,742.0

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 2018 the liquidity buffer comprised the following on and off balance sheet assets, all held within the Bank.

	Note	2018 £m	2017 £m
Balances with central banks	33	724.9	615.0
Short term investments	34	-	-
Total on balance sheet liquidity		724.9	615.0
FLS drawings	51	108.7	109.0
		833.6	724.0

The Bank manages its Liquidity Coverage Ratio ('LCR'), the level of its High Quality Liquid Assets ('HQLA') relative to its short term forecast net cash outflows. A minimum level of LCR, the Liquidity Coverage Requirement is set through regulation for all regulated financial institutions. As at 30 September 2018, 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 2018 and 30 September 2017 based on their carrying values. These are analysed between non-recourse (securitisation) and other funding, with the liquidity position arising principally from the other funding.

	Financial liabilities falling due:				Total £m
	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	
The Group					
30 September 2018					
Secured bank borrowings	-	-	-	935.6	935.6
Asset backed loan notes	-	-	-	5,554.7	5,554.7
Total non-recourse funding	-	-	-	6,490.3	6,490.3
Bank overdrafts	1.1	-	-	-	1.1
Retail bonds	-	-	184.3	111.8	296.1
Corporate bond	-	-	-	149.3	149.3
Central bank facilities	80.0	-	944.4	-	1,024.4
	81.1	-	1,128.7	6,751.4	7,961.2
30 September 2017					
Secured bank borrowings	-	-	300.3	1,005.7	1,306.0
Asset backed loan notes	-	-	142.4	6,333.4	6,475.8
Total non-recourse funding	-	-	442.7	7,339.1	7,781.8
Bank overdrafts	0.6	-	-	-	0.6
Retail bonds	-	-	184.0	111.7	295.7
Corporate bond	-	-	-	149.1	149.1
Central bank facilities	-	-	700.0	-	700.0
	0.6	-	1,326.7	7,599.9	8,927.2
The Company					
30 September 2018					
Retail bonds	-	-	184.3	111.8	296.1
Corporate bond	-	-	-	149.3	149.3
	-	-	184.3	261.1	445.4
30 September 2017					
Retail bonds	-	-	184.0	111.7	295.7
Corporate bond	-	-	-	149.1	149.1
	-	-	184.0	260.8	444.8

IFRS 7 requires the disclosure of future contractual cash flows (including interest) on these borrowings, and these are shown below.

Non-recourse funding

The Group has historically used securitisation as a principal source of funding, but currently only accesses this market on a strategic basis. In a securitisation an SPV company within the Group will issue asset backed loan notes ('Notes') secured on a pool of mortgage or other loan assets beneficially owned by the SPV in a public offer. The Notes have a maturity date later than the final repayment date for any asset in the pool, typically over thirty years from the issue date. The noteholders are entitled to receive repayment of the Note principal from principal funds generated by the loan assets from time to time, but their right to the repayment of principal is limited to the cash available in the SPV. Similarly, payment of accrued interest to the noteholders is limited to cash generated within the SPV. There is no requirement for any Group company other than the issuing SPV to make principal or interest payments in respect of the Notes. This matching of the maturities of the assets and the related funding substantially reduces the Group's exposure to liquidity risk. Details of Notes in issue are given in note 47 and the assets backing the Notes are shown in note 36.

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 2018 or the year ended 30 September 2017. 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 £71.0m of additional cash would be retained in the SPV companies (2017: £80.5m). The cash balances of the SPV companies are included within the restricted cash balances disclosed in note 33 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 company functions in a similar way to an SPV, except that funds are drawn down as advances are made or loans are sold in, repaid when loans are securitised or refinanced by an internal asset sale and may subsequently be redrawn up to the end of a commitment period. The Group's Paragon Second Funding facility was initiated as a warehouse, but is no longer available for new drawings.

Repayment of the principal amount of the facilities is not required unless amounts are realised from the secured assets either through repayment, securitisation or asset sales, even after the end of the period. There is no further recourse to other assets of the Group in respect of either interest or principal on the borrowings. The Group has reduced its available warehouse facilities in the period.

As with the SPVs, the Group provides subordinated funding to the 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 2018, but the amount of subordinated funding outstanding in the active warehouse companies at 30 September 2017 was £71.8m.

Further details of the warehouse facilities are given in note 48 and details of the loan assets within the warehouses are given in note 36.

The final repayment date for all of the securitisation borrowings and the Paragon Second Funding warehouse borrowing is more than five years from the balance sheet date, the earliest falling due in 2033 and the latest in 2050.

The equivalent sterling principal amount outstanding at 30 September 2018 under the SPV and warehouse arrangements, allowing for the effect of the cross-currency basis swaps, described under currency risk (note 12), which are net settled with the loan payments, was £5,669.1m (2017: £6,894.6m). The total sterling amount payable under these arrangements, were these principal amounts to remain outstanding until the final repayment date would be £8,874.2m (2017: £10,576.0m). 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 period.

None of the Group's corporate or retail bond issuance falls due for payment earlier than 2020.

Central bank facilities

The Group has accessed term facilities under the central bank schemes described in note 51. 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 2018 the amount of drawings available in respect of prepositioned assets was £703.2m (2017: £84.1m).

Contractual cash flows

The total undiscounted amounts, inclusive of estimated interest, which would be payable in respect of the non-securitisation borrowings of the Group and the Company, should those balances remain outstanding until the contracted repayment date, or the earliest date on which repayment can be required, are set out below.

	Contingent consideration £m	Corporate bonds £m	Retail bonds £m	Central bank facilities £m	Total £m
a) The Group					
30 September 2018					
Payable in less than one year	2.5	10.9	18.0	87.3	118.7
Payable in one to two years	5.7	10.9	18.0	10.0	44.6
Payable in two to five years	18.9	32.6	217.6	958.3	1,227.4
Payable in over five years	-	182.6	119.3	-	301.9
	27.1	237.0	372.9	1,055.6	1,692.6

30 September 2017					
Payable in less than one year	2.5	10.9	18.0	2.1	33.5
Payable in one to two years	3.5	10.9	18.0	4.8	37.2
Payable in two to five years	8.1	32.6	228.9	712.6	982.2
Payable in over five years	-	193.5	126.0	-	319.5
	14.1	247.9	390.9	719.5	1,372.4

	Corporate bonds £m	Retail bonds £m	Total £m
b) The Company			
30 September 2018			
Payable in less than one year	10.9	18.0	28.9
Payable in one to two years	10.9	18.0	28.9
Payable in two to five years	32.6	217.6	250.2
Payable in over five years	182.6	119.3	301.9
	237.0	372.9	609.9

30 September 2017			
Payable in less than one year	10.9	18.0	28.9
Payable in one to two years	10.9	18.0	28.9
Payable in two to five years	32.6	228.9	261.5
Payable in over five years	193.5	126.0	319.5
	247.9	390.9	638.8

Amounts payable in respect of the 'other accruals' and 'trade creditors' shown in note 52 fall due within one year. The cash flows described above will include those for interest on borrowings accrued at 30 September 2018 disclosed in note 52.

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:

	2018	2017
	Total cash outflow / (inflow)	Total cash outflow / (inflow)
	£m	£m
On derivative liabilities		
Payable in less than one year	(1.9)	(2.0)
Payable in one to two years	4.7	1.7
Payable in two to five years	22.6	10.9
Payable in over five years	(0.4)	0.2
	25.0	10.8
On derivative assets		
Payable in less than one year	(4.3)	(3.9)
Payable in one to two years	(1.2)	(2.3)
Payable in two to five years	0.2	(0.7)
Payable in over five years	-	-
	(5.3)	(6.9)
	19.7	3.9

11. 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 Group's risk management framework for IRRBB continues to evolve in line with updates in regulatory guidance on methods expected to be used by banks measuring, managing, monitoring and controlling such risks. The Group will continue to develop these processes as interpretation of these standards becomes clearer as they become more widely implemented.

IRRBB is managed through Board approved risk appetite limits and policies. The Group seeks to match the structure of assets and liabilities naturally where possible or by using appropriate financial instruments, such as interest rate swaps. Day to day management of interest rate risk is the responsibility of the Group's Treasury function, with control and oversight provided by ALCO.

IRRBB exposures

Risk exposure in the Group's operations might occur through:

- Gap or re-pricing risk. The risk created when interest rates on assets, liabilities and off-balance sheet items reprice at different times causing them to move by different amounts
- Basis risk. The risk arising where assets and liabilities re-price with reference to different reference interest rates, for example Bank of England base rate and LIBOR. Relative changes in the difference between the reference rates over time may impact earnings
- Option or prepayment risk. The risk that settlement of asset and liability balances at different times from those forecast due to economic conditions or customer behaviour may create a mismatch in future periods

Due to the maturity transformation inherent in the Group's business model it is also exposed to the risk that the relationship between the rates affecting the shorter term funding balance and the rates affecting the longer term lending balance will have altered when the funding has to be refinanced.

The Group measures these risks through a combination of economic value and earnings-based measures considering prepayment risk:

- Economic Value of Equity ('EVE') – 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

In July 2017 the FCA announced that it was its intention that by the end of 2021 the LIBOR reference rate would have been superseded and therefore, it would no longer be necessary for it to compel banks to make submissions to the LIBOR setting process after that point. A clear consensus has yet to emerge on how the transition from LIBOR and other Interbank Offered Rates to alternative benchmarks will be managed across the banking industry. LIBOR is used in setting interest rates on significant amounts of the Group's loan assets and borrowings and the Group has established an internal working group to identify the impact on the business and ensure a consistent approach is taken to its transition from LIBOR to other reference rates.

The Group's use of financial derivatives for hedging interest rate risk is discussed further in note 40.

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 2018, 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 2018 by £1.7m (2017: £2.1m) and increase profit before tax by £10.5m (2017: increase by £12.3m).

This calculation allows only for the direct effects of any change in UK interest rates. In practice such a change might have wider economic consequences which would themselves potentially affect the Group's business and results.

Although certain of the Group's borrowings have interest rates dependent on US Dollar and Euro LIBOR rates, the effect of the cross-currency basis swaps is such that the Group's results have no material exposure to movements in these rates. The effects of independent 1.0% increases in US or Euro interest rates would be to increase the Group's equity by £0.6m (2017: £0.3m) and £1.4m (2017: £1.9m) 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.

12. CURRENCY RISK

The Group has no appetite for material amounts of exposure to foreign currency movements and applies a hedging strategy for any material open positions through the use of spot or forward contracts or derivatives.

All of the Group's significant assets and liabilities are denominated in sterling with the exception of the asset backed loan notes denominated in US dollars and euros, which are described in note 47. Although IAS 39 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 equivalent sterling principal amounts of notes in issue under the arrangements described above, and their carrying values at 30 September 2018 and 30 September 2017 are set out below:

	2018	2018	2017	2017
	Equivalent	Carrying	Equivalent	Carrying
	sterling principal	value	sterling principal	value
	£m	£m	£m	£m
US dollar notes	897.3	1,321.8	974.7	1,395.9
Euro notes	1,320.5	1,724.5	1,652.7	2,127.3
	2,217.8	3,046.3	2,627.4	3,523.2

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 40.

None of the assets or liabilities of the Company are denominated in foreign currencies.

13. ACQUISITIONS

The Group acquired two businesses in the year ended 30 September 2018. Iceberg was acquired during December 2017 and Titlestone was acquired on 3 July 2018. The disclosures required by IFRS 3 – ‘Business Combinations’ in respect of these acquisitions are given in notes 14 and 15.

Amounts shown in other notes in respect of these acquisitions are analysed as shown below.

	Note	Iceberg (Note 14) £m	Titlestone (Note 15) £m	Total £m
Goodwill arising on acquisition	43	16.5	47.6	64.1
Intangible assets acquired	43	0.1	1.3	1.4
Property, plant and machinery acquired	42	-	-	-
Loans to customers acquired	35	2.0	227.4	229.4
Deferred tax balances at acquisition	55	-	(0.3)	(0.3)
Cash flows on acquisition	62	6.8	274.2	281.0
Acquisition related costs		0.2	2.0	2.2

Had both acquisitions taken place on 1 October 2017, the consolidated revenue of the Group for the year ended 30 September 2018 would have been £530.4m and its consolidated profit before tax for the period would have been £193.4m.

14. ACQUISITION OF ICEBERG

On 13 December 2017 the Group acquired the trade and assets of The Iceberg Partnerships LLP and on 20 December 2017 it acquired the trade and assets of Iceberg Client Credit LLP. These entities (together ‘Iceberg’) were related to each other. Iceberg is a finance broker and lender dealing with specialist business lending to mid-sized UK law firms and similar concerns. The acquisition allows the Group to increase the reach of its commercial finance operations to new products and customer groups.

The consideration for the acquisition will be satisfied entirely in cash. Cash transferred on completion was £6.6m, with a further payment made, following the agreement of completion accounts, of £0.2m.

Further contingent consideration, of between £nil and £13.0m, is payable in cash based on volumes and pricing of lending generated by the acquired business over a five year period. £11.8m has been provided in the accounts in respect of this contingent consideration, based on the net present value of the maximum amount. This is considered to be the fair value of the consideration at the transaction date, based on initial forecasts for the business. Transaction costs of £0.2m have been included in operating expenses for the year ended 30 September 2018.

The post-acquisition contribution of Iceberg to consolidated revenue for the year ended 30 September 2018 was £1.8m and its contribution to consolidated profit before tax for the period was £0.1m.

The amounts recognised in the consolidated accounts on acquisition in respect of the identifiable assets acquired are set out below. The amounts presented are considered to be materially consistent with the existing accounting policies of the Group. The Group has yet to finalise its exercise to determine these balances and therefore the amounts presented in this note should be considered as provisional. Final amounts will be presented with the Group’s annual results for the year ending 30 September 2019.

	Note	£m
Assets		
Loans to customers	a	2.0
Intangible assets	b	0.1
Total net identifiable assets		2.1
Goodwill	c	16.5
Consideration	d	18.6

a) Loans to customers

The financial assets acquired comprised loans to individuals in advance of amounts which become payable in respect of probate and matrimonial legal processes. Their fair value was £2.0m, the gross contractual value was £2.1m and the contractual flows not to be collected were £0.1m.

b) Intangible assets

Identifiable intangible assets acquired represent broker networks and trading arrangements. They will be amortised over a ten year period.

c) Goodwill

The goodwill of £16.5m arising from the acquisition consists of the values of the business relationships, market positions and knowledge base inherent in the business which do not qualify for recognition as intangible assets. These will be utilised in the future development of the acquired business and in expanding the Group's asset finance activities. None of the goodwill is expected to be deductible for tax purposes.

The goodwill has been allocated to the asset finance cash generating unit ('CGU') for impairment testing purposes as its activities have become part of the activities of the wider asset finance business.

The Group's review of the valuation of the goodwill included in this CGU for the purpose of IAS 36 'Impairment of Assets' is described in note 44.

d) Consideration

The total consideration accounted for on acquisition was:

	Total
	£m
Consideration paid on completion	6.6
Consideration paid on agreement of completion accounts	0.2
Contingent consideration	11.8
Total consideration	18.6

15. ACQUISITION OF TITLESTONE

On 3 July 2018 the Group acquired the entire share capital of Titlestone Property Finance Limited ('TPF'), together with a portfolio of loans held by companies related to it, (together 'Titlestone'). Titlestone is a development finance business, active in similar markets to the Group's own development finance operation, and its acquisition allows the Group to increase the reach of its proposition and to reach a more economic scale more rapidly than would be possible through organic growth alone.

The Group acquired 100% of the voting interests in TPF and the consideration for the shares and the loan portfolio was satisfied entirely in cash. Cash transferred on completion was £274.3m and there are no deferred or contingent consideration arrangements. Transaction costs of £1.1m have been included in operating expenses for the year ended 30 September 2018.

The contribution of Titlestone to consolidated revenue for the year ended 30 September 2018 was £6.6m and its contribution to consolidated profit before tax for the period is set out below.

