paragon

ANNUAL REPORT 2021

Paragon Banking Group PLC

CAUTIONARY STATEMENT Sections of this Annual Report, including but not limited to the Directors' Report, the Strategic Report and the Directors' Remuneration Report may contain forward-looking statements with respect to certain of the plans and current goals and expectations relating to the future financial condition, business performance and results of the Group. These statements can be identified by the fact that they do not relate strictly to historical or current facts. They use words such as 'anticipate', 'estimate', 'expect', 'intend', 'will', 'project', 'plan', 'believe', 'target' and other words and terms of similar meaning in connection with any discussion of future operating or financial performance but are not the exclusive means of identifying such statements. These have been made by the directors in good faith using information available up to the date on which they approved this report, and the Group undertakes no obligation to update or revise these forward-looking statements for any reason other than in accordance with its legal or regulatory obligations (including under the UK Market Abuse Regulation, UK Listing Rules and the Disclosure Guidance and Transparency Rules of the Financial Conduct Authority ('FCA')).

By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of the Group and depend upon circumstances that may or may not occur in the future that could cause actual results or events to differ materially from those expressed or implied by the forward-looking statements. There are also a number of factors that could cause actual future financial conditions, business performance, results or developments to differ materially from the plans, goals and expectations expressed or implied by these forward-looking statements and forecasts. As a result, you are cautioned not to place reliance on such forward-looking statements as a prediction of actual results or otherwise.

These factors include, but are not limited to: material impacts related to foreign exchange fluctuations; macro-economic activity; the impact of outbreaks, epidemics or pandemics, such as the Covid pandemic and ongoing challenges and uncertainties posed by the Covid pandemic for businesses and governments around the world, including the duration, spread and any recurrence of the Covid pandemic and the extent of the impact of the Covid pandemic on overall demand for the Group's services and products; potential changes in dividend policy; changes in government policy and regulation (including the monetary, interest rate and other policies of central banks and other regulatory authorities in the principal markets in which the Group operates) and the consequences thereof (including, without limitation, actions taken as a result of the Covid pandemic); actions by the Group's competitors or counterparties; third party, fraud and reputational risks inherent in its operations; the UK's exit from the EU; unstable economic conditions and market volatility, including currency fluctuations; the risk of a global economic downturn; technological changes and risks to the security of IT and operational infrastructure, systems, data and information resulting from increased threat of cyber and other attacks; general changes in government policy that may significantly influence investor decisions (including, without limitation, actions taken in support of managing and mitigating climate change and in supporting the global transition to net zero carbon emissions); societal shifts in customer financing and investment needs; and other risks inherent to the industries in which the Group operates.

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

Contents

Financial Highlights

Results in brief

Highlights Page 4

Financial highlights Page 5

Strategic Report

The business and its performance in the year

A1. Chair of the Board's introduction Page 8

A2. Business model and strategy Page 10

A3. Chief Executive's review Page 26

A4. Review of the year Page 29

A5. Future prospects Page 54

A6. Citizenship and sustainability Page 57

A7. Approval of Strategic Report Page 75

Corporate Governance

How the business is controlled and how risk is managed

B1. Chair's statement on corporate governance Page 78

B2. Corporate governance statement Page 80

B3. Board of Directors and senior management Page 82

B4. Governance framework Page 88

B5. Nomination Committee Page 102

B6. Audit Committee Page 105

B7. Remuneration Committee Page 114

B8. Risk management Page 145

B9. Directors' report Page 157

B10. Statement of directors' responsibilities Page 160

Independent Auditor's Report

On the financial statements

C1. Independent auditor's report to the members of Paragon Banking Group PLC Page 164

The Accounts

The financial statements of the Group

D1. Primary financial statements Page 174

D2. Notes to the accounts Page 181

Appendices to the Annual Report

Additional financial information

E1. Appendices to the Annual Report Page 304

Useful information

Additional information for shareholders and other users

F1. Glossary Page 310

F2. Shareholder information Page 312

F3. Other public reporting Page 314

F4. Contacts Page 315

Highlights
For the year ended 30 September 2021

BUY-TO-LET MORTGAGES

Specialist landlords generate over 95% of new buy-to-let business

COMMERCIAL LENDING

Commercial lending customer base now over 35,000 small and medium sized businesses

SAVINGS

Savings deposits pass £9 billion

Five year performance summary

	2017 £m	2018 £m	2019 £m	2020 £m	**2021 £m**
Underlying profit before taxation	145.2	156.5	164.4	120.0	**194.2**
Profit before taxation	144.8	181.5	159.0	118.4	**213.7**
Profit after taxation	117.2	145.8	127.4	91.3	**164.5**
Total loans to customers	11,124.1	12,127.8	12,186.1	12,631.4	**13,402.7**
Shareholders' funds	1,009.4	1,095.9	1,108.4	1,156.0	**1,241.9**

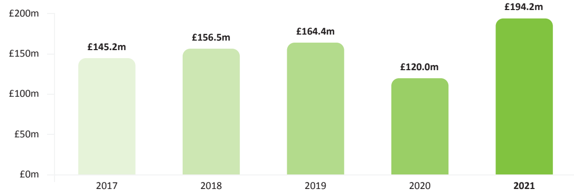
	2017	2018	2019	2020	**2021**
Return on tangible equity	13.4%	16.1%	14.1%	9.7%	**16.2%**
Earnings per share					
- basic	43.1p	55.9p	49.4p	36.0p	**65.2p**
- diluted	41.9p	54.2p	48.2p	35.6p	**63.0p**
Dividend per ordinary share	15.7p	19.4p	21.2p	14.4p	**26.1p**

The exclusions from underlying results relate principally to acquisitions and significant asset sales in prior periods, which do not form part of the day-to-day activities of the Group, and which have impacted on the reported results for the year concerned. The underlying basis also excludes fair value postings arising from hedging activities, but not qualifying for hedge accounting.

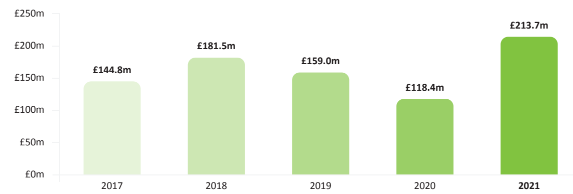
The calculation of return on tangible equity ('RoTE') is shown in note 53b. The derivation of underlying profit before taxation and other underlying measures is described in Appendix A.

Financial highlights

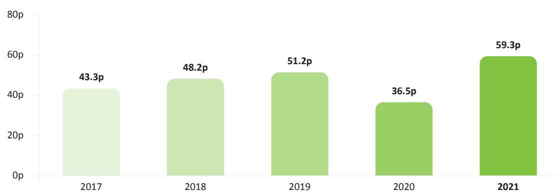
Underlying profit before tax
£194.2 million 61.8% higher (2020: £120.0 million)



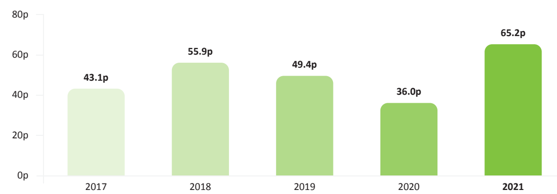
Profit before tax
£213.7 million 80.5% higher (2020: £118.4 million)



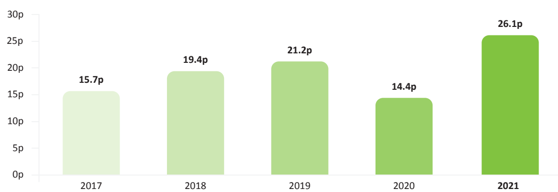
Underlying basic earnings per share
59.3 pence 62.5% higher (2020: 36.5 pence)



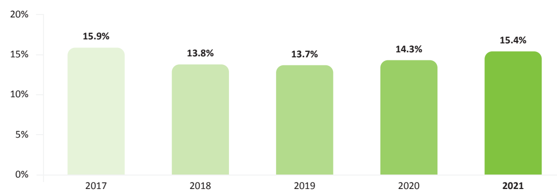
Basic earnings per share
65.2 pence 81.1% higher (2020: 36.0 pence)



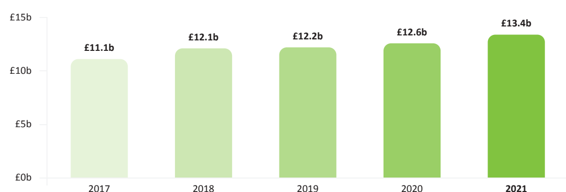
Dividend per share
26.1 pence 81.3% higher (2020: 14.4 pence)



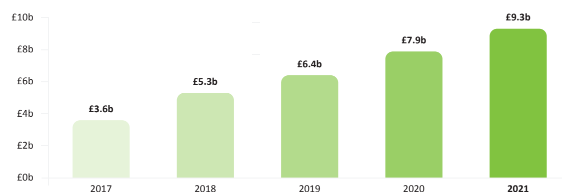
Capital - CET1 ratio
15.4% Strengthened in the year (2020: 14.3%)



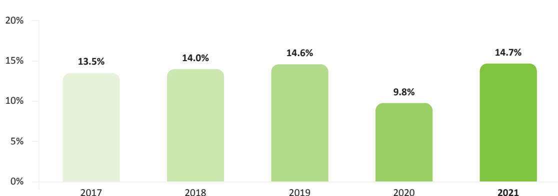
Total loans to customers
£13.4 billion 6.1% higher (2020: £12.6 billion)



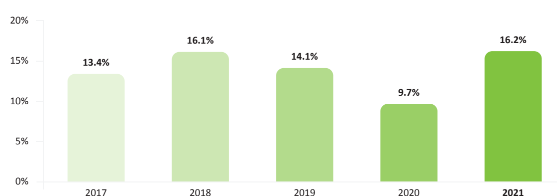
Retail deposits
£9.3 billion 18.4% higher (2020: £7.9 billion)



Underlying return on tangible equity
14.7% (2020: 9.8%)

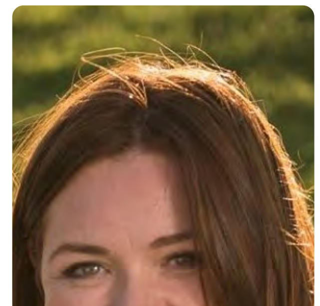


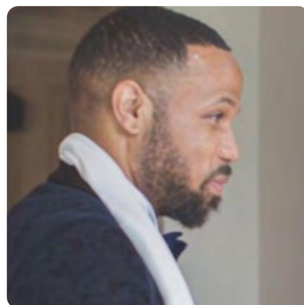
Return on tangible equity
16.2% (2020: 9.7%)



EDI Network

Our Equality, Diversity and Inclusion Network, formed in 2020, works together to support all employees and champion ideas to make Paragon an even more inclusive workplace.





A. Strategic Report

The business and its performance in the year

P8 **A1. Chair of the Board's introduction**
The year in summary

P10 **A2. Business model and strategy**
An overview of what the Group does and the significant risks to which it is exposed

P26 **A3. Chief Executive's review**
Strategic summary of the Group's performance and position

P29 **A4. Review of the year**
The financial and operational performance of the Group in the year

P54 **A5. Future prospects**
How the Group is placed looking forward

P57 **A6. Citizenship and sustainability**
The Group's impact on its employees, the environment and the community, including non-financial reporting

P75 **A7. Approval of Strategic Report**
Approval of the Strategic Report

A1. Chair of the Board's introduction

> **We are able to enter the new financial year with increased strength and confidence...**
>
> **Fiona Clutterbuck,** Chair of the Board

Dear Shareholder

The year you will read about in this annual report was a challenging one, but despite that, the Group delivered exceptional results. The Covid pandemic continued to impact the UK throughout the year, with considerable uncertainty remaining as the year closed and we face the prospect of a second winter with the virus. However, many of the worst fears of twelve months ago for the progress of the pandemic failed to materialise, and we are able to enter the new financial year with increased strength and confidence.

In compiling this report, we have tried to explain both the unfolding of the Group's strategy, and the continuing impact of the pandemic, in a way that enables you, and all our other stakeholders to thoroughly understand our developing business and its financial results for the year. I hope you find it useful.

The business and its purpose

The Group's purpose is to support the ambitions of the people and businesses of the UK by delivering specialist financial services. We do not seek to compete with mass market banks, but instead focus on customers who will value an expert approach, and who may otherwise be underserved by the banking sector as a whole.

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

Despite the impact of the pandemic, all our businesses continued to make progress on their strategic aims, developing new products, systems and approaches. Our people delivered these enhancements while coping with changes in working practices throughout the year, as government advice changed. Through the second half of the year new lending grew strongly across the business and the performance of the loan book remained robust, even as the impact of government support began to recede.

The Group's ability to provide support for our people, customers and intermediaries throughout the pandemic demonstrates the resilience of our proposition.

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

Results

The Group's new lending in the year was £2.6 billion, a significant increase from £2.0 billion in 2020 despite some constraint on volumes in the first half of the year. The savings deposit base continued to grow, reaching £9.3 billion, from £7.9 billion at 30 September 2020, a green Tier-2 Bond was issued, and the Bank of England TFSME programme continued to be accessed.

The Group achieved its highest ever underlying profit in the year, at £194.2 million, increased from £120.0 million in the previous year, partly as a result of provisions unwinding as the economic outlook became more positive. Profit before tax on the statutory basis increased to £213.7 million from £118.4 million, with the difference between the two measures a result of the impact of interest rate fluctuations on hedging instruments.

Underlying earnings per share ('EPS') increased to 59.3 pence (2020: 36.5 pence) and statutory EPS increased to 65.2 pence (2020: 36.0 pence). Underlying RoTE was 14.7% (2020: 9.8%), 16.2% on the statutory basis (2020: 9.7%), all reflecting the growth in earnings year-on-year.

Regulatory capital has remained strong during the period, with the year end Core Equity Tier 1 ('CET1') ratio reaching 15.4% (2020: 14.3%) and the capital surplus also increasing as a result of a positive capital review by the regulator. Group liquidity was also maintained at a healthy level.

The financial results and operational performance are reviewed in Section A3

Stakeholders

The Group takes its responsibility to all stakeholder groups very seriously and we acknowledge our duties as a corporate citizen. During the Covid pandemic our priorities have been to protect the interests of customers, employees and suppliers as well as preserving shareholder value.

I continue to be hugely impressed by the resilience of our people in the face of the pandemic and I found it very helpful to hear some of their stories first-hand at the Group's People Forum. I was therefore pleased that we could announce enhanced holiday provision for all our employees during the year.

Diversity continues to be a focus of our employment policies and the additional impetus given to this agenda by the establishment of the Equality, Diversity and Inclusion ('EDI') Network in its first year of operation has been very welcome. Towards the end of the year I was gratified to receive the news that the Group has achieved its first phase targets under the Women in Finance initiative, and continued to meet the expectations of the FTSE Women Leaders project. I am confident that these will form a solid basis for the Group's further development in this area.

The Group continued to progress its climate change agenda across a number of fronts. Green products have been developed in various parts of the business, data-gathering and analysis has been enhanced and we have contributed to various industry initiatives in the year. The Group became a TCFD Supporter during the year and disclosures in this annual report have been developed as we move towards the introduction of TCFD into the UK Listing Rules.

The Group will also publish its first sustainability report, the 'Responsible Business Report' during December 2021.

Social responsibility and citizenship issues are discussed in Section A6

Governance

The Group continues to operate under the UK Corporate Governance Code, complying with its provisions in the year. As I have now served on the Board for more the nine years, I will be stepping down once a new Chair has been appointed, and an appropriate handover has taken place.

I was pleased to welcome Peter Hill, the former Chief Executive of the Leeds Building Society, to the Board during the year as an independent non-executive director and Chair of the Risk Committee. His long experience in the UK financial services sector will be very valuable to us.

Finlay Williamson stepped down from the Board in December 2020, having overseen the development of the risk processes of Paragon Bank, and later the Group, from the Bank's earliest days. I thank him for his contribution.

The ongoing Covid crisis has continued to put pressure on Board members, both through increased workloads and also from the impact of new working methods, and therefore I was delighted to meet my colleagues in person for the first time in many months towards the end of the year. I would like to thank them all for their commitment over this difficult period.

Corporate governance is discussed in Section B3

Risk

The Group continues to focus on the strategic development of its risk management processes, with the Enterprise Risk Management Framework ('ERMF') a particular area of focus in the year. The continuing evolution of working arrangements in response to Covid, and the consequent adaptation of control processes, made it a priority to ensure that risk management within the Group was maintained.

The impact of new products and the Group's participation in government-backed lending schemes also saw new processes and controls brought into the risk framework. The Group's management of risk remains strong and ready to face any future challenges, whether from Covid or other factors.

The Risk Management report is set out in Section B8

Shareholder returns

The Group is committed to maintaining the strength of its capital base, whilst providing appropriate returns to shareholders. The trading performance through the year remained strong and the results of the latest regulatory review endorsed the effectiveness of our capital management processes and governance. During the year, following significant capital stress testing, the Board was able to declare an interim dividend at the half year, and announce a share buy-back programme of up to £40.0 million at the same time.

Having reviewed the capital position at the year end, the Board concluded that a final dividend for the year of 18.9 pence per share can be declared, subject to shareholder approval, bringing the total dividend for the year to 26.1 pence per share, and giving a dividend cover of 2.5 times, broadly in line with policy. It also authorised up to £50.0 million of share buy-backs, in addition to the £2.2 million required to complete the £40.0 million programme announced in June 2021. We would like to thank our shareholders for their continuing support during the year.

Conclusion

As I noted above, this is likely to be the last time I write to you as Chair of the Board, and I find myself reflecting on the changes I have seen since joining the Board in September 2012. In that period the Group has received its banking licence, building a £9 billion deposit franchise from scratch; new lending in the Group's buy-to-let mortgage operation has increased almost ten-fold; significant development finance and SME lending operations have been established; and operating profit more than doubled.

More recently, the Covid crisis has demonstrated the Group's operational robustness and its ability to respond rapidly to new situations, developing new processes, systems and ways of working. This is a tribute to the culture and spirit of the Group's people and the strength of the relationships on which the business is based. In my view this is the best demonstration of our ability to live the values of fairness, professionalism, integrity, humour, commitment, creativity, teamwork and respect, and of the positive results that these bring.

I would like to take this opportunity to thank my colleagues on the Board, past and present, for their challenge and counsel. I must also thank the Group's managers and people both for their support for me personally during my tenure, and for their efforts on behalf of the business.

The underlying fundamentals of the Group's business are sound, our business plans and capital base are robust, and despite the short-term economic uncertainties, I believe that the Group is well placed to move forward.

I wish the Group all possible success for its future and hope that my successor as Chair, whoever they may be, finds the position as rewarding as I have.

Fiona Clutterbuck
Chair of the Board
7 December 2021

A2. Business model and strategy

Paragon at a glance

Paragon is a specialist banking group. We offer a range of savings products and provide finance for landlords, small businesses and property developers in the UK. Listed on the London Stock Exchange, we are a FTSE 250 company, headquartered in Solihull, employing almost 1,450 people.

Our operations are organised into three divisions and new lending is funded largely by retail deposits.

Our operations

Mortgage Lending

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

See pages 18 and 19

Commercial Lending

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

See pages 20 to 23

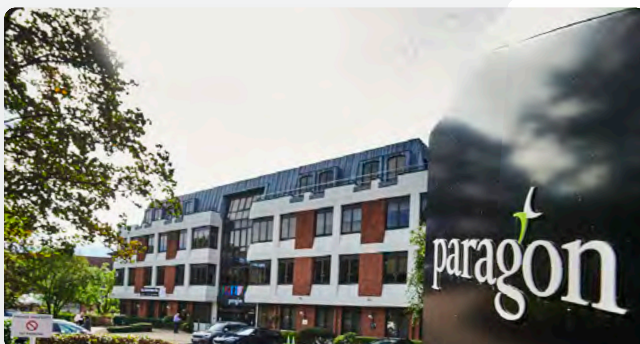
Idem Capital

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

Funding

Since gaining our banking licence in 2014, our principal source of funding for new lending has been through our range of savings products offered to UK savers. Other funding for lending is derived from the efficient use of Bank of England funding schemes, while securitisation continues to fund elements of the book and is used tactically. Central funding is provided through corporate and retail bonds.

See pages 16 and 17



Headquarters
Solihull, West Midlands

Our purpose

Paragon's purpose is to support the ambitions of the people and businesses of the UK by delivering specialist financial services.

This provides the foundation for everything we do and today we are helping more than 400,000 customers to achieve their ambitions.

We have helped the UK to develop a thriving private rented sector over the last 25 years, supporting landlords up and down the country to invest in and build valuable businesses that deliver flexibility for those who choose to rent, homes for students and for people who simply can't afford to buy their own home.

We are helping property developers turn unused sites into new housing, addressing the continuing housing shortage in the UK, and small and medium sized businesses deliver post-pandemic recovery. We're supporting savers to reach personal goals – providing them with better returns to save towards a holiday or a deposit for a house.

As a specialist bank, we focus on lending to customers who require specialist products in markets typically underserved by larger high street banks. This approach requires us to be experts in these areas, and we seek to know more than our competitors about our customers and the markets in which we operate, the products and services we offer, and the risks we incur. We see specialisation as what makes us different and as our competitive advantage, and it runs through our business model and strategy.

This strategy relies on the quality of our people. By living our purpose, we can help them achieve their own ambitions to grow and develop, to enjoy a successful career and to build strong foundations for their own lives.

Our values

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

Fairness

To work together to ensure fair outcomes for all our customers

Professionalism

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

Integrity

To be honest and open in everything we do

Humour

To ensure we have fun while achieving success!

Commitment

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

Creativity

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

Teamwork

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

Respect

To treat people as individuals and listen to their views

Our strategy

Our strategy is driven by our purpose and helps us achieve our vision to become the UK's leading technology-enabled specialist bank and an organisation of which our employees are proud.

We focus on specialist customers and aim to deliver long-term sustainable growth and shareholder returns through a low risk and robust model. We have five clear strategic priorities that help us deliver our strategy, underpinned by three strategic pillars.

Our strategic priorities

Growth

We are focused on growing our lending in specialist market segments where customers are underserved by the large high street banks. Using our expert knowledge and experience, we aim to grow both organically and by acquisition, in a low-risk robust manner, that allows us to balance our stakeholder needs while moving towards sustainable long-term returns.

Diversification

We are continually developing our range of savings and specialist lending products, in both existing and new markets, to grow our business and to help us succeed in becoming the UK's leading technology-enabled specialist bank. We are also seeking to reduce barriers to growth in UK banking through our move toward an Internal Ratings Based ('IRB') approach to capital measurement and a growing and increasingly segmented funding strategy.

Our strategic pillars

A customer focused culture

Expert knowledge and experience, supported by proprietary insight, data and analytics ensuring a deep understanding of our specialist customers and markets.

A dedicated team

An experienced, skilled and engaged workforce, and a unique culture underpinned by eight values.

Principal risks

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

We have an Enterprise Risk Management Framework ('ERMF') in place to ensure that these risks are monitored and managed in accordance with the Group's risk appetite. These risks and the steps the Group takes to safeguard against them are discussed in more detail in Section B8.

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

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

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

Capital
Insufficient capital to operate effectively and meet minimum requirements.

Digitalisation

The transformation of our technology is focused on implementing sophisticated, digitally-enabled, cloud-based platforms that will allow us to deliver outstanding customer service, become more efficient and support decision making, whilst retaining the flexible and specialist capabilities that our customers desire. Advances in technology are also helping us expand our addressable market and reach new customers directly and through intermediaries and partnerships.

Capital management

A strong and diverse balance sheet is fundamental to the Group's success and forms one of our three strategic pillars. Management of capital is a critical lever as we invest to grow our business and people while evolving our technology, risk, governance and enterprise frameworks with a goal of delivering a sustainable return on tangible equity in excess of 15%.

Sustainability

For Paragon, sustainability means reducing the impact that our operations have on the environment, ensuring we have a positive effect on our stakeholders and communities, doing the right thing and delivering sustainable lending through the products we offer and markets in which we operate, enabling our customers to meet their own targets. Strong environmental, social and governance ('ESG') qualities are embedded in the Group's culture and values, and influence every aspect of our business.

Strong financial foundations

Prudentially strong, with a low-risk approach to lending, reducing volatility of earnings and enhancing sustainability of dividends.

Model
Making incorrect decisions based on the output of internal models.

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

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

Reputational
Failing to meet the expectations and standards of our stakeholders.

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

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

Our business model

Our business model is designed to allow us to add value by focusing on meeting the specialist needs of a broad range of customers, while positioning ourselves to deliver returns for shareholders and meet our broader obligations to society.

WHAT WE DO...

A broad funding base

We fund our assets using a variety of sources and take care to secure competitive funding over an appropriate term to underpin our assets, meet working capital requirements and maintain a strong financial position.

Retail deposits

Securitisation

Bond issuance

Central bank funding

USING OUR CORE STRENGTHS...

Customer expertise

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

650 million+
items of customer data analysed each month

Risk management

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

Net release of impairment provision
£4.7 million

Technology

We are utilising technology to improve productivity and access new markets, and are well placed to take advantage of digital changes to expand our addressable customer base.

New asset finance portal
for intermediaries launched during 2021 to increase automation and efficiency

Management expertise

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

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

TO DELIVER VALUE TO ALL OUR STAKEHOLDERS...

Shareholders

Creating long-term shareholder value through growing profits and dividends.
See page 41

Dividend per share
26.1p

Employees

Helping all our people develop their career and reach their potential.
See page 62

Average training per employee in 2021:
4.6 days
('CIPD' average 2.8 - 3.2 days)

Society

Helping the UK economy grow and supporting the communities in which we operate.
See page 72

Charitable contributions in 2021:
£39,600

Our section 172 statement can be found on pages 92 to 98.

Lending on diversified loan assets

We focus on building our asset base by originating new loans, developing new products and diversifying into new markets.

Buy-to-let mortgages

Residential development loans

SME lending

Motor finance

Cost control

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

Underlying cost: income ratio
41.7%

Our people

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

Gold Investors in People accreditation
INVESTORS IN PEOPLE | Gold

Culture

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

96% of employees agreed there is a clear and consistent set of values and behaviours that underpin how we operate[1]

Strong financial foundations

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

CET1 ratio
15.4%

Customers

Providing tailored lending products, expertise and working with intermediaries to help our customers achieve their ambitions.
See pages 17 and 19

+58 Net promoter score ('NPS') for savings account opening

Environment

Continually reducing our environmental impact and designing products that support positive environmental change.
See page 70

100% of electricity used in 2021 at sites for which we are responsible was from renewable sources.

[1]Paragon employee survey 2021

In focus:

Savings

Throughout 2021, the pandemic continued to have a sizeable impact on the savings market. Despite household deposits reaching record highs, switching levels reduced. Despite these market conditions, the savings business grew the value of its deposits by 18% year-on-year, outpacing the overall market growth considerably. This is a testament to our strong product proposition, our growing leadership within the ISA space, and our adaptive response to a fast-changing market.

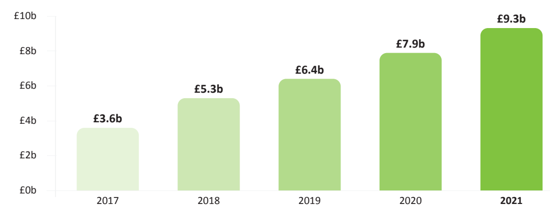
Michael Helsby, Strategic Development Director

Our principal source of funding for new lending is our range of savings products offered to UK savers. The savings arm of the business entered its seventh year in 2021 and the total volume of retail deposits has continued to grow and now stands at £9.3 billion, a 18.4% growth year-on-year.

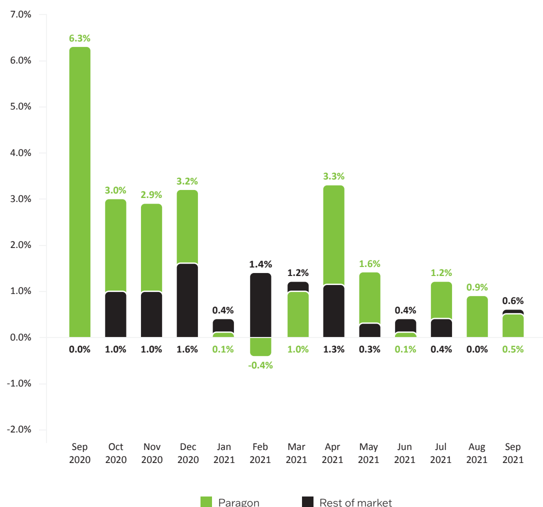
The growth of Paragon's savings deposits has consistently outperformed industry average, shown through Bank of England data.

From September 2020 to September 2021, Paragon deposits grew by 18.4%. This compares to total growth of 10% over the same period within the market.

Volume of retail deposits
£9.3 billion



Paragon vs Rest of market monthly stock growth (Source: Bank of England)



Products

Paragon's product offering remains simple – we offer straightforward products at competitive rates. These range from fixed term products to easy access, including notice and defined access accounts and ISAs.

ISA leadership

Last year we launched Wallet and Flexible ISA features across our portfolio to allow savers to split their yearly ISA allowance across a range of ISAs held with Paragon. Through these flexible features, we have carved out a point of difference that targets proactive savers who benefit the most from the tax efficiency of those products.

During 2021, our market share of ISA stock increased by 11% in the twelve months to September 2021. This performance bucked the industry trend, with Bank of England data showing that the cash ISA market stalled in the past 12 months...

Distribution

Customers typically apply for our products through our own website after initially finding our products listed on price comparison websites, mentioned by expert commentators or included in best buy tables.

In the last year, we have continued to work with deposit platforms, targeting those considered to provide the best strategic fit, while also engaging with regulators to help shape the future of that business model. We broadened our network of partners, offering savings products to Aviva customers through Aviva Save and also successfully launched our pilot SME business savings proposition via a deposit platform as we continue to extend our distribution and product range to support growth ambitions.

Market

The UK household savings market is estimated at £1.4 trillion. Paragon's share of this market now stands at 0.66%, a small increase of 0.04% from last year.

The pandemic has created a mixed landscape for savings providers. The climate of financial uncertainty brought on by the pandemic had a profound impact on household deposits and created a division amongst UK savers. Whilst many households were at a financial disadvantage due to Covid, others were able to supplement their savings, aided by reduced opportunities for consumer spending.

As a result, deposits increased and have continued at higher levels than the pre-pandemic average throughout 2021, however the bulk of these savings continue to reside with the incumbent current account providers. At the same time, switching levels have been lower than previous years, due to increased inertia amongst savers in a low-rate environment.

The fixed rate bond market has also reduced by 11% over the course of the pandemic, while the value of Paragon's fixed rate bonds has grown by 10% in the last year. Paragon's performance once again belied the industry trend.

Customers

In order to monitor customer satisfaction and identify areas for improvement, we ask every new customer why they choose to save with us. We also display customer feedback sourced through the independent service ratings provider Feefo on our website. Our average Feefo customer rating stands at 4.5/5, which is based on more than 1,300 reviews in the last year.

We survey our savers at three stages of the customer journey: when they open a new account, at the maturity of a fixed rate product and if they close an account.

Existing customers

NPS +52 Net promoter score for customers with maturing products

84% of customers were satisfied with the customer service they received when their fixed rate product matured and 89% would take out another savings account with Paragon in the future.

Amongst customers that were leaving Paragon, 86% found the process of withdrawing their funds easy or very easy. 73% reported being very satisfied with the customer service they received and 80% indicated they would consider us in the future.

Net promoter score +52 for maturity accounts where fixed rate period ended based on an online survey of 3,408 savings customers between 1 October 2020 and 30 September 2021 (total respondents to this survey were 3,541). Net Promoter Score of +58 for new savings account opening process based on an online survey of 4,290 savings customers between 1 October 2020 and 30 September 2021 (total respondents to this survey were 4,457).

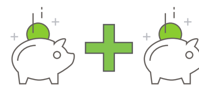
New customers

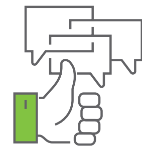
NPS +58 Net promoter score for account opening

76% of new customers reported being very satisfied with the customer service that they received, with 87% finding the account opening process easy or very easy.

Amongst new customers, **89%** chose Paragon because we offered the highest rate of interest, however the FSCS guarantee, online access and the easy application process were also popular reasons.

88% of new customers would consider taking another savings account with Paragon





87% of new customers find the account opening process easy

Customer feedback

"No fuss, very efficient, in fact haven't had a better ISA opening experience.... ever and I've opened quite a few. Thank you for making it so easy...

In focus:

Buy-to-let mortgages

> The long-term trend of growing demand for privately rented homes has accelerated over the past year. With the way we live so significantly impacted by the Covid pandemic, demand for buy-to-let mortgages will be driven by fundamental changes to our society and Paragon will continue to support professional landlords to make the investment needed to ensure housing supply meets demand.
>
> **Richard Rowntree,** Managing Director, Mortgages

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

Our expertise in property valuation and risk assessment means we are trusted by a significant proportion of professional landlords and are well placed to support those investing in complex properties or operating through corporate structures.

Our prudent approach to underwriting and surveying expertise means we play an active part in maintaining high standards in accommodation and improving energy efficiency. Our business proposition means we are naturally aligned to professional landlords and we work to increase knowledge amongst this community. Our position as a conduit between property investors and regulators means we are a trusted voice in conversations aimed at improving the sector.

70,000+ buy-to-let accounts

4.0% share of all new buy-to-let mortgages in the UK

£11.4 billion buy-to-let loan assets

25 years of buy-to-let

2021 saw the 25th anniversary of the official launch of buy-to-let mortgages. Paragon was one of the pioneers of buy-to-let lending and has played an integral part in creating a finance product that has helped transform the PRS since the 1990s. We have an unrivalled level of expertise in the market and have become a leading authority on the sector.

> Paragon has helped a wide range of landlords to grow their businesses, originating £25.4 billion of buy-to-let mortgages since 1996...

Supporting diverse property investment

Abdulkader Kadri is a full-time landlord with a portfolio consisting of eight properties. Six of these properties are classed as houses in multiple occupation (HMOs) which he lets to a mix of domestic and international students attending the University of East Anglia.

He thinks that buy-to-let remains a sound investment and plans to purchase more buy-to-let properties over the next 12 months to diversify his portfolio.

> With such high demand for property in the UK, investors need to think differently and the possibility of converting commercial premises into residential properties is interesting. I know that Paragon specialises in this type of mortgage, which is suited to the more complex properties and larger portfolios; I'm currently renewing one of my mortgages with them and would definitely consider Paragon in future as I grow my business...

Market

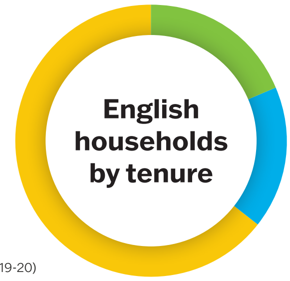
The PRS is an essential component of the UK's housing market, providing affordable and stable homes for people that cannot afford to buy or those that desire greater flexibility and choose to rent.

These aspects, combined with a series of economic, social and demographic changes, have driven considerable expansion of the PRS since the turn of the millennium. The UK PRS is made up of almost five million households today, accounting for just under 20% of homes. This makes the PRS the second most common housing tenure after owner-occupation.

Private rented sector:
4.4 million (18.7%)

Social rented sector:
4.0 million (16.7%)

Owner-occupiers:
15.4 million (64.6%)



(Source: MHCLG English Housing Survey 2019-20)

Total lending for UK buy-to-let mortgages
£45.1 billion

57%
of landlords reported increased tenant demand over the past three months

24.8 million
households in the UK by 2028

21%
increase in the number of build-to-rent homes completed, under construction or in planning

Market trends

In the 12 months to 30 September 2021, UK buy-to-let mortgage lending totalled £45.1 billion, an increase of 20% on 2020, including 112,000 loans for new house purchase, nearly double the previous year (Source: UK Finance).

In the quarter ended 30 September 2021, an all-time high of 57% of landlords reported increased tenant demand over the past three months. This marked a continuation of the trend for rising tenant demand seen throughout 2021, following the low of 14% recorded in the quarter ended 30 June 2020 (Source: BVA BDRC).