	£m	£m
Contribution to consolidated profit excluding costs of acquisition		3.8
Transaction costs	(1.1)	
Other acquisition related expenses	(0.9)	
Total costs of acquisition		(2.0)
Contribution to consolidated profit after costs of acquisition		1.8

The amounts recognised in the consolidated accounts on acquisition in respect of the identifiable assets acquired and liabilities assumed are set out below. The amounts presented are considered to be materially consistent with the existing accounting policies of the Group. The Group has yet to finalise its exercise to determine these balances and therefore the amounts presented in this note should be considered as provisional. Final amounts will be presented with the Group's annual results for the year ending 30 September 2019.

	Note	£m	£m
Cash	c		0.1
Loans to customers	a		227.4
Sundry assets			0.2
Intangible assets	b		1.3
Total assets			229.0
Sundry liabilities		(2.0)	
Deferred tax		(0.3)	
Total liabilities			(2.3)
Total net identifiable assets			226.7
Goodwill	d		47.6
Consideration	c		274.3

a) Loans to customers

The financial assets acquired at 3 July 2018 comprised development finance loans. Their fair value was £227.4m, the gross contractual value was £231.0m and the total value expected not to be collected was £5.9m.

b) Intangible assets

Identifiable intangible assets acquired represent broker networks and trading arrangements. They will be amortised over a ten year period.

c) Cashflow on acquisition

	£m
Net cashflow on acquisition were	
Payment for shares	46.7
Payments for loans	227.6
Total payments on completion	274.3
Cash	(0.1)
Net cash outflow	274.2

The fair value and the gross contractual value of the cash balances acquired were equal to their book value. There are no contractual cash flows which are expected not to be collectible.

d) Goodwill

The goodwill of £47.6m arising from the acquisition consists of the values of the business relationships, market positions and knowledge base inherent in the business which do not qualify for recognition as intangible assets. These will be utilised in the future development of the Group's development finance operations, with which the acquired activities are being merged. None of the goodwill is expected to be deductible for tax purposes.

The acquired goodwill has been allocated to a CGU including both the acquired operations and the Group's organically generated development finance business with which it has been merged.

The Group's review of the goodwill arising in this transaction for the purposes of IAS 36 - 'Impairment of Assets' is described in note 44.

16. SEGMENTAL INFORMATION

The Group analyses its operations, both for internal management reporting and external financial reporting, on the basis of the markets from which its assets are generated. The segments used are described below:

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

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.

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.

The costs arising in the year ended 30 September 2018 from the Iceberg and Titlestone acquisitions of £2.2m have not been allocated as they are not directly related to customer facing activity, nor has the gain relating to the sale of financial assets.

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 2018

	Mortgages	Commercial Lending	Idem Capital	Unallocated items	Total Segments
	£m	£m	£m	£m	£m
Interest receivable	299.1	50.1	97.9	4.8	451.9
Interest payable	(141.5)	(17.9)	(10.1)	(27.8)	(197.3)
Net interest income	157.6	32.2	87.8	(23.0)	254.6
Other operating income	7.6	10.9	0.7	28.1	47.3
Total operating income	165.2	43.1	88.5	5.1	301.9
Direct costs	(14.9)	(21.2)	(10.4)	(67.7)	(114.2)
Provisions for losses	(5.5)	(2.0)	0.1	-	(7.4)
	144.8	19.9	78.2	(62.6)	180.3

Year ended 30 September 2017

	Mortgages	Commercial Lending	Idem Capital	Unallocated items	Total Segments
	£m	£m	£m	£m	£m
Interest receivable	274.7	33.8	98.9	1.8	409.2
Interest payable	(123.6)	(10.6)	(11.4)	(31.0)	(176.6)
Net interest income	151.1	23.2	87.5	(29.2)	232.6
Other operating income	9.6	9.9	0.7	-	20.2
Total operating income	160.7	33.1	88.2	(29.2)	252.8
Direct costs	(13.7)	(18.9)	(10.8)	(58.9)	(102.3)
Provisions for losses	(3.7)	(0.1)	(1.5)	-	(5.3)
	143.3	14.1	75.9	(88.1)	145.2

The segmental profits disclosed above reconcile to the group results as shown below.

	2018	2017
	£m	£m
Results shown above	180.3	145.2
Fair value items	1.2	(0.4)
Operating profit	181.5	144.8

The assets and liabilities attributable to each of the segments at 30 September 2018 and 30 September 2017 on the basis described above were:

	<i>Note</i>	Mortgages	Commercial Lending	Idem Capital	Total Segments
		£m	£m	£m	£m
30 September 2018					
Segment assets					
Loans to customers	35	10,473.5	1,133.2	521.1	12,127.8
Operating lease assets	42	-	35.4	-	35.4
Cross-currency basis swaps	40	829.7	-	-	829.7
Securitisation cash	33	319.0	-	19.8	338.8
		11,622.2	1,168.6	540.9	13,331.7
Segment liabilities					
Allocated deposits		4,702.4	1,443.5	411.0	6,556.9
Securitisation funding		6,457.2	-	33.1	6,490.3
		11,159.6	1,443.5	444.1	13,047.2

	<i>Note</i>	Mortgages	Commercial Lending	Idem Capital	Total Segments
		£m	£m	£m	£m
30 September 2017					
Segment assets					
Loans to customers	35	9,953.9	558.8	611.4	11,124.1
Operating lease assets	42	-	23.4	-	23.4
Cross currency basis swaps	40	896.3	-	-	896.3
Securitisation cash	33	543.0	-	31.0	574.0
		11,393.2	582.2	642.4	12,617.8
Segment liabilities					
Allocated deposits		3,401.2	686.9	249.8	4,337.9
Securitisation funding		7,597.1	-	184.7	7,781.8
		10,998.3	686.9	434.5	12,119.7

An analysis of the Group's financial assets by type and segment is shown in note 35. 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 £19.3m (2017: £12.9m) 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.

	2018	2017
	£m	£m
Total segment assets	13,331.7	12,617.8
Unallocated assets		
Central cash and investments	971.8	922.9
Unallocated derivatives	26.0	10.3
Operational property, plant and equipment	21.4	22.8
Intangible assets	169.3	104.4
Other	(5.1)	4.0
Total assets	14,515.1	13,682.2
Total segment liabilities	13,047.2	12,119.7
Unallocated liabilities		
Unallocated retail deposits	(1,260.3)	(722.5)
Derivative financial instruments	4.7	7.1
Central bank borrowings	1,470.9	1,145.4
Tax liabilities	27.0	22.2
Retirement benefit obligations	19.5	29.8
Other	110.2	71.1
Total liabilities	13,419.2	12,672.8

17. REVENUE

	<i>Note</i>	2018	2017
		£m	£m
Interest receivable	18	451.9	409.2
Operating lease income	20	16.3	14.4
Gain on disposal of financial assets	21	28.0	-
Other income	22	15.5	17.2
Total revenue		511.7	440.8
Arising from:			
Mortgages		306.7	284.3
Commercial Lending		73.5	55.1
Idem Capital		98.6	99.6
Total revenue from segments		478.8	439.0
Unallocated revenue		32.9	1.8
Total revenue		511.7	440.8

18. INTEREST RECEIVABLE

	2018 £m	2017 £m
<i>Interest receivable in respect of</i>		
Loans and receivables	408.9	375.1
Finance leases	34.4	28.8
Factoring income	2.2	2.2
Interest on loans to customers	445.5	406.1
Other interest receivable	6.4	3.1
Total interest on financial assets	451.9	409.2

Interest on loans to customers includes £2.3m (2017: £3.9m) charged on accounts where an impairment provision has been made.

19. INTEREST PAYABLE AND SIMILAR CHARGES

	Note	2018 £m	2017 £m
On retail deposits		83.1	47.9
On asset backed loan notes		60.3	70.2
On bank loans and overdrafts		16.5	22.7
On corporate bonds		10.9	13.1
On retail bonds		18.6	18.6
On central bank facilities		5.2	1.1
Total interest on financial liabilities		194.6	173.6
On pension scheme deficit	56	0.8	1.3
Discounting on contingent consideration	52	0.5	0.3
Other finance costs		1.4	1.4
		197.3	176.6

20. NET OPERATING LEASE INCOME

	Note	2018 £m	2017 £m
Income			
Operating lease rentals		11.4	9.7
Maintenance income		4.9	4.7
Total operating lease income		16.3	14.4
Costs			
Depreciation of lease assets	42	(5.9)	(4.4)
Maintenance salaries	24	(1.5)	(1.7)
Other maintenance costs		(5.1)	(5.3)
Total operating lease costs		(12.5)	(11.4)
Net operating lease income		3.8	3.0

21. GAIN ON DISPOSAL OF FINANCIAL ASSETS

During the year, the Group realised a gain of £28.0m on the disposal of second charge mortgages and unsecured consumer loans held in its Idem Capital division. The loans were originally acquired from various third parties as part of a number of portfolio purchases over time.

As a consequence of this transaction, facility break costs of £1.2m were incurred. These have been included within interest payable on asset backed loan notes.

22. OTHER INCOME

	2018	2017
	£m	£m
Loan account fee income	9.0	9.0
Broker commissions	2.1	3.6
Third party servicing	3.4	3.3
Other income	1.0	1.3
	15.5	17.2

23. OPERATING EXPENSES

	<i>Note</i>	2018	2017
		£m	£m
Employment costs	24	73.3	64.3
Auditor remuneration	27	1.6	1.1
Amortisation of intangible assets	43	2.1	1.6
Depreciation of operational assets	42	1.9	1.9
Operating lease rentals payable	65	2.2	2.6
Other administrative costs		33.1	30.8
		114.2	102.3

24. EMPLOYEES

The average number of persons (including directors) employed by the Group during the year was 1,349 (2017: 1,317). The number of employees at the end of the year was 1,367 (2017: 1,344).

Costs incurred during the year in respect of these employees were:

	2018	2018	2017	2017
	£m	£m	£m	£m
Share based remuneration	6.1		4.2	
Other wages and salaries	57.2		51.4	
Total wages and salaries		63.3		55.6
National Insurance on share based remuneration	1.2		1.0	
Other social security costs	6.6		5.1	
Total social security costs		7.8		6.1
Defined benefit pension cost	1.8		2.4	
Other pension costs	1.9		1.9	
Total pension costs		3.7		4.3
Total employment costs		74.8		66.0

Of which

Included in operating expenses (note 23)		73.3		64.3
Included in maintenance costs (note 20)		1.5		1.7
		74.8		66.0

Details of the pension schemes operated by the Group are given in note 56.

The Company has no employees. Details of the directors' remuneration are given in note 25.

25. 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 B5.2.2.

	2018	2018	2017	2017
	£m	£m	£m	£m
Salaries and fees	1.9		1.6	
Cash amount of bonus	1.5		1.4	
Social security costs	0.5		0.6	
Short-term employee benefits		3.9		3.6
Post-employment benefits		0.5		1.4
IFRS 2 cost in respect of directors	2.2		1.9	
National Insurance thereon	0.5		0.4	
Share based payment		2.7		2.3
		7.1		7.3

Post-employment benefits shown above are shown as 'pension allowance' in Section B5.2.2. Costs in respect of share awards shown in the Annual Report on Remuneration are determined on a different basis to the IFRS 2 charge shown above.

Social security costs paid in respect of directors are required to be included in this note by IAS 24, but do not fall within the scope of the disclosures in the Directors' Remuneration Report.

26. 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 24.

Further details of share based payment arrangements are given in the Annual Report on Remuneration in Section B5.2.2.

A summary of the number of share awards outstanding under each scheme at 30 September 2018 and at 30 September 2017 is set out below.

	Number 2018	Number 2017
(a) Sharesave Plan	3,265,788	3,113,587
(b) Performance Share Plan	4,297,809	5,103,963
(c) Company Share Option Plan	549,061	390,746
(d) Deferred Bonus Plan	496,762	445,252
(e) Restricted Stock Units	82,787	60,115
	8,692,207	9,113,663

(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 2018 and the year ended 30 September 2017 is shown below.

	2018 Number	2018 Weighted average exercise price p	2017 Number	2017 Weighted average exercise price p
Options outstanding				
At 1 October 2017	3,113,587	275.56	3,236,126	255.27
Granted in the year	464,112	408.80	690,540	341.76
Exercised or surrendered in the year	(107,235)	335.74	(637,607)	247.16
Lapsed during the year	(204,676)	307.04	(175,472)	265.03
At 30 September 2018	3,265,788	281.60	3,113,587	275.56
Options exercisable	21,966	345.68	-	-

The weighted average remaining contractual life of options outstanding at 30 September 2018 was 19.7 months (2017: 28.6 months). The weighted average market price at exercise for share options exercised in the year was 492.50p (2017: 414.02p).

Options are outstanding under the Sharesave plans to purchase ordinary shares as follows:

Grant date	Period exercisable	Exercise price	Number 2018	Number 2017
23/12/2013	01/02/2019 to 01/08/2019	276.32p	147,415	153,059
11/06/2015	01/08/2018 to 01/02/2019	345.68p	21,966	130,750
11/06/2015	01/08/2020 to 01/02/2021	345.68p	10,063	10,063
20/06/2016	01/08/2019 to 01/02/2020	249.44p	1,593,061	1,680,287
20/06/2016	01/08/2021 to 01/02/2022	249.44p	445,077	449,765
28/07/2017	01/09/2020 to 01/03/2021	341.76p	541,521	628,762
28/07/2017	01/09/2022 to 01/03/2023	341.76p	52,653	60,901
31/07/2018	01/09/2021 to 01/03/2022	408.80p	391,019	-
31/07/2018	01/09/2023 to 01/03/2024	408.80p	63,013	-
			3,265,788	3,113,587

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 2018 and the year ended 30 September 2017, are shown below.

Grant date	31/07/18	31/07/18	28/07/17	28/07/17
Number of awards granted	401,099	63,013	628,762	61,778
Market price at date of grant	498.0p	498.0p	428.5p	428.5p
Contractual life (years)	3.5	5.5	3.5	5.5
Fair value per share at date of grant (£)	1.00	0.91	0.88	0.81

Inputs to valuation model

Expected volatility	28.39%	26.47%	28.49%	27.47%
Expected life at grant date (years)	3.45	5.44	3.45	5.44
Risk-free interest rate	1.23%	1.39%	0.67%	0.88%
Expected dividend yield	3.31%	3.31%	3.24%	3.24%
Expected annual departures	5.00%	5.00%	5.00%	5.00%

The expected volatility of the share price used in determining the fair value for the three-year schemes is based on the annualised standard deviation of daily changes in price over the three years preceding the grant date. The five-year schemes use share price data for the preceding five years.

(b) Paragon Performance Share Plan ('PSP')

Awards under this plan comprise a right to acquire ordinary shares in the Company for nil or nominal payment and will vest on the third anniversary of their granting, to the extent that the applicable performance criteria have been satisfied, if the holder is still employed by the Group. The awards will lapse to the extent that the performance condition has not been satisfied on the third anniversary.

Awards are exercisable from the date on which the Remuneration Committee determines the extent to which the performance conditions have been satisfied to the day before the tenth anniversary of the grant date. Clawback provisions apply to awards granted under the PSP as detailed in the remuneration policy.

The conditional entitlements outstanding under this scheme at 30 September 2018 and 30 September 2017 were:

Grant date	Period exercisable	Number 2018	Number 2017
21/05/2009	21/05/2012 to 20/05/2019 †	15,000	15,000
04/01/2010	04/01/2013 to 03/01/2020 †	33,664	79,334
17/12/2010	17/12/2013 to 16/12/2020 †	12,424	290,964
21/12/2011	21/12/2014 to 20/12/2021 †	15,335	320,712
28/02/2013	28/02/2016 to 27/02/2023 †	8,824	293,546
10/12/2013	10/12/2016 to 09/12/2023 †	77,717	317,592
18/12/2014	18/12/2017 to 17/12/2024 ‡	243,297	1,028,364
22/12/2015	22/12/2018 to 21/12/2025 §	1,384,246	1,390,247
01/12/2016	01/12/2019 to 30/11/2026 ◊	1,342,051	1,368,204
08/12/2017	08/12/2020 to 07/12/2027 ◊	1,165,251	-
		4,297,809	5,103,963

† These awards, which were conditional on the achievement of performance based criteria, have now vested.

‡ 50% of these awards were subject to a TSR test and 50% were subject to an EPS test. The TSR test compared the rank of the Company's TSR against a comparator group of companies comprising the constituents of the FTSE-250. 25% of the TSR-tested awards vest for median performance, increasing on a straight line basis to full vesting for upper quartile performance. The EPS test provided that 25% of EPS tested awards would vest where EPS growth was equal to the increase in the retail price index plus 3%, increasing on a straight line basis to full vesting for EPS growth equal to the increase in the retail price index plus 7% or more. For both tests the testing period was the three financial years commencing with the year of grant.

§ 50% of these awards are subject to a TSR test and 50% are subject to an EPS test as described above, except that full vesting of the EPS-tested awards takes place where EPS growth is equal to the increase in the retail price index plus 13% or more.

◊ 50% of these awards are subject to a TSR test and 25% are subject to an EPS test as described at † above, except that the comparator group for the TSR test is limited to a group of listed UK financial service entities rather than the entire FTSE-250. This group is determined at the point of grant. 25% of these awards are subject to risk performance conditions which take in to account factors deemed appropriate by the Remuneration Committee, who will ultimately decide the extent to which the risk condition has been satisfied.

Once the outcomes of these tests have been determined, the gross number of awards vesting will be reduced so that the gain to the recipient from the PSP and the CSOP described below is equal to the gain from the gross PSP vesting.

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 2018 and the year ended 30 September 2017 are shown below:

Grant date	08/12/17	01/12/16
Number of awards granted	1,177,290	1,390,371
Market price at date of grant	483.20p	369.40p
Fair value per share at date of grant	338.66p	245.73p

Inputs to valuation model

Expected volatility	28.25%	29.55%
Risk-free interest rate	0.94%	0.76%
Expected dividend yield	3.25%	3.65%

For all of the above grants the contractual life and expected life at grant date is three years and no departures are expected.

The expected volatility for awards granted after 30 September 2008 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 and 2017 grants.

(c) Company Share Option Plan ('CSOP')

The PSP includes a tax advantaged element under which CSOP options can be granted. The CSOPs may be exercised alongside their accompanying PSPs based upon the exercise price that was set at the grant date. Each member of staff may be granted up to a maximum total value of £30,000 of tax benefitted options.

A reconciliation of movements in the number and weighted average exercise price of CSOP options over £1 ordinary shares during the year ended 30 September 2018 and the year ended 30 September 2017 is shown below.

	2018 Number	2018 Weighted average exercise price p	2017 Number	2017 Weighted average exercise price p
Options outstanding				
At 1 October 2017	390,746	361.88	-	-
Granted in the year	179,722	477.76	404,499	361.88
Exercised or surrendered in the year	-	-	-	-
Lapsed during the year	(21,407)	378.59	(13,753)	361.88
At 30 September 2018	549,061	399.16	390,746	361.88
Options exercisable	-	-	-	-

The conditional entitlements outstanding under this scheme at 30 September 2018 and 30 September 2017 were:

Grant date	Period exercisable	Exercise price	Number 2018	Number 2017
01/12/2016	01/12/2019 to 30/11/2026 ◊	361.88p	372,426	390,746
08/12/2017	08/12/2020 to 07/12/2027 ◊	477.76p	176,635	-
			549,061	390,746

◊ 66.7% of these awards are subject to a TSR test and 33.3% are subject to an EPS test. These tests operate in the same manner and with the same conditions as those for the PSP grant of the same date.

To the extent that the CSOP awards vest, the vesting of the PSP award granted at the same time will be abated so that the overall gain to the grantee is the same as would be received on the related PSP award had the CSOP not been in place.

No separate fair value has been attributed to the CSOP options for IFRS 2 purposes as the IFRS 2 market values for the CSOP and PSP combined will equate to that calculated for the PSP without allowing for the CSOP. The benefit from the CSOP is in relation to the employees' tax position, which does not affect the IFRS 2 charge.

(d) Deferred Bonus awards

Awards under these plans comprise a right to acquire ordinary shares in the Company for nil or nominal payment. The conditional entitlements outstanding under these plans at 30 September 2018 and 30 September 2017 were:

Grant date	Period exercisable	Number 2018	Number 2017
10/12/2013	10/12/2016 to 09/12/2023	55,302	92,208
18/12/2014	18/12/2017 to 17/12/2024	99,102	113,202
22/12/2015	22/12/2018 to 21/12/2025	134,524	134,524
01/12/2016	01/12/2019 to 30/11/2026	105,318	105,318
08/12/2017	08/12/2020 to 07/12/2027	102,516	-
		496,762	445,252

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 December 2017 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 2018 and the year ended 30 September 2017 are shown below.

Grant date	08/12/17	01/12/16
Number of awards granted	102,516	105,318
Market price at date of grant	483.2p	369.4p
Fair value per share at date of grant	483.2p	369.4p

(e) Restricted Stock Units ('RSUs')

Since 2016, the Company has permitted certain employees to elect to receive RSU awards instead of PSP awards. RSU awards have vesting conditions based upon the grantee's personal performance (including a risk element) rather than conditions in the wider business. These conditions are determined to be met to the extent to which the Remuneration Committee deems that to be the case.

The conditional entitlements outstanding under this scheme at 30 September 2018 and 30 September 2017 were:

Grant date	Period exercisable	Number 2018	Number 2017
01/12/2016	01/12/2019 to 30/11/2026	60,115	60,115
08/12/2017	08/12/2020 to 07/12/2027	22,672	-
		82,787	60,115

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 2018 and the year ended 30 September 2017 are shown below.

Grant date	08/12/17	01/12/16
Number of awards granted	22,672	60,115
Market price at date of grant	483.2p	369.4p
Fair value per share at date of grant	483.2p	369.4p

27. 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.

	2018	2017
	£000	£000
Audit fee of the company	445	142
Other services		
Audit of subsidiary undertakings pursuant to legislation	716	703
Total audit fees	1,161	845
Audit related assurance services		
Interim review	62	60
Other	20	-
Other assurance services	68	-
Other services	-	52
Total fees	1,311	957
Irrecoverable VAT	262	191
Total cost to the Group	1,573	1,148
Of which:		
Charged to profit and loss account (note 23)	1,573	1,121
Included in issue costs of debt	-	27
Total cost to the Group	1,573	1,148

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.

28. PROVISIONS FOR LOSSES

	2018	2017
	£m	£m
Impairment of financial assets (note 38)		
First mortgage loans	5.5	3.7
Second charge mortgage loans	(0.5)	0.4
Finance lease receivables	1.8	-
Development finance loans	-	-
Other loans	0.6	1.2
	7.4	5.3

29. FAIR VALUE NET GAINS / (LOSSES)

	2018	2017
	£m	£m
Net profit on derivatives designated as fair value hedges	15.5	14.6
Fair value adjustments from hedge accounting	(17.4)	(13.2)
Ineffectiveness of fair value hedges	(1.9)	1.4
Ineffectiveness of cash flow hedges	-	-
Net gains / (losses) on other derivatives	3.1	(1.8)
	1.2	(0.4)

The fair value net gain / (loss) 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.

Foreign exchange gains of £67.6m (note 61) on asset backed loan notes denominated in US dollars and euros (2017: gains of £468.9m) have been offset against the movements on the cross-currency basis swaps used to hedge these liabilities as part of the cash flow hedge accounting treatment applied.

30. TAX CHARGE ON PROFIT ON ORDINARY ACTIVITIES

(a) Analysis of charge in the year

	2018	2017
	£m	£m
Current tax		
UK Corporation Tax on profits of the period	38.0	31.7
Adjustment in respect of prior periods	(1.1)	(1.3)
Total current tax	36.9	30.4
Deferred tax	(1.2)	(2.8)
Tax charge on profit on ordinary activities	35.7	27.6

During the year ended 30 September 2015 the UK Government substantively enacted provisions reducing the rate of corporation tax from 20.0% to 19.0% with effect from 1 April 2017 and to 18.0% from 1 April 2020. The tax rate applying from 1 April 2020 was further reduced to 17.0% during the year ended 30 September 2016.

Therefore, the standard rate of corporation tax applicable to the Group for the year ended 30 September 2017 was 19.5%, the rate in the year ended 30 September 2018 was 19.0%, the rate in the year ending 30 September 2019 is expected to be 19.0%, the rate in the year ending 30 September 2020 is expected to be 18.0% and the rate in subsequent years is expected to be 17.0%.

The Bank Corporation Tax Surcharge was introduced with effect from 1 January 2016. This subjects any taxable profits arising in the Group's banking subsidiary, Paragon Bank PLC (and no other Group entity) to an additional 8.0% of tax to the extent these profits exceed £25.0m. The surcharge impacted the Group for the first time in the period and its effect is shown in note (c) below.

(b) Deferred tax credit for the year

The deferred tax credit in the income statement comprises the following temporary differences:

	2018	2017
	£m	£m
Accelerated tax depreciation	(0.9)	(0.4)
Retirement benefit obligations	0.3	0.1
Impairment and other provisions	(0.8)	(1.5)
Utilisation of tax losses	-	-
Other timing differences	(0.7)	(1.5)
Deferred tax (credit) for the year	(2.1)	(3.3)
Prior period adjustment	0.9	0.5
Change in tax rate	-	-
Deferred tax (credit) (note 55)	(1.2)	(2.8)

The expected impact on deferred tax balances of the changes in the rate of Corporation Tax to 19.0% and 17.0% described above was accounted for in the year ended 30 September 2016.

(c) Factors affecting tax charge for the year

The Group operates wholly in the UK and all but a nominal amount of the Group's income arises in UK resident companies. Consequently, it is appropriate to use the prevailing UK corporation tax rate as the comparator to the effective tax rate. As noted in (b) above, the UK Corporation tax rate applicable to the Group for the year was 19.0% (2017: 19.5%).

	2018	2017
	£m	£m
Profit on ordinary activities before taxation	181.5	144.8
Profit on ordinary activities multiplied by the UK standard rate of corporation tax	34.5	28.2
Effects of:		
Permanent differences		
- Disallowable acquisition costs	0.3	-
- Income from structured entities	(0.6)	(0.7)
- Recurring disallowable expenditure and similar items	0.1	0.3
Mismatch in timing differences	0.5	0.6
Change in rate of taxation on deferred tax assets and liabilities	-	-
Bank Corporation Tax Surcharge	1.1	-
Prior year (credit)	(0.2)	(0.8)
Tax charge for the year	35.7	27.6

The income from the Group's investment in structured entities is recognised in the income statement net of taxes incurred by the structured entities and consequently appears as a reconciling item in the tax charge.

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

As practically all of the Group's profit is subject to UK corporation tax the effective tax rate is expected to fall in line with the reductions in the standard rate described above.

The Group includes a leasing business in PAF. Whilst such businesses do not, in general, have significant permanent differences, the taxable profits in a given accounting period are usually significantly different from the accounting profits due to temporary differences. Consequently, the operation will have no material impact on the effective tax rate, but may have on the Group's tax payments.

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').

31. PROFIT ATTRIBUTABLE TO MEMBERS OF PARAGON BANKING GROUP PLC

The Company's profit after tax for the financial year amounted to £43.0m (2017: £47.4m). 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 2018 or 30 September 2017.

32. EARNINGS PER SHARE

Earnings per ordinary share is calculated as follows:

	2018	2017
Profit for the year (£m)	145.8	117.2
Basic weighted average number of ordinary shares ranking for dividend during the year (million)	260.8	271.6
Dilutive effect of the weighted average number of share options and incentive plans in issue during the year (million)	8.4	8.0
Diluted weighted average number of ordinary shares ranking for dividend during the year (million)	269.2	279.6
Earnings per ordinary share		
- basic	55.9p	43.1p
- diluted	54.2p	41.9p

33. CASH AND CASH EQUIVALENTS

	2018	2017	2016
	£m	£m	£m
Balances with central banks	895.9	615.0	315.0
Balances with other banks	414.7	881.9	922.6
Cash and cash equivalents	1,310.6	1,496.9	1,237.6

Only 'Free Cash' is unrestrictedly available for the Group's general purposes. Cash received in respect of loan assets funded through warehouse facilities and securitisations is not immediately available, due to the terms of those arrangements. This cash is shown as 'securitisation cash' below.

Balances with central banks form part of the liquidity buffer of Paragon Bank PLC and are therefore not available for the Group's general purposes. Free cash may also be deposited at the Bank of England.

Cash held by the Trustee of the Group's employee share ownership plan may only be used to invest in the shares of the Company, pursuant to the aims of that plan. This is shown as 'ESOP cash' below.

The total consolidated 'Cash and Cash Equivalents' balance may be analysed as shown below:

	2018	2017	2016
	£m	£m	£m
Free cash	238.0	305.5	383.1
Securitisation cash	338.8	574.0	537.1
Liquidity buffer	724.9	615.0	315.0
ESOP cash	8.9	2.4	2.4
	1,310.6	1,496.9	1,237.6

The 'Cash and Cash Equivalents' amount of £24.9m (2017: £277.6m; 2016: £361.3m) shown in the Company balance sheet is included in 'Free Cash'.

'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.

34. SHORT TERM INVESTMENTS

This amount represents fixed rate securities issued by the UK Government for which a liquid market exists and which are held from time to time, as part of the liquidity requirement of Paragon Bank PLC. As such they are designated as 'Available for Sale', as defined by IAS 39 - 'Financial Instruments: Recognition and Measurement' and consequently shown at fair value which corresponds to their market value.

No such securities were held at either 30 September 2018 or 30 September 2017, but the Group held this type of investment during the year.

35. LOANS TO CUSTOMERS

	Note	2018 £m	2017 £m	2016 £m
Loans and receivables	36	11,407.4	10,636.1	10,391.8
Finance lease receivables	37	720.4	488.0	345.7
Loans to customers		12,127.8	11,124.1	10,737.5
Fair value adjustments from portfolio hedging	39	(24.1)	(8.7)	12.5
		12,103.7	11,115.4	10,750.0

The movements in the Group's investment in loans to customers in the year ended 30 September 2018 and the year ended 30 September 2017 were:

	2018 £m	2017 £m
Cost		
At 1 October 2017	11,124.1	10,737.5
Acquisitions (note 13)	229.4	-
Additions	2,455.1	1,965.9
Disposals	(62.2)	(18.5)
Effective Interest Rate ('EIR') adjustments	108.1	85.5
Other debits	323.0	298.5
Provision charge (note 38)	(7.4)	(5.3)
Repayments and redemptions	(2,042.3)	(1,939.5)
At 30 September 2018	12,127.8	11,124.1

'Other debits' includes primarily interest and fees charged to customers on loans outstanding.

The Group's loan assets at 30 September 2018, analysed between the segments described in note 16 are as follows:

	Mortgages	Commercial Lending	Idem Capital	Total
	£m	£m	£m	£m
At 30 September 2018				
First mortgages	10,332.2	-	-	10,332.2
Consumer loans	141.3	-	448.3	589.6
Motor finance	-	256.6	72.8	329.4
Asset finance	-	403.4	-	403.4
Development finance	-	352.8	-	352.8
Other loans	-	120.4	-	120.4
Loans to customers	10,473.5	1,133.2	521.1	12,127.8
At 30 September 2017				
First mortgages	9,855.5	-	-	9,855.5
Consumer loans	98.4	-	611.4	709.8
Motor finance	-	163.0	-	163.0
Asset finance	-	325.0	-	325.0
Development finance	-	42.3	-	42.3
Other loans	-	28.5	-	28.5
Loans to customers	9,953.9	558.8	611.4	11,124.1

The Group's purchased loan portfolios include £11.7m of first mortgages in the Mortgages segment (2017: £12.6m), and £352.5m of consumer loans and £72.8m of motor finance loans in the Idem Capital segment (2017: £490.9m and £nil). Information on the ERCs for first mortgages and consumer loans is given in note 9. All other loans above are internally generated or arise from acquired operations.