Market outlook

The latest data published by the Office for National Statistics ('ONS') in 2018 estimated that by 2021 there would be 23.6 million households in the UK. This is expected to grow to 24.8 million by 2028 and 26.3 million by 2038.

The British Property Federation published figures in Q1 2021 highlighting a 21% increase in the number of build-to-rent ('BTR') homes completed, under construction or in planning compared to the same period in 2020. With this equating to 188,456 homes, it is expected that even with such substantial growth, BTR will supplement buy-to-let over the coming years and both property types can coexist to help tackle the UK's housing shortage.

Residential property is currently responsible for around a quarter of UK emissions and the PRS will need to build on the progress it has made during the past decade to become more sustainable. Although the proportion of PRS homes rated with Energy Performance Certificate ('EPC') ratings of C or above is higher than the owner-occupied market, Paragon and other lenders will need to support landlords with finance to facilitate significant investment in enhancing the energy efficiency of PRS stock.

Customers

We have extensive experience in serving the specialist section of the buy-to-let mortgage market and have supported landlords to grow large and diverse portfolios - 59% of Paragon landlords own four or more properties and 72% are experienced landlords with more than 10 years' experience.

59%
of Paragon landlords own four more more properties

In Q3 2021, a typical landlord's portfolio:

consisted of 6.9 properties **valued at an average of £192,000** each[1]

achieved a gross rental income of **£57,000 per annum**[1]

generated an **annual income of £8,300** per property[1]

was worth **£1.3 million**[1]

[1](Source: Paragon/BVA BDRC Landlord panel Q3 2021)

Strategic Report

In focus:

Development finance

"Demand continues to significantly outstrip supply for housing and SME developers are delivering the type of homes that people want to live in. Activity has accelerated since the market reopened last year and that strength has continued throughout 2021. Looking forward, the energy performance of homes will grow in prominence and that puts the new build sector in a strong place.

Robert Orr, Managing Director, Paragon Development Finance

Our development finance business provides competitive and flexible financing solutions targeted at SME property developers.

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

Our team has increased by 200% since 2018 with the recruitment of experienced and driven individuals to enhance our customer offering.

Market

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

The UK Government has set a target of 300,000 new homes per year

Relaunched in April 2021 with 5% deposit for first-time buyers

75-80%
lower carbon emissions in new homes by 2025

Market trends

Demand for new homes in the UK continues to exceed supply, driven by expansion and forecast household formation. The UK Government has set a target of 300,000 new homes per year, yet housebuilding activity currently falls below that – 194,063 homes were completed in England and Wales in the year ended March 2021.

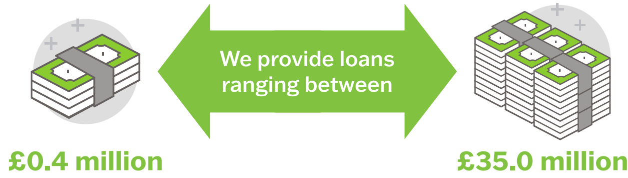
To accelerate the number of new homes being constructed, the UK Government announced the Planning Bill in the May 2021 Queen's Speech. One of the Bill's aims is to facilitate more housebuilding by smaller developers. Thirty years ago smaller builders were responsible for around 40% of new homes built, but currently this figure is only 12%.

The Help-to-Buy scheme was relaunched by the UK Government in April 2021 to help first-time buyers with a 5% deposit to buy a home. Regional price caps have been introduced as part of the new phase of the scheme so that buyers can only use the initiative to purchase a home costing no more than 1.5 times the average first time buyer property price in their region. The scheme runs until 2023.

As part of its response to the consultation on the Future Homes Standard, the UK Government has set out plans to radically improve the energy performance of new homes, with all homes to be highly energy efficient, with low carbon heating and be zero carbon ready by 2025. These homes are expected to produce 75-80% lower carbon emissions compared to current levels.

Products

We focus on residential development loans and support experienced developers involved in multi-unit residential, new build, conversion or refurbishment projects. We provide loans ranging between £0.4 million and £35.0 million and we lend up to 70% of the gross development value ('GDV'). To encourage developers to build the most energy efficient properties, we have launched a Green Homes initiative, offering a financial incentive for developments constructing EPC A-rated homes.



NEW

Green Homes initiative

Energy Efficiency

We have launched a Green Homes initiative, offering a financial incentive to developments constructing **EPC A-rated homes**.

Customers

Stephens + Stephens

Lend: £16.6 million

The Cornwall-based husband and wife company Stephens+Stephens is developing 74 luxury apartments on the site of the former Fistral Bay Hotel in Newquay. Paragon's funding has supported the acquisition of the site and the development costs of the scheme.

> We enjoy a strong relationship with the team at Paragon; they understand our business and our requirements and are able to act quickly and efficiently...

Watford Riverwell (Family Housing) LLP

Lend: £25.5 million

Paragon provided a total gross facility of £25.5 million to support the acquisition of land and the development of 85 new homes as part of the Watford Riverwell scheme, the largest regeneration project in Watford transforming more than 60 acres of land to the south of Watford General Hospital and Watford Football Club.

> Paragon has been a key partner, understanding our requirements completely and showing the expertise needed to progress the funding efficiently and within a tight timeframe...

Customer feedback

> Paragon is a company we have worked with over a number of years. Their relationship driven approach fits perfectly with us; they fully understand our business and what we are trying to achieve...

In focus:

SME lending

> Over the course of 2021, we have continued to support our customers and have remained open for business throughout. We became one of the first new lenders to be accredited to offer the Recovery Loan Scheme and have assisted thousands of customers and brokers with their post-pandemic recovery. We are now seeing signs of recovery within the asset finance market and will continue to help businesses with their bespoke funding needs as they plan for the future.
>
> **John Phillipou,** Managing Director, SME lending

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

We provide a range of finance solutions for SMEs covering a wide array of sectors, including agriculture, aviation, construction, business equipment, manufacturing, technology and vehicles, including electric vehicles.

Our expert SME lending teams have deep and specialist knowledge, not only in finance but also in the asset categories within which they operate.

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

Market

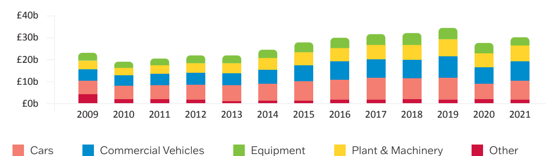
The SME lending market is broad, and Paragon is focussed on specific asset classes.

The general economic conditions within the UK which influence activity in these markets and other key drivers include:

- Supply issues and manufacturing delays created by the pandemic
- The rate of new work in industries such as construction
- Government regulations and trading restrictions
- Advances in technology and SME growth
- Environmental concerns and the drive towards fuel efficiency

Asset Finance New Business

(£ billion)



The chart above sets out new business volumes in the UK asset finance market as a whole, as reported by the Finance and Leasing Association ('FLA').

90% of asset finance providers expect new business growth over the next 12 months

Electric car sales increased by 186%

Market trends

The total asset finance new business market grew by 6% in September 2021 compared with the same month in 2020.

In the twelve months to September 2021, new business was 10% higher than in the same period in 2020.

The plant and machinery finance and business equipment finance sectors reported new business up in September 2021 by 31% and 21% respectively, compared with the same month in 2020. By contrast, IT equipment finance new business fell by 24% over the same period.

The FLA's Q4 2021 industry outlook survey shows that 90% of asset finance providers expected new business growth over the next twelve months.

In the nine months to September 2021, new business volumes in the new car market were 9% higher than in the same period in 2020, while they were 11% higher for the same period in the used car market.

Electric passenger car sales increased by 186% in 2020 and today there are an estimated 300,000 electric vehicles on the road in the UK and 600,000 plug-in hybrids.

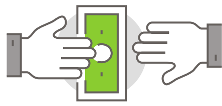
The growth of the electric vehicle market is expected to continue as the ban on new petrol and diesel vehicle sales, due in 2030, approaches. By the end of 2021, it is estimated that one in ten new cars in the UK will be electric[1] with a total of 260,000 electric car sales forecast for 2022.

[1] Data from the Society of Motor Manufacturers and Traders (SMMT)

Supporting our customers

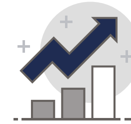
During the past 18 months, our lending lines have remained open, and we have supported thousands of our customers and brokers through the pandemic, helping those worst impacted with forbearance while also supporting their recovery and post-pandemic growth through our lending activity. 98% of those customers are no longer in forbearance.

To support our business customers as they recover and grow following the pandemic, we were accredited to the government-backed Recovery Loan Scheme ('RLS'). We were one of the first lenders to be accredited and will provide asset finance funding of up to £2 million under the scheme.



£70.1 million

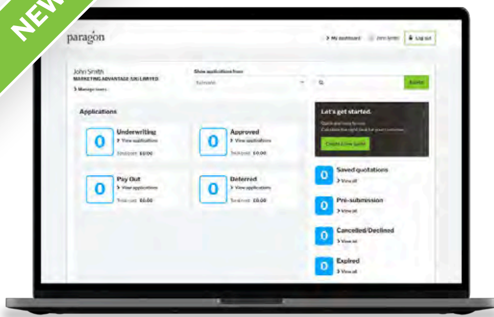
Total CBILS and BBLS lending
- including £44.2 million in the last financial year



£20.0 million

Total lending through RLS between April 2021 and September 2021

> **Our business offering is multi-disciplined and complex so it's very important for us to work with funders who understand our businsess model. As our business grows, it is key for our partners to have known our business pre-Covid and understand our journey and growth plans for the future...**
>
> *Del Bhanot, Director at KKB Group*



Digital solution launched for introducers

During 2021 we launched a new asset finance portal initially for intermediaries, to automate and speed up the client journey, with increased accuracy, real time tracking and a simple three step application process. This is part of a £10 million investment into new IT infrastructure that is being delivered over the next three years, to deliver a step change in capabilities and capacity.

> **£10 million investment into new IT infrastructure that is being delivered over the next three years...**

Customers

Alkmonton Dairy

Paragon provided Alkmonton Dairy Farm with the funding to invest in the infrastructure to process and bottle milk from its farm and supply its local community directly.

> **There is no doubt that starting a new business in the middle of a pandemic was daunting, but I'm so glad we took the plunge! We've had a great response from the local community. We know sustainability and provenance are really important to our customers, and it's great to be able to offer them locally sourced produce...**
>
> **The team at Paragon was really easy to deal with and took the time to understand our business and what we were hoping to achieve, which made the process of securing funding really seamless...**
>
> *Jo Harris, co-owner of Alkmonton Dairy*

Sustainability

Sustainability is one of our key strategic priorities and influences every aspect of our business. We aim to use our influence and resources wisely and understand our responsibilities towards society and the environment. We understand that climate change is one of the greatest challenges facing society and take care to identify, manage and minimise our impact on the environment.

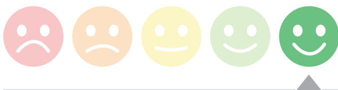
Earlier this year we set up a Sustainability Committee to further embed sustainability considerations across Paragon as well as to provide a platform for discussion and debate on emerging ESG issues.

We have published our inaugural sustainablility report, the Responsible Business Report, which explains our progress on the main ESG issues for our business and our stakeholders. We have divided our responsibilities into the following areas and more detailed information on each of them can be found in the report, available on our website.

Helping customers

Our customers are the lifeblood of our business and, as a specialist bank, we use our expertise to develop and structure products, services, and support to meet their needs and help them achieve their ambitions. We are committed to delivering good customer outcomes in line with our values and treating customers fairly throughout our business.

A dedicated customer insight team augments our customer understanding and enables us to improve our overall customer experience.



Our customer commitment is underpinned by a wide range of conduct policies and standards, from product governance to complaints handling and distribution to remediation.

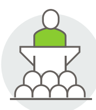
Customer satisfaction scores

88%

of savers would consider taking another savings account with Paragon

91%

of mortgage intermediaries satisfied with the ease of obtaining a query response from Paragon during the offer process



100%

employees completed customer vulnerability training during 2021.

4.5/5 Feefo review score from savings customers.

46%
year-on-year reduction in emissions since 2017

100% renewable electricity at controlled sites

Operational footprint

We operate in mortgage, consumer, and commercial finance markets and therefore the overall environmental impact of our operations is low, however we are committed to identifying, measuring, and managing how our actions affect the environment and finding ways to reduce their negative impact.

Building a strong team

We employ almost 1,450 people across the UK who work together to help our customers achieve their ambitions. To build a more sustainable future, we need a team with a diverse mix of people and skills, where everyone feels welcome and able to succeed.

We are exceptionally proud of our culture which underpins how we do things at Paragon and helps us recruit and retain the best people for our business. In our recent employee survey 95% of employees agreed they are proud to tell people they work for Paragon and 96% agreed there is a clear and consistent set of values and behaviours that underpin how we operate.

87%
Employee engagement
(2017: 81%)

+24
Employee NPS
(2017: -3, Industry norm: +21)

Contributing to our communities

Positively impacting society by giving back to the communities in which we live and work has always been important at Paragon. We aim to be an energetic and valuable contributor to these communities and our commitment includes active involvement in a range of community volunteering and charity partnerships.

- Through our community volunteer scheme, every Paragon employee is provided with a day each year to volunteer for specific initiatives that help with education and tackling poverty
- Each year, employees select a charity of the year and a dedicated Charity Committee made up of employee volunteers organise a variety of fundraising activities, which also bring people together and support our values and culture. In 2021, employees raised more than £30,000 for Alzheimer's Society

Lending sustainably

We support the UK's ambition to reduce greenhouse gas emissions to net zero by 2050 and want to help our customers meet their environmental responsibilities and to understand the impact of our lending on the climate.

We are taking steps to manage climate related financial risks associated with our lending. During 2021, we:

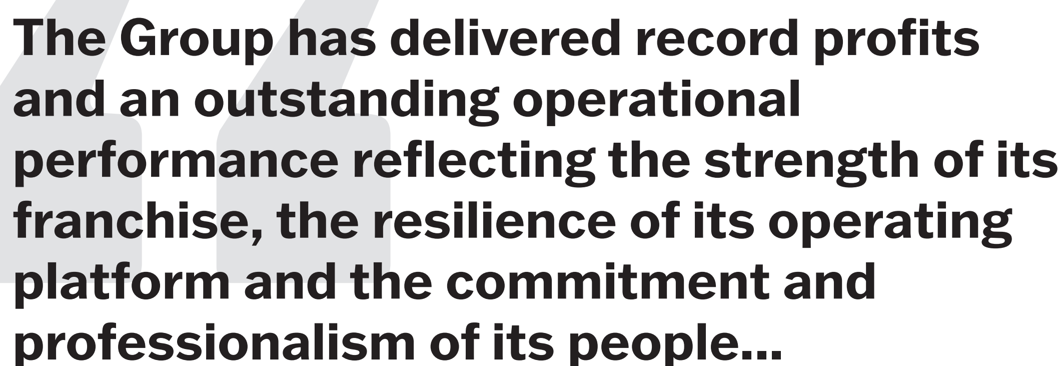
- Issued our first green bond, the first UK bank to do so, raising £150 million of green capital which has begun to be allocated to mortgages on properties with an EPC rating of at least B
- Launched a range of green mortgage products, specifically for properties with an EPC rating A to C, and motor finance products for electric vehicles
- Offered tailored finance for green assets to our SME customers and brokers to support their sustainability plans and introduced a green homes initiative to support housebuilders

Doing business responsibly

Being a responsible business and doing the right thing for our stakeholders is engrained in how we do business at Paragon. We actively promote good practice on a range of important issues and expect the same from our suppliers and other business partners.

- We are a signatory to the UK's Prompt Payment Code ('PPC'), administered by the Office of the Small Business Commissioner, to ensure suppliers are treated fairly in respect of payment terms and receive payment on time
- Our Supplier Code of Conduct sets out our overall approach to supplier engagement and the standards of behaviour we expect from our suppliers, and we have robust processes and controls in place to ensure all elements of our procurement cycle are managed responsibly
- We ensure our employees understand the different rules and regulations we must adhere to in order to support our customers properly and operate fairly. A series of mandatory learning courses were launched in 2021

Nigel Terrington
Chief Executive Officer



The Group has delivered record profits and an outstanding operational performance reflecting the strength of its franchise, the resilience of its operating platform and the commitment and professionalism of its people...

A3. Chief Executive's review

Introduction

The Group has delivered record profits and an outstanding operational performance reflecting the strength of its franchise, the resilience of its operating platform and the commitment and professionalism of its people.

The Group's business model has been designed, using its extensive through-the-cycle experience, to be resilient in its operational performance and to maintain a strong balance sheet. Having developed an effective working approach at the onset of the crisis, the business was well placed to deal with the changing Covid conditions, particularly over the winter months, maintaining new business activities and paying close attention to the needs of our customers, employees and business partners as the situation developed.

This testing period brought out the best in our people and has given us the opportunity to demonstrate the fundamentals of the Group as we continue to generate improved returns and strong growth rates.

Despite the operational challenges the lockdowns brought, we have strengthened our franchise by building stronger relationships with customers, intermediaries and other business partners. Alongside this, we have delivered a number of key technology developments during the year. We also have an active change programme in progress, designed to optimise customer journeys, operational efficiencies and data and control needs across the business. The delivery of these, together with accessing the capacity and efficiencies they bring, will form a core part of our strategy in continuing to drive strong growth in a prudent manner in the UK's specialist financial services markets.

Financial performance

The Group delivered a strong financial performance reflecting the improvements in the UK economy and strong underlying trading. A combination of strong loan growth, improving net interest margins, tight cost control and a reversal of some of the Covid-related impairments enabled underlying profits to increase by 61.8% to £194.2 million.

Impairments for expected credit losses fell materially from their 2020 level, ending 2021 with a £4.7 million write-back compared to the £48.3 million charge in 2020 and an £8.0 million charge in 2019, before the imact of Covid. Notwithstanding this impairment volatility, pre-provision profits were up 12.6% on their 2020 level at £189.5 million. With the credit for impairments in the year, and strong fair value gains reflecting yield curve movements, overall reported profits before tax were 80.5% higher than their 2020 equivalent at £213.7 million.

Basic earnings per share were 65.2 pence on a statutory basis and 59.3 pence on a underlying basis. We continue to operate with a 40% dividend pay-out policy, which results in a dividend for the year of 26.1 pence, reflecting the strong underlying performance, impairment releases and fair value movements.

Trading performance

The Mortgage Lending and Commercial Lending divisions have each outperformed expectations during 2021, delivering strong new business flows, low arrears and finishing the period with record pipelines.

In Mortgage Lending, where we celebrated 25 years of serving the Private Rented Sector ('PRS'), we have continued to see strong demand from professional landlords, who generated 97% of new buy-to-let completions in the year. Total buy-to-let completions exceeded £1.6 billion in the year, generating an 8% increase in balances to £11.4 billion. Strong house price inflation and stable arrears have created a lower impairment requirement year-on-year and the portfolio remains conservatively leveraged with an average loan to value ('LTV') of 61.2% and only 1.9% of the portfolio having an LTV over 80%. The pipeline at the year end exceeded £1 billion, boding well for continued strong flows into the new financial year. With our half-year results we announced the cessation of lending on second charge mortgages, with the business being unattractive at our chosen risk appetite. All employees were offered redeployment in the wider business, with only six choosing the alternative of voluntary redundancy.

New business flows in Commercial Lending exceeded £0.97 billion, up 22.9% on their 2020 levels and above their 2019 equivalent. The growth was strongest in development finance, where new advances rose 32.5%, year-on-year, reflecting the continued high demand for residential property development in the UK and the Group's investment in expanding the relationship team. The development finance year end pipeline was up 63.2% from its equivalent level in 2020. SME lending saw a 17.0% increase in origination flows, but these remain below the pre-Covid equivalent given sector-wide challenges and the broad take-up of government-backed loans under the CBILS, BBLS and RLS during the year. However, growth was strongest in the longer-term, asset-secured part of the operation. The new portal delivered during the year leaves the business well placed to seize opportunities going forward as this sector recovers. Motor Finance volumes were broadly flat year-on-year, but this disguises a strong second-half recovery and strong momentum being carried through to 2022. Finally, our structured lending team has now refocused its attentions from account management to business development, driving portfolio growth and adding new facilities during the second half of the year.

Capital and funding

The past year has seen a material change in our funding structure, with our savings proposition delivering an 18.4% growth in balances at attractive rates. System enhancements during the year enabled increased levels of deposits to be sourced from third party platforms, while the SME savings market was accessed for the first time. During March 2021 we became the first UK bank to successfully issue a Green Tier-2 Bond, at a coupon of almost 3% less than the bond it was replacing. We have also refinanced the majority of our legacy securitisation structures, substantially repaid borrowings under the Bank of England Term Funding Scheme ('TFS') and drawn further on the Term Funding Scheme with additional incentives for SMEs ('TFSME'). Overall, the Group's cost of funds has dropped by 39 basis points from its 2020 level.

The refinancing of the legacy securitisations removed over £400 million of derivative assets from the Group's balance sheet against which regulatory capital had previously been carried, reducing capital requirements. The refinancing also facilitated the transition of the bulk of the Group's LIBOR-linked loan exposures to a Term SONIA basis. For all remaining LIBOR-linked assets an exit strategy is in place and the Group's remaining LIBOR-linked liabilities were either transitioned during the financial year, or a transition methodology has been agreed with the relevant counterparties.

With the strong capital position at the half-year, the Group declared an interim dividend in line with its guidance (being one half of the previous year's final dividend) and also announced a share buyback of up to £40.0 million, with £37.5 million (excluding costs) being utilised by the year end. This programme will be completed in the early part of the new financial year, and in December 2021 the Board authorised a futher buy-back programme of up to £50.0 million, acknowledging the Group's continuing capital strength.

We also benefitted from revised total capital requirements following the regular supervisory review undertaken by the PRA in late 2020. This saw our total capital requirement ('TCR') fall from 10.8% to 8.9% and contributed to a continued strong surplus over regulatory requirements at 30 September.

The Group submitted its buy-to-let Phase 2 IRB application modules to the PRA during the year. The process remains protracted, but we continue to receive constructive engagement from the PRA. In addition to further phases of the buy-to-let accreditation, our preparations to submit an IRB application for our development finance business, which represents the next stage in the IRB roadmap are well advanced.

Business model developments

Key developments during the year include the completion and roll-out of our Commercial Lending portal and the introduction of auto-decisioning to SME lending. We have also developed a new digital system for our surveyors, established a single payment platform across our banking relationships and implemented Mambu, a cloud-based core banking module, for managing our portfolio of savings platform relationships. Complementing these completed developments, our teams are actively managing process improvements in our Mortgage Lending division, embedding Mambu into development finance, reviewing post-completion systems across the Group and broadening the scope of our savings proposition to support additional future capacity.

People

Our people have made a remarkable effort during the past year, working flexibly to support the business and showing great agility as the operating and working environment has changed. Against this backdrop, the wellbeing of our people has been a primary consideration for the Board and has been demonstrated through numerous initiatives and regular engagement to ensure that effective feedback and communications were maintained throughout the year.

Our 2021 employee survey demonstrated exceptional levels of engagement, with an engagement score of 87% and an employee NPS of +24, where +21 is the industry norm. 95% of our people agreed that they are proud to say that they work at Paragon.

I am pleased to confirm that the Group has also met all its diversity targets under the Women in Finance Charter, set in 2017, while the Group's EDI network, designed to ensure Paragon is a fully inclusive employer, was launched in the year. The new network has already contributed to a number of Group initiatives in this area.

Having spent much of the year with a working-from-home focus, the Group is now undertaking a series of hybrid working pattern trials, designed to optimise the efficiency, control, flexibility and wellbeing features of our longer-term operating model.

Sustainability

Climate change and sustainability considerations have been highlighted during 2021. Against a backdrop of creating the appropriate focus and governance around the Group, we launched the first green capital bond to be issued by a UK bank in March 2021, to replace our existing Tier-2 bond. The establishment of the Green Bond Framework and associated deployment commitments reflect the importance of the sustainability agenda within the Group.

A new Sustainability Committee was established in the year. Products to promote more energy-efficient properties have been launched in both the buy-to-let mortgage and development finance areas. Our motor finance operation began lending on electric vehicles after the year end, following substantial preparatory work during the year. There has also been material board engagement regarding the actions the Group needs to take to support the UK's path to net-zero by 2050.

Internally the Group relocated its London operations to more energy-efficient premises, reducing its carbon footprint while affirming its commitment to office-based working and the City as a physical venue for doing business.

The requirements of the Taskforce on Climate-related Financial Disclosures ('TCFD') become binding on the Group in 2022. Our disclosures for 2021 are materially enhanced and substantially meet these standards, and we have signed up as a TCFD supporter. Alongside the annual report and accounts we are publishing our first separate sustainability report, the Responsible Business Report, which will be accessible via the Group's website.

Outlook

Despite the challenging environment, Paragon leaves its 2021 financial year with strong lending pipelines, an increasingly diversified funding structure and strong capital resources to continue to take advantage of opportunities going forward, both organic and potentially through further acquisitions, if appropriate. We are accelerating our investment in technology, enhancing our customer proposition while preserving the key specialisms that are embedded within our operating model. Careful consideration of impairment coverage levels leaves us appropriately provisioned in the event of future macro-economic volatility or idiosyncratic examples of Covid-related scarring amongst our customers. With a CET1 ratio of 15.4% and good progress being made with our IRB applications, our capital position remains strong, supporting further growth and returns to stakeholders.

Nigel Terrington

Chief Executive Officer

7 December 2021

A4. Review of the year

This section reviews the activities of the Group in the year under these headings.

Business review	Funding	Capital	Financial results	Operations
Lending and performance for each business line	Deposit taking and other sources of finance	Regulatory capital, liquidity and distributions	Results for the year	Systems, people, sustainability and risk
A4.1	A4.2	A4.3	A4.4	A4.5

Strategic Report

A4.1 Business review

The Group reports its results analysed between three segments, based on product type, origination, and servicing capabilities. This organisational and management structure has been in place throughout the year.

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

	Advances in the year		Net loan balances at the year end	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Mortgage Lending	**1,630.0**	1,259.7	**11,608.7**	10,819.5
Commercial Lending	**971.5**	790.8	**1,568.8**	1,514.8
Idem Capital	**-**	-	**225.2**	297.1
	2,601.5	2,050.5	**13,402.7**	12,631.4

The Group's total loan balance increased by 6.1% in the year following a 3.7% increase in the preceding twelve months. This highlights the Group's ability to continue to pursue its strategy despite the economic impacts of Covid through the last eighteen months. Total advances increased 26.9% as the economy bounced back from the pandemic and exceeded the pre-pandemic levels of 2019, despite lockdowns and other Covid-related restrictions continuing to impact during the year.

A4.1.1 Mortgage Lending

The Group's Mortgage Lending division principally provides buy-to-let mortgages secured on UK residential property to specialist landlords. The buy-to-let mortgage sector celebrated its 25th anniversary in the year and the Group was one of the first lenders in this market. This gives the Group an unparalleled understanding of this form of mortgage and the landlord customer base it targets.

During the period the Group also offered loans to non-specialist landlords and limited numbers of owner-occupied first and second charge mortgages on residential property.

However, during the year it withdrew from the second charge market entirely, to increase its buy-to-let focus.

In all its offerings, the Group targets niche markets where its focus on detailed case-by-case underwriting and its robust and informed approach to property risk differentiate it from both mass market and other specialist lenders.

Housing and mortgage market

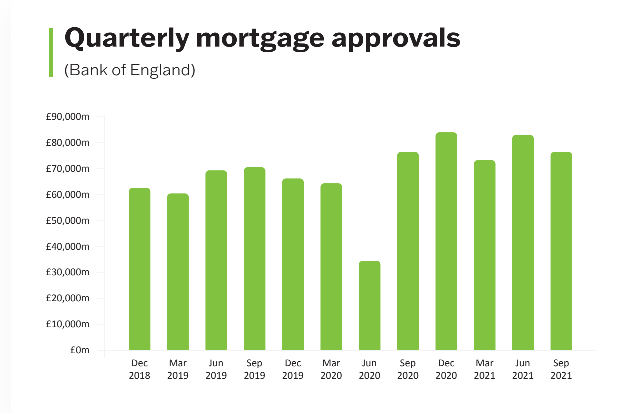
During the year the housing market in the UK continued to be affected by the Covid pandemic and the associated relief schemes including payment holidays, effective prohibitions on some forms of enforcement action and the continuing availability of stamp duty holidays, which were extended until June 2021. While the period over which payment holidays were available was extended, the maximum relief was capped at six months and the immediate impact of such holidays began to reduce as borrowers reached their maximum allocation. Lockdowns and social distancing requirements at various points in the year also put practical constraints on the operation of the housing market.

Activity in the residential property market recovered in the year, boosted by the stamp duty holiday. Transactions for the year reported by HMRC, at 1,562,000, were 58.3% higher than the 987,000 in the previous year. In their September 2021 Residential Market Survey, RICS noted positive activity levels in the market and a stable outlook for property sales.

Despite the year beginning with a pessimistic outlook for property prices from some forecasters, house prices saw strong growth in the period, with the Nationwide House Price Index recording a year-on-year increase of 10.0% to September 2021. RICS forecast continuing growth in the short to medium term, with demand outstripping supply, however, Nationwide amongst other forecasters, remain cautious as to the medium-term outlook as reliefs unwind, and the Group continues to position itself conservatively.

New mortgage lending in the market was strong in the year, with the Bank of England reporting new approvals of £317.3 billion in the year ended 30 September 2021, a 31.0% increase on the £242.3 billion reported for the previous financial year and a higher value than any year since 2007. Particularly high volumes were seen in the months leading up to June 2021, when stamp duty reliefs began to be withdrawn.

Quarterly UK mortgage approval data for the last three financial years is set out below.



At 30 September 2021 the UK Finance ('UKF') survey of mortgage market arrears and possessions reported arrears remaining at historically low levels, despite the phasing out of Covid reliefs. Indeed, in a significant number of cases, customers had been able to reduce arrears during the pandemic. Possessions remained very low, with the majority relating to cases already in serious difficulties before the onset of Covid. Based on its research, UKF concluded that the availability of payment holidays fulfilled the purpose of enabling borrowers to stay out of arrears through the pandemic.

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

Specialist landlords form the largest part of the Group's target market. Such landlords typically let out four or more properties, run their portfolio as a business and have a high level of personal day-to-day involvement.

The Group considers that the experience of its customers, their level of involvement and the diversification of their income streams across properties make them less vulnerable to cash flow shocks in the event of a downturn and better able to cope when faced with an adverse economic situation. This has proved to be the case in the Covid pandemic to date, with customers engaging quickly to manage any risks they faced.

The Group is amongst a small number of specialist lenders addressing this sector, which is underserved by many of the larger lenders. Some constraint in supply was seen during the pandemic, with certain non-bank lenders withdrawing from the market, although by the end of the year most had resumed activity.

New issuance of buy-to-let mortgages followed the trend in the wider property and mortgage markets. New advances reported by UKF, at £45.1 billion for the year ended 30 September 2021, were 14.8% higher than for the previous year (2020: £39.3 billion). This included an 86.3% increase in house purchase activity with an 8.4% reduction in remortgage activity. Some of this increase was driven by an increase in the number of amateur landlords, seeking investments offering returns not available elsewhere, but the activity amongst professionals was also strong.

In the lettings market RICS' September 2021 UK Residential Market Survey reported rising tenant demand coupled with a scarcity of new landlord instructions driving an increase in rents. ARLA Propertymark, in its September 2021 PRS Report, identified 75% of tenants as having experienced year-on-year increases in rent (2020: 58%) while RICS members continue to predict, on average, rent increases of 3% over the coming year. This continuing demand will benefit affordability and cash flows for the Group's landlord customers.

Landlord confidence measures reached a five-year high in the third quarter of the 2021 calendar year. Independent research carried out for the Group reported that on all five measures of confidence surveyed: rental yields, capital gains expectations, the future of their own business, the prospects for the sector as a whole and the UK financial markets more generally, optimism was higher than at any time since 2016. Larger landlords were particularly confident about prospects for their businesses, with 56% feeling 'good' or 'very good'.

The proportion of landlords in the survey reporting increasing tenant demand had reached the highest level since the survey began, with six out of ten landlords reporting rising tenant demand, and 30% reporting significant increases. Only 2% of landlords in the survey reported missing a mortgage payment, and only one of the landlords surveyed anticipated missing one in the next three to six months.

Demand for HMO ('house in multiple occupancy') lets remained strong. Despite concerns as to whether student demand might be particularly affected by the effects of Covid, this did not transpire in the year, with strong lettings even where lectures were being delivered online.

The UKF analysis of arrears and possessions also provided analysis of buy-to-let cases, showing a similar picture to the wider mortgage market, with a significant uptake of payment holidays serving to keep arrears and possessions low, even after these reliefs had expired.

All these factors provide a strong indication of the current strength of the buy-to-let mortgage market and the opportunities for the Group going forward.

Mortgage Lending activity

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

	2021 **£m**	2020 £m
Originated assets		
Specialist buy-to-let	**1,562.2**	1,119.0
Non-specialist buy-to-let	**52.2**	86.4
Total buy-to-let	**1,614.4**	1,205.4
Owner-occupied	**1.5**	0.3
Second charge	**14.1**	54.0
	1,630.0	1,259.7

Total mortgage originations in the Group increased by 29.4%, following a 19.7% fall in the preceding year. Activity exceeded the £1,564.4 million of new advances achieved in 2019, before the Covid outbreak, demonstrating the impact of real growth, rather than just a Covid bounce-back on the Group's mortgage business.

Buy-to-let

Advances continue to be focused on specialist buy-to-let, the main focus of the division's activity. New lending of these products increased by 39.6% following the 14.9% fall in the 2020 financial year. The £1,562.2 million of completions was also 22.8% higher than the result for 2019, prior to the pandemic, demonstrating the strength of the Group's proposition.

Specialist buy-to-let comprised 95.8% of the division's advances, reflecting the sharpening of focus on this area. Other mortgage lending remains modest in comparison, with advances declining by 51.8%, in large part due to the Group's exit from the non-core second charge market during the year. The new business pipeline, being the loans passing through the underwriting process, stood at a record £1,008.1 million at the year-end, 8.8% higher than a year earlier (2020: £926.7 million), providing a strong platform for growth into the 2022 financial year.

The Group sources the majority of its new buy-to-let lending through specialist intermediaries, and it continues to invest to ensure the service offered to them is excellent. During the year the Group's regular surveys of its intermediaries showed 91% were satisfied with the ease of obtaining a response from the Group (2020: 91%), delivering an NPS at offer stage of +43 (2020: +56).

Two thirds (66%) of brokers dealing with the Group rated its service as better than that provided by other lenders (2020: 68%). Paragon Mortgages was also named as 'Best Professional Buy-to-let Lender' at the 2021 Your Mortgage awards – the ninth time it has won this title.

During the period the business launched a long-term, in-depth, end-to-end transformation programme to restructure processes and enhance systems, increase the effectiveness of the operation and upgrade the offering to both customers and intermediaries. This represents a significant commitment of time and resources to the future of the business, with enhancements starting to come online from the 2022 financial year.

The Group understands the potential for climate change to impact its mortgage business and seeks to mitigate risk through careful consideration of the properties on which it will lend. It also continues to develop systems and refine data to allow its overall position to be measured and the behaviour of its security portfolio under climate-related stresses to be better understood.

During the year the Group launched its first range of green buy-to-let mortgages. These market-leading products have a maximum 80% loan-to-value ratio and offer lower interest rates for energy efficient properties with EPC ratings of C or higher. While initially limited to certain property types, this lending was extended to all properties within the Group's lending criteria in October 2021.

The UK Government has identified the provision of more energy efficient housing as a prime objective in its response to climate change, with EPC levels being set as one of the principal benchmarks to be used. It has announced a target of upgrading as many homes as possible in the PRS to an EPC rating of C or higher. In order to achieve this, there is an expectation that lenders will set minimum quality thresholds, and advantage customers with more energy efficient properties, as is the case with the Group's green mortgage products.

The Group has also designated EPC grades as a principal metric for evaluating climate change risk in its mortgage book and has continued to develop systems to analyse this data and to ensure that it has reliable and up-to-date information on as much of its book as possible, including legacy cases. It is unfortunate that some public information sources are not currently configured in a way which easily facilitates in-life monitoring and analysis or allows customers in need of support in improving their properties to be indentified.

The Group's latest analysis identified EPC grades for 88.3% of its mortgage book by value at 30 September 2021 (2020: 85.1%). Of these 98.4% were graded E or higher (2020: 98.1%) with 37.6% rated A, B or C (2020: 37.7%). The year-on-year movements are principally a result of refining the data, with 39.7% of new originations in the year having one of the top three grades (94.2% coverage).

The Group's advances volumes on green buy-to-let lending, which have increased by 27.7% in the year, are set out below.

	2021	2020
	£m	£m
EPC rated A or B	**134.3**	112.7
EPC rated C	**443.4**	339.8
EPC rated A to C	**577.7**	452.5
Coverage (England and Wales)	**93%**	94%

While the Group monitors EPC performance it is also conscious of the need to avoid unintended consequences by focussing lending on this. Although upgrading existing properties is beneficial to overall emissions, the demolition and replacement of properties may be less so.

The Group also monitors the potential physical risks to security values arising from climate change. This includes assessing a property's flood risk as part of the underwriting process. At 30 September 2021, approximately 2.5% by number of properties securing the Group's buy-to-let mortgages in England and Wales were considered to be at medium or high risk of flooding from the sea or rivers, based on data from the Environment Agency (2020: 2.2%).

The Group continues to refine and develop its use of both internal and external data to manage climate change risk. However, it recognises the important part that the development of reliable and easily accessible information sources by the UK authorities must play in quantifying these exposures. It would therefore welcome any initiatives by the UK Government to enhance national reporting as part of its own response to climate change.

The business is currently working with the Green Finance Institute on a number of industry initiatives to develop standards for mortgage products which would encourage energy and carbon efficiency for the future, and this work continues to inform the development of the Group's own buy-to-let product range. Given that RICS has highlighted cost as one of the principal barriers to energy efficiency improvements in residential property, the provision of financial solutions will be key to the achievement of climate goals.

Further information on these metrics and the Group's wider climate change agenda is given in the Section A6.4.

Other lending

Other first and second charge mortgage lending is ancillary to the Group's main buy-to-let focus and is carefully managed to ensure that only lending with appropriate risks which provides an acceptable return on capital is undertaken.

Lending in the Group's second charge mortgage operation was scaled back in summer 2020 in response to Covid, with people transferred to provide support to other business areas, and lending remaining low in the first half of the year. The Group took this opportunity to review the long-term strategic potential of second charge lending in light of its capital requirements and the Group's overall risk appetite and announced its withdrawal from this market in May 2021. Completions in the year were £14.1 million compared to £54.0 million in 2020.

The Group's exposure to first charge residential lending is strictly limited, given the yields available in this market at acceptable levels of risk, and a limited demand for products where its specialist approach is cost-effective and adds value. The opportunities for the Group in this area principally relate to complex propositions, which will arise on an opportunistic basis, including lending to the existing professional landlord customer base.

Performance

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

	2021	2020
	£m	£m
Post-2010 assets		
First charge buy-to-let	**7,379.0**	6,202.5
First charge owner-occupied	**35.6**	51.2
Second charge	**148.1**	182.6
	7,562.7	6,436.3
Legacy assets		
First charge buy-to-let	**4,045.3**	4,381.3
First charge owner-occupied	**0.7**	1.9
	11,608.7	10,819.5

At 30 September 2021, the total net mortgage portfolio was 7.3% higher than at the start of the financial year, reflecting strong lending and retention performance in spite of the on-going impacts of Covid. The balance of post-2010 buy-to-let lending grew by 19.0% and it now represents 63.6% of the division's total loan assets (2020: 57.3%).

The annualised redemption rate on buy-to-let mortgage assets, at 6.9% (2020: 6.6%), has continued at a low level, partly due to the continued seasoning of five-year fixed rate loans, partly to customers adopting a cautious approach to remortgaging during Covid, but also as a result of the Group's strategic initiatives to retain customers whose mortgage accounts reach the end of their fixed rate period.

Covid-related payment holidays were granted on 13,503 of the Group's buy-to-let accounts which were still live at the year end, representing 19.9% of the book by number. 5,165 of these holidays were extended (7.6%), but all of them had expired by 30 September 2021.

Arrears on the buy-to-let book increased in the year to 0.21% (2020: 0.15%), although part of the increase is attributable to the suppression of arrears by payment holidays at the previous year end. Arrears on post-2010 lending were at 0.09% (2020: 0.03%). Despite the small increases, these arrears remain very low compared to the national buy-to-let market, with UKF reporting arrears of 0.45% across the buy-to-let sector at 30 September 2021 (2020: 0.52%).

While the principal credit metrics for the buy-to-let mortgage portfolio have remained positive throughout the year, the extent to which these have been influenced by UK Government interventions, such as furlough payments and other income support, underpinning tenant rental payments, funding from government-backed loan schemes accessed by landlords and the stamp duty holiday, cannot be established from data available. We remain confident in our lending but, as these initiatives begin to be withdrawn, the long-term prospects will be subject to a higher than normal level of uncertainty.

The Group's buy-to-let underwriting is focussed on the credit quality and financial capability of its customers, underpinned by a robust assessment of the available security. This approach relies on a detailed and thorough assessment of the value and suitability of the property as security and this approach to valuation, including the use of a specialist in-house valuation team, provides it with significant security in the face of economic stress.

The loan-to-value coverage in its buy-to-let book, at 61.2% (2020: 65.8%) represents significant security, enhanced over the year by the generally rising levels of house prices. Levels of interest cover and stressed affordability in the portfolio remain substantial, leaving customers well placed to develop their businesses going forward.

Second charge arrears increased to 1.18% from 0.62% in the year, reflecting the increased seasoning and size of the portfolio and the effect of payment holidays on the 2020 measure. Of the live second charge accounts at the year end 470, representing 17.9% of the book by number, had been given payment holidays during the pandemic, with 256 of those extended (9.8%). No payment holidays remained in place at the year end.

The Group's receiver of rent process for buy-to-let assets helps to reduce the level of losses by giving direct access to the rental flows from the underlying properties, while allowing tenants to stay in their homes. The Group's receiver of rent team was able to manage tenant rental flows and occupancy levels through the various pandemic restrictions in the year, to ensure good outcomes for customers and their tenants. At the year end 553 properties were managed by a receiver on the customer's behalf, a reduction of 11.2% since 2020 (2020: 623 properties). Almost all these cases currently relate to pre-2010 lending, with cases being resolved on a long-term basis.

Outlook

The division's operations were affected by Covid in the year, however, the buy-to-let mortgage portfolio continued to grow, with strong credit performance, despite the circumstances. The year end pipeline was at record levels, signposting strong completions into the new financial year. In the wider market, transactions are increasing, tenant demand is strong and rental projections are encouraging, with positive landlord and broker sentiment.

These combine to provide an outlook for the Mortgage Lending business in which it should be able to accelerate out of the pandemic and generate high quality assets and returns for the Group, while contributing to the development and renewal of the nation's housing stock.

A4.1.2 Commercial Lending

The Group's Commercial Lending division includes four key specialist business streams lending to, or through, commercial organisations, mostly on a secured basis. This division had been a major source of growth within the Group before the impact of Covid and remains a focus for growth going forward.

The four business lines address:

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

Each of these businesses is led by a managing director, supported by a specialist team with a strong understanding of their market. The principal competitors for each of the business lines are small banks and non-bank lenders.

The Group operates principally in markets where the largest lenders have little presence, creating both a credit availability issue for customers and significant opportunities for the Group.

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

The SME sector has been the focus of government-mandated support programmes throughout the pandemic including payment reliefs from lenders, VAT deferral schemes and the provision of loans under the Coronavirus Business Interruption Loan Scheme ('CBILS'), Coronavirus Large Business Interruption Loan Scheme ('CLBILS'), Bounce Back Loan Scheme ('BBLS') and Recovery Loan Scheme ('RLS'). These reliefs have resulted in significant increases in cash balances held in the sector, which makes long-term prospects more difficult to gauge.

During the period the Group has continued to enhance operational functionality in this area, developing technological solutions and investing in systems, particularly focussing on administration systems for SME lending and development finance. These enhancements should provide benefits for both customer service and in the procuration processes, enabling potential customers or their brokers to access appropriate finance solutions more easily and efficiently, while providing the Group with the information needed to support increasingly technologically advanced decision-making and the adoption of an IRB capital model for this business.

The division continues to develop its approach to green financing, where funding can be deployed in support of more climate conscious business activities, such as supporting local authorities in replacing refuse collection fleets with greener vehicles. Work is also in progress to classify the environmental impacts of lending in accordance with the UK's Green Taxonomy, although the Group's lending conncected to 'brown' industries (those with a high environmental impact) has already been assessed as low.

Commercial Lending activity

The Commercial Lending segment saw a 22.9% increase in new business during the year following the 18.3% reduction in 2020. Development finance continued its growth trajectory while SME lending also grew, particularly in its longer term asset finance product lines. Motor finance operated at a reduced level through the early part of the year, but returned strongly to the market in the spring.

The new lending activity in the segment during the year is set out below, analysed by principal business line. As the structured lending business comprises revolving credit facilities, the net movement in the period is shown.

	2021	2020
	£m	£m
Development finance	**510.4**	385.3
SME lending	**336.9**	288.0
Structured lending	**24.0**	7.6
Motor finance	**100.2**	109.9
	971.5	790.8

The impact of this new business has been to increase the Group's overall Commercial Lending exposure by 3.6% in the year to £1,568.8 million (2020: £1,514.8 million).

Development finance

The continuing growth of the Group's development finance business saw it reach the milestone of £1.5 billion of total lending over the last three years, with 13,000 new homes financed in that time. Enhancements to the product range and the expansion of the relationship team continued thoughout the current year, which alongside an active market, helped drive volumes higher.

The Group's target customer is a small to medium-sized developer of UK residential property. Projects currently in progress have an average development value of £7.8 million against which the Group has extended average facilities of £5.0 million, giving a substantial level of security cover. These projects are generally focussed on the more liquid parts of the residential market (houses and smaller blocks of flats), avoiding developments with high unit values.

The development finance business remained robust throughout the period, although Covid-related restrictions and supply chain issues meant that many projects progressed more slowly than they might have done in normal times, especially in the first half of the year. This, however created an element of pent-up demand moving into the second half with advances, pipeline and enquiries strengthening as the year progressed. Market sentiment appears positive with developers generally optimistic about the future, despite the short-term supply issues.

While the business has been historically concentrated in the English Home Counties, with 63.6% of balances at the year end located in London and the South East (2020: 67.0%), the Group's strategic objective is to lend more widely across the UK. Central London property hot-spots have generally been avoided with approximately 4% of the balance located in this area.

During the year the product range was expanded to include finance for projects in the £0.4 million to £1.0 million range, widening its potential market to include smaller, growing developers as they expand their businesses as well as expanding options for existing customers. It also reintroduced lending of up to 70% of total development value, suspended in response to the pandemic, for the highest quality propositions. Together these will expand the range of projects the business is able to consider.

Following the end of the year, the business launched a Green Homes Initiative to promote the development of energy efficient properties, by halving exit fees if EPC ratings of A are achieved on 80% or more of units within a development, incentivising developers to meet the demand for greener properties and to support the UK's net zero target.

The Group's customers have remained resilient through the Covid pandemic with delays minimised and completed projects being taken to market. To safeguard its investments, the Group engages independent monitoring surveyors to review progress and costs on a regular basis through the build phase of each project.

The volume of new proposals being received increased steadily during the second half of the year, with the increased amounts of undrawn approvals, at record levels at the year end, providing a springboard for the beginning of the new financial year. Undrawn amounts on live facilities at 30 September 2021 at £500.4 million were 31.4% higher than at the previous year end (2020: £380.9 million) while the post-offer pipeline of £298.6 million was 74.1% higher (2020: £171.5 million).

During the year, the business invested in both people and systems, while increasing its national and regional coverage with the recruitment of experienced specialist relationship directors and portfolio managers. These initiatives will support the further growth and broadening of the business going forward.

The Group has also made progress on the development of an IRB capital model for this business, which should reduce the cost of capital in the longer term, as well as enhancing capital discipline.

The performance of the development finance business through the pandemic has demonstrated the attractiveness of the proposition going forward. The demand for new housing in the UK shows no sign of reducing and smaller developers, who have historically struggled with credit availability, will be needed if the country's needs are to be met. Sentiment in the market looks positive entering the new financial year and the Group's business model, its investment in systems and people and the developments in its product range mean it is well-placed to support the aspirations of its developer customers and to help support housing provision across the UK.

SME lending

The SME lending business continued to perform well in the face of Covid-related constraints throughout the financial year, although certain business lines were particularly affected by either reduced economic activity, logistical difficulties in equipment sourcing, payment deferrals reducing the need for finance or the availability of cost-effective CBILS and BBLS funding. Lending strengthened considerably in the second half of the year, with the growth in longer term asset backed lending particularly encouraging for income.

Research carried out for the Group during the second half of the year suggested that 92% of UK SMEs were confident about their ability to bounce back from Covid, while 22% had already seen their turnover return to pre-Covid levels. Cash flow was identified as the principal issue for most SMEs, with UK Government support accessed by the majority. Levels of available cash remained the principal concern for SMEs looking forward.

This confidence in the sector led to a 17.0% growth In the Group's SME lending advances in the year, although the performance varied across product types. Generally all lines reported a stronger second half, with the economy opening up and business confidence beginning to increase.

In the division's core asset leasing business volumes increased by 19.3% to £198.2 million, excluding government-backed balances (2020: £166.1 million), with business levels strengthening towards the end of the period. This reflects the performance of the asset finance market in general, with the Finance and Leasing Association ('FLA') reporting depressed volumes through the winter months and business picking up through the summer. Investment in operating leases has also continued with £13.0 million of assets acquired in the period (2020: £12.9 million).

The Group continued to advance loans under the UK Government-sponsored British Business Bank's CBILS and BBLS programmes to support SMEs potentially affected by the Covid pandemic, until those schemes closed for new applications in March 2021. The Group has been authorised to take part in the follow-on RLS programme and began lending under this scheme in the second half of the year. RLS loans have the benefit of an 80% government guarantee (after the proceeds of any business assets are applied for leasing balances), but unlike CBILS lending, customers will be required to meet interest payments from the outset of the loan.

The existing RLS scheme closes for new offers from 31 December 2021 and will be replaced by a scheme with a 70% government guarantee. The Group expects to use these schemes to provide support to SME customers until 30 June 2022, the currently expected end date of the schemes. The Group's lending in this area has been primarily focussed on its existing customers, and the majority of both BBILS and RLS lending has been on asset-secured products.

During the year £64.2 million was advanced under schemes backed by a government guarantee (2020: £25.9 million), of which £50.4 million was asset leasing business. The Group continues to closely monitor the portfolio for any adverse indications, particularly at the point at which customers, rather than the Government, are expected to commence payments.

Short-term lending to professional services firms outside the government supported schemes fell by 21.6% to £62.0 million (2020: £79.1 million). Despite this fall in volumes, this represents a recovery in the second half of the year following twelve months of very low volumes during the pandemic. This resulted from both the deferral of tax balances, where customers had typically taken out short term loans to spread the impact, and of the wide availability of cheap CBILS and BBLS lending in the market. The second half of the year saw the impact of these factors diminishing and lending moving back towards pre-Covid levels with the underlying requirement for finance remaining for the longer term.

The Group has continued to invest in system improvements to create efficiency gains in this business throughout the year despite the pandemic. Enhancements to the new lending process were rolled out in April, offering improvements for customers and brokers including the launch of a new finance broker portal, providing enhanced functionality, in response to extensive research amongst the broker community.

The finance broker portal, which provides significant benefits in terms of process automation and response speed was rolled out to a larger population following the year end and the reengineering programme will continue into the new financial year, enhancing controls, operational agility and the customer experience.

With the FLA quarterly industry outlook survey showing 90% of providers expecting new business growth in the next twelve months, growing confidence in the customer base, a strengthening new business pipeline and system developments, the Group is optimistic for the future prospects for the business.

Structured lending

The Group's structured lending exposure has seen an increased level of activity in the year, with several new facilities agreed, diversifying the business' exposures, and the overall balance increasing.

Structured lending facilities generally fund non-bank lenders of various kinds providing the Group with increased product diversification. The facilities are constructed to provide a buffer for the Group in the event of default in the ultimate customer population. The Group's experienced account managers have received regular reporting on the performance of the security assets and they maintained a high level of contact with the Group's customers throughout the Covid crisis to safeguard its position.

The Group has a number of well-progressed additional facilities in the pipeline, with an expectation of more drawings in the new financial year. These include new asset classes, spreading the risk inherent in such lending. The Group continues to actively seek new opportunities in this field, with a particular interest in facilities linked to green initiatives.

Motor finance

The Group's motor finance business is a focussed operation targeting propositions which are not addressed by mass-market lenders, including specialist makes and vehicle types, such as light commercial vehicles, motorhomes and caravans.

During the first part of the year the Group operated tighter lending criteria and temporarily diverted resources from the new business teams in the area to support the wider Group's customer servicing requirements through the pandemic, including the provision of payment reliefs. In the second half the Group relaunched its proposition with a renewed focus as dealerships began to open and market activity increased.

Following the year end the operation extended its lending criteria to include battery electric cars for the first time, following consultation with dealers and brokers. This will help to support the UK's move away from petrol and diesel powered vehicles.

The Group's advances in the year reflect this operational strategy, with £100.2 million of completions in the year, a broadly similar level to the £109.9 million achieved in 2020. However, this represents a significant post-Covid recovery with £71.4 million of advances in the second half of the year, compared to £28.8 million in the first half and £35.1 million in the second half of 2020. This returns completions to the level seen in the first half of 2020, before the outbreak when advances of £74.8 million were made.

This Group's performance follows the trajectory of the wider motor finance market, with the FLA reporting falling volumes until February 2021, before a recovery began to take hold in March.

Performance

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

	2021	2020
	£m	£m
Asset leasing	**468.7**	478.0
Professions finance	**33.1**	22.3
CBILS, BBLS and RLS	**83.8**	25.2
Invoice finance	**20.9**	13.5
Unsecured business lending	**10.3**	15.0
Total SME lending	**616.8**	554.0
Development finance	**608.2**	609.0
Structured lending	**118.9**	94.9
Motor finance	**224.9**	256.9
	1,568.8	1,514.8

Credit quality in the development finance book has been good, and the overall performance of the projects has been in line with expectations, with the pandemic having no significant impact on the disposal of completed developments. Accounts are regularly monitored and graded on a case-by-case basis by the Credit Risk function. At 30 September 2021 only one account had been identified as at risk of loss, a long standing legacy case. While the impact of Covid on development finance projects has been limited to issues relating to the progress of some projects, rather than credit concerns, the Group recognises the potential impact of increased economic uncertainty and execution risk on its portfolio.

The average loan to gross development value for the portfolio at the year end, a measure of security cover, was 61.7% (2020: 63.1%), which gives the Group a substantial buffer if any project encounters problems. No new serious credit issues arose during the financial year and a number of problem cases identified in prior periods were resolved.

Credit performance in the division's finance leasing portfolios generally remains relatively stable, with arrears in asset leasing at 0.27% and motor finance at 2.30% (2020: 1.75% and 1.76% respectively), however there have been a small number of cases where serious credit issues have been identified and the sector is expected to display more volatile credit performance as government support initiatives unwind.

Of the division's live motor finance accounts at 30 September 2021, 1,507 cases (9.5%) had been granted payment holidays during the course of the pandemic with 312 (2.0% of cases) of those holidays extended. None of these payment holidays remained in place at the year end.

In SME lending 2,570 of the live accounts at 30 September 2021 had been granted payment holidays with 316 of those extended, of which 28 remained in place at the year end.

The majority of CBILS and BBLS lending remained in its initial twelve-month period where interest payments were met by the UK Government throughout the financial year. Payments from customers began to fall due in the second half of the financial year on a limited number of accounts in the first tranches of lending, and the Group has appropriate systems, processes and resource in place to deal with any issues as they arise. Of the guaranteed portfolio, £5.0 million (2020: £4.6 million) comprises fully guaranteed BBLS loans.

With the exception of a small number of irregularly submitted applications, where claims have been submitted under the guarantee scheme, the Group has yet to encounter any serious credit issues with its CBILS and BBLS portfolios. Any emerging payment behaviours will be kept under close scrutiny.

In the structured lending business, the Group carefully monitors the performance of the underlying asset pool on a monthly basis, to ensure its security remains adequate. The Group relies on its data monitoring and verification processes to ensure that these reviews are able to detect any credit issues. Performance in the year has been in line with expectations, with generally improved metrics across the book and only one loan remaining in IFRS 9 Stage 2 at the year end.

Outlook

The Group's Commercial Lending division has emerged from Covid well placed for future growth. Work to develop products, systems and services has been ongoing throughout the pandemic and the year ended with increased pipelines and building momentum.

With sentiment largely positive in the division's customer base, and new, green product ranges launched in the new year, the Group is optimistic for its prospects in the Commercial Lending space.

A4.1.3 Idem Capital

The Idem Capital segment contains the Group's acquired loan portfolios, together with its pre-2010 legacy consumer accounts. These include mostly second charge and unsecured consumer loans. The division's success rests on understanding assets, strong analytics, advanced servicing capabilities and the efficient use of funding.

When considering portfolios for acquisition the Group currently focusses on specialist loan portfolios which might augment its own organic origination activities. This model is essentially opportunistic and the flow of appropriate opportunities to the market is both limited and sporadic, even in a normal economic environment.

The Group carefully considers the capital requirements for any potential acquisition, particularly where the asset types offered require relatively large amounts of regulatory capital to be held. It also evaluates the potential for conduct risk issues to arise in portfolios which may contain more vulnerable customers. The Group will only pursue transactions where it considers that its wider capabilities in specialist administration and funding can provide a real benefit and where the projected return is attractive in comparison to the other opportunities for the deployment of its capital.

The Idem Capital back book includes consumer lending portfolios where customers may have historically rescheduled their debt repayments and its processes aim to generate fair outcomes for all customers, recognising any vulnerabilities. This aim has formed a principal focus in the Group's response to Covid in respect of such customers.

New business

Although the UK loan portfolio market remained active in the period, the impact of Covid continued to depress activity levels, and complicated the pricing and execution of potential deals, discouraging vendors from coming to market.

During the period, no portfolio acquisitions were completed (2020: none) although the division undertook a limited number of reviews of opportunities that were ultimately not progressed.

The main focus of the business in the year was the careful management of its existing books and ensuring that appropriate processes and systems are in place to address the Covid outbreak with customers, many of whom were already identified as vulnerable or who had developed vulnerabilities as a result of the ongoing pandemic.

Performance

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

	2021	2020
	£m	£m
Second charge mortgage loans	**133.6**	171.9
Unsecured consumer loans	**87.2**	109.7
Motor finance	**4.3**	15.5
	225.2	297.1

Balances in the segment have continued to decline as outstanding amounts are collected on existing portfolios, with no additions in the period. Cash flows remained strong across all books, despite the on-going effects of Covid on consumers. This level of collections resulted in, the 120 month Estimated Remaining Collections ('ERC'), a measure of future expected cash flows, on acquired consumer assets falling to £245.2 million at 30 September 2021 (2020: £313.7 million).

Arrears on the segment's secured lending business have risen to 24.3% (2020: 18.8%). These arrears levels remain higher than the average for the sector, but this reflects the seasoning of the balances, while the continuing upward trend reflects the redemption of performing accounts. This book contains a significant number of accounts which are currently making full monthly payments but had missed payments at some point in the past, inflating the arrears rate. Average arrears for secured lending of 8.6% at 30 September 2021 were reported by the FLA (2019: 8.4%).

Of the division's live secured lending accounts at 30 September 2021, 1,270 cases (14.1%) had been granted payment holidays during the course of the pandemic with 578 (6.4% of cases) of those holidays extended. In the motor finance portfolio 463 live cases (15.6%) had received a payment holiday with 136 (4.6%) having been extended. No payment holidays remained in place at the year end.

None of the live Idem Capital loan portfolios were regarded as materially underperforming at the year end, with cash generation continuing to hold up. The Group monitors actual cash receipts from acquired portfolios against those forecast in the pre-purchase evaluation of the portfolio. Up to 30 September 2021 these collections were 109.8% of those forecast to that point (2020: 109.8%).

The Group continues to invest in systems and people to ensure that Idem Capital customers receive an efficient and effective service which delivers fair outcomes. Given the nature of the books, particular attention is given to providing training, and establishing processes to ensure that vulnerable customers are identified, and their needs are addressed

Outlook

The Group's strategy for the Idem Capital business is to consider only those opportunities which would enhance its overall positioning, provide attractive returns and represent a productive use of capital. These will be essentially opportunistic, and there is no volume target.

In the meantime, the division will continue to focus on its commitment to providing appropriate outcomes for its existing customers as it has done throughout the Covid pandemic and ensuring any vulnerability issues are carefully addressed.

A4.2 Funding

The Group is principally funded by retail deposits but also accesses a variety of other funding sources. This maintains an adaptable and sustainable funding position as the business and its operating environment develop. The Group is therefore able to access cost-effective funding despite issues in any particular funding market, as well as raising funding for strategic initiatives on a timely basis.

Throughout the period the Group raised the majority of its new funding through the retail deposit market, where demand for deposit products has remained strong, with consumers trending towards saving rather than spending in the year, either through increased prudence or merely through the reduction in 'big-ticket' spending opportunities caused by lockdowns and other Covid-related measures. It has also continued to draw on the Bank of England TFSME scheme to support its lending to SME customers.

The Group's funding at 30 September 2021 is summarised as follows:

	2021	2020	2019
	£m	£m	£m
Retail deposit balances	**9,300.4**	7,856.6	6,391.9
Securitised and warehouse funding	**1,246.0**	3,928.3	5,206.9
Central bank facilities	**2,819.0**	1,854.4	994.4
Tier 2 and retail bonds	**386.1**	446.6	446.1
Total on balance sheet funding	**13,751.5**	14,085.9	13,039.3
Off balance sheet central bank facilities	**-**	-	109.0
Other off balance sheet liquidity facilities	**150.0**	150.0	-
	13,901.5	14,235.9	13,148.3

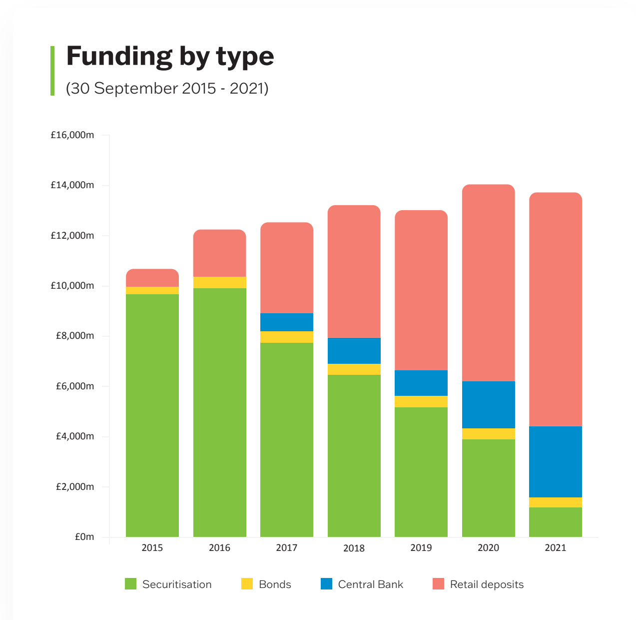
The Group's retail deposit balance grew by 18.4% in the year to £9,300.4 million (2020: £7,856.6 million), representing over two thirds (67.6%) of balance sheet funding (2020: 55.8%), with wholesale borrowings continuing to reduce over the year.

At 30 September 2021 the proportion of easy access deposits, which are repayable on demand, was 24.1% of total on-balance sheet funding (2020: 16.8%). This increase is partly a result of market sentiment with savers reluctant to commit funds to term deposits in a low rate environment, and partly as a result of the Group's maturing liquidity policy. This percentage remains low compared to the rest of the banking sector and can be expected to rise going forward.

With the generally uncertain economic outlook, the Group has maintained a cautious approach to liquidity in the period. Some loosening of policy took place in the period in response to the gradual opening up of the UK economy, but at the end of the year the Group still had £1,236.5 million of cash available for liquidity and other purposes (2020: £1,701.1 million). The Group's contingent liquidity policy will be kept under review as the ultimate outcome of the Covid crisis becomes clearer and longer-term trends become more evident, but the Group intends to maintain a conservative approach.

The Group's long-term funding strategy, following the granting of its banking licence in 2014, has been to move to using retail deposits as its primary funding source, using the debt markets on an opportunistic basis for additional funding requirements.

The Group's progress towards this goal is illustrated by the chart below which shows, at each of the financial year ends since 2015, the outstanding funding balance by type.



The Group's response to the withdrawal of the London Interbank Offered Rate ('LIBOR'), due at the end of the calendar year, is well progressed. While the London Interbank Offered Rate ('LIBOR') had been the principal benchmark rate used by the Group, a transition to other, risk-free rates, notably rates linked to the Sterling Overnight Index Average ('SONIA'), has been ongoing for more than two years.

No new LIBOR-linked derivative contracts have been entered into since February 2020 and remaining LIBOR-linked derivatives will transition to SONIA in accordance with the International Swaps and Derivatives Association ('ISDA') protocol. Meanwhile, all the Group's LIBOR-linked borrowings have either been retired, transitioned or have an agreed transition process in place.

A transition process for the Group's principal LIBOR-linked asset class, legacy buy-to-let mortgages, was communicated to customers and completed in the second half of the year. Other LIBOR-linked assets have either been transitioned, have an agreed transition methodology or are expected to fall due before the LIBOR transition date. Overall, the Group considers that it is well placed to meet the withdrawal deadline of 31 December 2021.

A4.2.1 Retail funding

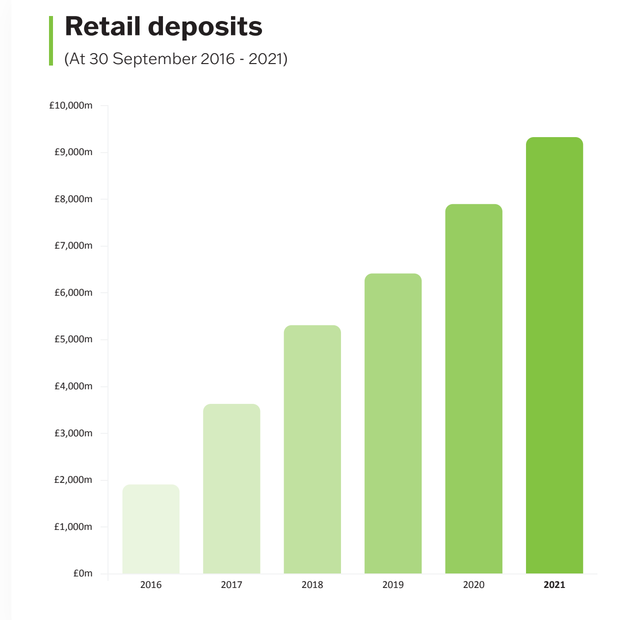
The Group considers the retail deposit market to be a reliable, scalable and cost-effective source of funding, which has remained fully functional throughout the Covid crisis. The Group's offering has been centred on sterling household deposits, although it began to access the SME sterling deposit market in the year.

A variety of products are offered, including term deposits, ISAs and easy access accounts and the business accesses the market through a variety of in-house and external channels. The proposition is based on competitive rates and value for money, combined with the Group's strong customer service ethic and the protection provided to depositors by the Financial Services Compensation Scheme ('FSCS').

The retail deposit market in the UK is large, deep and well developed. During the year UK household savings balances reported by the Bank of England continued to increase with balances at 30 September 2021 reaching £1,402.5 billion (2020: £1,287.9 billion), an increase of 8.9% in the year. This has resulted from increased saving by consumers during the pandemic and has also depressed market interest rates. Some of this increase may be reversed as the UK economy returns to a more normal footing, but as a small participant the Group is less likely to be affected by this than larger banks and building societies.

The Group's retail deposit franchise has continued to perform strongly in the year with a reduced funding cost, reflecting improvements in the business process, increased channels to market and downward market pressures on rates.

The growth of the retail funding balance over recent years is set out below.



Savings accounts at the financial year end are analysed below.

	Average interest rate		Proportion of deposits	
	2021	2020	**2021**	2020
	%	%	**%**	%
Fixed rate deposits	**1.25%**	1.69%	**58.8%**	63.3%
Variable rate deposits	**0.42%**	0.72%	**41.2%**	36.7%
All balances	**0.91%**	1.34%	**100.0%**	100.0%

The average initial term of fixed rate deposits was 26 months (2020: 27 months). Market savings rates in the year have remained at historically low levels, with the Bank of England quoting average interest rates at 30 September 2021 for new 2-year fixed rate deposits at 0.46% (2020: 0.48%) and for instant access balances at 0.10% (2020: 0.07%).

During the year the Group has grown its business both through a focus on its in-house channel and through expanding its offering across other third party platforms. Significant infrastructure investment in the Group's new Mambu platform has enabled the number of external channels where the Group has a presence to be expanded while embedding a strong control environment, providing an effective and efficient service and offering future digital optionality.

Offerings through these channels, which include investment platforms and savings marketplaces operated by digital banks, provide access to a different customer demographic to the Group's mainstream customers. This more diversified sourcing offers enhanced opportunities to manage inflows and costs. The Group has added three new relationships in the period, including one with Aviva Savings, bringing the total to seven. These channels now represent around 12% of the total deposit base and the system investment in the year gives the Group capacity to expand further in this area.

The Group regards the quality of its customer service as a vital component of its savings market strategy and conducts insight surveys throughout the customer journey. In this research 88% of customers opening a savings account with the Group in the year who provided data, stated that they would 'probably' or 'definitely' take a second product (2020: 88%). The NPS in the same survey was +58, similar to that in the previous year (2020: +61).

When customers with maturing savings balances in the year were surveyed, 89% stated that they would 'probably' or 'definitely' consider taking out a replacement product with the Group (2020: 90%) with an NPS at maturity of +52, slightly increased from the 2020 financial year (2020: +50).

These positive responses demonstrate the quality of the Group's customer interaction operations, which support its efforts to retain customers and deposits in the current active and competitive market. This has been enhanced in the year with additional functionality on the Group's website, such as automated password resets, introduced in response to customer feedback.

This level of customer satisfaction is also demonstrated by the Group's continuing success in industry awards. During the year awards won included 'Best Internet Account Provider' at the 2021 Moneyfacts Awards, 'Best Cash ISA Provider' at the 2021 YourMoney awards, 'ISA Provider of the Year' at the 2020 MoneyAge awards, 'Best Notice Savings Provider' at the 2021 Moneynet awards, 'Best Easy Access Savings Provider' and 'Best Easy Access Cash ISA Provider' in the MoneyComms 2021 Top Performers list and 'Best Cash ISA Provider' in the 2021 Savings Champion Awards.

Both aspects of the Group's savings infrastructure, its outsourced deposit administration system and its infrastructure supporting external savings platforms, continue to provide a solid and scalable operating model for the business. Service standards and customer satisfaction have been maintained despite the effects of ongoing Covid restrictions, and servicing resources have continued to develop with the business.

The retail deposit funding stream provides a stable principal funding base for the Group's operations where volumes and rates can be effectively and flexibly managed. The operation will continue to develop on a strategic basis, expanding its offerings, addressing wider demographics and expanding its presence on third party platforms.

This increasing diversification and the FSCS guarantee are likely to reduce the potential for liquidity impacts and the Group's profiling of its target customers suggests they may be more resilient than average in the event of future economic stresses.

A4.2.2 Central bank facilities

The Bank of England Term Funding scheme for SMEs ('TFSME') continued to be available throughout the year to support lenders in providing credit to SME customers through the Covid pandemic. The Group has continued to draw on these funds to support its lending, particularly in its SME lending and development finance businesses.

During the year the Group's drawings under TFSME increased to £2,750.0 million (2020: £910.0 million). As TFSME provides funding at or very close to base rate, it is a particularly cost-effective form of borrowing for lenders which, like the Group, wish to support their SME customers through the economic uncertainties of the pandemic. Shortly after the year end the Group repaid and redrew all of its TFSME borrowings, extending the maturities.