36. LOANS AND RECEIVABLES

Loans and receivables at 30 September 2018, 30 September 2017 and 30 September 2016, which are all denominated and payable in sterling, were:

	2018	2017	2016
	£m	£m	£m
First mortgage loans	10,332.2	9,855.5	9,640.6
Second charge mortgage loans	415.9	490.7	526.8
Other unsecured consumer loans	173.7	219.1	195.1
Development finance loans	352.8	42.3	9.1
Other secured commercial lending	72.9	17.5	15.0
Other commercial loans	59.9	11.0	5.2
	11,407.4	10,636.1	10,391.8

First mortgage loans have a contractual term of up to thirty years, second charge mortgage loans up to twenty five years and other unsecured consumer loans up to ten 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.

First mortgages are secured on residential property within the UK; second charge mortgage loans enjoy second charges on residential property. The estimated value of the security held against those loans above which are considered to be impaired or past due, representing, for each such account, the lesser of the outstanding balance on the loan and the estimated valuation of the property was:

	2018	2017
	£m	£m
First mortgage loans	23.1	22.4
Second charge mortgage loans	46.2	69.4
	69.3	91.8

The development finance loans have an average term of 21 months (2017: 17 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.

Other secured commercial lending includes structured lending, aviation, mortgages and invoice factoring.

Other loans includes 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 51 or under the external funding arrangements described in notes 47 and 48 are shown below. 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 2018				
In respect of:				
Asset backed loan notes	5,052.2	40.8	-	5,093.0
Warehouse facilities	1,030.2	-	-	1,030.2
Central bank facilities	1,670.1	-	-	1,670.1
Total pledged as collateral	7,752.5	40.8	-	7,793.3
Prepositioned with Bank of England	1,171.1	-	-	1,171.1
Other assets not pledged as collateral	1,408.6	548.8	485.6	2,443.0
	10,332.2	589.6	485.6	11,407.4

30 September 2017

In respect of:

Asset backed loan notes	5,328.8	270.5	-	5,599.3
Warehouse facilities	1,449.3	-	-	1,449.3
Central bank facilities	1,224.9	-	-	1,224.9
Total pledged as collateral	8,003.0	270.5	-	8,273.5
Prepositioned with Bank of England	122.1	-	-	122.1
Other assets not pledged as collateral	1,730.4	439.3	70.8	2,240.5
	9,855.5	709.8	70.8	10,636.1

37. FINANCE LEASE RECEIVABLES

The Group's finance lease receivables are motor finance and asset finance loans. The average contractual life of the motor finance loans was 55 months (2017: 53 months) while that of the asset finance loans was 52 months (2017: 42 months), but it is likely that a significant proportion of customers will choose to settle their obligations early.

The Group's finance leases can be analysed as shown below.

	2018	2017	2016
	£m	£m	£m
Motor finance	329.4	163.0	95.3
Asset finance	391.0	325.0	250.4
Carrying value	720.4	488.0	345.7

The minimum lease payments due under these loan agreements are:

	2018	2017	2016
	£m	£m	£m
Amounts receivable			
Within one year	259.5	174.9	133.0
Within two to five years	530.2	357.6	255.8
After five years	30.9	17.8	7.6
	820.6	550.3	396.4
Less: future finance income	(95.2)	(58.3)	(47.7)
Present value	725.4	492.0	348.7

The present values of those payments, net of provisions for impairment, carried in the accounts are:

	2018	2017	2016
	£m	£m	£m
Amounts receivable			
Within one year	226.4	151.9	116.1
Within two to five years	471.7	323.8	225.8
After five years	27.3	16.3	6.8
Present value	725.4	492.0	348.7
Allowance for uncollectible amounts	(5.0)	(4.0)	(3.0)
Carrying value	720.4	488.0	345.7

Whilst on motor finance cases the Group has the benefit of the underlying vehicle as security on these loans, no account of this is taken in the allowance for uncollectible amounts shown above. The Group has insufficient information on the current condition of finance leased vehicles to derive a reliable estimate of the value which could be realised from vehicles to offset against arrears accounts. Accordingly, no such disclosure is provided.

For the Group's asset finance loans, estimated valuations of security assets for balances in arrears are undertaken as part of the credit management process. These exercises suggest that the security value of assets under finance leases which are past due or impaired is £16.4m (2017: £12.2m).

None of the Group's finance lease receivables were pledged as collateral for liabilities at 30 September 2018 or 30 September 2017.

38. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS

The following amounts in respect of impairment provisions, net of allowances for recoveries of written off assets, have been deducted from the appropriate assets in the balance sheet.

	First mortgages £m	Other loans and receivables £m	Finance leases £m	Total £m
At 1 October 2016	88.8	22.6	1.2	112.6
Amounts provided in the period	3.8	2.3	2.2	8.3
Amounts written off	(3.5)	(6.6)	(0.2)	(10.3)
At 30 September 2017	89.1	18.3	3.2	110.6
Amounts provided in the period	5.6	0.6	2.9	9.1
Amounts written off	(3.7)	(7.6)	(1.0)	(12.3)
At 30 September 2018	91.0	11.3	5.1	107.4

Of the above balances, the following provisions were held in respect of realised losses not charged off, which remain on the balance sheet and are provided for in full.

	First mortgages £m	Other loans and receivables £m	Finance leases £m	Total £m
At 30 September 2018	78.2	-	0.9	79.1
At 30 September 2017	76.4	0.3	0.3	77.0

The amounts charged to the profit and loss account, net of recoveries of previously provided amounts are set out below.

	First mortgages £m	Other loans and receivables £m	Finance leases £m	Total £m
Year ended 30 September 2018				
Amounts provided in the year	5.6	0.6	2.9	9.1
Recovery of amounts previously provided	(0.1)	(0.5)	(1.1)	(1.7)
Net impairment for year (note 28)	5.5	0.1	1.8	7.4
Year ended 30 September 2017				
Amounts provided in the year	3.8	2.3	2.2	8.3
Recovery of amounts previously provided	(0.1)	(0.7)	(2.2)	(3.0)
Net impairment for year (note 28)	3.7	1.6	-	5.3

39. FAIR VALUE ADJUSTMENTS FROM PORTFOLIO HEDGING

The Group applies fair value hedge accounting in respect of portfolios of loan assets (note 35) and retail deposits (note 46) where the appropriate criteria are met. In these circumstances the change in the fair value of the hedged items attributable to the hedged risk is shown under this heading next to the carrying value of the hedged assets or liabilities in the appropriate note.

40. DERIVATIVE FINANCIAL ASSETS AND LIABILITIES

Use of derivative financial instruments

The Group uses derivative financial instruments for risk management purposes. Such instruments are contracts with counterparties and are used only to reduce or eliminate the risk exposure of the Group. No trading in derivative financial instruments is undertaken.

It is, and has been throughout the year under review, the Group's policy not to trade in financial instruments, and hence all of the Group's derivative financial instruments are entered into for hedging purposes only. These are used to protect the Group from exposures principally arising from fixed rate lending or borrowing and borrowings denominated in foreign currencies.

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, while 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 has designated a number of derivatives as fair value hedges for accounting purposes. In particular this treatment is used for:

- (a) hedging the interest rate risk of groups of fixed rate prepayable loan assets with interest rate derivatives on a portfolio basis; and
- (b) hedging the interest rate risk of groups of fixed rate retail deposits with interest rate derivatives on a portfolio basis.

In both cases the Group believes this solution is the most appropriate as it is consistent with the economic hedging approach taken by the Group to these assets and liabilities.

As interest rate swaps are used to hedge pipeline loan exposures which are not yet recognised on the balance sheet an unmatched fair value cost or credit can 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.

The Group's securitisation borrowings are denominated in sterling, euros and US dollars. All currency borrowings are swapped at inception using bespoke cross-currency basis swaps with principal amortisation and interest rates linked to the underlying borrowing. The currency borrowings therefore have the effect of sterling borrowings.

These swaps provide an effective economic hedge against exchange rate and interest movements, but accounting standards require that they are carried at fair value leading, when exchange rates have moved significantly since the issue of the notes, to large balances for the swaps being carried in the balance sheet. This is currently the case with both euro and US dollar swaps, although the debit balance is compensated for by retranslating the borrowings at the current exchange rate. Cash flow hedging relationships have been designated in respect of these arrangements.

In addition, the Group utilises currency derivatives to hedge its exposure on the small amount of its lending denominated in foreign currencies.

Analysis of derivative financial instruments

The analysis below splits derivatives between those accounted for as part of the portfolio fair value and cash flow hedges described above and those which, despite representing an economic hedge, do not qualify for this treatment. There were no individual interest rate risk hedging arrangements in place either in the year ended 30 September 2018 or the preceding year.

	2018 Notional amount £m	2018 Assets £m	2018 Liabilities £m	2017 Notional amount £m	2017 Assets £m	2017 Liabilities £m
Derivatives in accounting hedge relationships						
<i>Fair value hedges</i>						
Interest rate swaps	4,753.9	23.9	(4.5)	3,213.9	8.8	(6.4)
<i>Cash flow hedges</i>						
Cross-currency basis swaps	2,217.8	829.7	-	2,627.4	896.3	-
	6,971.7	853.6	(4.5)	5,841.3	905.1	(6.4)
Other derivatives						
Interest rate swaps	857.7	2.1	(0.2)	507.4	1.5	(0.7)
Currency futures	5.8	-	-	-	-	-
Total recognised derivative assets / (liabilities)	7,835.2	855.7	(4.7)	6,348.7	906.6	(7.1)

At 30 September 2018 cash deposits of £67.5m had been pledged as collateral in respect of cross-currency basis swaps shown above by the respective swap counterparties (2017: £723.6m) as described in note 9.

Collateral received or posted in respect of interest rate swaps is shown in notes 41 and 52 respectively.

41. SUNDRY ASSETS

(a) The Group

	2018	2017	2016
	£m	£m	£m
Current assets			
Accrued interest income	0.6	0.2	0.3
Trade receivables	2.2	4.2	2.4
Prepayments	2.6	2.8	2.6
CSA Assets	3.8	2.0	3.7
CRDs	6.2	1.6	0.6
Other tax	1.1	0.2	0.8
Other receivables	2.5	1.7	2.3
	19.0	12.7	12.7

The Group uses the International Swaps and Derivatives Association ('ISDA') Master Agreement for documenting certain derivative activity within Paragon Bank. 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 the table above, while collateral pledged to the Group is shown in note 52.

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.

Accrued interest income, trade receivables, CSA assets, CRDs and other receivables fall within the definition of financial assets given in IAS 32.

(b) The Company

	2018	2017	2016
	£m	£m	£m
Current assets			
Amounts owed by Group companies	216.3	40.1	84.5
Accrued interest income	0.7	-	0.1
	217.0	40.1	84.6

Accrued interest income and other debtors fall within the definition of financial assets given in IAS 32.

42. PROPERTY, PLANT AND EQUIPMENT

(a) The Group

	Leased assets £m	Land and buildings £m	Plant and machinery £m	Total £m
Cost				
At 1 October 2016	18.9	22.7	10.1	51.7
Acquisitions	-	-	-	-
Additions	12.9	0.1	1.6	14.6
Disposals	(1.8)	-	(0.8)	(2.6)
At 30 September 2017	30.0	22.8	10.9	63.7
Acquisitions	-	-	-	-
Additions	19.3	-	0.8	20.1
Disposals	(2.9)	-	(1.0)	(3.9)
At 30 September 2018	46.4	22.8	10.7	79.9
Accumulated depreciation				
At 1 October 2016	2.9	2.4	7.2	12.5
Charge for the year	4.4	0.6	1.3	6.3
On disposals	(0.7)	-	(0.6)	(1.3)
At 30 September 2017	6.6	3.0	7.9	17.5
Charge for the year	5.9	0.6	1.3	7.8
On disposals	(1.5)	-	(0.7)	(2.2)
At 30 September 2018	11.0	3.6	8.5	23.1
Net book value				
At 30 September 2018	35.4	19.2	2.2	56.8
At 30 September 2017	23.4	19.8	3.0	46.2
At 30 September 2016	16.0	20.3	2.9	39.2

Plant and machinery shown above is used within the Group's business. Leased assets includes £25.7m in respect of assets leased under operating leases (2017: £16.5m) and £9.7m of assets available for hire (2017: £6.9m).

During the year the Group entered into a transaction with the Paragon Pension Plan, effectively granting a first charge over its freehold head office building as security for its agreed contributions under the recovery plan. The carrying value of the assets subject to this charge was £18.3m (2017: £nil).

(b) The Company

	Land and buildings £m
Cost	
At 1 October 2016	19.9
Disposals	-
At 30 September 2017	19.9
Disposals	(19.9)
At 30 September 2018	-
Accumulated depreciation	
At 1 October 2016	1.0
Charge for the year	0.3
On disposals	-
At 30 September 2017	1.3
Charge for the year	0.2
On disposals	(1.5)
At 30 September 2018	-
Net book value	
At 30 September 2018	-
At 30 September 2017	18.6
At 30 September 2016	18.9

During the year the Group's head office building was transferred to a subsidiary entity as part of the arrangements to establish the effective charge described above.

43. INTANGIBLE ASSETS

	Goodwill (note 44) £m	Computer software £m	Other intangible assets £m	Total £m
Cost				
At 1 October 2016	104.4	7.0	9.2	120.6
Acquisitions	(0.3)	-	-	(0.3)
Additions	-	0.9	-	0.9
At 30 September 2017	104.1	7.9	9.2	121.2
Acquisitions (note 13)	64.1	-	1.4	65.5
Additions	-	1.5	-	1.5
At 30 September 2018	168.2	9.4	10.6	188.2
Accumulated amortisation and impairment				
At 1 October 2016	6.0	4.9	4.3	15.2
Amortisation charge for the year	-	1.0	0.6	1.6
At 30 September 2017	6.0	5.9	4.9	16.8
Amortisation charge for the year	-	1.4	0.7	2.1
At 30 September 2018	6.0	7.3	5.6	18.9
Net book value				
At 30 September 2018	162.2	2.1	5.0	169.3
At 30 September 2017	98.1	2.0	4.3	104.4
At 30 September 2016	98.4	2.1	4.9	105.4

Other intangible assets comprise brands and the benefit of business networks recognised on the acquisition of businesses.

44. GOODWILL

The goodwill carried in the accounts is attributable to three cash generating units, as analysed below:

	2018 £m	2017 £m
Asset finance	113.0	96.5
Development finance	47.6	-
TBMC	1.6	1.6
At 30 September 2017	162.2	98.1

(a) Asset finance

The goodwill carried in the accounts relating to the asset finance cash generating unit was recognised on the acquisitions of PAF and Premier in the year ended 30 September 2016 and Iceberg in the current year (note 14).

An impairment review undertaken at 30 September 2018 indicated that no write down was required.

The recoverable amount of the asset finance cash generating unit used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board covering a five year period. The pre-tax discount rate applied to the cash flow projection is 13.4% and cash flows beyond the five year budget are extrapolated using a constant growth rate of 2.2% which does not exceed the long term average growth rates for the markets in which the business is active.

The key assumptions underlying the value in use calculation for the asset finance cash generating unit are:

- Level of business activity, based on management expectations. 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 the Group's cost of capital

As an illustration of the sensitivity of this impairment test to movements in the key assumptions, the Group has calculated that a 12.6% reduction in profit levels coupled with a 185 basis point increase in the pre-tax discount rate would eliminate the headroom in the projection.

(b) Development finance

The goodwill carried in the accounts relating to the development finance cash generating unit was recognised on the acquisition of Titlestone in the current year (note 15).

An impairment review undertaken at 30 September 2018 indicated that no write down was required.

The recoverable amount of the development finance cash generating unit used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board covering a five year period. The pre-tax discount rate applied to the cash flow projection is 13.4% and cash flows beyond the five year budget are extrapolated using a constant growth rate of 2.2% which does not exceed the long term average growth rate for the UK economy.

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. 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 the Group's cost of capital

Management believes any reasonably possible change in the key assumptions above would not cause the recoverable amount of the Development finance cash generating unit to fall below the balance sheet carrying value.

(c) TBMC

The goodwill carried in the accounts relating to the TBMC cash generating unit was recognised on the acquisition of The Business Mortgage Company Limited and its subsidiaries ('TBMC') in December 2008 and impaired by £6.0m in 2009.