Drawings under the Bank of England's original Term Funding Scheme ('TFS') which were due to mature in the current financial year began to be retired early during the period, improving the maturity profile of the Group's borrowings. At 30 September 2021 the remaining TFS borrowings provide £69.0 million of the Group's funding (2020: £944.4 million), but will be repaid in the early part of the new financial year. The Group retains access to other Bank of England funding channels but did not utilise them in the year.

The Group expects to continue to make use of these facilities going forward, in accordance with the objectives of the schemes. Where using them is appropriate and cost-effective, mortgage loans pre-positioned with the Bank of England are available to act as collateral for future drawings, if and when required. This provides access to potential liquidity or funding of up to £1,424.2 million (2020: £684.0 million).

A4.2.3 Wholesale funding

The Group's wholesale funding includes securitisation funding, warehouse bank debt and retail and Tier 2 corporate bonds, which are each accessed from time to time as appropriate. The Group's Long-Term Issuer Default Rating was affirmed at BBB by Fitch in March 2021, with the outlook upgraded from negative to stable, reversing the change which was applied to all the major UK banks during 2020 as a result of the Covid crisis.

During the year capital markets remained active, with activity in most areas of funding. The securitisation markets remained open, but with most volume driven by those lenders without access to central bank facilities.

Wholesale pricing has been attractive for issuers, with strong demand for new issuance. Against this backdrop the Group issued a £150.0 million Tier-2 Green Bond in March 2021. This was the first issuance certified under the Group's Green Bond Framework, approved in March 2021, which sets out how the proceeds of the bond will be applied, and which is available on the Group's website at www.paragonbankinggroup.co.uk.

The new bond carries an interest rate of 4.375%, fixed for five years, and will count in full towards tier 2 capital for a five year period. It was rated BB+ by Fitch on issue. This interest rate represents a considerable saving on the Group's previous Tier 2 bond, issued in 2016, which bore interest at 7.25% per annum.

The majority of the Group's £150.0 million 2016 Tier-2 Bond was acquired by the Group in a tender process during March 2021. The remainder was redeemed at the call date in September 2021.

These bond transactions reduce overall funding costs and place the Group's tier 2 capital position on a longer-term footing, as well as accessing the green bond market.

Historically the Group has been one of the principal issuers of UK residential mortgage backed securities ('RMBS'), however its reliance on this funding source has been significantly reduced over recent years, with the most recent issuance held internally rather than issued in the market.

The Group's four mature legacy securitisation transactions were refinanced during the period. An agreement was also reached in the period to transition the only other LIBOR-linked deal, Paragon Mortgages (No. 25) PLC, from its interest payment date in February 2022. These transactions benefit the Group's overall long-term funding position by releasing cash collateral; removing LIBOR-linked liabilities ahead of transition; crystallising derivative positions, thereby reducing the Group's TRE for capital purposes; and releasing loan assets for use in creating eligible securities which can be used to access TFSME and other forms of funding.

A fully-retained securitisation transaction, Paragon Mortgages (No. 28) PLC was completed in the year. In this transaction £703.1 million of rated notes were issued to group companies, to be used as collateral in other funding transactions, such as TFSME. This repeats the structure of Paragon Mortgages (No. 27) PLC, issued in 2020.

The Group renegotiated its £400.0 million warehouse funding facility during the period reducing the interest margin from 1.05% above LIBOR to 0.60% above LIBOR. This facility is used to provide standby capability, particularly in the event of market disruption elsewhere, where funds need to be deployed rapidly or as an alternative to retail deposit funding for liquidity purposes. After the year end this facility was extended to £450.0 million and the interest rate was transitioned to 0.50% over SONIA. These changes will make this funding more cost effective and practical going forward.

The Group's retail bond issued in 2013 was repaid at maturity in December 2020. The Group also entered into sale and repurchase transactions from time to time, to ensure it retains access to this channel for liquidity purposes.

Overall, these initiatives reduced the Group's dependency on legacy securitisation debt, lowered funding costs, facilitated LIBOR transition, and increased average remaining maturities for its other borrowings. This demonstrates the adaptability of the Group's wholesale funding activities and the Group will continue to access all these funding sources on a strategic and opportunistic basis as appropriate.

A4.2.4 Funding outlook

The year has seen growth in the Group's savings franchise, while the tenor of its wholesale and central bank borrowings has been extended, with the average cost of funding reduced and the green finance market accessed for the first time.

This has been consistent with the Group's funding strategy developing and enhancing its access to funding sources while maintaining its principal focus on the retail savings market. The Group is well placed to maintain this diverse, robust and adaptable strategy going forward, which will support the needs of its developing business into the future.

Further information on all the above borrowings is given in notes 26 to 31.

A4.3 Capital

The Group's capital policy is designed to provide appropriate returns to shareholders, preserve the strength of its balance sheet, maintain strong regulatory capital and liquidity positions to safeguard its depositors and to ensure sufficient capital is available to meet strategic objectives and opportunities going forward. The safeguarding of this capital strength has been a fundamental objective of the Group's ongoing Covid response.

This enabled the Group to return to a more normal approach to capital and distributions in the year ended 30 September 2021, with an interim dividend declared and share buy-backs undertaken. The Group's position was also enhanced by a favourable result from the most recent regulatory review of its capital position, which reduced its requirement to hold regulatory capital.

For regulatory purposes the Group's capital comprises shareholders' equity and its Tier-2 green bond. It has no outstanding Additional Tier-1 ('AT1') issuance, but has the capacity to issue such securities, if considered appropriate, under an authority granted by shareholders at the 2021 Annual General Meeting ('AGM'), which will be proposed for renewal at the 2022 meeting.

A4.3.1 Regulatory capital

The Group continued to maintain strong regulatory capital ratios throughout the year, with capital balances having grown as a result of its prudent approach to capital management through the Covid pandemic. During the period the Prudential Regulation Authority ('PRA') conducted a supervisory review of the Group's capital requirements, based on the Internal Capital Adequacy Assessment Process ('ICAAP') analysis. The results of this review were very positive, with the regulator significantly reducing its capital requirement based on its assessment of the Group's risk exposures and management systems.

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 a Total Capital Requirement ('TCR') setting an amount of regulatory capital, defined under the international Basel III rules, currently implemented through the EU Capital Requirements Regulation and Directive regime ('CRD IV'), which was transposed to the PRA Rulebook as part of the Brexit arrangements.

The TCR includes elements determined based on the Group's total risk exposure together with fixed elements, and is held in order to safeguard depositors in the event of severe losses being incurred by the Group.

As a matter of strategy, the Group maintains strong capital and leverage ratios. It was granted transitional relief on the adoption of IFRS 9, along with most other banks, with additional relief granted in 2020 for the impact on capital of provisions created in response to the Covid pandemic.

The PRA requires firms to disclose capital measures both on the regulatory basis and as if these reliefs had not been given, referred to as the 'fully loaded' basis.

The Group's principal capital measures, CET1 and Total Regulatory Capital ('TRC'), are set out below on both bases.

	Regulatory basis		Fully loaded basis	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Capital				
CET1 capital	**1,055.8**	991.2	**1,026.1**	948.9
Total Regulatory Capital ('TRC')	**1,205.8**	1,141.2	**1,176.1**	1,098.9
Requirement				
TCR	**604.2**	749.6	**601.8**	745.3

As the value of IFRS 9 reliefs will taper over time, the difference between measures on the regulatory and fully loaded bases will narrow and eventually converge.

The Group's CET1 capital comprises its equity shareholders' funds, adjusted as required by the CRD IV rules and can be used for all capital purposes. TRC, in addition, includes tier-2 capital representing the Tier-2 Bonds. This tier-2 capital can be used to meet up to 25% of the Group's TCR. The increase in capital over the year is a result of the positive trading performance, which outweighed the impact of dividend payments and share buy-backs in the period.

The TCR is specific to the Group and is set by the regulator, based on its supervisory reviews. The reduction in TCR on both the regulatory and fully loaded bases shown above has arisen principally as a result of the successful outcome of the most recent review process.

This saw the TCR on both bases reduced to 8.9% of TRE from 10.8% of TRE at 30 September 2020, compared to the minimum TCR allowed under the Basel III framework of 8.0%. This represents a significant benefit to the Group's capital management and reflects the maturity of the Group's systems for the management of capital and risk.

CET1 capital must also cover the CRD IV buffers, the Counter-Cyclical ('CCyB') and Capital Conservation ('CCoB') buffers. These apply to all firms and are based on a percentage of total risk exposure. The CCoB remained at 2.5%, its long-term rate, throughout the year (2020: 2.5%), while the UK CCyB remained at 0.0% (2020: 0.0%), having been reduced from 1.0% during 2020 as a regulatory response to the pandemic. However, it has been stated by the Financial Policy Committee of the Bank of England that the long-term standard rate of the CCyB will be 2.0% and this requirement for additional capital in the future has been factored into the Group's capital planning.

CET1 capital required to cover CRD IV buffers therefore reduced to £170.9 million at the year end on the regulatory basis (2020: £173.7 million).

Further buffers may be set by the PRA on a firm-by-firm basis but cannot be disclosed.

The Group's capital ratios, after allowing for the proposed dividend for the year, are set out below.

	Basic		Fully loaded	
	2021	2020	**2021**	2020
CET1 ratio	**15.4%**	14.3%	**15.1%**	13.7%
Total capital ratio	**17.6%**	16.4%	**17.3%**	15.9%
UK leverage ratio	**7.5%**	7.1%	**7.3%**	6.8%

All of the Group's capital ratios show strong improvement over the period, despite the resumption of distributions to shareholders. This reflects the trading profits, including a reduction in Covid-based impairment provisions, a gain on the pension scheme liability and reductions in risk weighted asset values following the repackaging of legacy securitisations.

The Basel Committee on Banking Supervision ('BCBS') has set the implementation date for its revisions to the Basel III framework as 1 January 2023. This is, however, subject to those revisions being enacted in the relevant jurisdiction. Following the UK's exit from the EU, these rules are expected to be enacted for UK banks through the PRA Rulebook. The PRA has also launched a more extensive consultation on its approach to regulating non-systemically important banks without international activities. The Group is monitoring these developments and will respond through its capital planning as appropriate.

The Group submitted the second stage of its application for the accreditation of its IRB approach to buy-to-let credit risk for capital adequacy purposes to the PRA in March 2021. The project continues to progress to plan, and work continues into the new financial year on both the buy-to-let portfolio and development finance lending, which represents the next step in the Group's IRB roadmap.

A4.3.2 Liquidity

It is Group policy to hold sufficient liquidity in the business to meet 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. This policy has a consequent effect on the Group's operational capital and funding requirements.

The Board regularly reviews liquidity risk appetite and closely monitors a number of key internal and external measures. The most significant of these, which are calculated for the Paragon Bank regulatory group on a basis which is standardised across the banking industry, are the Liquidity Coverage Ratio ('LCR') and Net Stable Funding Ratio ('NSFR').

The LCR measures short-term resilience and compares available highly liquid assets to forecast short-term outflows, calculated according to a prescribed formula, with a 30 day horizon. The monthly average of the Bank's LCR for the period was 165.6% compared to 173.7% during the 2020 financial year. The reduction is a liquidity policy response to the reduction in Covid-related impacts to the business and in the wider economy.

The NSFR is a longer-term measure of liquidity with a one year horizon, supporting the management of balance sheet maturities. At 30 September 2021 the Bank's NSFR stood at 119.6% (30 September 2020: 114.7%), reflecting the strengthening of the overall funding and capital position over the year.

A4.3.3 Dividends and distribution policy

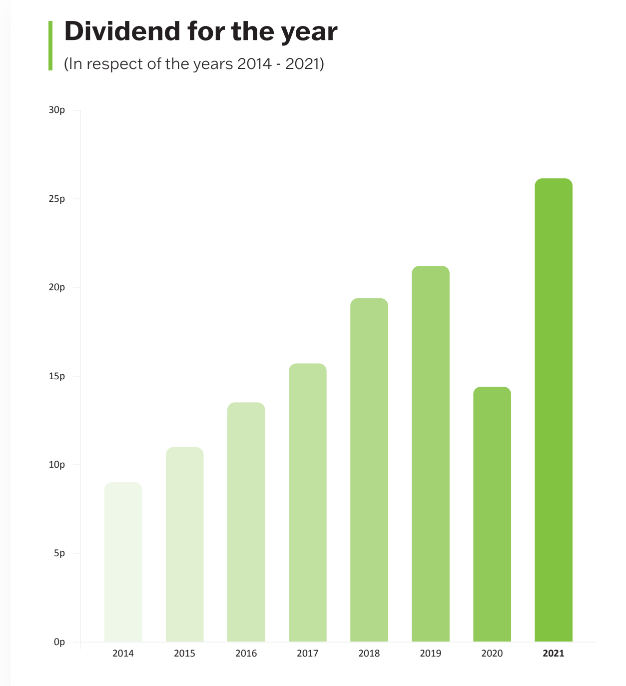
The Group's distribution policy over recent years has been based on the objective of enhancing shareholder returns on a sustainable basis, while protecting the capital base. In order to achieve this, its stated policy has been to distribute 40% of consolidated earnings to shareholders in ordinary circumstances, achieving a dividend cover ratio of approximately 2.5 times. It has also undertaken buy-backs of shares in the market from time to time as part of its management of overall capital, where these enhance shareholder value.

The Group managed its capital cautiously through the pandemic and accumulated a capital and cash surplus over its requirements, including its regulatory requirements, to the level that it was considered appropriate to resume distributions to its shareholders, both in the form of dividends, and in a share buy-back, addressing the needs of different investor groups.

An interim dividend for the year of 7.2 pence per share (2020: nil pence per share) was paid in July 2021 and the Board is proposing, subject to approval at the AGM on 2 March 2022, a final dividend for the year of 18.9 pence per share (2020: 14.4 pence per share). This would give a total dividend of 26.1 pence per share (2020: 14.4 pence per share). This dividend would be in line with the stated policy, giving a dividend cover of 2.50 times (2020: 2.50 times).

The 81.3% increase in total dividend from 2021 reflects the increase in group earnings, including the impact of Covid-related impairment provisions made in 2020 reversing in the current year, which effectively deferred dividend to 2021. The 2021 dividend is also inflated by the high level of fair value gains in the year, which would not necessarily be repeated in a future year. Care must therefore be taken in extrapolating future dividend levels from the current year dividend alone.

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



The directors have considered the distributable reserves and available resources of the Company and concluded that the proposed dividend is appropriate.

In addition, the Board authorised a buy-back of up to £40.0 million of shares in the market, initially to be held in treasury. The Group has the authority to make such purchases under a resolution approved by shareholders at the AGM in February 2021. £37.5 million (excluding costs) was expended during the year on the buy-back programme, and it is the Board's intention to complete the programme following the announcement of the annual results.

As part of its review of the Group's capital and dividend policy following the completion of its annual results and the financial forecasts for the coming period, the Board concluded that a further buy-back programme of up to £50.0 million, initially to be held in treasury, was appropriate, and this will commence following the completion of the initial £40.0 million. In this way, the Group seeks to balance the expectations of different investor groups, while maintaining a strong capital position.

Any purchases made under these programme will be announced through the Regulatory News Service ('RNS') of the London Stock Exchange on the day of the transaction.

The Board has affirmed the existing dividend policy going forward, subject to an assessment of prevailing conditions at the time, but noted that, given the unusual factors affecting the 2021 distribution, any interim dividend declared for 2022 would not necessarily bear the normal relation to the preceding final distribution.

A4.3.4 Capital outlook

The Group's current and forecast capital position is kept under regular review, in light of the level and form of capital demanded by current business, regulatory and economic conditions, as well as the Group's strategic objectives.

The capital and liquidity position of the Group had strengthened through the year. The Group's operations increased the capital balance, the Tier-2 issuance has been replaced at a lower cost and the positive result of the regulatory review of the Group's capital management systems has resulted in a lowering of the minimum capital requirement.

The Group ends the year well capitalised, even after the resumption of distributions to shareholders in the form of dividends and buy-backs, and allowing for the return of CCyB requirements and withdrawal of IFRS 9 reliefs in the longer term. This position is both prudent and sustainable and helps ensure the viability of the business for the benefit of all stakeholders.

A4.4 Financial results

The Group's trading performance before impairment charges in the year ended 30 September 2021 highlights the level of progress towards its strategic objectives, in spite of the impact of the Covid pandemic on the UK economy and the necessary steps taken to address this. Income and margins both increased, generally in line with expectations.

As the UK economy began to open up towards the end of the year, and the level of the effectiveness of the UK's vaccination programme became evident, the assumptions underlying the Group's impairment provisioning were revisited, resulting in a release of provision. However the Group remains well provided in the face of what remains an uncertain economic outlook.

These factors leave the Group's results significantly improved, year-on-year, with underlying profit (Appendix A) for the year, at £194.2 million, 61.8% higher than for the preceding twelve months (2020: £120.0 million), with a provision release of £4.7 million (2020: charge of £48.3 million), unwinding some of the previous year's Covid-related impacts. On the statutory basis, which also includes the impact of fair value gains on hedging, profit before tax increased 80.5% to £213.7 million, the largest pre-tax profit the Group has ever recorded (2020: £118.4 million).

Earnings per share increased by 81.1% to 65.2 pence (2020: 36.0 pence) on the statutory basis, and by 62.5% to 59.3 pence excluding the effect of the fair value gains (2020: 36.5 pence) (Appendix A).

A4.4.1 Consolidated results

Consolidated results

For the year ended 30 September 2021

	2021	2020
	£m	£m
Interest receivable	**484.2**	491.7
Interest payable and similar charges	**(173.7)**	(213.6)
Net interest income	**310.5**	278.1
Net leasing income	**3.5**	3.0
Other income	**10.9**	14.0
Total operating income	**324.9**	295.1
Operating expenses	**(135.4)**	(126.8)
Provisions for losses	**4.7**	(48.3)
	194.2	120.0
Fair value net gains / (losses)	**19.5**	(1.6)
Operating profit being profit on ordinary activities before taxation	**213.7**	118.4
Tax charge on profit on ordinary activities	**(49.2)**	(27.1)
Profit on ordinary activities after taxation	**164.5**	91.3

	2021	2020
Dividend – rate per share for the year	**26.1p**	14.4p
Basic earnings per share	**65.2p**	36.0p
Diluted earnings per share	**63.0p**	35.6p

Income

The Group's total operating income in the year increased by 10.1% to £324.9 million (2020: £295.1 million). Net interest income increased in the year by 11.7% to £310.5 million (2020: £278.1 million). Part of this increase was a result of growth in the average loan book in the year, 4.9% higher at £13,017.0 million (2020: £12,408.7 million) (Appendix B), but the business also generated a 15 basis point increase in net interest margin ('NIM') for the year.

NIM in the year ended 30 September 2021 was 239 basis points (2020: 224 basis points) (Appendix B). Each of the Group's segments showed improved NIM in the period as a result of yield management activities in the business areas, coupled with tighter funding costs.

Excluding the impact of the declining Idem Capital business, NIM increased by 19 basis points, from 209 basis points in 2020, to 228 basis points in the current year.

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

	Total	Excluding Idem Capital
	Basis points	Basis points
Year ended 30 September		
2021	**239**	**228**
2020	224	209
2019	229	192
2018	219	153
2017	213	141

Other operating income was £14.4 million for the year, with the reduction from the £17.0 million reported in 2020 principally representing a reduction in income from non-core servicing contracts.

Costs

The Group's operating expenses for the year were £135.4 million, increasing by 6.8% year-on-year (2020: £126.8 million). The majority of the increase is attributable to charges for share-based payments (including related National Insurance ('NI') provision) which increased by £8.7 million, following a low charge in 2020 when Covid impacted on vesting expectations and depressed the Group's share price, on which the NI provision calculation is based.

The Group's average number of employees increased to 1,426 for the period, an increase of 2.9% over 2020 (2020: 1,385), generating an increase in non-share-based employment costs of 3.0%.

Costs unrelated to employment reduced in the year. The administration cost of the Group's outsourced savings deposits is determined by reference to the balance outstanding and increased by £0.5 million in the year, as a result of the 18.4% year-on-year growth in the Group's savings balance. These increases were offset by reductions in other areas, including travel and accommodation and office running costs, which reflect the direct impacts of the pandemic and of the associated lockdowns through much of the year.

Despite the impact of Covid, the Group has continued to invest in the development of systems to improve customer service and operational efficiency. Significant improvements were delivered to capabilities in the retail deposit business and new functionality was introduced to the SME lending business.

Much of the Group's IT systems and infrastructure development is carried out by its experienced in-house resource, and the Group has therefore tended to capitalise less software than might be seen elsewhere in the sector, with more costs being taken immediately to profit. During the period £0.7 million of software was capitalised (2020: £1.0 million).

The Group's IRB project made further progress through the period, with the second stage of the application for buy-to-let submitted in March 2021. Costs for the year include expenditure of around £1.3 million on this project, relating to both internal resources and external advice.

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

	Underlying	Idem excluded	Statutory
	%	%	%
Year ended 30 September			
2021	**41.7**	**42.8**	**41.7**
2020	43.0	44.9	43.0
2019	42.1	48.5	40.7
2018	40.6	54.2	37.8
2017	40.5	55.6	40.5

Cost: income reduced in the year as a result of income rising faster than costs, as described above.

The Group considers that the ongoing management of costs is key to the achievement of its operational strategy and seeks to enhance cost-effectiveness from efficiencies and scale, with targeted investment in people and systems. However, the costs of these investments, coupled with new business initiatives and increasing regulatory expectations mean that the achievement of a sustainably lower ratio is a longer-term goal.

Impairment provisions

The Group's Expected Credit Loss ('ECL') evaluation at the year end has resulted in a net release of impairment provision for the year of £4.7 million (2020: charge of £48.3 million). This movement arises from a careful consideration of the factors impacting the Group's loan portfolio, including the progress and impact of the Covid pandemic, both generally and on particular customers, and requires a significant exercise of judgment.

The progress of the impairment charge and cost of risk in the three years since the introduction of IFRS 9 in 2019 is set out below.

	(Release) / charge	Cost of risk
	£m	%
Year ended 30 September		
2021	**(4.7)**	**(0.04)**
2020	48.3	0.39
2019	8.0	0.07

The high level of provisions in 2020 arose as the initial impact of the Covid pandemic was recognised, attempting to represent a weighted average expected loss based on many plausible outcomes of significantly varying severity. This exercise was skewed by the natural asymmetry of provision for secured lending – increased stress will, on average, increase loss more than decreased stress reduces it.

The ongoing development of the pandemic since 30 September 2020 has differed, to a greater or lesser degree, from the scenarios advanced by commentators at the year end, but has generally been more benign, particularly following the rollout of the UK vaccination programme.

To date, little of the provision established at the previous year end has been utilised in writing off defaulted accounts, nor have arrears or enforcement actions generally seen significant increases. However, credit issues, some significant, have been identified with a small number of customers and the Group remains cautious on the future prospects of those loans for which provision is being carried. Support schemes from the UK Government, including furlough support to households and businesses, remain in place and, as at 30 September 2021, levels of CBILS and BBLS loans where customers have so far been required to make repayments have been low. This means that significant uncertainty as to the future behaviour of both directly and indirectly supported customers still exists.

At 30 September 2021, therefore, the Group had to consider whether sufficient hard evidence of both customer performance and a sustainable improvement in UK macro-economic conditions was available to justify a reduction in provision levels, and whether factors existed that suggested that its statistical impairment models might not be able to fully interpret current economic conditions.

Payment holidays and outcomes

The Group offered payment relief to a significant number of its customers during the initial period of the pandemic. Most of these came to an end before the previous year end on 30 September 2020, but some continued into the current financial year. By 30 September 2021, the number of the Group's customers remaining on these arrangements was minimal, with the requirement to make monthly payment arrangements back in place.

The post-relief behaviour in the Group's principal class, buy-to-let mortgages, at 31 October 2021 is summarised in the table below. This highlights, separately for accounts which did not receive payment holidays, those which received a single three month relief and those which had extended relief, the relative change between the October 2021 arrears position and the 29 February 2020, pre-Covid position.

	No relief	Single relief only	Extended relief	Total
	£ billion	£ billion	£ billion	£ billion
Balance	9.24	1.39	0.74	11.37
Proportion	81.2%	12.2%	6.6%	100.0%
% with arrears deterioration	0.3%	0.8%	5.2%	0.7%
% with arrears improvement	0.4%	0.9%	7.1%	0.9%

Whilst the overwhelming majority of accounts which had been granted relief have since returned to a fully paying status, there has been materially more arrears volatility amongst those loans where extensions were granted, both worsening and improving. This generally increased level of volatility for the portfolio has resulted in management identifying such accounts as, on the whole, riskier than average and transferring accounts with extended payment holidays from Stage 1 to Stage 2 for impairment purposes.

Performance across the books has been generally strong, with arrears metrics and loss experience broadly in line with pre-pandemic experience, while external credit measures, such as credit bureau information have also remained positive. However, due to government interventions and lender forbearance across the sector, it is unclear whether these measures are fully representative of underlying credit quality.

From the Group's customer surveys and interactions with its customers it is clear that while many customers may have taken payment reliefs for precautionary reasons, these accounts may have been able to perform due to external support. Examples of this might include tenants of buy-to-let landlords accessing furlough payments to meet rent demands and SME customers using drawings under CBILS and BBLS schemes to meet day-to-day payments. These reliefs would still have an impact at the end of the financial year, but have a limited time scale and the current level of performance may not be fully representative of the true underlying credit position.

As a result, management have maintained the approach of critically assessing the outputs of business as usual provisioning methodologies to ensure all elements of credit quality in the portfolio are adequately addressed. This approach has been taken throughout the Covid crisis and has resulted in substantial overlays to model outputs.

Multiple economic scenarios and impacts

While there is somewhat more consensus on the likely direction than at the previous year end, the setting of economic scenarios for the purposes of IFRS 9 remains complex. The broad thrust of economic data for the UK over the past six months has been positive, but this has been in a period where government interventions have continued and there is continuing uncertainty over the direction the economy will take once these begin to be withdrawn, with potentially radically different medium term outcomes.

The approach to setting economic scenarios for IFRS 9 impairment at 30 September 2021 is broadly aligned to that used at the half year. The Group has adopted a two-part approach:

- The three main scenarios, central, upside and downside, were derived as they would be at a 'normal' year end with the central scenario based on public forecasts and the upside and downside scenarios more benign or severe variants of this. This follows the general sentiment towards the UK economy, assuming a continuation of the easing of Covid restrictions and no significant impact from a new wave of infections.
- The severe scenario has been set to represent a potential negative outturn, either for the economy, for the pandemic, or for both. This is largely based on the Bank of England's stress testing scenarios, but with a less optimistic outlook on house prices, the variable which has the most significant impact on the value of the Group's ECLs. This scenario models a radically different future course for the UK, which is plausible and potentially has a very different impact on the Group's customers.

The weightings applied to each scenario have been held at those used at both 30 September 2020 and 31 March 2021, in the light of the continuing economic uncertainty described above.

The forecast economic assumptions within each scenario, and the weightings applied, are set out in more detail in note 18.

To illustrate the impact of these scenarios, the impairment provision at 30 September 2021 before post model adjustments ('PMA's) has been recalculated, weighting each of the central scenario and the severe scenario at 100%, with the results shown below.

	Provision before PMAs	Cover ratio
	£m	%
Weighted average	46.0	0.34%
Central scenario	33.3	0.25%
Severe scenario	86.7	0.64%

The level of provisions calculated by the Group's models are lower than might be expected, given the economic conditions. The Group has therefore considered the extent to which this is due to weaknesses in the modelling approach, and should be corrected by PMAs.

Post-model adjustments

It is important to note that the impairment model focusses principally on the impact of future economic changes on the portfolio. Where accounts are currently only being kept from defaulting by external short-term support measures they may still default when these are removed, despite an improved economic climate. The models may also fail to fully allow for longer-term damage caused to particular industries or customers' businesses by the pandemic.

It is also clear that positive movements in economic indicators such as house prices, unemployment and UK Gross Domestic Product ('GDP'), both in actual and forecast terms have had a positive impact on the modelled outputs for cases benefitting from support measures without any broader evidence of improvement in the underlying credit quality of the customer balances being available.

Therefore the Group applies PMAs, based on its experience and its understanding of current customer positions, to allow for the potential for losses in such cases not being identified by the modelling approach.

In order to size the requirement for PMAs across the loan book the Group has considered, on a portfolio-by-portfolio basis the extent to which modelled provisions diverge from long-run experience and the appropriateness of such differences given the underlying economic environment at the period end. All available external information on general customer performance was analysed and the impact of the potential take-up of government support and other reliefs was assessed. The Group also considered whether there were any issues of post-Covid scarring applying to any particular industry.

Notwithstanding this data analysis, the Group considered the potential for apparently well-performing accounts to default, for the reasons set out above, applying the market understanding and credit judgement of its experienced team. The SME lending business was a particular area of focus, given the prevalence of CBILS / BBLS funding in the customer base and the identification of potential credit issues on certain large exposures.

The PMAs generated by this process, analysed by division are set out below.

	2021	2020
	£m	£m
Mortgage Lending	**8.9**	14.0
Commercial Lending	**10.2**	5.8
Idem Capital	**0.3**	-
	19.4	19.8

These broader assessments were then allocated amongst accounts, focussing on higher risk segments, or accounts where sufficient data existed to identify any issues. Any accounts identified as being at significant risk by the PMA process were restaged appropriately.

The PMAs described above align the overall reported provision with current loss expectations, given the inherent uncertainties on a macro and micro level and based on the Group's internal monitoring of credit risk and customer contact metrics. The Group maintains a cautious approach and will require evidence as to customer behaviour once government interventions are scaled back, before moving scenario weightings to more normal levels and revising PMA methodologies so that actual emergent behaviour is reflected.

Ratios and trends

The impact of the economic scenarios adopted, together with PMAs adopted to address uncertainties over the future performance of accounts, particularly those which may have had payment relief or other government-backed support during the pandemic, has resulted in the overall provision amounts and coverage ratios set out below.

	2021	2020	2019
	£m	£m	£m
Calculated provision	**46.0**	62.0	41.9
PMAs	**19.4**	19.8	-
Total	**65.4**	81.8	41.9
Cover ratio			
Mortgage Lending	**0.30%**	0.44%	0.26%
Commercial Lending	**1.74%**	1.85%	0.73%
Idem Capital	**1.27%**	1.62%	1.12%
Total	**0.49%**	0.64%	0.34%

These ratios demonstrate the movement in the Group's overall provisioning back towards more normal levels, without yet reaching the 0.34% coverage ratio seen pre-pandemic at 30 September 2019. The extent to which coverage levels revert to these levels will depend on future performance of the UK economy and on the emergence of reliable evidence on the underlying credit quality of the Group's loan assets.

Fair value movements

The fair value movements reported in the profit and loss account are a consequence of the impact of market movements in spot and forward interest rates on valuations of derivatives held as part of the Group's hedging strategy. While all these instruments are part of economic hedging relationships, their accounting treatment can result in the recognition of substantial gains or losses, especially in periods of market fluctuation. However, the Group remains appropriately hedged.

Movements in rates in 2021 led to a gain of £19.5 million being recognised. While this is of far greater magnitude than the £1.6 million charge recognised in the year ended 30 September 2020, it is comparable in size to the charge of £15.1 million recognised during 2019. These fair value movements reflect non-cash items and revert to zero over the lives of the instruments involved. This, and the volatility of the balance, leads the Group to consistently exclude this item from its measures of underlying results.

Tax

The effective tax rate applied to the Group's profits has increased marginally from 22.9% in 2020 to 23.0% during 2021. While the standard tax rate applying to the Group remained at 19.0%, the proportion of Group profits arising in Paragon Bank and consequently attracting the banking surcharge, increased. This caused the impact of the surcharge on the effective rate to increase from 338 basis points to 454 basis points in the current year, with other timing differences representing the reconciling item to the actual charge.

The effective tax rates for both the current and preceding year have been impacted by legislation for changes in future tax rates enacted in each period, impacting on the carrying value of the Group's deferred tax assets and liabilities.

While the Group's future profitability will be affected by the increase in the basic rate of UK corporation tax to 25.0% legislated for in the year, the proposed reduction in the bank surcharge to 3.0% and the increase in the profit threshold at which it applies to £100.0 million should reduce the divergence of the Group's effective rate of tax from the standard rate.

Results

Profit before tax for the year was 80.5% higher than in 2020 at £213.7 million (2020: £118.4 million), representing the Group's highest ever annual profit. Profit after tax increased 80.2% to £164.5 million (2020: £91.3 million).

Basic earnings per share for 2021 were 65.2 pence (2020: 36.0 pence) and the diluted measure was 63.0 pence per share (2020: 35.6 pence), driven by both the increase in profit and share buy-backs in the year.

This result increased consolidated equity to £1,241.9 million (2020: £1,156.0 million), representing a tangible net asset value of £4.34 per share (2020: £3.90 per share) and a net asset value on the statutory basis of £5.03 per share (2020: £4.57 per share) (Appendix D).

A4.4.2 Assets and liabilities

Summary balance sheet

30 September 2021

	2021	2020	2019
	£m	£m	£m
Investment in customer loans			
Mortgage Lending	**11,608.7**	10,819.5	10,344.1
Commercial Lending	**1,568.8**	1,514.8	1,452.1
Idem Capital	**225.2**	297.1	389.9
	13,402.7	12,631.4	12,186.1
Derivative financial assets	**44.2**	463.3	592.4
Cash	**1,360.1**	1,925.0	1,225.4
Intangible assets	**170.5**	170.1	171.1
Other assets	**159.5**	315.7	220.5
Total assets	**15,137.0**	15,505.5	14,395.5
Equity	**1,241.9**	1,156.0	1,108.6
Retail deposits	**9,300.4**	7,856.6	6,391.9
Other borrowings	**4,451.4**	6,229.7	6,648.4
Derivative financial liabilities	**43.9**	132.4	80.5
Pension deficit	**10.3**	20.4	34.5
Other liabilities	**89.1**	110.4	131.6
Total equity and liabilities	**15,137.0**	15,505.5	14,395.5

The Group's loan portfolio grew by 6.1% during 2021, with growth in both Mortgage Lending and Commercial Lending. Balances in the Idem Capital division continued to pay down. More detail on these movements is given in Section A4.1. This increase, together with the Group's liquidity and capital policy, determines its funding requirements and hence the level of its liabilities.

Funding structure and cash resources

The Group's funding balance reduced by 2.0% during the year, despite the growth in the business, in response to the Group's cautious relaxation of the liquidity strategy put in place in response to the pandemic and the refinancing of its legacy securitisation transactions. The proportion represented by retail deposits increased to 67.6% in accordance with the Group's long-term funding strategy (2020: 55.8%). The Group's cash balance reduced by £564.9 million, partly due to a £100.1 million reduction in cash held in securitisation vehicles, following the collapse of schemes in the year, and partly due to liquidity policy. Movements in funding balances are discussed in more detail in Section A4.2.

Derivatives

The largest part of the movements in the derivative financial asset balance reflects the retirement of the Group's remaining currency denominated floating rate notes during the year and the consequent settlement of their related hedging instruments. The value of these swaps in the 2020 balance sheet was £445.3 million. These movements do not impact the Group's results.

Derivative assets used for interest rate hedging increased by £24.3 million, while derivative liabilities decreased by £88.3 million, mostly as a result of volatility in the year in market interest rate movements. These were largely offset by a £104.2 million decrease in the hedging adjustment on loans to customers, included in sundry assets above, and a £13.4 million reduction in the adjustment on retail deposits, included in sundry liabilities.

Pension obligations

The International Accounting Standard ('IAS') 19 valuation of the Group's defined benefit pension scheme deficit reduced by £10.1 million in the period. The principal factor in this reduction was the better than expected performance of the scheme assets, as world markets began to recover from losses suffered in the early stages of the pandemic. The deficit at 30 September 2021 stood at £10.3 million (2020: £20.4 million).

The Group's pension arrangements were restructured in the year to limit future exposure. However this has no impact on obligations already accrued, or their valuation.

While the valuation under IAS 19 is that which is required to be disclosed in the accounts, pension trustees generally use the technical provisions basis as provided in the Pensions Act 2004 to measure scheme liabilities. On this basis, the deficit at 30 September 2021 was estimated at £1.0 million, a reduction of £8.7 million in the period (2020: £9.7 million), representing a 99.4% funding level (2020: 93.9%).