An impairment review was undertaken at 30 September 2018 which indicated no further impairment. The recoverable amount of TBMC used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board covering a five year period. The pre-tax discount rate applied to the cash flow projection is 5.66% and cash flows beyond the five year budget are extrapolated using a 2.0% growth rate, being the average long term growth rate in the UK economy over a twenty year period.

The key assumptions underlying the value in use calculation for the TBMC business are:

- Level of business activity, based on management expectations. Management have concluded that the levels of activity assumed for the purpose of this forecast are reasonable, based on past experience and the current economic environment
- Discount rate, which is based on market rates of interest plus a margin appropriate to the risk profile of the TBMC business as an investment

The directors believe that no reasonably possible change in any of the key assumptions above would cause the carrying value of the unit to exceed its recoverable amount.

45. INVESTMENT IN SUBSIDIARY UNDERTAKINGS

	Shares in group companies £m	Loans to group companies £m	Loans to ESOP Trusts £m	Total £m
At 1 October 2016	519.4	451.9	13.5	984.8
Investments in subsidiaries	378.6	-	-	378.6
Disposal of subsidiaries	(150.0)	-	-	(150.0)
Loans advanced	-	88.9	4.2	93.1
Loans repaid	-	(494.5)	-	(494.5)
Provision movements	11.4	-	(4.3)	7.1
At 30 September 2017	759.4	46.3	13.4	819.1
Investments in subsidiaries	12.5	-	-	12.5
Disposal of subsidiaries	-	-	-	-
Loans advanced	-	200.0	6.5	206.5
Loans repaid	-	(46.3)	-	(46.3)
Provision movements	(1.2)	-	(6.2)	(7.4)
At 30 September 2018	770.7	200.0	13.7	984.4

Investments in and disposals of subsidiaries represent transactions between the Company and various of its subsidiaries. In the year ended 30 September 2017 these transactions were mostly related to the Group restructuring in September 2017. Crystallisation of provisions as a result of these transfers is the major component of the provision movements in the period.

During the year ended 30 September 2018 the Company received £62.0m in dividend income from its subsidiaries (2017: £44.7m) and £12.6m of interest on loans to Group companies (2017: £27.0m).

The Company's subsidiaries, and the nature of its interest in them, are shown in note 67.

46. RETAIL DEPOSITS

The Group's retail deposits, held by Paragon Bank PLC, were received from customers in the UK and are denominated in sterling. The deposits comprise principally term deposits and 120 day notice accounts. The method of interest calculation on these deposits is analysed as follows:

	2018 £m	2017 £m	2016 £m
Fixed rate	3,643.1	2,675.9	1,332.5
Variable rates	1,653.5	939.5	541.4
	5,296.6	3,615.4	1,873.9

The weighted average interest rate on retail deposits at 30 September 2018, analysed by charging method, was:

	2018 %	2017 %	2016 %
Fixed rate	1.94	1.89	2.11
Variable rates	1.36	1.21	1.65

The contractual maturity of these deposits is analysed below.

	2018	2017	2016
	£m	£m	£m
Amounts repayable			
In less than three months	256.8	211.4	55.7
In more than three months, but not more than one year	2,024.7	1,399.6	690.3
In more than one year, but not more than two years	1,010.6	770.0	572.9
In more than two years, but not more than five years	655.3	629.7	283.9
Total term deposits	3,947.4	3,010.7	1,602.8
Repayable on demand	1,349.2	604.7	271.1
	5,296.6	3,615.4	1,873.9
Fair value adjustments for portfolio hedging (note 39)	(4.2)	(3.5)	0.8
	5,292.4	3,611.9	1,874.7

47. ASSET BACKED LOAN NOTES

The Group's asset backed loan notes ('Notes') are secured on portfolios comprising variable and fixed rate mortgages or personal, retail and car loans. The maturity date of the Notes matches the maturity date of the underlying assets (except as noted below). The Notes can be prepaid in part from time to time, but such prepayments are limited to the net capital received from borrowers in respect of the underlying assets. There is no requirement for the Group to make good any shortfall on the Notes out of general funds. It is likely that a substantial proportion of the Notes will be repaid within five years.

For its public issues, the Group has an additional option to repay all of the Notes at an earlier date (the 'call date'), at their outstanding principal amount.

Interest is payable at a fixed margin above;

- The London Interbank Offered Rate ('LIBOR') on notes denominated in sterling
- The Euro Interbank Offered Rate ('EURIBOR') on notes denominated in euros
- The London Interbank Offered Rate ('US Dollar LIBOR') on notes denominated in US dollars

All payments in respect of the Notes are required to be made in the currency in which they are denominated.

All of the Notes are rated and publicly listed, except for those issued by Idem Luxembourg (No. 8), which were issued privately.

The notes outstanding at 30 September 2018 can be analysed as follows:

	2018			2017		
	Listed	Not listed	Total	Listed	Not listed	Total
	£m	£m	£m	£m	£m	£m
Secured on first mortgage assets	5,521.6	-	5,521.6	6,291.1	-	6,291.1
Secured on other assets	33.1	-	33.1	42.3	142.4	184.7
	5,554.7	-	5,554.7	6,333.4	142.4	6,475.8

The Group publishes detailed information on the performance of all of its listed note issues on the Bond Investor Reporting section of its website at www.paragonbankinggroup.co.uk. A more detailed description of the securitisation structure under which these Notes are issued is given in note 10.

On 25 April 2018, a Group company, Paragon Mortgages (No. 25) PLC, issued £435.3m of sterling mortgage backed floating rate notes to external investors at par. £375.0m of the notes were class A notes, rated AAA by Fitch and Aaa by Moody's, £31.8m were class B notes, rated AA by Fitch and Aa1 by Moody's and £28.5 were class C notes rated A- by Fitch and A1 by Moody's. The interest rates above LIBOR on the notes were 0.65% on the A notes, 0.95% on the B notes and 1.30% on the C notes. The initial average interest margin on the transaction was 0.72% and the proceeds were used to refinance existing short-term liabilities. The Group retained £289.4m of notes of various classes meaning that its investment represented 39.9% of the issued notes.

Notes in issue at 30 September 2018 and 30 September 2017, net of any held by the Group, were:

Issuer	Maturity date	Call date	Principal outstanding		Average interest margin		
			2018 £m	2017 £m	2018 %	2017 %	
Sterling notes							
Paragon Mortgages (No. 8) PLC	15/04/44	15/10/08	-	178.1	-	0.59	
Paragon Mortgages (No. 9) PLC	15/05/41	15/05/09	102.4	108.2	0.38	0.38	
Paragon Mortgages (No. 10) PLC	15/06/41	15/12/09	169.5	194.6	0.50	0.46	
Paragon Mortgages (No. 11) PLC	15/10/41	15/04/10	258.9	277.9	0.15	0.15	
Paragon Mortgages (No. 12) PLC	15/11/38	15/08/10	100.4	106.4	0.41	0.41	
Paragon Mortgages (No. 13) PLC	15/01/39	15/10/10	475.8	502.7	0.27	0.27	
Paragon Mortgages (No. 14) PLC	15/09/39	15/03/11	466.1	508.7	0.23	0.22	
Paragon Mortgages (No. 15) PLC	15/12/39	15/06/11	128.3	138.9	0.30	0.29	
Paragon Mortgages (No. 20) PLC	15/11/41	15/08/18	-	110.1	-	0.75	
Paragon Mortgages (No. 21) PLC	15/06/42	15/12/18	55.2	86.9	1.13	1.01	
Paragon Mortgages (No. 22) PLC	15/09/42	15/06/19	48.3	78.0	1.15	1.02	
Paragon Mortgages (No. 23) PLC	15/01/43	15/10/19	55.9	139.3	1.56	1.28	
Paragon Mortgages (No. 24) PLC	15/07/43	15/04/20	71.5	218.4	2.36	1.78	
Paragon Mortgages (No. 25) PLC	15/05/50	15/05/23	435.3	-	0.71	-	
First Flexible No. 5 PLC	01/06/34	01/07/09	50.3	55.2	0.99	0.99	
First Flexible No. 6 PLC	01/12/35	01/03/08	52.5	55.8	1.27	1.27	
First Flexible (No. 7) PLC	15/09/33	15/03/11	12.4	16.0	0.33	0.28	
Paragon Secured Finance (No. 1) PLC	15/11/35	15/11/08	33.1	42.3	0.98	1.02	
Idem Luxembourg No. 8*	15/10/18	N/A	-	143.2	-	3.50	
US dollar notes							
			\$m	\$m	%	%	
Paragon Mortgages (No. 9) PLC	15/05/41	15/05/09	16.7	17.6	0.36	0.36	
Paragon Mortgages (No. 12) PLC	15/11/38	15/08/10	743.8	804.2	0.24	0.24	
Paragon Mortgages (No. 13) PLC	15/01/39	15/10/10	154.3	164.5	0.18	0.18	
Paragon Mortgages (No. 14) PLC	15/09/39	15/03/11	185.3	204.6	0.20	0.20	
Paragon Mortgages (No. 15) PLC	15/12/39	15/06/11	611.2	668.9	0.19	0.19	
First Flexible No. 6 PLC	01/12/35	01/03/08	8.2	8.7	0.56	0.56	
Euro notes							
			€m	€m	%	%	
Paragon Mortgages (No. 8) PLC	15/04/44	15/10/08	-	238.9	-	0.48	
Paragon Mortgages (No. 9) PLC	15/05/41	15/05/09	158.9	168.0	0.56	0.56	
Paragon Mortgages (No. 10) PLC	15/06/41	15/12/09	254.1	256.7	0.39	0.39	
Paragon Mortgages (No. 11) PLC	15/10/41	15/04/10	213.6	229.2	0.54	0.54	
Paragon Mortgages (No. 12) PLC	15/11/38	15/08/10	326.0	340.8	0.54	0.54	
Paragon Mortgages (No. 13) PLC	15/01/39	15/10/10	303.8	313.0	0.42	0.42	
Paragon Mortgages (No. 14) PLC	15/09/39	15/03/11	338.2	350.1	0.47	0.46	
Paragon Mortgages (No. 15) PLC	15/12/39	15/06/11	254.5	260.0	0.71	0.70	
Paragon Mortgages (No. 22) PLC	15/09/42	15/06/19	26.3	58.4	0.50	0.50	
Paragon Mortgages (No. 23) PLC	15/01/43	15/10/19	14.1	60.5	0.70	0.70	
Paragon Mortgages (No. 24) PLC	15/07/43	15/04/20	16.1	104.2	1.10	1.10	
First Flexible No. 6 PLC	01/12/35	01/03/08	29.6	31.4	1.05	1.05	

* Although the maturity date of these notes may be earlier than the potential final redemption date of the underlying loans, repayment cannot be enforced except to the extent that cash can be realised from those assets at that time.

The details of the assets backing these securities are given in note 36.

On 15 November 2018, after the year end, all of the outstanding notes of Paragon Secured Finance (No. 1) PLC were redeemed at par. The underlying assets were subsequently funded by other Group resources. On 12 November 2018 notice was also given of the intention to redeem all of the outstanding notes of First Flexible No. 5 PLC at par and this is expected to take place in December 2018.

48. 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 10 and details of assets held within the warehouse facilities are given in note 36. Details of the Group's bank borrowings are set out below.

	2018			2017		
	Principal value	Maximum available facility	Carrying value	Principal value	Maximum available facility	Carrying value
	£m	£m	£m	£m	£m	£m
i) Paragon Second Funding	935.6	935.6	935.6	1,005.7	1,005.7	1,005.7
ii) Paragon Fifth Funding	-	-	-	158.0	350.0	157.3
iii) Paragon Seventh Funding	-	-	-	143.0	200.0	143.0
	935.6	935.6	935.6	1,306.7	1,555.7	1,306.0

- 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 (2017: 0.675% above LIBOR).
- ii) On 26 September 2012, the Group entered into a £200.0m committed sterling facility provided to Paragon Fifth Funding Limited by the wholesale division of Lloyds Bank, which was renewed in January 2014. On 15 May 2015 the facility was increased to £350.0m, and certain other changes were made to its terms. The facility was renewed in 2016, but without changes to its terms. This facility was secured on all the assets of Paragon Fifth Funding Limited and was structured with a three year term to permit drawings and re-drawings until June 2018. The facility was not renewed prior to this date and expired during the year. Interest on this loan was payable monthly in sterling at 2.75% above three month LIBOR until January 2014, when the margin was reduced to 1.75%.
- iii) On 26 September 2015, a Group company, Paragon Seventh Funding Limited, entered into an additional £200.0m committed sterling facility with Bank of America Merrill Lynch International Limited. This facility was secured on all the assets of Paragon Seventh Funding Limited and was available for drawings and redrawings until 8 October 2017. This facility bore interest at a rate of three month LIBOR plus 1.30%. The facility was not renewed at the end of the commitment period and was repaid during the year.

The weighted average margin above LIBOR on bank borrowings at 30 September 2018 was 0.675% (2017: 0.873%).

Following the year end, on 14 November 2018, a new £200.0m facility was agreed between Paragon Seventh Funding Limited and Bank of America Merrill Lynch. The facility is secured over all of the assets of Paragon Seventh Funding Limited, with a 12 month commitment period. Interest is payable at 0.95% over three month LIBOR.

49. 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	2018 £m	2017 £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 £296.1m (2017: £295.7m).

50. CORPORATE BONDS

On 9 September 2016 the Company issued £150.0m of 7.25% Fixed Rate Reset Callable Subordinated Tier 2 Notes due 2026 at par to provide long term capital for the Group. These bonds bear interest at a fixed rate of 7.25% per annum until 9 September 2021, after which interest will be payable at a fixed rate which is 6.731% over the sterling 5-year mid-market swap rate at that time. These bonds are unsecured and subordinated to any other creditors of the Company. At issue the Notes were rated BB+ by Fitch and this rating was upgraded to BBB- in the year.

The carrying value of these bonds in the accounts of the Group and the Company at 30 September 2018 was £149.3m (2017: £149.1m).

51. CENTRAL BANK FACILITIES

During the year, the Group has utilised facilities provided by the Bank of England including through its Sterling Monetary Framework. These facilities enable either funding or off-balance sheet liquidity to be provided to Paragon Bank on the security of designated pools of the Bank's first mortgage assets, with the amount available based on the value of the security given, subject to a haircut.

Drawings under the FLS are used to provide off balance sheet liquidity and form part of the Bank's HQLA. Fees are charged under the FLS at 0.25% of the market value of the liquidity drawn and are repayable in June 2020.

Drawings under the Indexed Long-Term Repo Scheme ('ILTR') have a maturity of six months and a rate of interest set in an auction process. At 30 September 2018 the average rate of interest on the Group's ILTR drawings was 0.90% (2017:N/A).

Drawings under the Term Funding Scheme ('TFS') have a maturity of four years and bear interest at bank base rate. The average remaining maturity of the Group's drawings is 34 months (2017: 45 months). As these drawings are provided at rates below those available commercially, by a government agency, they are accounted for under IAS 20. The TFS is no longer available for new drawings.

The amounts drawn under these facilities are set out below.

	2018 £m	2017 £m
TFS	944.4	700.0
ILTR	80.0	-
On balance sheet funding	1,024.4	700.0
FLS	108.7	109.0
Total central bank facilities	1,133.1	809.0

Further first mortgage assets of the Bank have been pre-positioned with the Bank of England for future use in such schemes. The assets pledged in support of these drawings are set out in note 36.

The balances arising from the TFS carried in the Group accounts are shown below.

	2018	2017
	£m	£m
TFS at IAS 20 carrying value	923.5	679.9
Deferred government assistance	20.9	20.1
	944.4	700.0

52. SUNDRY LIABILITIES

(a) The Group

	2018	2017	2016
	£m	£m	£m
Current liabilities			
Accrued interest	27.5	23.6	26.1
Deferred income	0.9	1.1	1.3
Deferred consideration	-	-	1.9
Trade creditors	2.7	3.5	3.8
Conduct (note 53)	-	0.5	1.9
CSA liabilities (note 41)	10.3	-	-
Other accruals	29.7	21.0	19.6
Other taxation and social security	2.5	1.4	1.7
	73.6	51.1	56.3
Non-current liabilities			
Accrued interest	12.4	7.2	6.5
Deferred income	2.5	2.1	1.7
Contingent consideration	25.7	14.0	13.7
Other accruals	0.2	0.2	0.5
	40.8	23.5	22.4
Total sundry liabilities	114.4	74.6	78.7

Accrued interest, contingent consideration, trade creditors and other accruals fall within the definition of financial liabilities set out in IAS 32 and IAS 39.