Other assets and liabilities

Sundry assets have decreased by £156.2 million over the year. This reduction arose principally as a result of hedging transactions where movements in swap rates generated the £104.2 million movement in fair value hedging referred to above and generated a £66.9 million decrease in Credit Support Annex ('CSA') collateral deposits as a result of the increased value of derivative liabilities.

Other movements included the recognition of a current tax liability, rather than last year's asset of £5.7 million, with payments on account in the year, based on the 2020 profit, being less than the calculated tax payable; an increase of £8.6 million in mandatory CRD deposits at the Bank of England, which are calculated based on the size of the Group's deposit base; and a £4.3 million increase in property, plant and equipment, mostly related to the recognition of a right of use ('ROU') asset in respect of the lease on the Group's new London office.

Within sundry liabilities, which reduced by £21.3 million, the reduction in the fair value adjustment of £13.4 million, as referred to above, and an £11.8 million reduction in accrued investment interest payable resulting from reduced interest rates, are offset by the £1.4 million tax creditor.

A4.4.3 Segmental results

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

	2021	2020
	£m	£m
Segmental profit		
Mortgage Lending	**213.8**	154.3
Commercial Lending	**75.7**	45.9
Idem Capital	**17.1**	19.6
	306.6	219.8
Unallocated central costs and other one-off items	**(112.4)**	(99.8)
	194.2	120.0

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

Mortgage Lending

The Mortgage Lending division continued to perform strongly, with a strong lending performance, a reduction in the proportion of older, lower yielding assets and the Group's tighter overall funding costs combining to deliver a 15 basis point improvement in segmental NIM.

With the average mortgage book increasing by 6.0% in the year, this delivered a 15.4% increase in net interest to £219.2 million (2020: £190.0 million).

The Group's mortgage accounts continued to perform well in the year, generating a provision release of £5.9 million (2020: charge of £25.8 million). Despite this release, coverage levels remain in excess of pre-Covid levels, in response to the uncertainties still prevalent in the UK economy.

Overall these factors drove a 38.6% increase in segment profit for the year, to £213.8 million (2020: £154.3 million).

Commercial Lending

The contribution to profit of the Commercial Lending segment for the year was £75.7 million, rising by 64.9% year-on-year (2020: £45.9 million), with the improvement generated by improved NIM and a reduced provision charge.

The average loan balance increased by 3.9% in the year, but within this there were important mix changes, with the average development finance balance increasing by 9.1% and structured lending by 16.8%. Government-backed loans, where margins are low, had increased to form 5.3% of the portfolio by the year end.

The combination of these changes and tighter funding costs across the Group saw divisional NIM increase from 5.53% to 6.13%, delivering a 15.1% increase in net interest for the year to £94.5 million (2020: £82.1 million).

The impairment charge for the division reduced to £2.9 million (2020: £21.7 million).

While the majority of accounts in the segment have continued to perform satisfactorily, provisions have not yet been returned to pre-Covid levels of cover, particularly in the SME lending business. As discussed under 'Impairment' above, many SME customers will potentially have been in receipt of CBILS and BBLS funds or other government support for their business operations. It is therefore too early to conclude that the current positive performance is sustainable in the long-term as the impact of these interventions fades. At the same time a limited number of SME lending cases with serious credit issues have already been identified and appropriately provided for.

Idem Capital

The acquired Idem Capital loan portfolios continued to run off through the year, with no new transactions completed. As a result the average loan balance fell by 24.0%, following the trend of the previous year. Net interest decreased by 22.6%, to £20.2 million (2020: £26.1 million), as a consequence of this reduction.

While annualised NIM improved in the year to 7.74% (2020: 7.60%), reversing the long-term decline in NIM in this segment, this was principally a result of a Covid-related interest adjustment in 2020 which depressed the margin in that period. On an underlying basis NIM in the segment continues to move down as higher margin portfolios pay off more rapidly than lower margin secured assets.

The performance of the division's portfolios in the year has been satisfactory, with cash flows in line with expectations. As a result of this and the improving economic outlook an impairment provision write back of £1.7 million was recognised (2020: charge of £0.8 million).

Overall, these factors restricted the decline in the segment profit to 12.8%, with a contribution of £17.1 million to the Group result (2020: £19.6 million).

A4.5 Operations

Throughout the pandemic, while the Group's business has inevitably been affected by the impact of the virus on its people, customers and other stakeholders, and by the changing official guidance and levels of restrictions imposed in the UK, its priority has been to maintain business as usual, as far as possible. This has largely been achieved and has played a large part in both delivering the outstanding results for the period and in ensuring the Group is well placed to take advantage of the recovering economy.

It is still too early to say how the experiences of the pandemic will impact both the Group's business model and the way it operates in the longer term, but, with most of the Group's people returning to its offices for at least part of the week by the end of the year, the process of developing working models for the future is well in hand.

A4.5.1 Operations

The Group employs almost 1,450 people, with the majority normally based in its Solihull offices. However, from the onset of the Covid pandemic approximately 90% of employees worked from home.

As a result, the Group was able to continue to provide a full service to customers, intermediaries and other business partners throughout the various lockdowns, while at the same time continuing to develop the business and address issues arising from the pandemic, particularly in dealing with the transition of customers from payment reliefs back to normal payment profiles.

For the vast majority of employees, working from home continued until September 2021 when hybrid working pilots were introduced. New hires during the period predominantly joined the Group working from home, with technology-enabled induction and training plans providing them with the support they needed to start their new roles. All employees are now trialling flexible, hybrid ways of working.

The Group is proud that it has been able to continue to develop the business through new systems, processes and products despite the restrictions on contact, rather than simply mark time until the pandemic is concluded.

Instead, the year has seen the Group complete or progress a significant number of technological, operational and regulatory projects. While long-term projects to provide better technology for the development finance, SME lending and savings operations continued in the period, other important projects included enhancing the Group's cyber-security, developing its operational resilience capabilities, putting in place contingency plans in case of negative interest rates and preparing for the transition of LIBOR-linked customer accounts to alternative reference rates. Overall, the year saw more projects delivered than most recent comparable time periods.

The Group continues to envisage that its office hubs will remain important to ensure that its culture and identity can continue to grow, that collaboration is encouraged and that its peoples' sense of belonging is nurtured. To that end it was pleased to sign a lease during the period on a new, more energy efficient, central London base, bringing together its City-based staff, replacing two existing locations, and providing a venue to interface with stakeholders in the capital.

The Group has demonstrated agility and flexibility in how its resources have been deployed throughout the pandemic, with short-term secondments being introduced to support operational volumes resulting from initiatives such as payment holidays.

Throughout the pandemic the Group's strategy has focussed on customer outcomes, particularly for more vulnerable customers and it was very pleasing that the Group's Financial Ombudsman Service ('FOS') complaints data shows no significant increase in the period. The number of complaint cases reported to FOS in the six months ended 30 June 2021, the most recent reporting period, was 50 with an uphold rate of 34.0% while the number for the six months ended 31 December 2020 was 60, with an uphold rate of 43.3%.

Overall, the Group is very pleased with the way that its people and infrastructure have continued to respond to the challenges posed by the pandemic.

A4.5.2 Governance

Through most of the year the Group continued to operate on a pandemic footing, with board and committee meetings being held remotely. However in June 2021, at its annual offsite strategy conference, the Board was able to meet in person for the first time since March 2020 and resumed physical board meetings in September 2021.

The impact of the pandemic on all the Group's stakeholders has continued to be an area of significant focus for the Board and the Group's ongoing response has been thoroughly reviewed. The Group's 2021 AGM was held in February on a closed basis, in accordance with UK Government guidance and the Board was disappointed that shareholders could not be given the opportunity to attend in person. However, arrangements were made to allow shareholders to view the meeting online and they were encouraged to participate in the meeting by completing and returning their proxy voting forms. The Board is hopeful that the 2022 AGM, due to be held in March, can be conducted on a more normal basis.

Throughout the year ended 30 September 2021, the Group continued to comply with the principles and provisions of the UK Corporate Governance Code ('the Code') and more detail on the application of the Code principles by the Group is set out in section B of this Annual Report and Accounts. The Group adopted the 'comply and explain' approach under Provision 19 of the Code to extend the Chair's tenure past nine years for succession planning purposes and to ensure the appointment of a suitable replacement Chair, as set out below.

Board of Directors

Fiona Clutterbuck's nine year term on the Board, came to an end in September 2021 since she was first appointed in 2012. However, the Board and Nomination Committee considered Fiona's re-appointment beyond nine years and agreed that, in the interests of succession planning purposes and to ensure a smooth transition of duties to Fiona's successor, her appointment be extended to September 2022. Fiona will therefore stand for re-election at the Annual General Meeting in March 2022. A search process, led by Hugo Tudor, the Senior Independent Director is taking place and the results will be communicated to stakeholders once the process is complete.

As announced in the Group's 2020 year end results announcement, Finlay Williamson stepped down from the Board on 31 December 2020. Peter Hill, who was appointed to the Board on 27 October 2020, assumed the role of Risk and Compliance Committee Chair from 31 December 2020.

Peter Hill was appointed to the Board following a robust search and selection process. He was Chief Executive Officer of Leeds Building Society, one of the UK's largest building societies, from 2011 until his retirement in 2019, having previously worked in a number of senior management positions within the society. Peter is currently a non-executive director of Pure Retirement Limited and chair of its risk committee and is also chair of the board at Mortgage Brain. He brings with him a wealth of experience in financial services and a proven track record in risk oversight, gained during his executive and non-executive career.

As at 30 September 2021, the Board has three female directors, including the Chair of the Board, out of a total of eight board members, forming 37.5% of the Board.

A4.5.3 Management and people

The Group employs almost 1,450 people and during the period headcount has grown by 3.6% (2020: 1.4%), largely driven by the creation of new roles in customer facing and risk and compliance functions.

People and development

During the period the Group's priority has continued to be the wellbeing of employees and ensuring that they were provided with adequate support as the pandemic continued. The Group's Wellbeing team has played an important role in helping employees with their mental, physical, financial, and emotional wellbeing over the year through numerous initiatives. Wellbeing pulse surveys ensured that the Group continually monitored and responded to how employees were coping with the pandemic and feedback continued to reflect that employees were pleased with the quality and frequency of communications and how the Group was responding to the ongoing situation.

No employees were placed on furlough or made redundant as a result of Covid, and no use was made of the UK Government Coronavirus Job Retention Scheme in the year.

The Group conducted an employee engagement survey in June 2021, its first since December 2017; this produced a very strong set of positive indicators, including an overall engagement score of 87% (2017: 81%) and an employee net promoter score of +24 (2017: -3, industry norm: +21).

Retention of employees continues to remain high, with the attrition rate of 8.6% (2020: 10.4%) continuing to track below the national average. These high levels of retention are further bolstered by 57% of employees achieving over 5 years' service, 13% achieving over 20 years with the Group and 5% achieving over 30 years' service.

Employees continued to show flexibility during the year with many undertaking secondments to different areas of the business to ensure that the Group continued to meet the needs of its customers. Although the decision was made to close the Second Charge Mortgage business in the year, all 26 affected employees were offered alternative roles, with only a small number deciding to take voluntary redundancy.

The Group maintains its accreditation from the UK Living Wage Foundation and minimum pay continues to meet the levels set by the Foundation, while holiday entitlement for all employees was enhanced during the year.

A new performance management approach was rolled-out, removing the need for a formal annual appraisal and replacing this with more frequent and timely conversations about performance throughout the year. This not only supports individual performance and personal development, but also helps the Group to effectively manage rising talent and fulfil its succession planning objectives.

The third cohort of the Group's senior leadership development programme launched this year with a further nine delegates. The programme is aimed at developing those identified as successors for the executive management team and their direct reports. During this year two members of this programme from previous cohorts secured promotions within the Group. To support the Group's wider training objectives, a new learning management system, Learn Amp was launched in February. This hosts internally designed content alongside relevant subscription material to ensure there is a broad, yet relevant range of learning available for all employees to access.

Equality and diversity

The Group made significant progress on its equality, diversity and inclusion ('EDI') strategy during the year. Richard Rowntree, Managing Director - Mortgages, has taken on the role of Executive Sponsor for EDI and sponsors the Group's EDI Network which was launched in October 2020. The Network has had a tremendous impact in a short space of time and has been involved in the launch of a number of training offerings to all employees, including new EDI eLearning, a new 'Inclusive Workplace' course and an 'Inclusive Leadership' course for all managers.

The Network worked with Human Resources to run a diversity data capture campaign in September 2021. 63% of employees completed a diversity profile on the HR management system and the collation of this data from employees provides the Group with an enhanced ability to monitor and improve the diversity of the workforce going forward.

The Group has made further important commitments to improving the diversity of its workforce by signing up to Business in the Community's Race at Work Charter and becoming accredited as a Disability Confident employer. These commitments complement the pledge the Group previously made to HM Treasury's, Women in Finance Charter in 2016.

The Group is pleased to report that is has now achieved each of its targets set under the Women in Finance Charter in 2017, which focussed on female and ethnic minority representation in the workforce and management. The Group is currently considering the next phase of this initiative.

Details of progress against our targets can be found below.

Measure	Target	Sep 2021	Status
Female representation in senior management *	35%	38.7%	Achieved
Females in workforce	50%	52.5%	Achieved
Females as a percentage of employees receiving management career development and leadership training	50%	52.0%	Achieved
Managers from an ethnic minority background	10%	13.4%	Achieved
Workforce on flexible working	10%	24.0%	Achieved
Flexible working on a part time basis	50%	73.6%	Achieved

*Senior management is defined using the FTSE Women Leaders definition, while the ethnicity measure is based on those employees who self-identified.

To support its efforts to improve gender equality the Group has continued to participate in the 'Women Ahead 30% Club' cross-company mentoring scheme. This programme has proven popular with both mentors and mentees and a similar scheme is being piloted for employees from ethnic minorities over the coming year.

The Group welcomes the increasing interest in the diversity and inclusion agenda from all its stakeholders and has participated in the recent FCA Diversity and Inclusion survey.

Remuneration policy

The PRA remuneration rules applicable to the Group changed with effect from 1 October 2021, as the Group qualifies as a Proportionality Level 2 ('Level 2') bank from that date, bringing it within the scope of more onerous rules. This is a result both of the reduction in the asset threshold defining a Level 2 bank from £15 billion to £13 billion, announced by the PRA in December 2020, and of the development of the rules themselves in response to Capital Requirements Directive V ('CRD V').

A full gap analysis was performed against the updated rules, with affected employees being identified and remuneration arrangements appropriately adjusted. The majority of the significant changes required to remuneration policies were prospectively approved at the 2020 AGM, with more minor changes approved by the Remuneration Committee in the period. Further information is given in the Directors' Remuneration Report (Section B7) and in the Remuneration Section of the Pillar 3 report for the year as appropriate.

The Group has also taken steps to assess the status of the small number of off-payroll workers in the business and made necessary changes to ensure the Group does not enter into engagements with workers who are paid through personal service companies and similar arrangements and fall within IR35 status for tax purposes, avoiding the complexities of such arrangements.

A4.5.4 Sustainability

Sustainability, including resilience in the face of climate change risks, is core to the Group's strategy: to focus on specialist markets, delivering long-term sustainable growth and returns through a low risk and robust business model. Sustainability influences every aspect of the Group's business and means:

- Reducing the impact of the Group's operations on the environment
- Ensuring that the Group has a positive effect on our stakeholders and communities
- Delivering sustainable lending through the design of products offered and the choices of sectors in which to operate

The Group publishes its 2021 Responsible Business Report, its first sustainability report, in December 2021, providing more detailed information on its sustainability initiatives.

Climate change

Climate change is designated as a principal risk within the Group's Risk Management Framework. Information and measures on climate change risks are considered at board level and the Group's responses are considered within the Board's overall strategy. These risks fall into two main groups:

- Physical risks (which arise from weather-related events)
- Transitional risks (which come from the adoption of a low-carbon economy)

The Group has an internal Climate Change Forum, sponsored at executive level and containing representation from across the business, to share information on initiatives within business areas and to help develop the Group's overall response.

During the year the first issuance was made under the Group's Green Bond Framework, which was published in the year and which reflects the Group's commitment to embed sustainability throughout its strategy, operations, and product offerings including funding and capital raising activities. This was the first issue of a green capital instrument by a bank in UK. The Sustainability Committee, established in the year under the oversight of the Executive Committee, is responsible for the Framework.

Developments in sustainable products and climate-related exposures are discussed in the relevant business reviews and within the Sustainability and Citizenship section (A6).

While the Group is not required to report on climate change risk and exposures under the TCFD framework until its 2022 year end, it has signed up as a TCFD supporter, and the disclosures made in respect of the year have been organised using TCFD as a template.

Social engagement

Despite the difficulties for fund-raisers created by the pandemic, the Group's Charity Committee raised over £43,000 for Macmillan Cancer Support, the Group's chosen charity for the 2020 calendar year. For the 2021 calendar year the Group is supporting the Alzheimer's Society with £22,000 raised by September 2021.

The Group has begun to restart its community and volunteering initiatives as pandemic restrictions cease, with employees looking forward to reengaging as soon as possible.

A4.5.5 Risk

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

Inevitably the ongoing impacts of the pandemic have, and continue to be, a priority for the Group and the longer-term implications are still unclear. The Group continues to monitor closely the economic impacts, changes to lending profiles, business volumes and customer credit risk as the immediate restrictions necessitated by the pandemic are released. It is recognised that the wider pandemic is still a global challenge and the possibility of further waves and subsequent lockdowns may pose further issues during the coming months.

However, given the work done over the last 18 months the Group feels it is well-placed to respond to any further Covid-related disruption. The Group's risk management framework has provided a robust mechanism to ensure that new risks are promptly identified, assessed, managed and appropriately overseen from a risk governance perspective.

The Group continues to focus on specific risk issues that have arisen as a direct result of the pandemic. These include:

- Ensuring a Covid-safe return to office-based working and in the longer-term trialling more flexible and hybrid ways of working which are core to the strategy of attracting and retaining highly skilled employees, through a group-wide pilot scheme
- Continuing oversight of the impacts of government schemes and initiatives implemented during the onset of Covid which necessitated rapid deployment of resources and innovation in processes. A small number of remaining payment holidays continue to be managed and where appropriate forbearance solutions necessitated through Covid are tailored to individual customer circumstances and aligned to regulatory guidance and expectation
- Continuing oversight of risks related to the provision of government-backed lending schemes to support businesses through Covid. Given the effective implementation of process changes and underwriting decisions the Group is positioned well to support any further government lending programmes of this nature

Whilst Covid has clearly dominated the risk landscape since early 2020, the Group has successfully continued to evolve and embed its risk management framework. Good progress has been made in further developing its ability to manage all categories of risk through the maturing ERMF.

The evolution of the Group's risk framework remains a core priority and ongoing work is being undertaken to ensure it remains effective and proportionate in line with the Group's strategic aspirations. Significant recruitment has been undertaken during the year to bolster capability, external benchmarking has been undertaken to validate work undertaken and future plans and a detailed roadmap for further development over the next 18 months has been agreed. Good progress has already been made in line with these commitments.

Despite the pervasive impact of the pandemic, the Group has identified and focussed on a number of non-Covid related strategic risk issues including:

- Strategy, operational and conduct-related risk implications of the changes in product design, funding and operations required to transition all LIBOR-linked customers to an alternative rate following the withdrawal of LIBOR in December 2021
- Further embedding operational resilience capabilities which have proven to be critical in handling the Covid situation. Importantly, lessons learned from the handling of the pandemic have been incorporated into the operational resilience framework together with continued refinement of the overarching approach in line with regulatory expectation
- Addressing the impact of climate change on managing financial risks and considering this as part of the wider ESG agenda across the Group
- Continuing to develop advanced models and embed the overarching model risk framework to enhance credit risk management and support the Group's IRB application process
- The impact of issues relating to defective cladding on high-risk buildings where these form the security for mortgage loans. Underwriting guidelines continue to be reviewed to ensure these remain in line with emerging best practice
- Enhancing stress testing procedures to ensure the robustness of capital and liquidity positions
- Ensuring effective cyber-security controls and a robust data protection approach particularly as these evolve in response to changing working practices

The Group continues to review its exposure to emerging developments in the Brexit process as further clarity is received as to future dealings with the EU. However, the end of the transition period on 31 December 2020 caused no immediate impact to the Group. Whilst the Group does not have operations outside the UK it has continued to review the capital, liquidity and operational implications of the stresses which might be caused by the process. In particular, it has continued to monitor the issues related to the supply of essential goods which are causing shortages in a number of sectors. Whilst the Group is not directly affected by these issues at present the Board is keeping the situation under ongoing review as supply issues in areas such as building materials and IT equipment could impact the Group's operations.

The principal challenges in the risk environment faced by the Group during the coming year and moving forward into 2023 and beyond include:

- Management of risks arising from changes introduced in response to Covid. With the ending of payment reliefs and the wider economic impacts of the crisis beginning to emerge, there will be a need to ensure appropriate treatment of ongoing arrears and the position of affected customers. Key to this will be ensuring that the treatment of customers is fair and conduct principles remain at the forefront of all interactions
- Addressing an increasing level of regulatory compliance standards, where the Group is committed to ensuring it remains compliant in all areas of its business. Particular focus in the Group is on ensuring that it meets regulatory expectations in respect of its anti-money laundering and wider financial crime control frameworks following the publication of the Dear CEO letter in May 2021
- Risks associated with climate change remain an ever-present challenge. The UK Government has confirmed its goal of net zero carbon by 2050 in November 2020 and the Group, and the rest of the financial services industry, have a vital role to play in that commitment. As global strategies continue to be refined the Group is looking to ensure both its operational impacts, and the impact of its lending activities, explicitly consider climate change risk as a core strategic driver

Further details regarding the governance model, together with the principal risks and uncertainties faced by the Group, the ways in which they are managed and mitigated and the extent to which these have changed in the year are detailed within Section B8 of this annual report.

A4.5.5 Regulation

Paragon 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 impact and pace of change necessitated through the ongoing programme of revisions to the Basel supervisory regime continue to pose a significant risk for the Group. These together with other potential regulatory changes to the business are closely monitored through the comprehensive governance and control structures in place.

Since March 2020, the impact of Covid has largely driven the priorities of both UK and European regulators. The Group has continued to respond effectively to these ongoing challenges despite short consultation and implementation periods. All regulatory publications have been considered by the Group, any implications identified and required changes implemented within an appropriate timeframe. Over the last few months the Group has experienced data requests from the FCA on arrears and forbearance increasing in both scale and frequency. The Group continues to respond to these requests, and to focus controls on the delivery of fair customer outcomes.

In addition to requirements introduced in response to Covid, the following developments currently in progress have the greatest potential impact on the Group:

- The Bank of England published a Consultation Paper ('CP') setting out proposed changes to the Minimum Requirement for Own Funds and Eligible Liabilities ('MREL') on 22 July 2021. The CP builds on the Discussion Paper published in December 2020 and factors in the responses it received from impacted banks and building societies.

On 3 December 2021 the Bank of England published a Statement of Policy based upon this consultation. Although the Group is not currently subject to MREL requirements, given its potential for growth it may be required to issue MREL eligible instruments at some point in the future

- The Bank of England MPC confirmed in February 2021 that negative interest rates still form part of its monetary policy toolkit. In response, the PRA issued a 'Dear CEO' letter requesting firms initiate the implementation of tactical solutions to process zero and negative rates by August 2021. The Group has undertaken this analysis which confirmed that it is well-placed to meet any operational requirements should rates fall to zero or below
- The FCA issued its consultation on "A New Consumer Duty" in May 2021. This seeks to set higher expectations for the standard of care provided to customers and will result in new rules relating to communications, products and services, customer service and price and value. The Group will continue to engage with UKF throughout the consultation period to ensure adequate preparation prior to the new rules coming into force
- The treatment of vulnerable customers continues to be a strong focus for the FCA, with further guidance having been finalised in February 2021. The Group continues to take its responsibilities in this regard seriously. Significant work continues to be undertaken to revise existing procedures, controls and training provisions to meet regulatory and industry expectations

- The FCA, PRA and Bank of England published their final rules and guidance on building operational resilience in financial services on 29 March 2021. As expected, this did not differ significantly from consultation papers and considerable work had already been undertaken by the Group to adhere to the draft proposals. Good progress has been made against the roadmap and the Group is well-positioned to meet the March 2022 policy implementation deadline including setting of impact tolerances, embedding a scenario testing approach and undertaking a self- assessment against the regulatory framework
- The Group continues to work towards embedding its approach to managing climate-related financial risks by the end of 2021 in line with the PRA expectations. A detailed plan of work has been developed which reflects regulatory and wider requirements and will continue to be refined as new thinking emerges. Managing the impacts of climate change is seen as a key strategic priority for the Group and significant effort has been made during 2021 to incorporate climate risk considerations within the Group's ERMF. The improved Governance which now includes the Sustainability Committee alongside the existing executive level risk committees ensures comprehensive consideration across all aspects of the business and ensures the Group is well-positioned to address the emerging challenges

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

The Group continues to monitor the impact of Brexit on its operations, but the longer-term regulatory changes are still unclear. With the extension of the temporary transitional powers for the regulators until 31 March 2022 by HM Treasury, regulatory obligations for firms generally remain the same. The Bank of England has commenced the consultation process for the incorporation of the prudential regulation regime previously set out in European legislation into the PRA Rulebook.

However, further clarity has yet to be provided as to how the regulatory landscape may evolve post March 2022. It is expected that the majority of requirements will be directly transcribed although the PRA has indicated it is willing to depart from EU text where this may enhance regulatory oversight in the UK.

The governance and risk management framework within the Group continues to be developed to ensure that the impacts of all new regulatory requirements are clearly understood and mitigated as far as possible.

Regular reports on key regulatory developments are received at both executive and board risk committees.

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

A5. Future prospects

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

- Explain how they have assessed the prospects of the Group and whether, on this basis, they have a reasonable expectation that the Group will be able to continue in operation (the 'viability statement')

- State whether they consider it is appropriate for the Group to adopt the going concern basis of accounting in the preparation of the financial statements presented in Section D (the 'going concern statement')

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

The business activities of the Group, its current operations and those factors likely to affect its future results and development, together with a description of its financial position and funding position, are described in the Chairman's Statement in Section A1, Chief Executive's review in Section A3 and review of the business in Section A4. The principal risks and uncertainties affecting the Group, and the steps taken to mitigate these risks are described in Section B8.5.

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

Note 53 to the accounts includes an analysis of the Group's working and regulatory capital position and policies, while notes 54 to 57 include a detailed description of its funding structures, its use of financial instruments, its financial risk management objectives and policies and its exposure to credit, interest rate and liquidity risk. Critical accounting judgements and estimates affecting the results and financial position disclosed in this annual report are discussed in notes 62 and 63.

Financial forecasts

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

The plans for the period commencing on 1 October 2021 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 economic assumptions used are consistent with the economic scenarios considered for determining impairment provisions.

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.

The Group makes extensive use of stress testing in compiling and reviewing its forecasts. This stress testing approach was reviewed in detail during the year as part of the annual ICAAP cycle, where testing considered the impact of a number of severe but plausible scenarios. During the planning process, sensitivity analysis was carried out on a number of key assumptions that underpin the forecast to evaluate the impact of the Group's principal risks.

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

- Increased business volumes – An increase of 20% in buy-to-let application volumes. This examined the impact of volumes on profitability and illustrated the extent to which capital resources and liquidity would be stretched due to the higher cash and capital requirements

- Higher funding costs – 25bps higher cost on all new savings deposits throughout. This scenario illustrated the impact of a significant prolonged margin squeeze on profitability and whether this would cause significant impacts on any capital, liquidity or encumbrance ratios

- Lower development finance growth – 50% lower loan book growth across the plan horizon coupled with a 50bp margin reduction. This scenario replicated a significant increase in competition within the sector, illustrating the impact of a lower proportion of the high-yielding development finance product in the Group's long-term asset mix on contribution to costs and other key ratios for the Group

- Higher buy-to-let redemptions – double redemption rates on all cohorts for the first three months post-reversion. With a significant volume of five-year fixes coming to an end in 2022, this scenario highlighted the potential risk that is inherent in the accounting difference between current and amortised cost balances on such loans, and invited discussion as to what mitigating action could be taken to avoid such an impact

- High impairment – a stress that modelled the IFRS 9 year end severe scenario across the plan horizon, simulating a significant short-term capital and profitability shock with prolonged house price deflation, but maintaining the same lending levels as the base case. This scenario is derived from, but more severe than, the stress testing scenario published by the Bank of England in January 2021. Although it is not deemed likely that such a scenario would materialise, since severe stresses almost always result in lower lending volumes, the output from this stress provides a benchmark for a plausible worst-case position that impacts all aspects of business performance and ratios, in particular, capital

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

As part of the ICAAP process the Group also assessed the potential operational risks it could face. This was done through the analysis of the impact and cost of a series of severe but plausible scenarios. This analysis did not highlight any factors which cast doubt on the Group's ability to continue as a going concern.

The outputs from these stresses present the Board with enough information to assess the Group's ability to continue on a going concern basis and ensure that there are enough management actions within their control to mitigate any plausible and foreseeable failure scenario.

The Group begins the forecast period with a strong capital and liquidity position, enabling the management of any significant outflows of deposits and / or reduced inflows from customer receipts. Overall, the forecasts, even under reasonable further levels of stress show the Group retaining sufficient equity, capital, cash and liquidity throughout the forecast period to satisfy its regulatory and operational requirements.

Risk assessment

During the year the Board discussed, reviewed and approved the principal risks identified for the Group. This process included debate and challenge regarding the most material areas for focus on an ongoing basis. No material changes were proposed to the principal risks other than the removal of pension obligation risk given the reducing deficit in the pension scheme.

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

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

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

The Board has spent considerable time monitoring the impacts of the pandemic including regular analysis and management information illustrating the impacts of Covid on the Group and its risk profile. They have continued to consider specifically regulatory impacts, conduct risks in dealing with customer vulnerabilities caused or exacerbated by Covid, customer credit and the changes in the Group's operational processes. The results of these considerations have fed into the Group's forecasting and risk assessment.

In addition, the directors held 'deep dive' sessions into key areas of risk focus including operational resilience; the ongoing assessment on the impact of cladding; climate change; LIBOR transition: anti-money laundering; and the potential impact of higher interest rates in the UK.
The output from these sessions was fed back into the Group's risk management process.

The directors also continued to monitor the potential impact of the UK Brexit process as the economic and regulatory implications of the UK's exit from the EU continue to crystallise.

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 Internal Capital Adequacy Assessment Process ('ICAAP'), Internal Liquidity Adequacy Assessment Process ('ILAAP') and its Recovery Plan.

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

The directors concluded that those activities, taken together, constituted a robust assessment of all of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity. These principal risks are set out in Section B8.5 of the Risk Management Report.

Availability of funding and liquidity

In considering going concern and viability, the availability of funding and liquidity is a key consideration. For the Group this includes retail deposits, wholesale funding, central bank lending and other contingent liquidity options.

The Group's retail deposits of £9,300.4 million (note 26), raised through Paragon Bank, are repayable within five years, with 77.6% of this balance (£7,212.9 million) payable within twelve months of the balance sheet date. The liquidity exposure represented by these deposits is closely monitored; a process supervised by the Asset and Liability Committee. The Group is required to hold liquid assets in Paragon Bank to mitigate this liquidity risk. At 30 September 2021 Paragon Bank held £942.7 million of balance sheet assets for liquidity purposes, in the form of central bank deposits (note 56). A further £150.0 million of liquidity was provided by an off balance sheet swap arrangement (note 56), bringing the total to £1,092.7 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, updated annually. The bank maintains a liquidity framework that includes a short to medium term cash flow requirement analysis, a longer-term funding plan and access to the Bank of England's liquidity insurance facilities, where pre-positioned assets would support drawings of £1,424.2 million.

Holdings of the Group's own externally rated mortgage backed loan notes can also be used to access the Bank of England's liquidity facilities or other funding arrangements. At 30 September 2021 the Group had £529.2 million of such notes available for use, of which £287.0 million were rated AAA. The available AAA notes would give access to £149.3 million if used to support drawings on Bank of England facilities.

The Group's securitisation funding structures, described in note 56, provide match funding for part of the asset base. Repayment of the securitisation borrowings is restricted to funds generated by the underlying assets and there is limited recourse to the Group's general funds. Recent and current loan originations are financed through retail deposits and may be refinanced through securitisation where this is appropriate and cost-effective. While the Group has not accessed the public securitisation market in the year, the market remains active with strong levels of demand, and the Group maintains the infrastructure required to access it.

The earliest maturity of any of the Group's bond debt is the £125.0 million retail bond, due January 2022. £69.0 million of TFS debt was paid down after the year end and all other central bank debt was refinanced and is not payable until 2025.

The Group's access to debt is enhanced by its corporate BBB rating, affirmed by Fitch Ratings in March 2021, and its status as an issuer is evidenced by the BB+ rating of its £150.0 million Tier 2 bond, issued in the year. It has regularly accessed the capital markets for warehouse funding and corporate and retail bonds over recent years and continues to be able to access these markets. The Group has access to the short-term repo market for liquidity purposes which it uses from time to time, including during the financial year ended 30 September 2021.

The Group's cash analysis, which includes the impact of all scheduled debt and deposit repayments, continues to show a strong position, even after allowing scope for significant discretionary payments and capital distributions.

As described in note 53 the Group's capital base is subject to consolidated supervision by the PRA. The most recent review of the Group's capital position and management systems resulted in a reduction of the minimum capital level. Its capital at 30 September 2021 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 2021. This aligns with the horizons used in the Group's analysis of risk and includes the two years covered by the detailed group forecast, together with one year of the less detailed forecasting period.

The directors considered:

- The Group's financial and business position at the year end, described in Sections A3 and A4
- The Group's forecasts, and the assumptions on which they were based
- The Group's prospective access to future funding, both wholesale and retail
- Stress testing carried out as part of the Group's ICAAP, ILAAP and forecasting processes
- The activities of the Group's risk management process throughout the period
- Risk monitoring activities carried out by the Risk and Compliance Committee
- Internal Audit reports in the year

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

On this basis, the directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the three-year period commencing on 1 October 2021.

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

Going concern statement

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

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

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

A6. Citizenship and sustainability

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

Sustainability is central to the long-term success of the Group and it is committed to its responsibilities as a good corporate citizen. It aims to reduce the impact that its operations and its customers have on the environment, have a positive effect on all its stakeholders and support the communities in which it operates.

Further information on the Group's sustainability profile can be found in the 'Responsible Business Report: 2021', its first sustainability report, published in December 2021 and available on the Group's website at www.paragonbankinggroup.co.uk.

A6.1 Non-Financial Information Statement

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

In addition to the description of the Group's business model, discussed in section A2, the Group's remaining disclosures are included in this section A6. This includes a discussion of the Group's risk, policies, outcomes and key performance indicators with respect to each of the five areas set out in the Act. The matters specified in the Act are discussed in the following sections.

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

This section also includes the information on the directors' engagement with employees required by Section 11 (1)(b) of Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ('Schedule 7') (as amended) (in section A6.3) and the information on business relationships with suppliers and customers required by section 11B of that schedule (in section A6.7 and section A6.2).

Sustainability analysts frequently request detail of significant fines or penalties incurred by companies for ESG related incidents, or confirmation that there were no such incidents.

The Group has incurred no such fines greater than US$ 100.0 million in the year (2020: none). Information on penalties and disciplinary incidents is given below in each section, where relevant.

A6.2 Customers

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

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

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

The desire to achieve positive outcomes for our customers is an important commercial differentiator which has helped the Group build strong relationships over many years. We recognise that customers in vulnerable circumstances are at greater risk of poor outcomes when dealing with their finances and we have focused working groups and employee training to deliver appropriate service and support for vulnerable customers. This pro-active approach accords with the FCA's Principles for Business, particularly with regard to ensuring good customer outcomes, preventing customer harm and ensuring that all communications are clear, fair and not misleading. We ensure that we know how well we are performing in respect of these requirements, regularly adjusting what we do to deliver better customer solutions.

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

Complaints

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

Handling

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

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

Monitoring

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

The Group's complaint case data, reported to FOS, continues to be low compared to the other firms in the sector. Information for the most recent FOS reporting periods is set out below.