The contingent consideration liability represents consideration payable in respect of corporate acquisitions which is dependent on the performance of the acquired businesses. Movements in the contingent liability are set out below.

	2018	2017
	£m	£m
At 1 October 2017	14.0	13.7
Acquisitions (note 14)	11.8	-
Revaluation of liability	(0.6)	-
Unwind of discounting (note 19)	0.5	0.3
At 30 September 2018	25.7	14.0

(b) The Company

	2018	2017	2016
	£m	£m	£m
Current liabilities			
Amounts owed to Group companies	125.7	36.5	168.5
Accrued interest	2.8	2.9	4.7
	128.5	39.4	173.2

Accrued interest and other accruals fall within the definition of 'financial liabilities' set out in IAS 32 and IAS 39.

53. 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, both in respect of PPI and other matters, through regulatory policies, legislative rules and court rulings, and while the Group's assessment is that it currently has no further potential liability for conduct issues, this is based on our current interpretation of requirements and hence further liabilities may arise as these develop over time.

54. CURRENT TAX LIABILITIES

Current tax in the Group and the Company represents UK corporation tax owed.

55. DEFERRED TAX

(a) The Group

The movements in the net deferred tax liability are as follows:

	Note	2018	2017	2016
		£m	£m	£m
Net liability at 1 October 2017		4.8	2.0	11.3
Acquisitions	13	0.3	-	(3.5)
Income statement (credit)	30	(1.2)	(2.8)	(0.4)
Charge / (credit) to equity		1.7	5.6	(5.4)
Net liability at 30 September 2018		5.6	4.8	2.0

The net deferred tax liability for which provision has been made is analysed as follows:

	2018	2017	2016
	£m	£m	£m
Accelerated tax depreciation	(4.1)	(4.0)	(4.2)
Retirement benefit obligations	(3.7)	(5.7)	(11.1)
Impairment and other provisions	14.0	14.9	16.4
Tax (losses)	(0.2)	(0.2)	(0.2)
Other timing differences	(0.4)	(0.2)	1.1
Net deferred tax liability	5.6	4.8	2.0

As stated in note 30 legislation has been introduced to reduce the standard rate of UK corporation tax to 17.0% from 1 April 2020. The temporary differences have been provided at the rate prevailing when the Group anticipates the temporary difference to reverse. In the event that the temporary differences actually reverse in different periods a credit or charge will arise in a future period to reflect the difference. The timing of reversal of temporary differences will be affected by both matters within the Group's control (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 surcharge to some extent. The deferred tax numbers above do not include any material temporary differences in Paragon Bank PLC.

In addition, the Group has tax losses of £1.7m (2017: £1.7m) in entities whose current taxable profits are insufficient to support the recognition of a deferred tax asset.

(b) The Company

The movements in the net deferred tax liability are as follows:

	2018	2017	2016
	£m	£m	£m
Net liability at 1 October 2017	1.8	1.9	1.9
Income statement (credit)	-	(0.1)	-
Net liability at 30 September 2018	1.8	1.8	1.9

The net deferred tax liability for which provision has been made is analysed as follows:

	2018	2017	2016
	£m	£m	£m
Other timing differences	1.8	1.8	1.9
Net deferred tax liability	1.8	1.8	1.9

56. 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 than the deficit will be higher.

The risks relating to death in service payments are insured with an external insurance company.

As a result of the Plan having been closed to new entrants since February 2002, the service cost as a percentage of pensionable salaries is expected to increase as the average age of active members rises over time. However the membership is expected to reduce so that the service cost in monetary terms will gradually reduce.

The most recent full actuarial valuation of the Plan's liabilities, obtained by the Trustee, was carried out at 31 March 2016, by Aon Hewitt, the Plan's independent actuary. This showed that the value of the Plan's liabilities on a buy-out basis in accordance with Section 224 of the Pensions Act 2004 was £214.0m, with a shortfall against the assets of £118.4m.

Following the 2016 actuarial valuation, the Trustee put in place a revised recovery plan. The Trustee's recovery plan aims to meet the statutory funding objective within six years and ten months from the date of valuation, that is by 31 January 2023. As part of this recovery plan, the Group entered into a transaction effectively granting the Plan a first charge over its head office building as security for payments under the plan (note 42).

(b) Defined benefit plan – financial impact

For accounting purposes the valuation at 31 March 2016 was updated to 30 September 2018 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 2018, 30 September 2017 and 30 September 2016 and their fair values were:

	2018	2017	2016
	£m	£m	£m
Cash	0.6	0.9	9.7
Equity instruments	61.8	58.7	56.0
Debt instruments	28.4	28.9	29.5
Real estate	10.7	9.8	8.9
Total fair value of Plan assets	101.5	98.3	104.1
Present value of Plan liabilities	(121.0)	(128.1)	(162.5)
(Deficit) in the Plan	(19.5)	(29.8)	(58.4)

At 30 September 2018 the Plan assets were invested in a diversified portfolio that consisted primarily of equity and debt investments. The majority of the equities held by the Plan are in developed markets. All investments of the Plan are in managed funds for which unit prices are quoted publicly by the fund managers, however they are not openly traded so are considered to be Level 2 financial instruments as defined by IFRS 13.

During October 2018, after the balance sheet date, 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.

For the purposes of the accounts of the Group for the year ending 30 September 2018 this is considered to be a non-adjusting post balance sheet event, as the ruling was handed down after the balance sheet date. The Group's present expectation is that the ruling will result in an additional charge to profit in the year ending 30 September 2019 of £0.2m before tax. However, this estimate is based on a preliminary interpretation of the ruling and a high-level calculation and therefore the actual amount posted may vary due to the Trustee's response to the ruling, idiosyncratic impacts on individual members and the development of a wider legal and accounting consensus on the proper interpretation of the courts requirements as the ruling is studied in more detail. There is also the potential for the ruling to be appealed.

The movement in the fair value of the Plan assets during the year was as follows:

	2018	2017
	£m	£m
At 1 October 2017	98.3	104.1
Interest on Plan assets	2.6	2.3
Cash flows		
Contributions by Group	4.5	3.7
Contributions by Plan members	0.2	0.2
Benefits paid	(4.7)	(19.0)
Administration expenses paid	(0.5)	(0.4)
Remeasurement gain		
Return on Plan assets (excluding amounts included in interest)	1.1	7.4
At 30 September 2018	101.5	98.3

The actual return on Plan assets in the year ended 30 September 2018 was £3.7m (2017: £9.7m).

Benefits paid in the year ended 30 September 2017 includes amounts transferred on the settlement of the Plan's commitments to certain members with large accrued benefits. No gain or loss arose on these transfers, which will reduce the Plan's exposure to future volatility.

The movement in the present value of the Plan liabilities during the year was as follows:

	2018	2017
	£m	£m
At 1 October 2017	128.1	162.5
Current service cost	1.8	2.4
Funding cost	3.4	3.6
Cash flows		
Contributions by Plan members	0.2	0.2
Benefits paid	(4.7)	(19.0)
Remeasurement (gain)		
Arising from demographic assumptions	(1.8)	(6.7)
Arising from financial assumptions	(6.0)	(10.7)
Arising from experience adjustments	-	(4.2)
At 30 September 2018	121.0	128.1

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 2018	30 September 2017	30 September 2016
In determining net pension cost for the year			
Discount rate	2.70%	2.40%	3.90%
Rate of compensation increase	3.60%	3.50%	3.55%
Rate of price inflation	3.10%	3.00%	3.05%
Rate of increase of pensions	2.90%	2.95%	3.00%
In determining benefit obligations			
Discount rate	2.95%	2.70%	2.40%
Rate of compensation increase	3.60%	3.60%	3.50%
Rate of price inflation	3.10%	3.10%	3.00%
Rate of increase of pensions	2.95%	2.90%	2.95%
Further life expectancy at age 60			
Male member aged 60	28	29	29
Female member aged 60	29	30	31
Male member aged 40	30	30	32
Female member aged 40	31	32	34

The amounts charged in the consolidated income statement in respect of the Plan are:

	Note	2018 £m	2017 £m
Current service cost	24	1.8	2.4
Administration expenses		0.5	0.4
Included within operating expenses		2.3	2.8
Funding cost of Plan liabilities		3.4	3.6
Interest on Plan assets		(2.6)	(2.3)
Net interest expense	19	0.8	1.3
Components of defined benefit costs recognised in profit or loss		3.1	4.1

The amounts recognised in the consolidated statement of comprehensive income in respect of the Plan are:

	2018 £m	2017 £m
Return on Plan assets (excluding amounts included in interest)	1.1	7.4
Actuarial gains		
Arising from demographic assumptions	1.8	6.7
Arising from financial assumptions	6.0	10.7
Arising from experience adjustments	-	4.2
Total actuarial gain	8.9	29.0
Tax thereon	(1.7)	(5.5)
Net actuarial gain	7.2	23.5

Of the remeasurement movements reflected above:

- The return on plan assets represents better than expected investment performance
- The change in demographic assumptions reflects the adoption of new mortality assumptions, using the most recent version of the tables adopted by the Trustee in the triennial valuation, which predict lower life expectancy among members than the previous versions
- The change in financial assumptions reflects principally the impact of increased inflation expectations on discount rates

(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 2018, 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.	Decrease by 2.1%
Rate of inflation*	0.1% p.a.	Increase by 2.1%
Rate of salary growth	0.1% p.a.	Increase by 0.4%
Rates of mortality	1 year of life expectancy	Increase by 2.1%

*maintaining a 0.5% assumption for real salary growth

The sensitivity analysis presented above may not be representative of an actual future change in the defined benefit obligation as it is unlikely that changes in assumptions would occur in isolation as some of the assumptions will be correlated. There has been no change in the method of preparing the analysis from that adopted in previous years.

In conjunction with the Trustee, the Group has continued to conduct asset-liability reviews of the Plan. These studies are used to assist the Trustee and the Group to determine the optimal long-term asset allocation with regard to the structure of liabilities within the Plan. The results of the studies are used to assist the Trustee in managing the volatility in the underlying investment performance and risk of a significant increase in the scheme deficit by providing information used to determine the investment strategy of the Plan. There have been no changes in the processes by which the Plan manages its risks from previous periods.

The target asset allocations for the year ending 30 September 2019 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. Before 1 April 2017 the agreed rate of employer contributions was 27.0% of gross salaries for participating employees with additional contributions of £1.5m per annum for deficit reduction and £0.4m per annum to cover administration and life cover costs, payable monthly. After 1 April 2017, following the finalisation of the March 2016 valuation, employer contributions increased to 32.0% of gross salaries and the additional contribution for deficit reduction increased to £2.5m per annum. The £0.4m per annum contribution in respect of costs remained in place.

The present best estimate of the contributions to be made to the Plan by the Group in the year ending 30 September 2019 is £4.5m.

The average durations of the benefit obligations in the Plan at the year end are shown in the table below:

Category of member	2018 Years	2017 Years
Active members	24	24
Deferred pensioners	23	23
Current pensioners	15	16
All members	22	22

(d) Defined contribution arrangements

The Group sponsors a defined contribution (Worksave) pension scheme, open to all employees who are not members of the Plan. The Group successfully completed the auto-enrolment process mandated by the UK Government in November 2013, using this scheme.

The PAF business also sponsors a number of defined contribution pension plans and makes contributions to these schemes in respect of employees.

The assets of these schemes are not Group assets and are held separately from those of the Group, under the control of independent trustees. Contributions made by the Group to these schemes in the year ended 30 September 2018, which represent the total cost charged against income, were £1.9m (2017: £1.9m) (note 24).

57. 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:

	2018 Number	2017 Number
Ordinary shares		
At 1 October 2017	281,489,701	295,852,094
Shares issued	107,235	637,607
Shares cancelled	-	(15,000,000)
At 30 September 2018	281,596,936	281,489,701

During the year the Company issued 107,235 shares (2017: 637,607) to satisfy options granted under Sharesave schemes for a consideration of £360,031 (2017: £1,575,925).

58. RESERVES

(a) The Group

	2018	2017	2016
	£m	£m	£m
Share premium account	65.8	65.5	64.6
Capital redemption reserve	28.7	28.7	13.7
Merger reserve	(70.2)	(70.2)	(70.2)
Cash flow hedging reserve	3.3	2.5	2.1
Profit and loss account	890.7	784.5	725.9
	918.3	811.0	736.1

(b) The Company

	2018	2017	2016
	£m	£m	£m
Share premium account	65.8	65.5	64.6
Capital redemption reserve	28.7	28.7	13.7
Merger reserve	(23.7)	(23.7)	(23.7)
Profit and loss account	390.0	384.0	415.5
	460.8	454.5	470.1

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.

The cash flows to which amounts included in the cash flow hedging reserve relate result from the cross-currency basis swaps described in note 12. The contractual life of these swaps, over which cash flows might take place and affect profit, extend over the next 25 years (2017: 27 years). However the cash flows in respect of these swaps will only continue for as long as the related notes remain outstanding, which is expected to be a much shorter period.

59. OWN SHARES

	The Group		The Company	
	2018	2017	2018	2017
	£m	£m	£m	£m
Treasury shares				
At 1 October 2017	66.6	46.2	66.6	46.2
Shares purchased	25.2	65.5	25.2	65.5
Shares cancelled	-	(45.1)	-	(45.1)
At 30 September 2018	91.8	66.6	91.8	66.6
ESOP shares				
At 1 October 2017	16.5	16.3	-	-
Shares purchased	6.2	4.2	-	-
Options exercised	(10.5)	(4.0)	-	-
At 30 September 2018	12.2	16.5	-	-
Balance at 30 September 2018	104.0	83.1	91.8	66.6
Balance at 1 October 2017	83.1	62.5	66.6	46.2

At 30 September 2018 the number of the Company's own shares held in treasury was 20,800,284 (2017: 15,693,643). These shares had a nominal value of £20,800,284 (2017: £15,693,643). 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 2018, the trusts held 2,874,825 ordinary shares (2017: 3,180,661) with a nominal value of £2,874,825 (2017: £3,180,661) and a market value of £13,764,662 (2017: £13,975,824). Options, or other share-based awards, were outstanding against all of these shares at 30 September 2018 (2017: all). The dividends on all of these shares have been waived (2017: all).

60. EQUITY DIVIDEND

Amounts recognised as distributions to equity shareholders in the Group and the Company in the period:

	2018	2017	2018	2017
	Per share	Per share	£m	£m
Equity dividends on ordinary shares				
Final dividend for the year ended 30 September 2017	11.0p	9.2p	28.9	25.5
Interim dividend for the year ended 30 September 2018	5.5p	4.7p	14.2	12.5
	16.5p	13.9p	43.1	38.0

Amounts paid and proposed in respect of the year:

	2018	2017	2018	2017
	Per share	Per share	£m	£m
Interim dividend for the year ended 30 September 2018	5.5p	4.7p	14.2	12.5
Proposed final dividend for the year ended 30 September 2018	13.9p	11.0p	35.8	28.9
	19.4p	15.7p	50.0	41.4

The proposed final dividend for the year ended 30 September 2018 will be paid on 18 February 2019, subject to approval at the Annual General Meeting, with a record date of 11 January 2019. The dividend will be recognised in the accounts when it is paid.

61. NET CASH FLOW FROM OPERATING ACTIVITIES

(a) The Group

	2018	2017
	£m	£m
Profit before tax	181.5	144.8
Non-cash items included in profit and other adjustments:		
Depreciation of operating property, plant and equipment	1.9	1.9
Profit on disposal of operating property, plant and equipment	(0.2)	(0.1)
Amortisation of intangible assets	2.1	1.6
Foreign exchange movement on borrowings	(67.6)	(468.9)
Other non-cash movements on borrowings	6.0	6.4
Impairment losses on loans to customers	7.4	5.3
Charge for share based remuneration	6.1	4.2
Net (increase) / decrease in operating assets:		
Operating lease assets	(12.0)	(7.4)
Loans to customers	(781.7)	(391.9)
Derivative financial instruments	50.9	459.8
Fair value of portfolio hedges	15.4	21.2
Other receivables	(6.1)	-
Net increase / (decrease) in operating liabilities:		
Retail deposits	1,681.2	1,741.5
Derivative financial instruments	(2.4)	(8.7)
Fair value of portfolio hedges	(0.7)	(4.3)
Other liabilities	24.6	(1.8)
Cash generated by operations	1,106.4	1,503.6
Income taxes (paid)	(32.0)	(28.9)
	1,074.4	1,474.7

Cash flows relating to plant and equipment held for leasing under operating leases are classified as operating cash flows.

(b) The Company

	2018	2017
	£m	£m
Profit before tax	39.6	44.6
Non-cash items included in profit and other adjustments:		
Depreciation of property, plant and equipment	0.2	0.3
Non-cash movements on borrowings	0.6	0.5
Impairment provision / (release) on investments in subsidiaries	7.4	(8.1)
Charge for share based remuneration	6.1	4.2
Net (increase) / decrease in operating assets:		
Other receivables	(176.9)	45.5
Net increase / (decrease) in operating liabilities:		
Other liabilities	89.1	(133.8)
Cash (utilised) / generated by operations	(33.9)	(46.8)
Income taxes received / (paid)	3.4	2.3
	(30.5)	(44.5)

62. NET CASH FLOW FROM INVESTING ACTIVITIES

	The Group		The Company	
	2018	2017	2018	2017
	£m	£m	£m	£m
Proceeds from sales of operating property, plant and equipment	0.5	0.3	18.4	-
Purchases of operating property, plant and equipment	(0.8)	(1.7)	-	-
Purchases of intangible assets	(1.5)	(0.9)	-	-
Decrease in short term investments	-	7.1	-	-
Movement in loans to subsidiary undertakings	-	-	(160.2)	401.4
Acquisitions (note 13)	(281.0)	(1.6)	-	-
Investment in subsidiary undertakings	-	-	(12.5)	(378.6)
Disposal of subsidiary undertakings	-	-	-	150.0
Net cash (utilised) / generated by investing activities	(282.8)	3.2	(154.3)	172.8

63. NET CASH FLOW FROM FINANCING ACTIVITIES

	The Group		The Company	
	2018 £m	2017 £m	2018 £m	2017 £m
Shares issued (note 57)	0.4	1.5	0.4	1.5
Dividends paid (note 60)	(43.1)	(38.0)	(43.1)	(38.0)
Issue of asset backed floating rate notes	432.5	69.8	-	-
Repayment of asset backed floating rate notes	(1,289.7)	(1,503.0)	-	-
Repayment of corporate bonds	-	(110.0)	-	(110.0)
Movement on central bank facilities	324.4	700.0	-	-
Movement on other bank facilities	(371.1)	(268.6)	-	-
Purchase of shares (note 59)	(31.8)	(69.7)	(25.2)	(65.5)
Net cash (utilised) by financing activities	(978.4)	(1,218.0)	(67.9)	(212.0)

64. RECONCILIATION OF NET DEBT

(a) The Group

	Cash flows			Non-cash movements			Closing debt £m
	Opening debt £m	Debt issued £m	Others £m	Acquisition £m	Foreign exchange £m	Other £m	
30 September 2018							
Asset backed loan notes	6,475.8	432.5	(1,289.7)	-	(67.6)	3.7	5,554.7
Bank borrowings	1,306.0	-	(371.1)	-	-	0.7	935.6
Corporate bonds	149.1	-	-	-	-	0.2	149.3
Retail bonds	295.7	-	-	-	-	0.4	296.1
Central bank borrowings	700.0	324.4	-	-	-	-	1,024.4
Bank overdrafts	0.6	-	0.5	-	-	-	1.1
Gross debt	8,927.2	756.9	(1,660.3)	-	(67.6)	5.0	7,961.2
Cash	(1,496.9)	(756.9)	1,224.1	(280.9)	-	-	(1,310.6)
Net debt	7,430.3	-	(436.2)	(280.9)	(67.6)	5.0	6,650.6
30 September 2017							
Asset backed loan notes	8,374.1	69.8	(1,503.0)	-	(468.9)	3.8	6,475.8
Bank borrowings	1,573.0	-	(268.6)	-	-	1.6	1,306.0
Corporate bonds	259.0	-	(110.0)	-	-	0.1	149.1
Retail bonds	295.3	-	-	-	-	0.4	295.7
Central bank borrowings	-	700.0	-	-	-	-	700.0
Bank overdrafts	1.2	-	(0.6)	-	-	-	0.6
Gross debt	10,502.6	769.8	(1,882.2)	-	(468.9)	5.9	8,927.2
Cash	(1,237.6)	(769.8)	510.5	-	-	-	(1,496.9)
Net debt	9,265.0	-	(1,371.7)	-	(468.9)	5.9	7,430.3

Other non-cash changes shown above represent EIR adjustments relating to the spreading of initial costs of the facilities concerned.

(b) The Company

	Opening debt £m	Cash flows		Non-cash movements		Closing debt £m
		Debt issued £m	Other £m	Foreign exchange £m	Other £m	
30 September 2018						
Corporate bonds	149.1	-	-	-	0.2	149.3
Retail bonds	295.7	-	-	-	0.4	296.1
Gross debt	444.8	-	-	-	0.6	445.4
Cash	(277.6)	-	252.7	-	-	(24.9)
Net debt	167.2	-	252.7	-	0.6	420.5
30 September 2017						
Corporate bonds	259.0	-	(110.0)	-	0.1	149.1
Retail bonds	295.3	-	-	-	0.4	295.7
Gross debt	554.3	-	(110.0)	-	0.5	444.8
Cash	(361.3)	-	83.7	-	-	(277.6)
Net debt	193.0	-	(26.3)	-	0.5	167.2

Other non-cash changes shown above represent EIR adjustments relating to the spreading of initial costs of the bonds.

65. OPERATING LEASE ARRANGEMENTS**(a) As Lessor**

The Group, through its asset finance business, leases assets under operating leases. In respect of certain of these assets, the Group also provides maintenance services to the lessee.

Assets subject to these arrangements are shown in note 42 and the income from these activities is shown in note 20.

The future minimum lease payments under these arrangements may be analysed as follows:

	The Group		The Company	
	2018 £m	2017 £m	2018 £m	2017 £m
Amounts falling due:				
Within one year	2.0	3.0	-	-
Between two and five years	7.2	7.5	-	-
After more than five years	0.6	0.3	-	-
	9.8	10.8	-	-

(b) As Lessee

	The Group		The Company	
	2018 £m	2017 £m	2018 £m	2017 £m
Minimum lease payments under operating leases recognised in operating expenses for the year				
Office buildings	1.8	2.1	-	-
Motor vehicles	0.3	0.3	-	-
Office equipment	0.1	0.2	-	-
	2.2	2.6	-	-

At 30 September 2018 the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	The Group		The Company	
	2018	2017	2018	2017
	£m	£m	£m	£m
Amounts falling due:				
Within one year	2.6	2.4	-	-
Between two and five years	6.8	6.8	-	-
After more than five years	2.9	3.8	-	-
	12.3	13.0	-	-

Operating lease payments represent rents payable by the Group in respect of certain of its office premises and lease payments on company vehicles and equipment. The average term of the current building leases from inception or acquisition is 8 years (2017: 6 years) with rents subject to review every five years, while the average term of the vehicle leases and office equipment is 3 years (2017: 3 years).

66. 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. The amount of such deposits outstanding at the year end was £250,000 (2017: £nil).

Mr A K Fletcher, a non-executive director of the Company, 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 £15,000 in the year ended 30 September 2018 by Paragon Finance PLC, the sponsoring company of the Plan (2017: £10,000).

The Plan is a related party of the Group. Transactions with the Plan are described in note 56.

The Group had no other transactions with related parties other than the key management compensation disclosed in note 25.

(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 26.

Details of the Company's investments in subsidiaries and the income derived from them are shown in notes 45 and 67.

Outstanding current account balances with subsidiaries are shown in notes 41 and 52.

During the year the Company incurred interest costs of £1.3m in respect of borrowings from its subsidiaries (2017: £10.2m).

67. DETAILS OF SUBSIDIARY UNDERTAKINGS

Subsidiary undertakings of the Group at 30 September 2018, where the share capital is held within the Group are shown below. The holdings shown are those held within the Group. The shareholdings of the Company in the direct subsidiaries listed below are the same as those held by the Group, except that:

- For the shareholdings marked * the Company holds only 74% of the share capital
- For the shareholdings marked † the Company holds only 66.7% of the share capital

In these cases the remainder is held by other group companies.

The issued share capital of all subsidiaries consists of ordinary share capital, except those companies marked § which have additional preference share capital held within the Group.

Company	Holding	Principal activity
Direct subsidiaries of Paragon Banking Group PLC		
Paragon Car Finance Limited	100%	Vehicle finance
Idem Capital Holdings Limited	100%	Intermediate holding company
Moorgate Servicing Limited	100%	Intermediate holding company
Paragon Bank PLC	100%	Deposit taking, residential mortgages and loan and vehicle finance
SPV Securities Limited	100%	Asset investment
The Business Mortgage Company Limited	100%	Mortgage broker
Paragon Fourth Funding Limited	100%	Residential mortgages
Paragon Mortgages (No. 7) PLC	100%	Residential mortgages
Paragon Mortgages (No. 8) PLC	100%	Residential mortgages
Paragon Mortgages (No. 9) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 10) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 11) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 12) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 13) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 14) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 15) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 16) PLC	100%	Residential mortgages
Paragon Mortgages (No. 17) PLC	100%	Residential mortgages
Paragon Personal and Auto Finance (No. 3) PLC	100%	Loan and vehicle finance
Paragon Secured Finance (No. 1) PLC	100%	Loan finance
First Flexible (No. 7) PLC	100% *	Residential mortgages
Collateralised Mortgage Securities (No. 12) PLC	100%	Non-trading
Colonial Finance (UK) Limited	100%	Non-trading
Earlswood Finance Limited	100% *	Non-trading
Finance for People (No. 3) Limited	100%	Non-trading
Finance for People (No. 4) 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
Homeloans (No. 4) PLC	100% §	Non-trading
Idem Luxembourg (No. 4) ‡	100%	Non-trading
Idem Luxembourg (No. 5) ‡	100%	Non-trading
Idem Luxembourg (No. 9) ‡	100%	Non-trading

Company	Holding	Principal activity
Direct subsidiaries of Paragon Banking Group PLC		
Mortgage Funding Corporation PLC	100%	Non-trading
NHL Second Funding Corporation Limited	100%	Non-trading
NHL Third Funding Corporation Limited	100%	Non-trading
Paragon Car Finance (1) Limited	100%	Non-trading
Paragon Dealer Finance Limited	100%	Non-trading
Paragon Finance Holdings Limited	100%	Non-trading
Paragon Lending 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. 1) PLC	100% §	Non-trading
Paragon Mortgages (No. 2) PLC	100% §	Non-trading
Paragon Mortgages (No. 4) PLC	100%	Non-trading
Paragon Mortgages (No. 5) PLC	100%	Non-trading
Paragon Mortgages (No. 27) Limited	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 Servicing Limited	100%	Non-trading
Paragon Third Funding Limited	100%	Non-trading
Paragon Vehicle Contracts Limited	100%	Non-trading
Plymouth Funding Limited	100%	Non-trading
Redbrick Real Estate Services Limited	100%	Non-trading
Paragon Loan Finance (No. 3) Limited <i>(formerly TBMC (2) Limited)</i>	100%	Non-trading
Townend Farm (Easington) Management Company Limited	100%	Non-trading
Universal Credit Limited	100%	Non-trading
Yorkshire Freeholds Limited	100%	Non-trading
Yorkshire Leaseholds Limited	100%	Non-trading
Direct and indirect subsidiaries of Paragon Bank PLC		
Paragon Finance PLC	100%	Residential mortgages and asset administration
Mortgage Trust Limited	100%	Residential mortgages
Paragon Mortgages Limited	100%	Residential mortgages
Paragon Mortgages (2010) Limited	100%	Residential mortgages
First Flexible No. 6 PLC	100% §	Residential mortgages
Mortgage Trust Services PLC	100%	Residential mortgages and asset administration
Paragon Second Funding Limited	100%	Residential mortgages and loan and vehicle finance
Paragon Asset Finance Limited <i>(formerly Paragon Bank Asset Finance Limited)</i>	100%	Holding company and portfolio administration
City Business Finance Limited	100%	Asset finance
Paragon Business Finance PLC <i>(formerly Paragon Bank Business Finance PLC)</i>	100%	Asset finance
Paragon Commercial Finance Limited <i>(formerly Dash Commercial Finance Limited)</i>	80%	Asset finance
Paragon Development Finance Limited <i>(formerly Capital Professions Finance Limited)</i>	100%	Development finance
Paragon Development Finance Services Limited <i>(formerly Titlestone Property Services Limited)</i>	100%	Development finance
Paragon Technology Finance Limited <i>(formerly Paragon Bank Technology Finance Limited)</i>	100%	Asset finance
PBAF Acquisitions Limited	100%	Residential mortgages and loan finance

Company	Holding	Principal activity
Direct and indirect subsidiaries of Paragon Bank PLC		
PBAF (No. 1) Limited	100%	Intermediate holding company
Premier Asset Finance Limited	100%	Asset finance broker
Specialist Fleet Services Limited	100%	Asset finance and contract hire
Collett Transport Services Limited	100%	Non-trading
Fineline Holdings Limited	100%	Non-trading
Fineline Media Finance Limited	100%	Non-trading
Homer Management Limited	100%	Non-trading
Lease Portfolio Management Limited	100%	Non-trading
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
Idem First Finance Limited	100%	Asset investment
Paragon Personal Finance Limited	100%	Consumer loan finance
Idem (No. 5) Limited	100%	Non-trading
Idem (No. 6) Limited	100%	Non-trading
Idem Capital Acquisitions Limited	100%	Non-trading
Idem Capital Limited	100%	Non-trading
Idem Luxembourg (No. 10) ‡	100%	Non-trading
Other indirect subsidiary undertakings		
Redbrick Survey and Valuation Limited	100%	Surveyors and property consulting
Buy to Let Direct Limited	100%	Non-trading
LOM Recoveries Limited	100%	Non-trading
Moorgate Asset Administration Limited	100%	Non-trading
Paragon Options PLC	100%	Non-trading
TBMC Group Limited	100%	Non-trading
The Business Mortgage Company Services Limited	100%	Non-trading

The financial year end of all of the Group's subsidiary companies is 30 September. They are all registered in England and Wales and operate in the UK except:

- Those entities marked ‡ which are registered in the Grand Duchy of Luxembourg
- Paragon Pension Investments GP Limited, which is registered in Scotland and operates in the UK

20% of the equity of Paragon Commercial Finance Limited is subject to a call option agreed as part of the acquisition of the company by PAF. No material minority interest attaches to this holding.

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 and are considered to be controlled by the Group, as defined by IFRS 10 and hence they are considered to be subsidiaries of the Group.