	Six months ended			
	30 June 2021	31 December 2020	30 June 2020	31 December 2019
Cases reported	50	60	40	83
Uphold rate	34.0%	43.3%	41.3%	48.2%

This low level of complaints is particularly pleasing given the impact of the Covid pandemic on customers through most of the period shown above.

FOS data across the financial services industry is published on the ombudsman's website at www.financial-ombudsman.org.uk. However, the Group's complaint level has regularly been below the threshold for publication.

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

A6.3 People

The Group employs almost 1,450 people, with the majority based at its Head Office in Solihull. During the past year, the Group has seen 3.6% growth in its headcount, predominately driven by the creation of new roles in customer facing and risk and compliance functions. This investment in resource has helped the Group to serve its customers and achieve its strategic priorities.

The Group is exceptionally proud of its culture, which is underpinned by a strong set of company values and a commitment to doing the right thing. This was shown in the results of the 2021 employee engagement survey where an 87% engagement score was achieved. High scores were achieved for culture, which was particularly pleasing, and the employee advocacy score, measured by NPS was far higher than international norms. This further supports the Group's Gold Investors in People status, which it will be seeking to retain next year.

Employee survey

The Group conducted a full employee engagement survey in June 2021 and 86% of employees shared their views. The survey produced a very strong set of positive indicators, including an overall engagement score of 87%; 10 percentage points above the industry norm and 6 percentage points greater than the Group's last survey completed in December 2017. Results are analysed into six pillars, with the Group scoring above the industry norm in each one. Results for five of the six pillars also improved since the 2017 survey, with 'employee voice' seeing the biggest increase with a 16 percentage point improvement.

Questions relating to the Group's culture were included, focusing on risk, responsible business actions, customers and inclusion. Overall culture score increased to 95% (2017: 92%). Employee advocacy measured through an employee NPS was at +24 (2017: -3, industry norm +21).

The survey followed a continued focus on monitoring employee wellbeing during the pandemic via short pulse surveys; six surveys were run between April 2020 and April 2021 and results indicated that employees continued to be happy with how the Group was managing the effects of the pandemic. Results have informed targeted actions such as promotion of wellbeing support available to employees, and the trials of hybrid working which are underway across the business.

Employment conditions

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

At 30 September 2021, employees on temporary or short-term contracts accounted for 2.3% of the workforce (2020: 1.5%) and no use was made of zero-hours contracts. The Group's annual employee turnover for the year was 8.7% (2020: 10.4%). XPert HR report average voluntary turnover in the UK financial services industry at 13.1%, demonstrating the strength of the Group's performance.

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.

Formal flexible working arrangements are in place for 24% of our employees (2020: 24.3%), with 73.6% of these working part-time (2020: 82%). The Group has continued to accommodate flexible working arrangements both on a formal and informal basis as the Covid pandemic continues.

No employees were placed on furlough or made redundant as a result of Covid and no use was made of the UK Government Coronavirus Job Retention Scheme in the year.

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

During the period the Group took the decision to close its Second Charge Mortgage business; the team of 26 employees were all offered redeployment opportunities, in line with the policy of avoiding redundancy wherever possible, however six employees chose to leave the business.

Remuneration packages across the business are compliant with the UK's national minimum wage rates. In addition, the Group has been accredited as a Living Wage employer since June 2016, by the Living Wage Foundation. The independent Living Wage Foundation sets an hourly rate, the 'real Living Wage', calculated according to the cost of living in the UK which is updated annually. This is a higher rate than the UK Government's National Living Wage. Accredited employers such as the Group must not only pay this rate to their own employees, but also ensure that any contractors used undertake to do so. From 1 November 2021 the Group will pay a minimum of £19,500 to all full-time employees, equivalent to £10 per hour.

The Group runs a Worksave defined contribution pension scheme in line with UK legal requirements. During the year the default investment fund for this pension was changed to a fund closer aligned to the Group's ESG strategy; this change was made in consultation with employees.

During the year the Group's defined benefit pension arrangements were restructured to protect the future of the pension plan, preserve benefits already accrued and rebalance the treatment of the scheme's beneficiaries with those of the wider workforce. A formal consultation with the active scheme members took place and the changes, which are described in more detail in Note 52 to the accounts, came into effect from 1 July 2021.

At 30 September 2021 the Group was making contributions towards the retirement provision of 85% of its employees.

During the year the Group also increased the minimum holiday entitlement for its employees from 22 to 25 days per year for full time employees, in line with its commitment to treating its employees properly.

Equality, diversity and inclusion

The Group is committed to eliminating discrimination and promoting EDI amongst all its employees through its policies, procedures and practices and through its professional dealings with employees, customers and third parties.

Every employee is entitled to a working environment that promotes dignity, equality and respect for all. The Group will not tolerate any acts of unlawful or unfair discrimination (including harassment) committed against an employee, contractor, job applicant or visitor because of a protected characteristic:

- Sex
- Gender reassignment
- Marriage and civil partnership
- Pregnancy and maternity
- Race (including ethnic origin, colour, nationality and national origin)
- Disability
- Sexual orientation
- Religion and or belief
- Age

Discrimination on the basis of work pattern (part-time working, fixed term contract, flexible working) which is unjustifiable will also not be tolerated.

The Board believes the achievement of a balanced workforce at all levels delivers the best culture, behaviours, customer outcomes, profitability and productivity and therefore supports Paragon's success as a business.

During the year the Group has made significant progress on its equlity, diversity and inclusion ('EDI') agenda. In October 2020 it launched its EDI Network; consisting of employees from across the Group who are passionate about shaping the Group's EDI plans. The Network and all the Group's other EDI activities are sponsored at ExCo level by Richard Rowntree, Managing Director – Mortgages, while the Nomination Committee provides board level oversight on all inclusivity matters affecting on the Group's people.

The primary objectives of the EDI Network are:

- Raising awareness and understanding of what EDI in the workplace means
- Providing feedback and advice to the Group's leadership on the issues affecting employees from under-represented groups
- Supporting the delivery of initiatives to improve EDI across the Group
- Promoting Paragon as a diverse and inclusive place to work

Employee satisfaction relating to the equality of opportunity was monitored in the recent employee engagement survey and the Group continues to monitor recruitment data relating to the provision of equal opportunities.

HR policies are reviewed regularly to ensure 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.

The EDI Network has driven several campaigns over its first year and championed signing up to some external schemes. Significant initiatives within the EDI agenda in the year include:

Signing up to the Race at Work Charter

The Race at Work Charter is an initiative run by Business in the Community ('BITC'). Signatories of the charter agree to five commitments to ensure that ethnic minority employees are represented at all levels in an organisation.

1. Appoint an Executive Sponsor for race
2. Capture ethnicity data and publicise progress
3. Commit at Board level to zero tolerance of harassment and bullying
4. Make clear that supporting equality in the workplace is the responsibility of all leaders and managers
5. Take action that supports ethnic minority career progression

The Group has a number of actions in progress to ensure that its commitments under this scheme are being met. Initiatives include involving EDI Network members in the selection process for the Group's development programmes, challenging any unconscious bias observed; piloting a mentoring programme for employees from ethnic minority groups; and running Executive Listening Circles to give employees in under-represented groups the opportunity to share their views with leadership.

Becoming a Disability Confident employer

In April 2021 the Group achieved Level 1 'Disability Confident Committed' status under the UK Government's Disability Confident scheme. As well as continuing to provide paid employment to people with disabilities, as a Disability Confident Committed organisation, the Group has agreed to the five Disability Confident core commitments:

- It will ensure its recruitment process is inclusive and accessible
- It will communicate and promote vacancies
- It will offer an interview to disabled people
- It will anticipate and provide reasonable adjustments as required
- It will support any existing employee who acquires a disability or long-term health condition, enabling them to stay in work

The Group makes every effort to retrain and support employees who suffer from disabilities during their employment, including the provision of flexible working to assist their return to work. Ensuring that opportunities and progression within the Group are available to people with disabilities is an important part of its inclusivity and diversity strategy and will form a strand of the work of the EDI Network.

Collecting diversity monitoring data

In September 2021 the Group launched a diversity profile in its CoreHR system which asks employees to disclose information about their gender identity, sexual orientation, ethnicity and race, religion, socio-economic background, disabilities and responsibilities outside of work. Over 60% of employees completed their profile; this data now gives the Group a better understanding of the composition of the workforce and will help it to monitor whether all employees have the same access to training, development, and job opportunities.

In addition, demographic questions were asked in the employee engagement survey allowing the sentiment of different groups of employees to be assessed. These two data sets will shape the next phase of the Group's EDI strategy.

Pride at Paragon

In June 2021 the Group celebrated 'Pride at Paragon' to recognise its LGBTQ+ employees and in September 50 employees joined the Birmingham Pride Parade event.

Inclusive workplace training

A new 'Inclusive workplace' training course was launched by the Group's learning and development team in 2021, designed and delivered in conjunction with the EDI Network. All employees were invited to attend the course which builds on themes such as unconscious bias, which are already addressed in eLearning courses.

Women in Finance

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

In January 2017 the Group's first set of internal targets under the charter was published on its website. They included a target of 35% female representation in senior management roles by January 2022, increasing from 26% at the time the targets were set. As at 30 September 2021 the Group had achieved 38.7% female representation (2020: 33.9%). The definition of senior management used in the Group's 'Women in Finance' targets is the same as that used by the FTSE Women Leaders initiative (formerly known as the Hampton-Alexander ('HA') Review).

By September 2021, the Group had achieved all its original charter targets, ahead of schedule and it will be reviewing its targets for the next phase of its Women in Finance initiative in the early part of the new financial year.

Gender pay

As required by legislation, the Group has calculated its gender pay gap at April 2021. The results will be published on the UK Government website and on the Group's own website and are summarised below.

	April 2021	April 2020
Median gender pay gap	**36.6%**	36.9%
Mean gender pay gap	**38.4%**	40.7%
Median bonus pay gap	**3.4%**	2.5%
Mean bonus pay gap	**76.5%**	82.6%

This year's gender pay measures are similar to those for 2020, as would be expected given the low staff turnover during Covid, and remain larger than the Group would like. The Group has continued to monitor these differences and found them to be predominately due to the seniority and nature of roles that men and women are undertaking in the organisation.

The results are broadly in line with those for the financial services sector reported by the Office of National Statistics in their 2021 Annual Survey of Hours and Earnings ('ASHE') which showed a median pay gap of 36.5% (2020: 35.9%) and a mean pay gap of 33.2% (2020: 28.8%).

Employees in our lower pay quartiles are predominantly female and typically include operational and processing roles. These roles lend themselves particularly well to part-time working arrangements.

Throughout the organisation females account for the majority of part-time working arrangements and, due to the nature of the gender pay gap calculation taking no account of hours worked by employees in calculating averages, this further increases the size of the gender pay gap.

The Group is proud that the vast majority (85%) of employees are eligible for a bonus under the Group's Profit Related Pay ('PRP') scheme; these awards lead to the small median bonus pay gap. 15% of employees are eligible for the Group's discretionary bonus scheme (31% of the scheme's participants are women), and 5% of employees are also eligible for share based awards of which 27% of recipients are female. This means that discretionary and share based bonus schemes are disproportionately awarded to men, and the large mean bonus gap is further driven by the bonuses awarded to the most senior executives, the majority of whom are men.

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

Composition of the workforce

During the year the workforce has grown by 3.6% to 1,441 people (2020: 1,391). Information on the composition of the workforce at the year end is summarised below:

	2021 Females	**2021 Males**	2020 Females	2020 Males
Employees				
Number	**757**	**684**	735	656
Percentage	**52.5%**	**47.5%**	52.8%	47.2%
Management grade employees				
Number	**136**	**198**	119	190
Percentage	**40.7%**	**59.3%**	38.5%	61.5%
Senior managers				
Number	**8**	**34**	6	33
Percentage	**19.0%**	**81.0%**	15.4%	84.6%
Directors				
Number	**3**	**5**	3	6
Percentage	**37.5%**	**62.5%**	33.3%	66.7%

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 FTSE Women Leaders Initiative.

Based on diversity profiles completed by employees during the year, ethnic minority employees comprised:

- 17.2% of employees
- 13.4% of managers
- 4.7% of senior managers

This is based on the 58% of employees who declared their ethnicity. For the purpose of this analysis, ethnic minority employees comprise all those not identifying as 'White British'. As the figures for the current year were prepared on the basis of employees self-identification, in line with best practice, they may not be strictly comparable to those presented in earlier years.

Health and wellbeing

The Group has continued to focus on supporting the wellbeing of employees throughout the year and during the period launched the Wellbeing Hub; a dedicated space on the intranet, which provides employees with support on emotional, physical, financial and social wellbeing issues. Through the Wellbeing Hub employees are able to access services such as free will writing, free exercise classes, support with budgeting and debt management, signposting specialist support services such as those who help with domestic violence or bereavement, as well as numerous resources to help with a wide range of wellbeing issues.

Training and development

Despite the challenges that the continuing pandemic has placed on the business, the Group has continued to focus on providing opportunities to develop all employees and on average employees received 4.6 days training per person in the year (2020: 4.2 days). This continues to significantly exceed the average figure for the private sector of between 2.8 and 3.2 quoted by the CIPD. This number included online training undertaken by all employees on various topics including regulatory requirements.

A new learning management system, Learn Amp, was launched in February this year. Learn Amp hosts relevant subscription content alongside internally designed content to ensure there is a broad, yet relevant range of learning available for employees to access.

During the period a new performance management approach was rolled-out, removing the need for a formal annual appraisal and replacing this with more frequent and timely conversations about performance throughout the year. This not only supports individual performance and personal development, but also helps the Group to effectively manage rising talent and fulfil its succession planning objectives.

The Group's senior leadership development programme launched its third cohort in September, with a further nine individuals undertaking bespoke development plans; two individuals from previous cohorts have been promoted internally. During the period the Group has launched a suite of leadership modules 'Leadership for the future', bringing together all layers of the Group's management structure to spread and share best practice through networking and learning together. Members of the EDI Network have been involved in the selection processes for candidates for some of the Group's talent programmes during the year, with the intention of identifying any unconscious bias and helping to ensure equal opportunities are afforded to all employees.

The Group has continued to focus on developing female talent during the year to support its Women in Finance Charter objectives. 52% of employees receiving management development are female, and the Group continues to support the cross-company Mission Gender Equity mentoring programme.

Apprenticeship Levy funds have been drawn down to support the Group's development objectives. These apprenticeships cover a range of specialist and operational roles including IT, audit, customer services and management. The number of apprenticeships has dropped slightly during the pandemic, with 37 apprentices (2.3% of employees) registered under the levy scheme (2020: 46), although utilisation of levy funding has increased slightly, to 42.6% of new levy funds in the past twelve months (2020: 41%). Usage has increased due to the inclusion of more managerial level apprenticeships which draw down greater funds. The Group also supports employees studying for professional qualifications outside the apprenticeship programme.

Recruitment

Headcount has continued to grow over the period, and in the last quarter of the year recruitment volumes have increased, following the relaxation of lockdown restrictions. Over 156 new hires started during the period with the majority being successfully onboarded remotely.

The Group also runs a successful 'refer a friend' scheme whereby employees receive a referral fee if an individual they refer for a role passes probation. This year 26 individuals were successfully recruited through this scheme (2020: 18).

Employees' involvement

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

The Forum has been designated as the primary channel through which the Board receives information on the views of the workforce, either by attendance at the meetings or through the People Director who reports to ExCo and the Nomination Committee on matters raised. This satisfies the 'Employee Voice' provisions of the UK Corporate Governance Code.

During the period non-executive directors have attended several People Forum meetings and discussed topics including executive and wider remuneration and the impact of the Covid pandemic on the workforce and the business.

The Forum has remained a valuable channel of engagement with employees over the year, despite the impact of the pandemic, with both non-executive directors and ExCo members attending meetings to discuss how the Group has addressed the impacts of Covid and the development of its hybrid working trials, amongst other topics.

The Forum also made a recommendation to grant employees additional leave for Christmas Eve and New Year's Eve, and this recommendation was approved by the Board, effective from 2021. Additionally, the Forum was consulted on the decision to increase the minimum annual holiday allowance in the year.

Executive directors also provide biannual updates on business progress to the entire workforce which have been delivered through video messages during the Covid pandemic. ExCo members also use the Group's intranet to deliver updates on important initiatives within the business from time to time.

To involve employees in the Group's performance, the Company operates a Sharesave share option scheme and a profit sharing scheme, both of which enable eligible employees to benefit from the performance of the business. At 30 September 2021, 65% of the Group's employees were members of one or more Sharesave scheme.

In addition, during December 2020 each employee below senior management level received a one off deferred award of £1,000 of shares, valued at the December 2020 market price which vest in December 2023, giving those employees a direct interest in the performance of the Group's shares.

Health and Safety

Throughout the year, the Group has remained compliant with all applicable health and safety legal requirements and implemented best practice management standards across its businesses. This is combined with a commitment to providing a healthy and safe working environment for all employees, contractors and visitors to its premises, and those impacted by its operations in public areas.

Employees are provided with appropriate levels of information, instruction, training and supervision, to empower them to take ownership of their responsibility for a healthy and safe environment and are encouraged to report any concerns in line with the Group's stated health and safety objectives, whether in the office or home based.

While the Group's primary source of health and safety related risk remains with the vehicle maintenance operations of Specialist Fleet Services Limited ('SFS') the focus for the vast majority of this year has been on the continuance of Covid-related control measures in the face of rapidly changing Government guidance.

Throughout the pandemic employee engagement has been a key factor on health, safety and wellbeing. For much of the year most of the Group's people were working from home, with several sites entirely closed. From June, planning began for a phased return to the office in September under a hybrid working model. Employees were engaged to determine if there were any duplicate equipment needs to ensure they have a healthy and safe environment both in the home and at the office with access to appropriate equipment.

In the Group's offices a Covid-secure environment was maintained throughout the year in accordance with the latest Government advice. Risk assessments, procedures and documentation have been kept under review to consider Covid measures and made available to all employees to provide awareness regarding the current control measures as best practice changed through the period.

The offices that remained open continued to comply with all health and safety rules, with the number of fire marshals, first aiders and other qualified personnel continuing to be sufficient, and this continues to be regularly monitored based on the number of occupants.

To ensure the health and safety of home-based employees, a proactive contact programme was put in place to ensure that employees were working in a safe and healthy manner throughout the pandemic.

A programme to automate workstation assessments through the use of software was launched in the year, Which will identify those who need assistance more rapidly. Processes are also being put in place to conduct visual inspections of electrical equipment remotely, ensuring that the Group's equipment in people's homes remains safe to use.

Management and systems

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

The Group (excluding SFS) remains certified to ISO45001:2018 and its Occupational Health and Safety Management System ('OHSMS') is audited for compliance bi-annually by a UKAS accredited auditor.

SFS has its own health and safety manager and OHSMS. Incidents are investigated locally with access to Group resources as required. The operation attained certification to ISO45001:2018 in September 2021 and is audited for compliance annually by a UKAS accredited auditor.

Resources within the health and safety function have been kept under review in the year and were sufficient to ensure that health and safety management has been maintained to expected standards throughout the period.

Performance

During the year, the Group reported 8 incidents (2020: 11). All were of a minor nature with no lost time. No incidents were notifiable under the Reporting of Incidents, Disease and Dangerous Occurrences Regulations 2013 ('RIDDOR') (2020: 1).

Health and safety performance continues to be good with the number of incidents remaining at a low level. During the financial year ended 30 September 2021 there were no prosecutions or any enforcement action from visits by the authorities for non-compliance in respect of health and safety matters (2020: None).

A6.4 Environmental impact

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

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

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

Until recently the focus of the Group's environmental policies has been on its own activities, which are described further below, however, in the last year we have begun to assess the use customers make of the funds loaned to them, with an initial focus across mortgages. This includes developing systems to assess and monitor the environmental impacts associated with the Group's financing activities.

Reporting on climate change

The Taskforce on Climate-related Financial Disclosures ('TCFD') has published a framework setting out the main themes which companies should cover in their reporting on climate change. The use of this framework by UK listed companies will be mandated through new Listing Rules, which will apply to the Group from its year ending 30 September 2022.

These rules will require the Group to state whether it has made disclosures consistent with the TCFD framework, where consistency must be assessed based upon the level of its exposure to climate-related risks and opportunities and the scope and objectives of its climate-related strategy.

The Group has identified its response to climate change as being key to its business strategy and designated it as a principal risk. It therefore presents material relevant to the TCFD objectives throughout its reporting. The table below sets out where material relevant to each TCFD pillar may be found.

Governance		
Disclose the organisation's governance around climate-related risks and opportunities		**Section**
a) Describe the board's oversight of climate-related risks and opportunities	• The Board has designated climate change as a principal risk within the Group's ERMF, following this the focus has been on developing their understanding of the issue through insight sessions and discussions on climate change strategy • The Terms of Reference of the Risk and Compliance Committee have been updated to ensure appropriate oversight of climate-related matters at a board level on a quarterly basis	**Governance** – Board oversight – Sustainability Committee and Climate change working group
b) Describe management's role in assessing and managing climate-related risks and opportunities	• The CFO has been designated as the director responsible for climate change matters • Throughout the year the terms of reference of key executive risk committees have been updated to incorporate climate change. The newly established Sustainability Committee helps to ensure appropriate escalation and awareness of climate related risks across the business as well as escalation up to the Board	**Governance** – Board oversight – Embedding climate change within the organisation's governance structure

Strategy		
Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning where such information is material		**Section**
a) Describe the climate-related risks and opportunities the organisation has identified over the short, medium, and long term	• The Group has focused its assessment on the most material segment of its balance sheet, buy-to-let mortgages. The initial phase concentrated on the risks posed by flooding, and on energy efficiency • The UK has set a target to increase the proportion of more energy efficient properties in the PRS. In support the Group has released a series of green products aiming to support landlords in improving the energy performance of their properties	**External (downstream) impact** – Impacts of climate change **Risk management** – Quantifying our climate exposure – Climate-related opportunities
b) Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning	• In the year the Group issued an inaugural green capital instrument which outlines its commitment to embed climate change into long-term strategy • During the Group's annual strategy session the Board received an update on climate change and ESG. The session set out the strategic framework for the Group focusing on the Group's own emissions, the climate impact of our financing activity, the delivery of sustainable funding and financing initiatives and the building of partnerships to support change	**Governance** – Board oversight **Risk management** – Climate-related opportunities
c) Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario	• Work is underway to review the Climate Biennial Exploratory Scenario ('CBES') released in June 2021 and to outline the implications that such scenarios have on the Group's exposure	**Risk management** – Use of scenario analysis

Risk management		
Disclose how the organisation identifies, assesses, and manages climate-related risks		**Section**
a) Describe the organisation's processes for identifying and assessing climate-related risks	• The Group's activity has focused on incorporating climate risk considerations within the ERMF. The Governance framework now includes the Sustainability Committee reporting to Performance ExCo and ensuring comprehensive consideration across all aspects of our business. This governance process allows for climate change updates and monitoring to be escalated up to the Board and the Risk and Compliance Committee as appropriate	**Governance** – Embedding climate change within the organisation's governance structure
b) Describe the organisation's processes for managing climate-related risks	• Underwriting processes consider climate risk factors. For mortgages these include flood, subsidence, coastal erosion and the EPC of the property. Further mitigation against the risk of loss is provided through the requirement to have valid insurance • The Sustainability Committee monitors climate change metrics that are relevant to the business model and the business response to them. The relevant executive level risk committees, such as the credit committee will also monitor relevant risks in their areas of responsibility	**Risk management** – Quantifying our climate exposure
c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organisation's overall risk management	• The governance structure has been updated to include the Sustainability Committee. This governance process allows for climate change updates and monitoring to be escalated as appropriate • The climate change risk policy is under development and will ultimately be approved by the Risk and Compliance Committee. The policy development will support the formalisation of climate change risk governance within the ERMF • The new governance structure and the development of the climate change risk policy are clear stepping stones in the development of risk appetite and further embedding of climate change risk into the Group's ERMF	**Governance** – Sustainability Committee and climate change working group **Risk management** – Future developments

Metrics and Targets		
Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material		**Section**
a) Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process	• Across the Group's mortgage portfolio energy efficiency, flood risk and ground instability have been qualitatively and quantitatively reviewed during risk driver assessments • Across SME lending SIC codes have been used to identify those operating in high carbon intensive industries • The Group continues to enhance the data, methodology and disclosures in this area to ensure any exposure to physical or transitional climate change risk can be identified and monitored	**Risk management** – Quantifying our climate exposure
b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks	• The process for measuring the carbon emissions from the Group's operations continues to be enhanced. Disclosures have been included for the Group's operational emissions (Scope 1, 2 and 3) • The Group has disclosed the financed emissions associated with its mortgage book for the first time. This demonstrates the ongoing work for monitoring the climate-related impact of the Group's lending	**Operational impact** – Performance indicators **Financed emissions** – Scope 3 mortgage emissions
c) Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.	• In March 2021 Paragon Banking Group PLC issued a £150 million Green Tier-2 Bond. The proceeds of the Green Bond are being exclusively allocated to eligible green loans. The focus being green residential real estate with an EPC rating of either A or B. The Green Bond Framework outlines the Group's target for green financing as well as its ambition to support its customers in achieving more sustainable outcomes through the products offered	**Risk management** – Climate related opportunities

External (downstream) impact

The Group's external, or downstream, impacts arise from the use to which its customers put the funds loaned to them. Most directly, for asset-backed lending it relates to the impacts of the asset being financed and its use by the customer.

Impacts of climate change

The uses to which customers put the funds advanced to them by the Group give rise to two related groups of risks:

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

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

The Group already considers these types of issues in its underwriting and credit risk processes to some extent. Examples of how the Group's lending businesses manage their exposure to climate change effects, and seek to promote environmentally positive behaviour by customers, are given in Section A4.1.

Governance

Board oversight

The Board has designated climate change as a principal risk within the ERMF. This means information and measures on climate change risks are considered at board level and the Group's responses considered within the Board's overall strategy. The Chief Financial Officer ('CFO') has been designated as the director responsible for climate change matters.

The Board is engaged on a regular basis on sustainability and climate-related matters receiving frequent sessions to build their understanding on climate change and its associated risks and opportunities.

- An insight session was held for the Board which focused on education and awareness of climate change risk and the session outlined the key considerations from a Paragon perspective
- Further to this as part of a broader ESG presentation, a comprehensive summary of climate change impacts was presented at the Board strategy day. The focus was on strategic alignment and the priorities and implications of our loan portfolio allocation with consideration of net zero pathway commitments

Sustainability Committee and climate change working group

During the year the Group established the Sustainability Committee which reflects the commitment to embed sustainability throughout the organisation. The Sustainability Committee has a broad ESG perspective and reports to Performance ExCo and the Board on a regular basis.

The climate change working group, working under the oversight of the Sustainability Committee and Performance ExCo, has:

- Delivered new green products to encourage our customers to transition to a low carbon economy
- Increased the availability of climate-related data across the business through enhanced data collection at underwriting
- Developed financed emissions estimates across the Group's mortgage book using the Partnership for Carbon Accounting Financials, as set out below
- Performed a climate change risk assessment across the mortgage portfolio focusing on the key risk drivers across both physical and transition risk
- Submitted responses to the CDP climate change questionnaire, for the first time. The CDP is a not-for-profit charity that runs the global disclosure system for investors, companies, cities, states and regions to manage their climate and environmental impacts
- Continued to engage with external climate change initiatives. This includes involvement in industry initiatives, particularly through the Green Finance Institute, the FLA's Green Finance Group and UK Finance's Sustainability Committee and 'COP26 and Beyond' roundtable

Embedding climate change within the organisation's governance structure

Throughout the last year, since designating climate change as a principal risk, climate change continues to be further embedded within the Group's governance structure and culture. During the year the terms of reference of key risk committees have been updated to reflect their responsibilities with respect to climate change.

Consequently, the wider impacts and transmission channels of climate related risks can be identified and managed across the Group. Through improved governance and increased climate related reporting into the Sustainability Committee, and other executive level committees, the process for identifying and managing climate-related risks has been enhanced. This ensures that the broad scope of climate change related risks is escalated and managed by personnel across the business. Examples of the topics discussed at executive level committees throughout the year include:

- An EPC risk paper was presented to the Credit Committee, an outcome of which has been for the Committee and the credit team to review the implications of EPC on loan performance
- An insight session was provided to ORC on the importance of climate considerations with a further session held on incorporating climate change into the RCSA process
- Climate change has been embedded throughout the monthly reporting at Asset and Liability Committee ('ALCO') through the monitoring of our green products and the wider green product market

Risk management

Assessment of current environmental risks and forward-looking climate change risks are factored into the Group's business. When assessing the appropriateness of a property as security on a buy-to-let mortgage, factors such as the EPC rating of the property, flood risk, risk of coastal erosion and ground stability are considered.

As part of the valuation report performed by surveyors, coastal erosion, ground stability and flood risk are assessed based on the surveyor's expertise of the local area, historic events and information from insurers. As part of the conservative approach taken, these risks are assessed on a property-by-property basis. Additionally it is essential for the Group to ensure that a property is and remains insurable providing cover from both subsidence and flood risk across the mortgage book.

Since 2018 all properties accepted as a security must have a minimum EPC rating of E at the time of offer unless valid exemptions are in place. EPC data is likely to be of increasing importance with regulations and government policy tightening with the aim of decarbonising the building stock. The Group's data capture process has been enhanced to improve the current understanding of the exposure but also for use in longer term climate scenario analysis.

Similar activity is planned to ensure any other lending subsets which might be particularly exposed to physical or transitional climate change risk can be identified and monitored. Throughout the year the energy efficiency of completed developments within the Group's development finance business has been assessed using EPC data. This information has been used across the business to assess the quality of the developments and to begin to review the climate change impact that this lending might have.

Climate-related opportunities

Climate change related opportunities have been and continue to be considered as part of the Group's strategy and the Group aims to support its customers in their transition to a low carbon economy.

In March 2021 the Group became the first bank in the UK to issue a green capital instrument. The proceeds of the bond are being allocated exclusively to eligible green loans. This funding structure is an indication of the Group's commitment to place sustainability and climate change at the heart of its long-term strategy.

The Group's lending businesses have released a series of green products during the year and after the year end. These have included

- Buy-to-let mortgage products aimed at supporting landlords to improve the energy performance of their properties and thereby increase the proportion of EPC A to C rated properties in the PRS
- Development finance products promoting the development of properties with high EPC ratings
- Motor finance products for electric vehicles

These are discussed in Section A4.1 in the reviews of the relevant businesses.

Quantifying our climate exposure

During the year the Group has made progress in assessing the potential financial impact of climate change on its buy-to-let mortgage book. The primary focus has been on the potential transitional risk related to the energy efficiency of the properties financed and the physical risk relating to flood risk and ground instability. The assessment included reviewing both the climate change screening during the loan origination process as well as assessing the total current portfolio exposure to such risks.

Throughout the year deep dive sessions and workshops were held with personnel across credit risk, property risk and mortgages on flood risk and ground instability which specifically considered the long-term impacts of climate change. The analysis indicated that the current processes are fit for purpose however they will continue to evolve as data availability improves.

EPC levels and associated regulation have the potential to impact our credit risk and the Credit Committee and our credit team continue to analyse the linkage between EPC and loan performance. Additionally the Sustainability Committee actively monitors the energy performance of properties to ensure that an excessive build up in concentration of less efficient properties is avoided. This EPC risk assessment has led to the launch of new 'green' products and enhancements to the underwriting process in support of climate consideration.

The tables below summarise the principal risk metrics for the Group's mortgage lending exposure in England and Wales. Coverage levels are shown as a percentage of accounts with properties in England or Wales, which represent 97.9% of the portfolio. Work is ongoing to source comparable data for the Group's Scottish and Northern Irish exposures.

Indicator	Measure	2021	Coverage	2020	Coverage
EPC	Grading A to B	8.1%	88.3%	7.8%	87.7%
	Grading A to C	37.6%	88.3%	36.9%	87.7%
	Grading A to E	98.4%	88.3%	98.2%	87.7%
Flood risk	High risk properties	0.7%	100.0%	0.4%	99.0%
	High or medium risk properties	2.5%	100.0%	2.2%	99.0%

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

Quantitative analysis for flood risk used localised postcode level data and indicated that only a small proportion of security properties were located within medium or high-risk zones. The Group is yet to experience any loss from flood or ground instability.

Green mortgage lending, for properties with EPC grades of A to C increased by 27.7% in the year to £577.7 million (2020: £452.5 million). For new buy-to-let mortgages in England and Wales advanced during the year ended 30 September 2021, the distribution of EPC grades is shown below.

Indicator	Measure	2021	Coverage	2020	Coverage
EPC	Grading A to B	9.4%	93.0%	10.2%	94.0%
	Grading A to C	40.3%	93.0%	40.8%	94.0%
	Grading A to E	100.0%	93.0%	100.0%	94.0%

The Group's completions continue to have a higher average EPC grade than the total portfolio stock, shifting the overall mix towards more energy efficient properties, a trend which will be accelerated by the launch of green mortgage products in the year. However, a focus by banks on green advances alone will not deliver the desired changes in the housing stock, and initiatives to decarbonise the existing stock will be needed.

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

Indicator	Sector	2021	Coverage	2020	Coverage
Sector	Water, sewerage and waste	4.53%	100%	3.54%	100%
	Extractive industries	2.35%	100%	1.75%	100%
	Power generation	0.01%	100%	0.01%	100%
	Total carbon intensive industries	6.89%	100%	5.30%	100%

This demonstrates that the Group's SME lending customer base is not disproportionately exposed to those industries considered to have the highest environmental impacts.

Measures addressing other risk elements including those in other business streams, for example, classifications of business assets and motor vehicles financed by environmental impacts, and classification of development finance projects by environmental rating, are under development and continue to evolve. Further work will also be undertaken to narrow reporting metrics beyond SIC codes, given the breadth of activities that can be included. These will be aligned to the UK's new Green Taxonomy due to be introduced during 2022.

Use of scenario analysis

As our understanding of climate risk develops climate change scenario analysis is becoming of increasing importance. Scenario analysis enables the identification of risks across the short, medium and long term. The complex nature of forward-looking scenarios and long-term scenarios beyond the planning horizon brings about many challenges.

The process to review the implications for the Group of the PRA Climate Biennial Exploratory Scenario ('CBES'), released in June 2021, is currently underway. The CBES is focused on testing the financial resilience of firms across three scenarios for government intervention on climate, referred to as 'Early policy action', 'Late policy action' and 'No additional policy action'. These are aligned with the Network for Greening the Financial System ('NGFS') scenarios which are seen as good practice.

Future developments

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

- Further embedding climate change risk management across the business
- Enhancement of the understanding of the climate change impact of the Group's lending within the business
- Development of the climate change risk policy which clearly documents the Group's approach to managing climate change risk within the ERMF. The Policy helps document how the understanding and management of climate risk is distributed across the business whilst articulating clear roles and responsibilities for managing and monitoring of climate change risk across the business
- Development of formal climate related risk appetites and a full suite of Key Risk Indicators and Key Performance Indicators. These will then be further developed into short-term and long-term climate related targets or ambitions for the Group
- Continued development of climate change scenario analysis leveraging off the CBES and NGFS scenarios to determine the resilience of the Group's strategy under different climate-related scenarios

Financed emissions

The Group supports the UK's ambition for net zero by 2050 and has a climate ambition of reducing the emissions associated with the mortgage book. This year, for the first time, it has calculated the Scope 3 emissions associated with its buy-to-let mortgage lending activities. With this data being relatively new, the Group is in the process of identifying other ways that it can support its customers whilst reducing the impact that its lending has on the environment.

The Group plans to continue to develop its financed emission disclosures over the next year scoping out methodologies to increase the balance sheet coverage as well as emission reductions. Whilst the Group has not yet set science-based targets across its financed emissions, there are plans to explore this further enabling the Group to track progress and alignment with a net zero pathway.

Scope 3 Mortgage emissions

Financed emissions – considered as scope 3 emissions – are the emissions that the Group's customers produce due to the financing provided. In line with PCAF standard the absolute financed emissions have been calculated across the buy-to-let mortgage portfolio. Under this approach a lender, such as the Group, is considered to be responsible for a proportion of the emissions based on an 'attribution factor'.