The principal companies party to these arrangements at 30 September 2018 comprise:

Company	Principal activity
First Flexible No. 4 PLC	Residential mortgages
First Flexible No. 5 PLC	Residential mortgages
Idem Capital Securities (No. 1)	Asset investment
Idem Luxembourg (No. 8)	Asset investment
Paragon Fifth Funding Limited	Residential mortgages
Paragon Sixth Funding Limited	Residential mortgages
Paragon Seventh Funding Limited	Residential mortgages
Paragon Mortgages (No. 18) Holdings Limited	Holding company
Paragon Mortgages (No. 18) PLC	Residential mortgages
Paragon Mortgages (No. 19) Holdings Limited	Holding company
Paragon Mortgages (No. 19) PLC	Residential mortgages
Paragon Mortgages (No. 20) Holdings Limited	Holding company
Paragon Mortgages (No. 20) PLC	Residential mortgages
Paragon Mortgages (No. 21) Holdings Limited	Holding company
Paragon Mortgages (No. 21) PLC	Residential mortgages
Paragon Mortgages (No. 22) Holdings Limited	Holding company
Paragon Mortgages (No. 22) PLC	Residential mortgages
Paragon Mortgages (No. 23) Holdings Limited	Holding company
Paragon Mortgages (No. 23) PLC	Residential mortgages
Paragon Mortgages (No. 24) Holdings Limited	Holding company
Paragon Mortgages (No. 24) PLC	Residential mortgages
Paragon Mortgages (No. 25) Holdings Limited	Holding company
Paragon Mortgages (No. 25) PLC	Residential mortgages
Arianty Holdings Limited	Holding company
Arianty No. 1 Limited	Non-trading
Arianty Services Limited	Non-trading
First Flexible No. 1 Limited	Non-trading
First Flexible No. 2 Limited	Non-trading
First Flexible No. 3 Limited	Non-trading

All of these companies are registered and operate in the UK except Idem Capital Securities (No. 1) and Idem Luxembourg (No.8) which are registered in the Grand Duchy of Luxembourg.

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 therefore considered to be subsidiary entities. Both are registered in England and Wales and operate in the UK.

Earlswood Finance (No. 3) Limited, a company limited by guarantee, is registered in England and Wales and operates in the UK. It is included in the consolidation as it is ultimately controlled by the parent company.

The Group accounts include the results of two Jersey companies, which are ultimately beneficially owned by a charitable trust, but are considered to be controlled by the Group, using the definition contained in IFRS 10 'Consolidated Financial Statements'. These companies, Idem Jersey (No. 1) Limited and Idem Jersey (No. 2) Limited are registered in the Bailiwick of Jersey and operate in the UK.

The share capital of Idem Jersey (No. 1) Limited is divided into A shares and B shares. All of the 600 B shares are held by Group companies 100 by the parent company and 500 by other Group companies.

The Paragon Pension Partnership LP is a limited partnership established under Scots law, in which control is vested in members which are Group companies. It is therefore considered to be a subsidiary entity. The outside member is the Group's Pension Plan and the Plan's rights to income from the partnership are set out in the partnership agreement. Therefore, no minority interest arises. The partnership is registered in Scotland and operates in the UK.

The registered office of each of the entities listed in this note is the same as that of the Company (note 1), except that;

- The registered office of The Business Mortgage Company Limited, Buy to Let Direct Limited, TBMC Group Limited, and The Business Mortgage Company Services Limited is Greenmeadow House, 2 Village Way, Greenmeadow Springs Business Park, Cardiff, CF15 7NE
- The registered office of State Security Limited is Burlington House, Botleigh Grange Office Campus, Grange Drive, Hedge End, Southampton, SO30 2AF
- The registered office of the Scottish companies is Citypoint, 65 Haymarket Terrace, Edinburgh, EH12 5HD
- The office of the Luxembourg entities is 8-10, Avenue de la Gare, L-1610 Luxembourg
- The registered office of the Jersey companies is IFC 5, St Helier, Jersey, JE1 1ST

All of the entities listed in this note are included in the consolidated accounts of the Group.

68. 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 67 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 2018 were:

	United Kingdom
	£m
Year ended 30 September 2018	
Total operating income	301.9
Profit before tax	181.5
Corporation tax paid	32.0
Public subsidies received	-
Average number of full time equivalent employees	1,103

	United Kingdom
	£m
Year ended 30 September 2017	
Total operating income	252.8
Profit before tax	144.8
Corporation tax paid	28.9
Public subsidies received	-
Average number of full time equivalent employees	1,229

The Group's participation in Bank of England funding schemes is set out in note 51.

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

E1

APPENDICES TO THE ANNUAL REPORT

A. UNDERLYING RESULTS

The Group reports underlying profit excluding fair value accounting adjustments arising from its hedging arrangements and certain one-off items of income and costs relating to asset sales and acquisitions. These include the direct transaction cost of the acquisitions, the additional net funding costs of deposits built up over time to satisfy consideration on acquisitions and the break costs of the Idem Capital facility.

The transactions relating to the acquisitions and asset sales 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. There were no corporate acquisitions or significant asset sales in the year ended 30 September 2017.

This measure 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.

	2018 £m	2018 £m	2017 £m
Profit on ordinary activities before tax		181.5	144.8
Less: Gain on disposal of financial assets		(28.0)	-
Add back: Acquisition related funding costs included in net interest	0.7		-
Add back: Overhead costs related to acquisition related funding	0.2		-
Add back: Transaction costs	1.3		-
Add back: Acquisition related costs (note 13)		2.2	-
Add back: Facility break costs (note 21)		1.2	-
Add back: Other one-off costs		0.8	-
Add back: Fair value adjustments		(1.2)	0.4
Underlying profit		156.5	145.2

Underlying basic earnings per share, calculated on the basis of underlying profit, charged at the overall effective tax rate, is derived as follows.

	2018 £m	2017 £m
Underlying profit	156.5	145.2
Tax at effective rate (note 30)	(30.8)	(27.7)
Underlying earnings	125.7	117.5
Basic weighted average number of shares (note 32)	260.8	271.6
Underlying earnings per share	48.2p	43.3p

Underlying return on tangible equity is derived using underlying earnings calculated on the same basis.

	2018 £m	2017 £m
Underlying earnings	125.7	117.5
Amortisation of intangible assets (note 23)	2.1	1.6
Adjusted underlying earnings	127.8	119.1
Average tangible equity (note 7(b))	915.8	884.5
Underlying RoTE	14.0%	13.5%

B. INCOME STATEMENT RATIOS

The average net interest margin is calculated as follows:

	Note	2018 £m	2017 £m
Opening loans to customers	35	11,124.1	10,737.5
Closing loans to customers	35	12,127.8	11,124.1
Average loans to customers		11,626.0	10,930.8
Net interest		254.6	232.6
Net interest margin		2.19%	2.13%
Impairment provision	28	7.4	5.3
Impairment as a percentage of average loan balance		0.06%	0.05%

Net interest margin on an underlying basis is derived as shown below

		2018 £m	2017 £m
Net interest (as above)		254.6	232.6
One off items related to interest			
Acquisition funding costs		0.7	-
Facility break costs		1.2	-
Underlying net interest		256.5	232.6
Average loans to customers (as above)		11,626.0	10,930.8
Underlying net interest margin		2.21%	2.13%

C. COST:INCOME RATIO

Cost:income ratio is derived as follows:

	Note	2018 £m	2017 £m
Cost – operating expenses	23	114.2	102.3
Total operating income		301.9	252.8
Cost / Income		37.8%	40.5%

Underlying cost:income ratio is derived as follows:

		2018 £m	2017 £m
Cost – as above		114.2	102.3
Acquisition costs expensed		(1.5)	-
Other one-off costs		(0.8)	-
Adjusted cost		111.9	102.3
Income – as above		301.9	252.8
Gain on disposal of financial asset		(28.0)	-
Acquisition net funding costs		0.7	-
Facility break costs		1.2	-
Adjusted income		275.8	252.8
Underlying cost:income ratio		40.6%	40.5%

D. NET ASSET VALUE

	Note	2018	2017
Total equity (£m)		1,095.9	1,009.4
Outstanding issued shares (m)	57	281.6	281.5
Treasury shares (m)	59	(20.8)	(15.7)
Shares held by ESOP schemes (m)	59	(2.9)	(3.2)
		257.9	262.6
Net asset value per £1 ordinary share		£4.25	£3.84
Tangible equity (£m)	7	926.6	905.0
Tangible net asset value per £1 ordinary share		£3.59	£3.45

F.

USEFUL INFORMATION

Information which may be helpful to shareholders and other users of the Annual Report and Accounts

F1	Glossary <i>A summary of abbreviations used in the Annual Report and Accounts</i>	PAGE 240
F2	Shareholder Information <i>Information about dividends, meetings and managing shareholdings</i>	PAGE 242
F3	Other Public Reporting <i>Current and future public reporting information for the Group</i>	PAGE 244
F4	Contacts <i>Names and addresses of the Group's advisers</i>	PAGE 246

F1

GLOSSARY

AGM	Annual General Meeting	EPS	Earnings per Share
ALCO	Asset and Liability Committee	EQA	External Quality Assessment
BCBS	Basel Committee on Banking Supervision	ERC	Estimated Remaining Collections
BEIS	Department for Business, Energy and Industrial Strategy	ESOP	Employee Share Ownership Plan
BEPS	Base Erosion and Profit Shifting	ESOS	Energy Savings and Opportunities Scheme
BS 18001	British Standard 18001:2007, 'Occupational Health and Safety Management Systems'	EU	European Union
CAGR	Compound Annual Growth Rate	EURIBOR	Euro Interbank Offered Rate
CCC	Compliance and Conduct Committee	EVE	Economic Value of Equity
CEO	Chief Executive Officer	FCA	Financial Conduct Authority
CET1	Core Equity Tier 1	FLA	Finance and Leasing Association
CFO	Chief Financial Officer	FLS	Funding for Lending Scheme
CGU	Cash Generating Unit	FOS	Financial Ombudsman Service
CIIA	Chartered Institute of Internal Audit	FRC	Financial Reporting Council
CIPD	Chartered Institute of Personnel and Development	FSC	Forest Stewardship Council
CMI	Chartered Management Institute	FSCS	Financial Services Compensation Scheme
CML	Council of Mortgage Lenders	GDPR	General Data Protection Regulation
CO₂	Carbon Dioxide	GHG	Greenhouse Gases
Code	UK Corporate Governance Code (2016 version)	HA	Hampton-Alexander
Compliance Plan	Compliance Monitoring Plan	HMRC	Her Majesty's Revenue and Customs
CPI	Consumer Price Index	HQLA	High Quality Liquid Assets
CRD IV	Current EU Capital Requirements Regulation and Directive regime	IAS	International Accounting Standard(s)
CRDs	Cash Ratio Deposits	IASB	International Accounting Standards Board
CRO	Chief Risk Officer	ICAAP	Internal Capital Adequacy Assessment Process
CRR	Capital Requirements Regulation EU Regulation 575/2013	IFRS	International Financial Reporting Standard(s)
CSA	Credit Support Annex	ILAAP	Internal Liquidity Adequacy Assessment Process
CSOP	Company Share Option Plan	ILG	Individual Liquidity Guidance
DEFRA	Department for Environment, Food and Rural Affairs	ILTR	Indexed Long Term Repo Scheme
Deloitte	Deloitte LLP	IMLA	Intermediary Mortgage Lenders Association
DSBP	Deferred Share Bonus Plan	IRB	Internal Ratings Basis
ECL	Expected Credit Loss	IRRBB	Interest Rate Risk in the Banking Book
EIR	Effective Interest Rate	ISA	Individual Savings Account
		ISDA	International Swaps and Derivatives Association
		KPMG	KPMG LLP, the Group's auditor
		LCR	Liquidity Coverage Ratio

LGD	Loss Given Default	RIDDOR	Reporting of Incidents, Disease and Dangerous Occurrences Regulation 2013
LIBOR	London Interbank Offered Rate	RoTE	Return on Tangible Equity
Ltd	Limited (company)	RPI	Retail Price Index
LTGDV	Loan to Gross Development Value	RRP	Recovery and Resolution Plan
LTV	Loan to Value	RSUs	Restricted Stock Units
MCA	Management Consultancies Association Ltd	SA	Standardised Approach
MCoB	Mortgage Conduct of Business	Schedule 7	Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008
MRC	Model Risk Committee	SFS	Specialist Fleet Service
NI	National Insurance	SICR	Significant Increase in Credit Risk
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	SMCR	Senior Managers and Certification Regime
NSFR	Net Stable Funding Ratio	SPPI	Solely Payments of Principal and Interest
OHSMS	Occupational Health and Safety Management System	SPV	Special Purpose Vehicle company
OLAR	Overall Liquidity Adequacy Requirement	TBMC	The Business Mortgage Company
ORC	Operational Risk Committee	TFS	Term Funding Scheme
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
PLC	Public Limited Company	The Plan	The Paragon Pension Plan
PM25	Paragon Mortgages (No. 25) PLC	TPF	Titlestone Property Finance Limited
POCI	Purchased or Originated Credit Impaired (assets)	TSR	Total Shareholder Return
PPI	Payment Protection Insurance	UK	United Kingdom
PRA	Prudential Regulation Authority (of the Bank of England)	UKF	UK Finance
Premier	Premier Asset Finance Limited	US	United States of America
PRS	Private Rented Sector	US Dollar LIBOR	The London Interbank Offered Rate on balances denominated in US dollars
PSD2	Second Payment Services Directive	VAT	Value Added Tax
PSP	Performance Share Plan	WEEE	Waste Electrical and Electronic Equipment
PwC	PricewaterhouseCoopers		
RBS	Royal Bank of Scotland		
RICS	Royal Institution of Chartered Surveyors		

Want more information or help?

The Company's share register is maintained by our Registrars, Computershare, who you should contact directly if you have questions about your shareholding or wish to update your address details.

Computershare Investor Services PLC
The Pavilions
Bridgwater Road
Bristol BS99 6ZZ

Telephone: 0370 707 1244*

and outside the UK +44 (0)370 707 1244

Online: www.investorcentre.co.uk

*Calls are charged at the standard geographic rate and will vary by provider. Calls outside the UK will be charged at the applicable international rate. Lines are open 8:30am to 5:30pm, Monday to Friday, excluding UK public holidays.

Electronic communications

You can view and manage your shareholding online by registering with Computershare's Investor Centre Service. To register:

- Visit www.computershare.com
- Go to 'Manage my shareholdings'
- Register using your Shareholder Reference Number and your postcode

We actively encourage our shareholders to receive communications via email and view documents electronically on our website, including our Annual Report and Accounts, as this has significant environmental and cost benefits. Should you wish to receive electronic documents please contact Computershare by telephone or online.

Website

You can find further useful information on our website, www.paragonbankinggroup.co.uk, including:

- Regular updates about our business
- Comprehensive share price information
- Financial results and reports
- Historic dividend dates and amounts

Shareholder fraud warning

Shareholders are advised to be very wary of any suspicious or unsolicited advice or offers, whether over the telephone, through the post or by email. If you receive any such unsolicited communication please check the company or person contacting you is properly authorised by the Financial Conduct Authority ('FCA') before getting involved. You can check at www.fca.org.uk/consumers/protect-yourself and can report calls from unauthorised firms to the FCA by calling 0800 111 6768.

Duplicate documents and communications

If you receive more than one copy of shareholder documents, it is likely that you have multiple accounts on the share register, perhaps with a slightly different name or address. To combine your shareholdings, please contact Computershare and provide your Shareholder Reference Numbers.

Financial calendar

January 2019 Trading update	July / August 2019 Trading update
22 May 2019 Half year results	November 2019 Full year results

Dividend calendar

10 January 2019 Ex-dividend date for 2018 final dividend	4 July 2019 Ex-dividend date for 2019 interim dividend
11 January 2019 Record date for 2018 final dividend	5 July 2019 Record date for 2019 interim dividend
18 February 2019 Payment date for 2018 final dividend	26 July 2019 Payment date for 2019 interim dividend

Annual General Meeting

14 February 2019 To be held at 9:00am at the offices of Jefferies International Limited at Vintners Place, 68 Upper Thames Street, London, EC4V 3BJ
--

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 2018, 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 2018, 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 first report against its Women in Finance charter commitments in January 2018.

All of this reporting will be continued in the financial year ending 30 September 2019.

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 Hoare Govett
Vintners Place
68 Upper Thames Street
London EC4V 3BJ

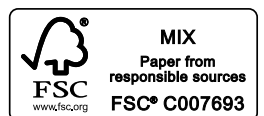
UBS Limited
5 Broadgate
London EC2M 2QS

Remuneration consultants

Deloitte LLP
Four Brindleyplace
Birmingham B1 2HZ

Consulting actuaries

Mercer Limited
Four Brindleyplace
Birmingham B1 2JQ





PARAGON BANKING GROUP PLC
51 Homer Road, Solihull, West Midlands B91 3QJ
Telephone: 0121 712 2323
www.paragonbankinggroup.co.uk
Registered No. 2336032