For buy-to-let mortgages the annual emissions relating to the finance property are attributed to the mortgage provider on a loan-to-value basis.

PCAF scope 3 financed emissions	
Scope 3 Annual buy-to-let mortgage emissions	**2021**
Balance of mortgage lending (£m)	11,312.7
Balance of mortgage lending with valid EPCs (£m)	9,775.2
Absolute Financed Emissions from properties with valid EPCs (tonnes CO_2)	148,607
Physical Emissions intensity of properties with valid EPCs ($kgCO_2$ per m^2)	47.24
Economics Emissions intensity of properties with valid EPCs ($kgCO_2$ per £ income)	13,419

Notes on calculation methods

1. The financed emission attribution factor uses outstanding balance and original valuation to calculate the (unindexed) loan-to-value factor – this is aligned with the PCAF guidelines.
2. The data contained in the EPC has not been altered or updated.
3. The data score calculated in accordance with the PCAF guidelines was 3 as all the data above relates to properties with available EPCs.
4. The calculation of physical emissions intensity used the sum of attributed floor area using loan-to-values ratios.

Operational Impact

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

SFS leases refuse collection vehicles to local authorities throughout the UK. SFS undertakes 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 and includes these within its legal compliance framework. The Group's environmental commitment is included within the Health, Safety and Environmental policy that is approved by the CEO and the People Director.

Its environmental commitments are expressed in its Green Charter which is approved by the CEO and kept under regular review.

Group-wide recycling and awareness campaigns are also run with employees to reduce various forms of waste such as food, consumables or energy.

Risk management

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

Energy data is collated by Group Property, the division responsible for managing the Group's premises. Consumption figures for all locations occupied, whether directly owned or tenanted, are actively monitored. This is reported upwards to board level.

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

The Group complies with the Energy Savings and Opportunities Scheme ('ESOS'). This is a UK Government initiative, and requires the Group to identify and reduce its energy consumption. The Group submitted its ESOS compliance notification to the Environment Agency in December 2019. The next submission is due in 2023.

Supply chain and procurement

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

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

All pre-printed stationery items used by the Group are from renewable sources certified by FSC.

84.5% (2020: 84.0%) of the purchased electricity in the year was obtained from sources certified as renewable by the Office of Gas and Electricity Markets ('OFGEM').

Environmental initiatives

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

During the year the Group's London operations were centralised at a new location at Fenchurch Street in the City. These new premises both reduce the Group's operational footprint and increase energy efficiency. The new location is a more modern, green building built to the latest BREEAM standards. The Group benefits from clean energy created on site by hydrogen fuel cells, and all waste is segregated on site by the building's facilities management team.

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

- Installation of a new, more energy efficient heating plant at the main SFS location, reducing the Group's gas consumption
- Continuing the programme of refurbishment work on washroom facilities at the head office building employing touchless energy and resource saving technology. All construction wastes are segregated and disposed of responsibly by the contractor
- Continuing to modernise the key components of the Heating, Ventilation and Air Conditioning ('HVAC') systems at the head office site, reducing the Global Warming Potential ('GWP') of chiller plant used during the summer months

The scope of initiatives in the period has been limited by the impact of lockdowns and other restrictions on access to the Group's buildings for large parts of the period, particularly for external contractors.

An independent assessment of the Group's energy performance, at the head office and its Leeds site, has been commissioned and will take place in the early part of the new financial year. The recommendations from this assessment will form part of the Group's resource planning and be used as the basis for setting short, medium and long term goals for reducing environmental impacts. These objectives will be approved, and progress monitored, at board level.

Key short term objectives are:

- Alignment of the Group's environmental management systems to ISO14001:2015 prior to obtaining external certification
- Set the baseline year to be used for the ongoing measurement of the Group's environmental performance going forward
- For leased buildings managed externally, liason with landlords to encourage the procurement of energy from renewable sources where possible, and generally encourage initiatives to reduce the carbon footprint at such locations
- Roll out training programmes to raise awareness of environmental impacts amongst the Group's people, with focussed training for those with specific responsibilities in the environmental management system

Performance indicators

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

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

This information is presented for the twelve months ended 30 September in each year and includes all entities consolidated in the Group's financial statements. Normalised data is based on total operating income of £324.9 million (2020: £295.1 million).

Greenhouse gas ('GHG') emissions

	2021 Tonnes CO_2e	2020 Tonnes CO_2e
Scope 1 (Direct emissions)		
Combustion of fuel:		
Operation of gas heating boilers	**450**	452
Petrol and diesel used by company cars	**353**	402
Operation of facilities:		
Air conditioning systems	**33**	33
	836	887
Scope 2 (Energy indirect emissions)		
Directly purchased electricity	**641**	697
Total scope 1 and 2	**1,476**	1,584
Normalised tonnes - scope 1 and 2 CO_2e per £m income	**4.5**	5.4
Scope 3 (Other indirect emissions)		
Fuel and energy related activities not included in scope 1 or 2	**426**	325
Water consumption	**4**	12
Waste generated in operations	**60**	61
Total scope 3	**490**	398
Total scopes 1, 2 and 3	**1,967**	1,982
Normalised tonnes scope 1,2 and 3 CO_2e per £m income	**6.1**	6.7

CO_2 equivalent ('CO_2e') values above are calculated based on the BEIS / DEFRA guidelines published on 1 June 2021.

The amounts shown above for total scope 1 and scope 2 emissions are those required to be reported under the Companies Act (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018. Other scope 3 emissions from operations not reported above are not considered to be significant. All these emissions relate to activities in the UK and its offshore area.

The reduction in emissions in the year is principally driven by the continuing effects of Covid. The majority of emissions included above relate to the provision of heat, light and power to the Group's premises. Several office buildings were closed for long periods, particularly during the winter months when the UK was in lockdown. Social distancing rules continued to mean that the scope for business travel, for meetings and other normal parts of the business process was sharply reduced, particularly in the first half of the year.

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

It is unlikely that these levels would be maintained in a normal operating environment.

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

Power usage

The Group uses mains electricity and natural gas from the UK grid to provide heat, light and power to its office buildings. It also uses fuel in company vehicles, which is included in Scope 1 above and through business travel of employees, which is included in Scope 3. The amount of power used in the year ended 30 September 2021 is shown below.

	2021	2020	2019
	MWh	MWh	MWh
Renewable electricity	**2,458.6**	2,509.3	3,123.5
Other electricity	**558.9**	478.2	768.1
Electricity	**3,017.5**	2,987.5	3,891.6
Natural gas	**2,454.9**	2,450.9	2,817.1
Motor fuel	**1,551.7**	1,900.3	3,099.9
	7,024.1	7,338.7	9,808.6
Normalised MWh per £m income	**21.6**	24.9	33.0

Consumption levels have remained low in the year as the pattern of Covid-related lockdowns and working from home, which commenced in March 2020 continued through much of the year. Some of the Group's buildings were closed for long periods, with the utilisation of others reduced.

Gas and electricity usage are based on consumption recorded on purchase invoices. Vehicle fuel usage is based upon expense claims and recorded mileage. Renewable energy is supplied through the grid with OFGEM accreditation received from the suppliers. No separate conversion factor is stated by BEIS / DEFRA for electricity from renewables and therefore the Group receives no benefit for this in the GHG emissions table above.

Water usage

The Group's water usage is limited to the consumption of piped water in the UK and no water is extracted directly. Water usage in the year ended 30 September 2021 was 8,500m^3 (2020: 11,950m^3), based upon consumption recorded on purchase invoices, a normalised amount of 26.1m^3 per £m income (2020: 40.5m^3 per £m income). The reduction in usage is a result of reduced office occupancy through most of the year.

Waste

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

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

All the Group's waste is either recycled, used in waste-to-energy initiatives or sent to landfill. Amounts of waste generated in the year ended 30 September 2021 together with the methods of disposal are shown below.

	2021	2020	2019
	Tonnes	Tonnes	Tonnes
Recycled	**87**	61	122
Waste to Energy Initiatives	**17**	29	-
Landfill	**125**	131	187
	229	221	309
Normalised tonnes per £m income	**0.70**	0.75	1.04

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

Generation of waste in the Group's buildings continues to be depressed by the low levels of occupancy, coupled with a concerted effort in several areas to reduce paper usage.

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

A6.5 Social and community

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

The Group operates as a specialist lender and provides funding for business propositions in the development finance and SME lending markets which might struggle to attract larger lenders, helping to support the SMEs which are crucial to the UK economy.

Where possible, the Group uses its lending relationships to promote good practice. The buy-to-let mortgage division demands minimum standards from landlords in the properties it funds, helping to drive up standards in the PRS. Looking forward, the Group is developing products which will help to drive action on climate change.

Industry initiatives

Through its activity within trade organisations in the UK, the Group is helping to formulate public policy and share experience on best practice to drive forward better financial provision. The Group has been particularly active in initiatives to enable the PRS to serve the UK housing market more effectively. The Group also regularly engages directly with Government to help inform departments on how market trends are impacting landlords, their sentiment and behaviours. The Group's CEO is a member of both HM Treasury's Home Finance Forum and the Bank of England Residential Property Forum which provide input to policy at the highest levels.

Membership of bodies such as UK Finance and the FLA enables the Group to be part of shaping the future of financial services provision to the benefit of the whole community. In 2021, this has been enhanced through work by the Mortgage Lending business with the Green Finance Institute on the potential for providing green products to the buy-to-let mortgage market. In particular the business worked with the Coalition for Energy Efficient Buildings formed by the Institute.

The Group contributes to registered charities providing debt advice to support its vulnerable customers. Contributions of £912,000 (2020: £1,110,000) were made by the Group during the year to the work of the Foundation for Credit Counselling which operates the StepChange Debt Charity. This ensures that such customers are able to receive free, independent advice on their finances from qualified counsellors.

Supporting the community

The Group actively supports charity initiatives, focussing on organisations serving the communities in which it operates. Contributions made in the year totalled £39,600. (2020: £157,800).

Charities which benefitted from the Group's charitable donations include local schools, sports clubs, hospitals and hospices, The Down's Syndrome Association, British Heart Foundation, Rethink Mental Illness, Happy Days Children's Charity, Demelza Hospice Care for Children, and many others. During Pride month the Group encouraged fundraising for LGBTQ+ affiliated charities with one of the beneficiaries being St Basil's charity.

Due to the Covid pandemic face-to-face volunteering with SIFA Fireside, local schools and 'Ready to Work' were unfortunately put on hold. Employees continued to make a difference to the local community, focusing on virtual volunteering and providing mentoring for individuals who require careers support. This achieved 49 volunteering days (2020: 23.5 days). The Group is also in the process of resuming its normal volunteering activities with early initiatives including:

- St Basil's charity – Yardley House, a residential housing unit for young vulnerable adults. The unit, specifically for mothers and babies, required support to refurbish its communal garden area
- Stanville Primary School – previously a hospital building which required extensive refurbishment. The school was under pressure to save money, and with reduced staffing due to the pandemic needed volunteers to assist with creating a safe and interesting play area for its Early Years section

At Christmas 2020, the annual donations of food and luxury items by employees for Christians Against Poverty continued. Even though this was impacted by the Covid lockdown with the majority of employees continuing to work remotely, a total of 54 families received a parcel delivery.

The Group also supports Paragon's Charity Committee, consisting of volunteer employees, who organise a variety of fundraising activities throughout the year. Each year all employees are given the opportunity to nominate a charity, and a vote is carried out amongst the employees to select the charity or charities to benefit from the following year's fundraising activities. In the calendar year 2020, £60,000 was raised for Macmillan, while in the first nine months of 2021, £22,000 has been raised for the Alzheimer's Society through online events, monthly raffles and employees taking part in sponsored events including 'Jog on or Step-up for Alzheimer's' and charity football.

Given the restrictions which continued to be imposed on office-based fund-raising activities by working from home, this is an impressive achievement by the Committee and the Group's employees.

Taxation policy and payments

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

The Group's tax strategy is to comply with all relevant tax obligations whilst co-operating 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 HMRC in March 2013. The Group has previously confirmed to HMRC that it was unconditionally committed to complying with the Bank Tax Code, and formally re-approved the Group's tax governance policies and the tax strategy outlined above.

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

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

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

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

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

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

	2021	2020
	£m	£m
Corporation tax	**48.3**	46.1
PAYE and NI	**29.1**	32.8
VAT	**3.8**	2.7
Stamp duty	**0.2**	-
Total national taxation	**81.4**	81.6
Business rates	**1.3**	1.4
	82.7	83.0

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

A6.6 Human rights

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

The Group's commitment to supporting its people's employment rights is described in Section A6.3.

The Group operates exclusively in the UK and, as such, is subject to the UK Human Rights Act 1998 which incorporates the European Convention on Human Rights into UK law. The Group has systems in place to ensure that its policies and procedures are compatible with all legal requirements applicable to it and to identify any new or emerging requirements.

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 and business partners comply with the relevant legislation and regulations in place in the UK and to promote good practice. The Group's policies are formulated and kept up-to-date by the relevant business areas, authorised in accordance with the Group's governance procedures and are communicated to all employees.

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

The Group supports the objective of the Modern Slavery Act 2015, in raising awareness of modern slavery and human trafficking.

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

The Group publishes an annual Modern Slavery Statement, describing policies for achieving this, which can be found on the Group's website: www.paragonbankinggroup.co.uk.

The Group undertakes extensive monitoring of the implementation of all its policies and has not been made aware of any incident in which the organisation's activities have resulted in an abuse of human rights or a breach of Modern Slavery legislation. No fines or prosecutions in respect of non-compliance with human rights legislation, including Modern Slavery legislation, have been incurred in the financial year (2020: none).

A6.7 Business practices

Business partners

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

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

The Group has a Supplier Code of Conduct, available on its website, which sets out our overall approach to supplier engagement and corporate responsibility and, importantly, the standards of behaviour expected from suppliers.

The Code of Conduct also includes the Group's conduct commitments and its expectations of business partners in relation to bribery and corruption, data protection and modern slavery. It also contains important information concerning the Group's employment practices, approach to health and safety, community matters and environmental policies.

When outsourcing activities, the Group retains responsibility for those services and the associated risks. Significant work has been focused on the most critical suppliers to meet enhanced regulatory requirements under the European Banking Authority's Guidelines on outsourcing. These changes strengthen the Group's resilience across the supply chain.

The Group aims to pay all of its suppliers within 30 days of receiving a valid invoice, where correct procedures are followed and actively engages with suppliers where issues arise. It is a signatory to the UK's Prompt Payment Code ('PPC'), administered by the Office of the Small Business Commissioner and as such commits to paying invoices within 60 days, unless there is good reason for non-payment. The PPC also aims to ensure all invoices from suppliers it defines as small businesses, are paid within 30 days unless under query.

The Group's central administration company, Paragon Finance PLC, reports its payment performance semi-annually under the 'Reporting on Payment Practices and Performance Regulations 2017'. Following some disruption to process caused by Covid restrictions in the first half of the year, data for the six months ended 30 September 2021 showed invoices paid in an average of 22 days and 95% of invoices paid within 60 days, on the basis set out in the regulations.

Anti-corruption

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

The Group carries out an annual risk assessment as required by the Bribery Act 2010 and continues to conclude that it is not a company with a high risk of bribery. The Group conducts all of its business within the UK and its only significant outsourcing arrangement relates to the administration of its savings operations by the outsourcing arm of a major UK building society. The UK is not considered a jurisdiction with a high incidence of corrupt practices, ranking eleventh safest in the Corruption Perceptions Index for 2020 out of 180 countries.

However, the Group takes its responsibilities seriously and will not tolerate bribery in any form on any scale and as such, its policies and procedures are kept under regular review. The Group will self-report any serious incidence of bribery or corruption that is identified.

The Group's policies cover the conduct of its business, its interactions 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 which is incorporated in the Supplier Code of Conduct. The policy is updated, and a risk assessment conducted on an annual basis.

All employees are required to read the Group's anti-bribery and corruption policy and undertake annual on-line training to assess their understanding. The anti-bribery culture forms part of the induction course for all new employees and is reinforced at subsequent training sessions. Any employee found to be in breach of these policies will be subject to disciplinary action. No such disciplinary action has taken place in the year ended 30 September 2021.

During the year the CRO, in conjunction with the Head of Financial Crime, who are both part of the 'second line' Risk and Compliance function, were responsible for ensuring the Bribery Act risk assessment is properly completed and that appropriate policies and procedures were in place and reviewed on a regular basis. They were also responsible for ensuring any changes in the law are identified and properly reflected in the Group's policies and procedures, where appropriate. In the last year there have been no material changes in legislation or guidance in the UK. Following the year end a new role of Head of Financial Crime Risk was created, taking on the risk management aspects previously part of the role of the Head of Financial Crime, enabling greater focus on both the first and second line aspects of the role.

The Group has not been involved in any incidents resulting in prosecutions, fines, or penalties or in similar incidents of non-compliance in respect of bribery, corruption, or other illegal business practices (2020: none).

Anti-money laundering

As a financial services entity, the Group also has procedures in place to ensure it cannot be used to facilitate money laundering, sanctions abuse or other forms of financial crime. These procedures are kept under constant review to ensure they remain robust and appropriate, and a further gap analysis was carried out during the year in light of the FCA 'Dear CEO' letter on anti-money laundering frameworks sent to retail banks in May 2021. Additional requirements identified are being addressed as an immediate priority.

Employees receive regular annual training in these areas, with their understanding being tested and levels of completion reported to regulators. At 30 September 2021 the Group's money laundering reporting officer was the CRO, pending the appointment of a new Head of Financial Crime Risk, following the departure of the previous role holder towards the end of the financial year.

Management responsibility

The Group's senior legal officer is the Group Counsel and Company Secretary, who is a member of the Executive Committee and attends meetings of the Board. The CRO has overall responsibility for the risk and compliance functions. He is also a member of the Executive Committee and reports directly to the Risk and Compliance Committee of the Board (see Section B8).

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

Whistleblowing

A whistleblowing hotline, run by an independent third party, Protect, is available to employees who have concerns over any aspects of the Group's business practices. The Group's principal regulators, the PRA and FCA, provide confidential whistleblowing services to customers and external third parties which are communicated to customers and publicised on the Group's and the regulators' websites. Whistleblowing arrangements are described further in Section B4.5.

A7. Approval of Strategic Report

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

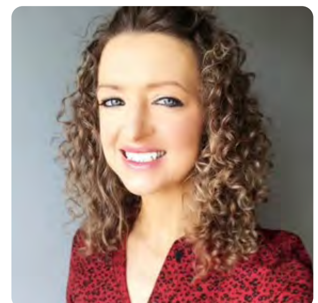
This Strategic Report has been drawn up and presented in accordance with, and in reliance upon, applicable English company law, in particular Chapter 4A of the Companies Act 2006, and the liabilities of the directors in connection with this report shall be subject to the limitations and restrictions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

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

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

Marius van Niekerk
Company Secretary
7 December 2021

International Women's Day
To celebrate International Women's Day 2021, female leaders from across the Group hosted a series of drop-in sessions to share their experience and offer encouragement to colleagues.



B. Corporate governance

How the Group is run and how risk is managed

P78 **B1. Chair of the Board's statement**
An overview of governance in the year

P80 **B2. Corporate Governance Statement**
How the Company complied with the Code in the year

P82 **B3. Board and senior management**
The directors and the operation of the Board during the year

P88 **B4. Governance framework**
The system of governance, committee structure and how the Board fulfils its duties

P102 **B5. Nomination Committee**
Policies and procedures on governance, board appointments and diversity

P105 **B6. Audit Committee**
How the Group controls its external and internal audit processes and its financial reporting systems

P114 **B7. Remuneration**
Policies and procedures determining how directors are remunerated

P145 **B8. Risk management**
How the Group identifies and manages risk in its businesses

P157 **B9. Directors' report**
Other information about the structure of the Company required by legislation

P160 **B10. Directors' responsibilities**
Statement of the responsibilities of the directors in relation to the preparation of the financial statements

B1. Chair's statement on corporate governance

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

Fiona Clutterbuck, Chair of the Board

Dear Shareholder

I am pleased to introduce this section of the annual report, which describes the Group's governance processes and how the Board and its Committees addressed the important issues facing the Group during the year.

The Group is committed to strong corporate governance as a foundation for strategic success and takes its responsibilities under the UK Corporate Governance Code (the 'Code') very seriously. As a board we recognise that a robust governance structure and effective risk management framework are integral to delivering sustainable growth and shareholder returns.

The Board noted with interest the BEIS proposals on governance, auditing and reporting published in the year. Final recommendations are due to be published in the coming year and the Board expects to spend considerable time considering these. It is my hope that the approach adopted by BEIS builds on the best aspects of the current UK approach to governance, developed over the thirty years since the Cadbury Committee first met.

The Group enhanced the governance framework in the year, with the establishment of a Sustainability Committee, which reports to the Executive Committee and is able to form a holistic view of sustainability issues across the Group's activities. An informal Non-Executive Technology and Change Group was also created to provide direct insight for the independent directors on these areas.

Stakeholder engagement

The Group has continued to develop its shareholder engagement programmes during the year, despite our inability to engage face-to-face, as a consequence of Covid.

The Group's People Forum continues to meet regularly and provides the Board with insight into the views of the employees.

The People Director updates the Nomination Committee on the outcome of these meetings and has a comprehensive action plan to ensure that the key themes captured are fed back into the Board's decision-making process and that these decisions are subsequently reported back to employees, through the Forum and through wider communications.

I have been pleased to attend meetings of the Forum, as have some of the Group's non-executive directors. It was very useful for us to receive direct feedback from employees on a number of significant areas, including remuneration, employment conditions, the Group's response to Covid, and the hybrid working arrangements now being adopted.

We also launched our first in-depth employee survey since the onset of Covid during the year. This, pleasingly, demonstrated a high level of engagement, with employees expressing positive views about the Group's culture and the quality of the internal communications.

I, and my Board colleagues, have had the opportunity of meeting with the representatives of various regulators in the year. We value these interactions, and take the views of our regulators very seriously in considering policy and strategy.

During the latter part of the year I met with representatives of shareholders and proxy advisers, together with Hugo Tudor, the Senior Independent Director and Chair of the Remuneration Committee. These discussions covered the Group's approach to executive remuneration and also covered other governance and broader sustainability issues. I find these interactions to be both constructive and useful, and would urge all of our principal shareholders to participate, if invited.

Purpose

During the year the Board reviewed and confirmed the Group's purpose: "To support the ambitions of the people and businesses of the UK by delivering specialist financial services". This was followed up with a campaign intended to emphasise to employees and business partners the centrality of the purpose and the Group's values to its culture and strategy.

Diversity and Inclusion

The promotion of the Group's diversity and inclusion agenda has been a particular focus of my tenure as Chair. I was pleased to see the impact the new EDI Network had in its first year, and this bodes well for future progress in this area.

I was also delighted that the Group had met its Hampton-Alexander ('HA') targets for board and senior management diversity, and its wider diversity targets under the Women in Finance initiative, set in 2016. I look forward to the next phase of both projects.

Whilst I am proud of this progress, we will maintain our vigilance to ensure that momentum is maintained and will bear this in mind as the Board develops. In particular we are aware of the value of ethnic and other diversities on boards and of increased expectations around the Parker review, and are considering how best to build these into our succession planning.

Board effectiveness

The Board conducted an internal effectiveness review during the year and continued to address development points that arose from past effectiveness internal reviews. Planning for the next triennial, externally facilitated, review of board and committee effectiveness, due in 2022, is currently in progress.

Board changes

Having completed nine years on the Board in September 2021, I will be stepping down as Chair once a suitable candidate is appointed to replace me, and after an appropriate handover period. The Board and Nomination Committee have considered my reappointment beyond nine years and agreed that, in the interests of succession planning, and to ensure a smooth handover to my successor, my appointment should be extended to September 2022. The search process for the new Chair is well under way and we will update stakeholders once an appointment is made.

Peter Hill was appointed to the Board on 27 October 2020, becoming Chair of the Risk Committee on 31 December 2021 when the previous Committee Chair, Finlay Williamson, stepped down from the Board. Peter was previously CEO of Leeds Building Society from 2011 until his retirement in 2019 and brings with him a wealth of experience in financial services, gained during his executive and non-executive career, which will be valuable to the Group going forward.

The Group's next AGM will be held on 2 March 2022 in London, and we look forward to welcoming shareholders, hopefully without any of the Covid-related restrictions which impacted on the 2021 AGM. However, if any such restrictions are required, shareholders will be updated on revised arrangements through the Group's website.

Fiona Clutterbuck
Chair of the Board
7 December 2021

B2. Corporate Governance Statement

The Board is committed to the principles of corporate governance contained in the UK Corporate Governance Code issued by the FRC in July 2018 (the 'Code'). Throughout the year ended 30 September 2021, the Company complied with the principles and provisions of the Code.

During the year under review, the Company adopted the 'comply and explain' approach under Provision 19 of the Code to extend the Chair of the Board's tenure past nine years for succession planning purposes and to ensure the appointment of a suitable replacement Chair, as set out below.

Fiona Clutterbuck's nine-year term on the Board came to an end in September 2021 since she was first appointed in 2012 and she has indicated her intention to step down as Chair once a suitable candidate is appointed, and after an appropriate handover period. The Board and Nomination Committee considered Fiona's position, including her other commitments, and agreed that, in the interests of succession planning and to ensure a smooth transition of duties to Fiona's successor, her appointment be extended beyond nine years to September 2022. Fiona will therefore stand for re-election at the AGM in March 2022. The Board believes this limited extension to be in the interests of the Company's shareholders and the Group's other stakeholders. Fiona will step down once a new Chair has been appointed, and an appropriate handover has taken place. The search process, which is being led by Hugo Tudor, the Senior Independent Director, is well underway and the outcome will be communicated to shareholders in due course. This is discussed further in the report of the Nomination Committee in Section B5.

The table below signposts the relevant sections of this report, which provide supporting information about how the Code Principles have been applied.

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

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

Section 3: Composition, Succession and Evaluation	Section
J. Appointments to the Board are subject to a formal, rigorous and transparent procedure, and an effective succession plan is in place for Board and senior management. Appointments and succession plans are based on merit and objective criteria and promote diversity.	B5
K. There is an appropriate mix of skills, experience and knowledge. Tenure and membership of the Board and its committees are regularly reviewed.	B4.4
L. The annual board evaluation provides an opportunity for the directors to consider their collective and individual effectiveness and decide where there are areas for improvement.	B4.4

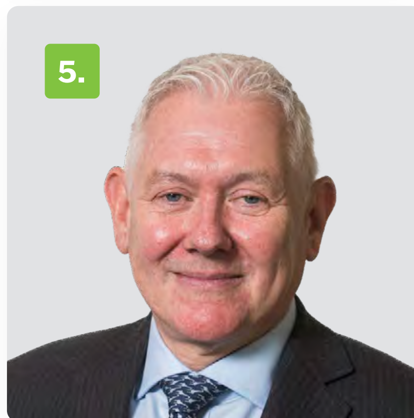
Section 4: Audit, Risk and Internal Control	Section
M. The policies and procedures, established by the Board, ensure the independence and effectiveness of internal and external audit functions. The Board has satisfied itself of the integrity of financial and narrative statements.	B6
N. The Board presents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

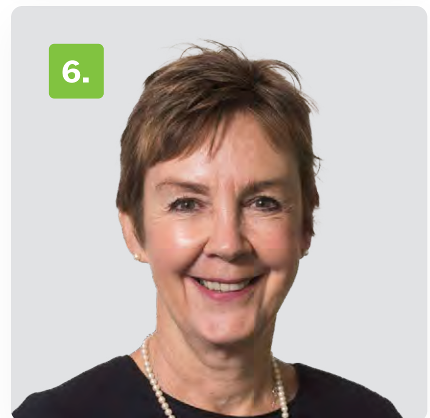
Section 5: Remuneration	Section
P. Remuneration policies and practices support strategy and promote long-term sustainable success. Executive remuneration is aligned to the Company's purpose, values and successful delivery of long-term strategy.	B7
Q. A formal and transparent procedure has been established to develop policy and determine director and senior management remuneration. No director is involved in deciding their own remuneration outcome.	B7
R. The directors exercise independent judgement and discretion over remuneration outcomes, taking account of company and individual performance and wider circumstances.	B7

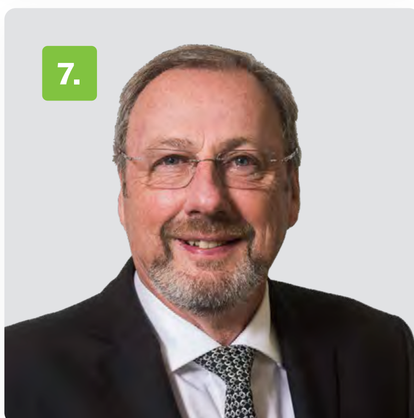
B3. Board of Directors and Senior Management

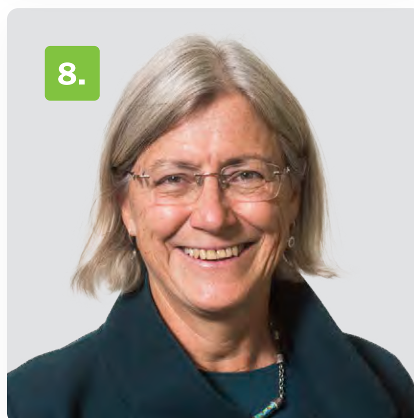
B3.1 The Board of Directors

Members of the Board of Directors at the date of approval of the annual report are set out below.









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

†In line with Code provision 10, Fiona's nine-year term was extended to September 2022, following Nomination Committee and Board deliberation during the year, to facilitate effective succession planning.

Finlay W Williamson stepped down from the Board on 31 December 2020.

1. Fiona J Clutterbuck

Chair of the Board (Age 63)

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

Experience

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

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

Specific areas of expertise*

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

Committee membership

Chair: Nomination Committee

Member: Risk and Compliance and Remuneration Committees

Current external appointments

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

Non-executive director and interim chair of M&G plc. In accordance with Code provision 15, the Board approved Fiona's appointment as interim chair of M&G plc in January 2021

Non-executive director of Investment Funds Direct Limited

2. Nigel S Terrington

Chief Executive (Age 61)

Appointed to the Board as Treasury Director in 1990, and became Finance Director in 1992 and CEO 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, becoming Treasurer shortly thereafter, before being appointed as Finance Director and then Chief Executive.

He is a member of the Board of UK Finance and is the Chairman of UK Finance's Specialist Bank Advisory Committee. Previously he was the Chairman of the Council of Mortgage Lenders ('CML'), Chairman of the Intermediary Mortgage Lenders Association ('IMLA'), Chairman of the FLA Consumer Finance Division and a Board member of the FLA.

Nigel is also currently a member of HM Treasury's Home Finance Forum and the Bank of England's Residential Property Forum.

He is an associate of the Chartered Institute of Bankers and in 2017 received an Honorary Doctorate from Birmingham City University for services to the finance industry.

Specific areas of expertise*

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

Committee membership

Member: Disclosure Committee

Current external appointments:

Board member of UK Finance

Chairman of UK Finance's Specialist Banks Advisory Committee

Member of HM Treasury's Home Finance Forum

Member of Bank of England's Residential Property Forum

3. Richard J Woodman

Chief Financial Officer (Age 56)

Appointed to the Board as Director of Corporate Development in 2012 and became CFO 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 and the Group's Mergers and Acquisitions ('M&A') programme.

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

Specific areas of expertise*

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

Committee membership

Member: Disclosure Committee

Current external appointments:

Director of Woodman Portfolio Holdings Limited and Rose Wine Limited.

4. Hugo R Tudor

Non-executive director (Age 58)

Appointed in 2014 – seven years served.

Became Senior Independent Director in July 2020

Experience

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

He is a Chartered Financial Analyst and a Chartered Accountant.

Specific areas of expertise*

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

Committee membership

Chair: Remuneration Committee

Member: Audit, Nomination and Risk and Compliance Committees

Current external appointments

Director of Damus Capital Limited

Director of Porthcothan Property Limited

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

5. Peter A Hill

Non-executive director (Age 60)

Appointed in December 2020 – one year served

Experience

Peter Hill's career in financial services has spanned over 40 years, including eight years as CEO of Leeds Building Society between 2011 and 2019, where he previously held the role of Operations Director.

He was chair of the CML for three years and was a member of the Board of UK Finance.

Peter is a fellow of the Royal Society of Arts and an associate of the Chartered Institute of Banking.

Specific areas of expertise*

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

Committee membership

Chair: Risk and Compliance Committee

Member: Audit Committee

Current external appointments

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

Chair of Mortgage Brain Holdings Limited

Director of Leeds Rugby Foundation

6. Alison C M Morris

Non-executive director (Age 62)

Appointed in 2020 – two years served

Experience

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

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

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

Specific areas of expertise*

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

Committee membership

Chair: Audit Committee
Member: Remuneration and Risk and Compliance Committees

Current external appointments

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

Non-executive director of M&G Group Limited, M&G Investment Management Limited and M&G Alternatives Investment Management Limited, all part of the M&G plc group

7. Graeme H Yorston

Non-executive director (Age 64)

Appointed in 2017 – four years 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 (now Santander).

Graeme has served on the CBI Council for Wales, the Board of Business in the Community in Wales and was HRH Prince Charles, Ambassador for BITC in Wales for two years.

He was awarded Director of the Year in Wales by the Institute of Directors in 2016.

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

Specific areas of expertise*

- Strong retail banking sector knowledge and experience particularly in marketing, communications and customer service
- Detailed experience of overseeing Business Change and IT systems

Committee membership

Member: Nomination, Remuneration and Risk and Compliance Committees

Current external appointments

None

8. Barbara A Ridpath

Non-executive director (Age 65)

Appointed in 2017 – four years 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 JPMorgan.

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

Specific areas of expertise*

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

Committee membership

Member: Audit, Nomination and Risk and Compliance Committees

Current external appointments

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

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

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

B3.2 Executive Committee

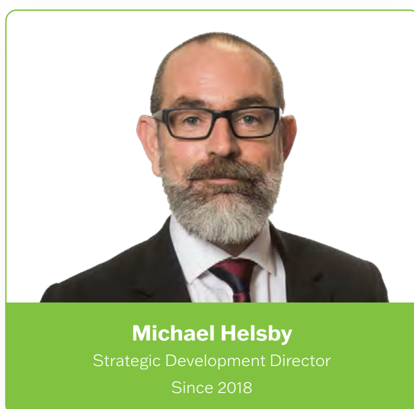
The members of the Group's Executive Committee are set out below, with their tenure in their current role.

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

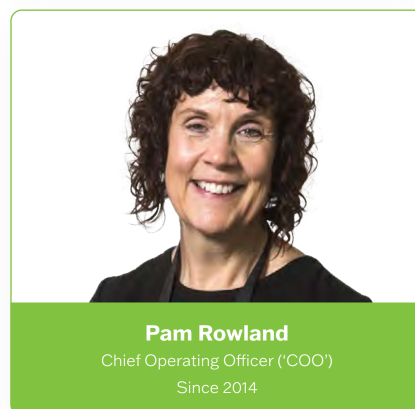
Richard Woodman
Chief Financial Officer ('CFO')
Since 2014

Richard Rowntree
Managing Director - Mortgages
Since 2020

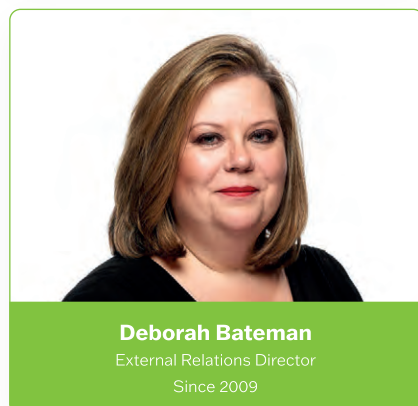
Dave Newcombe
Managing Director – Commercial Lending
Since 2019



Michael Helsby
Strategic Development Director
Since 2018

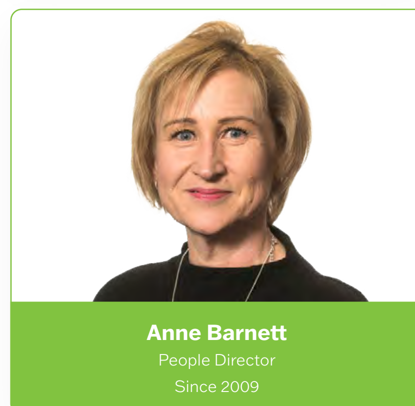


Pam Rowland
Chief Operating Officer ('COO')
Since 2014



Deborah Bateman
External Relations Director
Since 2009

Peter Shorthouse
Treasury and Structured Finance Director
Since 2010



Anne Barnett
People Director
Since 2009

Marius van Niekerk
General Counsel and Company Secretary
Since 2019

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

All members sit on both the Performance Executive Committee and the Executive Risk Committee. The Internal Audit Director, Sarah Mayne, attends both meetings as an observer.

B3.3 The Board's activities in the year

Matters considered by the Board

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

- Considering the impact of Covid, Brexit, and other macro-economic uncertainties on the Group
- Reviewing the Group's cyber security processes and operational resilience
- Assessing the impact of climate change on the Group and developing its ESG strategy
- Ensuring an effective transition away from LIBOR

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

Other significant matters overseen by the Board are set out below by theme:

Topic	Meeting
Cyber security / operational resilience	
Training / insight session on technology strategy and cyber security, presented by in-house experts.	Oct 2020
Update on cyber security, which included an overview of the Group's Security Operations Centre, new technologies and defence mechanisms deployed, and cyber security awareness initiatives across the organisation amongst other matters.	Mar 2021
Operational resilience training, which covered e.g. the regulatory perspective thereon, the Group's operational resilience framework, and steps the Group has taken and will take to enhance it, such as scenario tests and training.	May 2021
Corporate governance	
Annual review of the Corporate Governance Policy Framework.	Feb 2021
Succession planning for the Board and Group in conjunction with the Nomination Committee	Feb 2021, Jul 2021, Sep 2021
Training on CRD V, which provided an overview of the key remuneration requirements under CRD V and the key impacts on the Group's remuneration policies and practices	Mar 2021
Consideration of the annual whistleblowing report, which provided the Board with the assurance of the integrity of the Whistleblowing Policy, independence of the process and details of disclosures and developing trends identified during the reporting period.	Mar 2021
Approval of the Modern Slavery Statement and Policy following an annual review.	Mar 2021
Annual review of the Group's purpose with confirmation that it remained relevant and was fit for purpose for the next twelve months. In addition, the Board considered the Code requirement that the Group's purpose should align with its culture when making the assessment	Apr 2021
Approval of the declaration of a final dividend of 14.4 pence per share in respect of the financial year ended 30 September 2020.	Nov 2020
Approval of the declaration of an interim dividend of 7.2 pence per share and a buy-back programme of £40.0 million of the Group's ordinary shares in accordance with the approval granted at the 2021 AGM.	Jun 2021
Business strategy	
Training / insight session that explored the outlook for the UK economy and housing market. The session was facilitated by an economic research consultancy.	Oct 2020
Approval of the corporate plan for the financial years ending 2021 to 2025. More detail on the Group's strategy can be found in section A3 and A4.	Nov 2020
A deep dive review into Commercial Lending operations was provided to the Board by the managing director of the business. This was a further opportunity for the Board to meet a key management individual beyond strategy sessions, thereby enhancing engagement with senior management.	Jan 2021
An investment bank provided a market update on the financial services sector.	Feb 2021

Topic	Meeting
Risk and regulation	
Received training on the ILAAP.	Oct 2020
Approved lending to the Group's customers under the RLS.	Mar 2021
Approved the LIBOR transition approach for buy-to-let customers.	Mar 2021
Received training on pricing and cost of funds from in-house experts.	May 2021
Approved the Group's 2021 Recovery Plan.	May 2021
Received further training on IRB, following the training received in June 2020.	July 2021
Considered and approved revisions to the Group's principal risk categories.	July 2021
The General Counsel and Company Secretary and external counsel provided the Board with a legal and regulatory training session, which covered topics such as UK MAR and directors' duties.	July 2021
ESG	
Received a presentation from members of the Group's sustainability team on ESG.	Oct 2020
Received a presentation from members of the internal sustainability team and Ernst and Young on climate change.	Dec 2020
The People Director presented an update on employees to the Board, which outlined the employee experience and impact leading up to, and during, the second period of national lockdown across England.	Dec 2020
Approved a proposal to refinance the Group's Tier-2 Bond, which was subsequently issued as a green bond. Proceeds from the bond will be allocated to buy-to-let lending of properties with an EPC rating of A or B.	Jan 2021
Received an update on employee feedback via the Nomination Committee.	Feb 2021
Received an update on the Group's 'Return to Office' project.	Mar 2021
Received a presentation on investor relations from the External Relations Director, which covered matters including share price development, an overview of the Group's share register and movements over the preceding twelve months, and shareholder feedback following the half year results announcement.	Jul 2021
Approved the Group's updated Equality, Diversity and Inclusion Policy.	Sep 2021

The way in which the Board discharged its duty to consider the interests of all stakeholders in these discussions is discussed in Section B4.3. Contributors to board papers are required to consider and highlight any potential principal stakeholder impacts of any proposal as a matter of course.

Board and committee attendance

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

Director	Board	Audit Committee	Risk and Compliance Committee	Remuneration Committee	Nomination Committee
Fiona J Clutterbuck	10 (10)	-	4 (4)	6 (6)	3 (3)
Nigel S Terrington	10 (10)	-	-	-	-
Richard J Woodman	10 (10)	-	-	-	-
Peter A Hill	9 (9)	3 (3)	3 (3)	-	-
Alison C M Morris	10 (10)	5 (5)	4 (4)	6 (6)	-
Hugo R Tudor	10 (10)	5 (5)	4 (4)	6 (6)	3 (3)
Barbara A Ridpath	10 (10)	5 (5)	4 (4)	-	3 (3)
Finlay F Williamson	3 (3)	2 (2)	1 (1)	-	-
Graeme H Yorston	10 (10)	-	4 (4)	6 (6)	3 (3)

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

B4. Governance Framework

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

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

B4.1 Board and committee structures

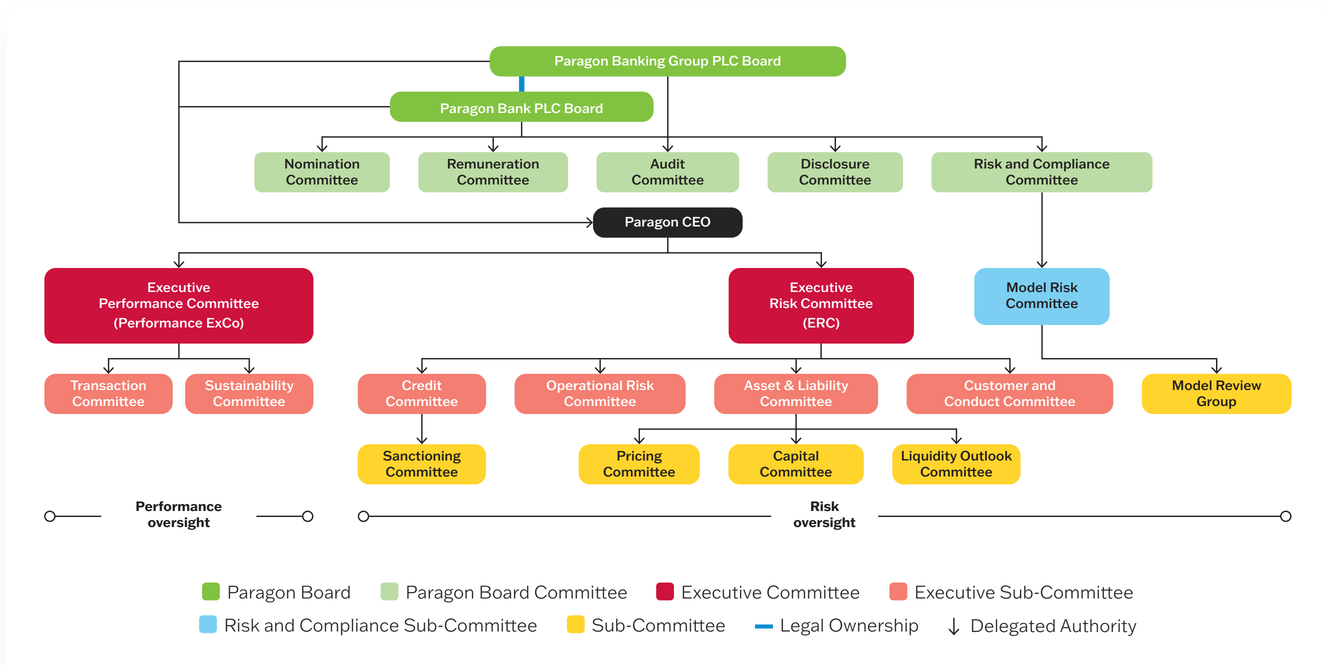
Board leadership, group purpose and the Corporate Governance Policy Framework

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

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

Board and committee structure and membership

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



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

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

*F F Williamson until December 2020.

Members	Independent non-executive	Audit	Remuneration	Risk and Compliance	Nomination
F J Clutterbuck	Until 10 May 2018*	No	Yes	Yes	Yes
P A Hill	Yes	From 25 February 2021	No	From 27 October 2020	No
A C M Morris	Yes	Yes	Yes	Yes	No
H R Tudor	Yes	Yes	Yes	Yes	Yes
B A Ridpath	Yes	Yes	No	Yes	Yes
F F Williamson **	Yes	Until 31 December 2020	No	Until 31 December 2020	No
G H Yorston	Yes	No	Yes	Yes	Yes

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

**Finlay Williamson resigned from the Board on 31 December 2020.

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

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

An informal Non-Executive Director Technology and Change Group was set up during the year and met with senior managers from the IT and Change functions on a quarterly basis (in March, May and August 2021) to increase the non-executive directors' understanding of current issues and developments in these areas.

Executive committee structures

The Group's executive management sit on two executive committees, the Performance ExCo and the ERC.

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

The ERC supports the CEO with monitoring adherence to risk appetite statements and identifying, assessing and controlling the principal risks within the Group and reporting on these to the Board. ERC also supervises the evolution and further embedding of the Group's risk management framework.

Sub-committees

Performance ExCo sub-committees

The Sustainability Committee was established in September 2021 and reports directly to the Performance ExCo. Its members are the External Relations Director, who chairs the committee, the Balance Sheet Risk Director, Director of Treasury and Structured Finance, Managing Director – Commercial Lending, Managing Director – Mortgages, COO, Savings Director, People Director and Enterprise Risk Director. The Committee's purpose is to deliver a coordinated, transparent approach to ESG matters, including climate change, considering strategy, commercial implications, disclosure, engagement and insight.

The Transaction Committee, which reports directly to the Performance ExCo, consists of the CEO, the CFO, the Director of Treasury and Structured Finance and the CRO, any two of which can form a quorum, but that quorum should include either the CEO or CFO. The Committee meets to consider potential acquisitions or disposals of loan assets, where these are not large enough to require consideration at the Board.

ERC sub-committees

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

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

B4.2 Elements of the Governance Framework

Culture

The Group is proud of its culture, which has been noted as part of its Gold Investors in People accreditation (see Section A6.3). The Board considered culture as part of the annual review of the Group's purpose, values and strategy in April 2021.

To assess and promote the Group's culture, non-executive directors have attended People Forum meetings as part of the Board's commitment to engage directly with the workforce. Further detail can be found at B5.3. In addition, the Group has continued to run regular employee surveys during the year as well as conducting a full employee engagement survey in June 2021 that included specific questions on the Group's culture. Results from these surveys, together with direct employee feedback, were reviewed by the Nomination Committee on behalf of the Board and the high level of employee engagement aligned with the Group's purpose, values and strategy was noted.

Matters Reserved for the Board

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

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

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

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

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

Role of independent non-executive directors

Throughout the year the independent non-executive directors have formed the majority of the Board and consequently there has been a strong non-executive representation on the Board, including the Senior Independent Director, providing effective balance and challenge.

In addition to the general legal and regulatory responsibilities of all directors, non-executive directors' more specific responsibilities include providing independent oversight and determining appropriate levels of remuneration for executive directors. Non-executive directors attended People Forum meetings during the year, which provided an opportunity for engagement with the Group's people. More detail on these interactions can be found in section A4.6.3.

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

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

Role of the Senior Independent Director

Hugo Tudor has served as Senior Independent Director since 23 July 2020. The Senior Independent Director provides a sounding board for the Chair and serves as an intermediary for the other directors when necessary. The Senior Independent Director is available to shareholders if they have concerns which contact through the normal channels has failed to resolve or for which such contact is inappropriate. The Senior Independent Director also leads the appraisal of the Chair of the Board's performance at least annually with the non-executive directors. Within this year's review consideration was given to the Chair's potential over-commitment due to her other Board roles. It was concluded that given that her M&G chair role is an interim position, and following positive confirmation from the other directors that no reduction in time commitment or performance had been identified, the Chair's performance remained at an exemplary level.

Conflicts of interest

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

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

Company Secretary

All directors have access to the advice and services of the Company Secretary, who is responsible for ensuring that board procedures are complied with, advising the Board on governance matters, supporting the Chair and helping the Board and its committees to function efficiently. Both the appointment and removal of the Company Secretary are matters reserved for the Board.

Subsidiary governance

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

Composition and succession

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

Board evaluation and training

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

Audit, risk and internal control

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

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

Remuneration

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

Whistleblowing

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

Further information

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

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

B4.3 Board and Stakeholders

Board and stakeholders

In addition to good corporate governance, maintaining a reputation for high standards of business conduct in all the Group's operations is a key priority for the Board, and management of conduct risk is a key part of the risk management framework. Section A6 sets out information on corporate responsibility, including the Group's people policies and engagement with employees, involvement in industry initiatives, support for the community and environmental, social and conduct impacts.

The Board, in its deliberations and decision-making processes, takes into account the views of the Group's stakeholders and, where applicable, considers the impact of those decisions on the communities and environment within which the Group operates. The Board is mindful of its duty to act in good faith and to promote the success of the Group for the benefit of its shareholders and with regard to the interests of all of its stakeholders.

The Board is kept updated on all material issues affecting stakeholders by the executive directors and receives regular updates from ExCo members, other senior managers and external advisers. Members of the Board also engage directly with employees, shareholders and regulators, as further detailed below.

The Board confirms that, for the year ended 30 September 2021, it has acted to promote the success of the Group for the benefit of its members as a whole and continues to have due regard to the following matters laid out in S172 (1) of the Companies Act 2006:

a. The likely consequences of any decision in the long-term;

b. The interests of the Company's employees;

c. The need to foster the Company's business relationships with suppliers, customers and others;

d. The impact of the Company's operations on the community and the environment;

e. The desirability of the Company maintaining a reputation for high standards of business conduct; and

f. The need to act fairly as between members of the Company.

Companies are required to describe in the Annual Report how the directors have had regard to the matters set out above when performing their duties.

The table below sets out how the Board and senior management take the above factors into account when engaging with the Group's key stakeholders, how this is aligned to the Group's strategic priorities and culture and why the stakeholders listed are significant for the Group.

Shareholders

Creating long-term shareholder value through growing profits and dividends (s172 a, f)

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

How we engage and / or monitor

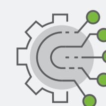
- The Group has an Investor Relations Programme, where nearly fifty meetings were held with shareholders. In addition, the CEO and CFO hold regular meetings with analysts
- A comprehensive update on Investor Relations is included in the CEO's report to each Board meeting
- The Chair and SID / Chair of the Remuneration Committee held several meetings with shareholder advisory groups
- The Board receives an in-depth update on Investor Relations, which includes investor feedback, following the publication of the Company's financial results

Capital management

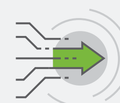
Growth

Outcome

- The data on shareholder feedback provided helps the Board align the Group's strategy with the interests of shareholders
- Shareholder feedback was taken into account when drafting and implementing the Remuneration Policy
- At the AGM in February 2021, all resolutions were approved by shareholders, with over 90% of votes cast in favour of each resolution
- Articles of Association were updated at the 2021 AGM to provide more flexibility around our AGM arrangements and allow virtual participation by shareholders in the event of further restrictions on gatherings or travel
- A total dividend for the year of 26.1 pence per share is proposed, and a share buy-back programme of £40.0 million was authorised in the year



Diversification



Specialisation

Further information on how the Group seeks to engage with and consider the views of all shareholders is given below.

The Group's approach to capital and distributions is set out in Section A4.3

Discussions with investors on remuneration matters are discussed in the Remuneration Report (Section B7)

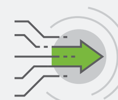
Customers

Supporting the ambitions of the people and businesses of the UK by delivering specialist financial services (s172 c)

Our customers are at the heart of our business and our eight core values underpin the way we interact with them every day. Engagement with our customers enables us to maintain our deep understanding of them and the markets they operate in, designing products to meet their needs and continually striving to exceed their expectations.

How we engage and / or monitor

- Regular customer satisfaction surveys on key product lines are reported to the Board
- Focussed analysis on key customer groups is undertaken
- The Board held a deep dive session on Customer Insights as part of its training agenda
- The Board considered and approved the transition from LIBOR to term SONIA for buy-to-let customers, focussing on customer outcomes
- Customer metrics have been a key element of the Performance Share Plan ('PSP') since 2020

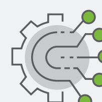


Specialisation

Sustainability

Outcome

- Customer feedback on key product lines, as measured by NPS, has remained strong
- Successful transition from LIBOR for buy-to-let customers completed by July 2021, with a rate promise to support a smooth transition and ensure our customers will not pay any more than they would have done had their account remained on LIBOR for the remainder of 2021
- Greater understanding of customers and their priorities is used to refine product offerings, documentation and processes
- Launch of the Asset Finance Broker Portal, allowing for a more efficient, automated process for customers
- Complaint levels remain low by industry standards



Diversification

Further information on the Group's relationship with its customers is set out in Section A6.2

Employees

Helping all of our people to develop their career and reach their potential (s172 b)

By working together, we help our customers to achieve their ambitions and we need a wide range of skills and expertise to succeed. Our shared values and focus on employee engagement provide the foundation for our success and help us to attract, develop and retain talent.

How we engage and / or monitor

Sustainability

- Regular employee Pulse Surveys and employee check-ins conducted
- Full employee engagement survey conducted in June 2021 with 86% of employees participating
- The People Director updates the Board and ExCo on employee feedback from surveys and from the People Forum, as well as other metrics
- Non-executive directors attend the Group's People Forum on a regular basis
- Designated ExCo members with responsibility for gender diversity and wider diversity regularly report progress on these matters
- EDI network launched in October 2020
- The Nomination Committee receives six-monthly updates on succession planning and feedback from the EDI network from the People Director
- People metrics have been a key element of the PSP since 2020

Outcome

- Employee survey results confirmed a very strong set of positive indicators, including an overall engagement score of 87%
- Hybrid working trial launched in 2021 following the easing of lockdown restrictions and incorporating employee feedback following an initial pilot
- Feedback from employee surveys enables the Board to support and understand employees and their engagement
- Tailored career development programmes embedded across the Group for apprentices through to high potential senior leaders
- Increased communication to employees regarding culture, values and purpose
- Enhanced annual leave provisions for all employees in the year

Further information on the involvement of the Group's people and the impact of policies on them, including steps taken to support them during the pandemic, can be found in Section A6.3

Regulators

Engaging transparently and openly with regulators to ensure we comply with current legislation and maintain the Company's reputation for high standards of business conduct (s172 c, e)

One of our key values is to be honest and open in everything we do. Frequent and transparent communication with regulators enables us to plan for regulatory change and maintain our high ethical standards.

How we engage and / or monitor

- Regular engagement with the PRA, throughout the year on key regulatory matters, including the IRB implementation
- Direct contact between the Chair and non-executive directors and regulators
- ExCo and the Board are kept updated on all interaction with the FCA and PRA
- SMCR is embedded across the Group, with conduct measures monitored monthly, overseen by the ERC
- Dialogue maintained with HMRC, with the CFO designated as Senior Accounting Officer, directly responsible for the Group's tax policies
- The risk element of the PSP includes an assessment of any material regulatory breaches

Capital management

Sustainability

Outcome

- Successful outcome to PRA review of capital and risk management processes in the year
- The Board approved the submission of IRB Module 2 to the PRA in February 2021
- All changes to the Board and Senior Management Functions are approved by the PRA and FCA

Further information on the Group's tax policies is set out in Section A6.5

Society and community

Helping the UK economy grow and supporting the communities in which we operate (s172 d)

We aim to be an energetic and valuable contributor to the communities in which we operate. Our commitment includes active involvement in a range of community volunteering and charity partnerships.

How we engage and / or monitor

- Members of the senior team are active in industry bodies, gaining insight into thinking about how the sector impacts communities and public policy
- ExCo members actively support community activities within the business
- Employees support a nominated charity each year via payroll donations and fund-raising efforts

Sustainability

Outcome

- During the first nine months of 2021 our employees raised nearly £22,000 for this year's nominated charity, the Alzheimer's Society
- Employees were supported to take part in a range of volunteering activities

Further information on the Group's community involvement is set out in Section A6.5

Environment and climate change

Continually reducing our environmental impact and designing products that support positive environmental change (s172 d)

We take care to identify, manage and minimise our impact on the environment, both in terms of the impact of our lending products and our own operational impact.

Sustainability

How we engage and / or monitor

- The Group has an executive level Sustainability Committee which addresses all climate related issues on a cross-group basis
- Climate change is designated a principal risk within the Group's risk management framework
- The Board received a comprehensive presentation on climate change and is regularly provided with a climate change summary
- The Board receives updates on the potential risks and strategic impacts of climate change
- The Group was part of the working group involved in establishing UK Finance's Sustainable Finance principles-based framework
- The CFO has been designated as the responsible director for climate change exposures and reports to the Board
- The Group complies with all applicable laws and regulations relating to the environment

Outcome

- The Group was the first UK bank to issue green bonds. The proceeds of the green bond are allocated to green loans, incentivising landlords to mitigate the impact of climate change
- London premises consolidated into a single, more energy-efficient location
- The Board established new objectives against current energy performance to further reduce consumption
- An ESG team was established, and the executive level Sustainability Committee was created during the year
- This year the Group will publish its first sustainability report in December 2021 and has a dedicated Sustainability section on its website

Further information on the Group's management of climate change risk and its environment policies is set out in Section A6.4

Business partners and suppliers

Commitment to the fair treatment of all business partners. In return, we expect our partners to help us deliver a high standard of service to our customers and act responsibly (s172 c)

We believe that working well with our business partners and suppliers is central to our purpose and key to our continued success.

Sustainability

How we engage and / or monitor

- Key business partner relationships, including intermediaries and suppliers are identified, actively monitored and reported to ExCo and the Board
- Regular feedback surveys conducted amongst intermediaries with the results fed back to ExCo and Board
- The Group has a Supplier Code of Conduct which sets out our overall approach to supplier engagement and corporate responsibility

Outcome

- Intermediary feedback key to designing new broker portals and other operational systems
- Our suppliers understand the minimum standards we expect from them and our commitments and expectations around bribery and corruption, data protection and modern slavery
- Ongoing engagement with our key suppliers ensuring operational resilience and reduced risk
- The Group is a signatory to the UK's Prompt Payment Code, with ensuring prompt payment a priority in the year

The Group's management of business partner relationships is discussed further in Section A6.7

Shareholders

The Board encourages communication with the Company's institutional and private investors. All shareholders have at least twenty working days' notice of the AGM, at which the directors and committee chairs are available for questions. The AGM is normally held in London during business hours and provides an opportunity for directors to report to investors on the Group's activities, to answer their questions and receive their views. At all AGMs 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 2022 AGM will take place at 9am on 2 March 2022 at the offices of UBS AG London Branch, 5 Broadgate, London, EC2M 2QS. In the event that Covid restrictions on gatherings or travel are imposed, the Group will make appropriate alternative arrangements to comply with any such restrictions and provide arrangements that will allow shareholders to participate in the meeting.

The CEO and CFO have a full programme of meetings with institutional investors and during the year ended 30 September 2021, meetings were held with investors from the UK, Europe and North America.

The Chair of the Board and the Senior Independent Director, who is also the Chair of the Remuneration Committee, held meetings with shareholder advisory groups covering governance and remuneration matters (as set out in the Remuneration Report in B7).

From time-to-time other presentations are made to institutional investors and analysts to enable them to gain a greater understanding of important aspects of the Group's business.

Investors' comments from all of these interactions are communicated to the Board, enabling the Board to develop an understanding of major shareholders' views of the Group, and take those views into account when determining strategy.

The 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. Meetings between the Senior Independent Director and shareholders can be arranged via the Company Secretary.

The Director of External Relations updates each meeting of the Performance ExCo on changes in the Group's shareholder base and on shareholder interactions.

B4.4 Board evaluation and development

Board evaluation

The effectiveness of the Board, individual directors and the Board's main committees is reviewed annually, with this year's review being internally facilitated as permitted by the Code. The Board also monitored progress on the recommendations from the internal review carried out in 2020. The next external evaluation will be conducted by the end of 2022.

2020 internal evaluation findings – Progress report

Following last year's internally facilitated evaluation, significant progress has been made on addressing actions arising out of the evaluation. Progress highlights are set out in the table:

Recommendation / action	Progress update
Board	
IT and digital experience	
More IT and digital experience and engagement.	An informal non-executive director Technology / Change Group was established, with quarterly meetings held with relevant senior executives.
Skills matrices	
Increased formality and reference to the skills matrix required for future non-executive director appointments.	A more formal process and greater reference to the skills matrix has been deployed.
Senior management contact	
More contact with the senior executives who are running the businesses.	Updates from ExCo members and their direct reports are incorporated into the Board forward planner and these persons regularly present to Board.
Mentoring by non-executives	
Non-executive director mentoring of high potential individuals was suggested.	It was agreed that this would not be pursued at this stage. The Board concluded that external mentoring would be preferable to mentoring by non-executive directors of the same organisation. High potential individuals will meet with the Board as appropriate, and the non-executive directors will confirm with the executive directors if there are particular individuals or areas of the business they want to meet with.

2021 internal evaluation

The output of the 2020 internal board evaluation was referred to in determining questions for this year's evaluation which, again, considered the performance of the Board, its committees, and all individual directors, including the Chair. In constructing the questions consideration was also given to the 2019 external evaluation, the Code and guidance from the FRC and other relevant sources.

The Board evaluation considered its composition, the balance of skills, experience, independence, knowledge and diversity, how the Board works together and other points pertinent to its effectiveness. The evaluation also included specific questions on Board performance during the pandemic. More detailed findings from the Board evaluation included the following, against which progress will be reported next year.

Issue	Recommendation / action
Board	
Length of papers	
Shorten papers, where possible.	The General Counsel and Company Secretary would look at increasing the use of the resources section of the board portal, where appropriate, and would liaise with other presenters with a view to making their papers more concise.
Board skills	
The need to address gaps in BAME representation / ethnic diversity and PLC experience.	Nomination Committee succession planning conversations actively consider the need for BAME representation / ethnic diversity on the Board. The Nomination Committee Chair will ensure focus is maintained on addressing this gap. The General Counsel and Company Secretary will look to enhance the level of PLC experience via additional board training.
Governance	
The volume of committee meetings should be reduced and / or authority levels improved (taking the learnings from the pandemic into account).	It was agreed that no change should be made to the volume of board committee meetings. It was also agreed that the action could be closed following approval of a delegated authority proposal for the executive directors.
Risk	
Wider horizon scanning to be undertaken.	The CRO and CEO will regularly bring emerging risk updates to the Risk and Compliance Committee and Board for challenge.
Audit Committee	
More finance team members to present papers at Audit Committee meetings.	The Audit Committee Chair and the CFO will keep this under review and will arrange for Audit Committee meeting attendance by finance team members when appropriate.
More work on combined assurance is required.	The Risk and Compliance Committee is monitoring progress on combined assurance work following Risk and Compliance Committee, Audit Committee and Board discussions on the matter.
Risk and Compliance Committee	
Over time, greater delineation between Risk and Compliance Committee and Board should be achieved, after which Risk and Compliance Committee membership should be reconsidered.	The Risk and Compliance Committee will continue to review its membership and effectiveness annually.

Individual director evaluations considered whether each director continued to contribute effectively and demonstrated commitment to their role, for example in devoting sufficient time to their board duties. The evaluation also reviewed whether the Board and committees continued to have the requisite expertise to properly discharge their duties.

A review of the performance of the executive directors took place at the Remuneration Committee meeting in September 2021 that considered remuneration packages for 2021/22.

Led by the Senior Independent Director, the performance of the Chair of the Board was evaluated by the non-executive directors

The Chair of the Board appraised the performance of the non-executive directors during August 2021, meeting with each non-executive director on a one-to-one basis to evaluate their performance and agree development areas. These conversations also provided an opportunity for the Chair to obtain individual non-executive directors' views on board effectiveness.

Results of these discussions were distributed to the Board, who considered the results and a schedule of follow up matters / actions at its meeting in October 2021. An action plan was reviewed and agreed for implementation during the next financial year, which will be refined and monitored during the period.

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

Induction

All directors receive an induction training schedule tailored to their individual requirements upon joining the Board. The induction, which is designed and arranged by the People Director in consultation with the Chair and Company Secretary, includes meetings with existing directors, senior management and other key personnel, to assist new directors in increasing their knowledge of the Group's operations, management and governance structures, as well as key issues for the Group.

During the year Peter Hill, who was appointed on 27 October 2020, has had meetings with senior employees in the Risk, Finance and Internal Audit areas to brief him on the work of those areas and the particular issues within those areas most relevant to his position as Chair of the Risk and Compliance Committee.

Development

Further to the 2020 board evaluation, a skills matrix was produced for completion by each board member, the aim of which was to identify the key areas for ongoing board development and to assess the necessary skills and experience when considering future board succession planning. Further detail on training undertaken by the Board during the year can be found in Section B3.3.

A number of topics have been agreed for board development over the coming year (including training on regulatory-focussed AML, IRB, conduct risk, the Enterprise Risk Management Framework, and the new FCA Consumer Duty), in order to retain a diverse balance of skills and increase coverage in key areas to support oversight and delivery of the corporate plan.

Separately, ongoing individual development opportunities will be provided, as required, during the forthcoming financial year. A training schedule is maintained by the Group's Human Resources department in conjunction with the Company Secretary.

The non-executive directors have received presentations during the year on various aspects of the Group's activities to support their on-going business awareness and development. The Board has dedicated a number of days during the year to training and will undertake additional training as required by the Group's strategy and operational needs.

Topics for board training sessions are recommended by the Board, and provide for a balance of technical, risk, management, governance and professional development. All directors completed a variety of regular training modules that are mandatory for Group employees.

Further business insight and awareness sessions and deep dives on particular areas are held regularly to provide non-executive directors with the appropriate depth of knowledge to contribute effectively at board meetings on key topics. In particular, during the year the Board received training on topics related to risk and sustainability. More detail is available in Section B3.3.

B4.5 Whistleblowing

The Group has an established procedure whereby employees can make disclosures regarding potential wrongdoing within the Group on a confidential basis, in accordance with the Public Interest Disclosure Act 1998 ('PIDA'). The policy also makes provision to ensure that no employee making such a disclosure suffers any detriment by doing so. A whistleblowing service is operated for the Group, at arm's length, by a third-party charity, Protect. This process was supervised by the Board during the year, in accordance with Code requirements, and any amendments to the policy required the approval of the Chair.

If an employee is dissatisfied with the investigation, or any action taken as a result, they may request a confidential meeting with any member of the Whistleblowing Committee to discuss the matter further. The Chair of the Audit Committee, a non-executive director, is the Group's designated whistleblowing champion.

To ensure that the policy is embedded in the operations of the Group all employees received training on the requirements of PIDA and the Group's policy during the year and were tested to ensure their understanding. There were also internal publicity campaigns promoting the whistleblowing procedures.

During the year ended 30 September 2021, there were no instances of whistleblowing which resulted in a requirement for full consideration by the Whistleblowing Committee or subsequent consideration by the Board.

In addition, the Group's principal regulators, the PRA and FCA, operate whistleblowing services available to customers and other third parties. Details of these services are provided to the Group's customers and included on its websites.

B5. Nomination Committee

The Group recognises the importance of diversity, including gender diversity, at all levels of the organisation.

Fiona Clutterbuck, Chair of the Nomination Committee

B5.1 Introduction by the Chair

Dear Shareholder

The Nomination Committee is the forum used by the Board to consider certain governance matters. These are vital issues for the Board and the Group, and this has seen the Committee's workload increase significantly over recent years.

During the year the Committee has overseen the appointment of a new Risk and Compliance Committee Chair. Peter Hill was appointed to the Board on 27 October 2020 and became Chair of the Risk and Compliance Committee with effect from 31 December 2020.

I have served as Chair of the Board and the Nomination Committee since May 2018. However, given my tenure on the Board reached nine years in September 2021 the Nomination Committee, on behalf of the Board, has begun the process to oversee the appointment of a new Chair.

The primary aims of the Committee in this process, which is well progressed, are to ensure that the person appointed has the requisite skills and knowledge for the role, benchmarked against the board skills matrix; that there is a strong cultural fit with the Group; and that an orderly handover process will be achieved. Following the appointment of the candidate best meeting these criteria, the Committee will consider the subsequent steps it needs to take to address the experience, skills and diversity of the board as a whole.

The remit of the Committee also covers people-related sustainability issues, with the launch of the Group's Equality, Diversity and Inclusion Network in the period and continued employee voice arrangements being particularly noteworthy. I look forward to the contribution these initiatives will continue to make to the Group's strategy and culture in the future.

The Committee supports the objectives of the Parker Review and is mindful of the required timescale for FTSE 250 companies. The Committee will oversee a recruitment and selection process during the forthcoming year to improve the ethnic diversity of the Board, with the intention of meeting the Parker Review requirements ahead of its 2024 deadline.

Overall, I believe the Committee has enjoyed a year of positive achievement and fully satisfied its mandate from the Board.

Fiona Clutterbuck

Chair of the Board and the Nomination Committee

7 December 2021

B5.2 Operations of the Committee

The Nomination Committee is chaired by the Chair of the Board and includes three independent non-executive directors. The Committee's role is to ensure that there is a formal, rigorous and transparent procedure for the appointment of new directors to the Boards of the Company and of Paragon Bank PLC; to lead the process for board appointments and make recommendations to the Board. Ultimate responsibility for any appointment remains with the Board. Its role also includes:

- Keeping under review the structure, size and composition of the Board (including its skills, experience, independence, knowledge and diversity) and making any recommendations it deems necessary to ensure that it is effective and able to operate in the best interests of shareholders and other stakeholders
- Considering re-appointment of directors, re-election of directors and the independence of non-executive directors
- Ensuring that plans are in place for orderly succession to positions on the Board and senior management and overseeing the development of a diverse pipeline for succession to the Board and senior management roles
- Overseeing the Group's initiatives on management of diversity, with a particular focus on its participation in external programmes, such as the Women in Finance Charter and reporting such as gender pay reporting
- Monitoring workforce engagement and seeking employee feedback on behalf of the Board

The membership of the Committee and the record of their attendance at meetings is given in Section B3.3.

B5.3 Matters considered by the Committee during the year

Board appointments

During the year, the Committee appointed a new Risk and Compliance Committee Chair, Peter Hill, to succeed Finlay Williamson who stepped down from the Board at the end of December 2020. Peter followed a structured induction and handover both prior to starting his role and during his first year of appointment. Peter brings with him a wealth of experience in financial services and a proven track record in risk oversight, gained during his executive and non-executive career.

The Committee, on behalf of the Board, has commenced a search to appoint a new Chair. This is expected to conclude over the coming months and is in response to the existing Chair reaching nine years' tenure during September 2021.

The search process is being led by Hugo Tudor, Senior Independent Director, with support from Anne Barnett, People Director and is being undertaken in conjunction with Jamie Risso-Gill from Per Ardua Associates. Per Ardua Associates do not have any connection with the Group or any of its directors.

The Committee has reviewed and agreed a role profile and a shortlist of candidates has been identified for a series of interviews with members of the Board, including the CEO. Once the Committee has made a recommendation to the Board an application will be submitted to the PRA for consideration and approval. PRA approval is required as the role will hold a Senior Management Function under the Senior Managers' Certification Regime.

As it has done for a number of years the Committee considered the re-appointment of the serving directors and recommended to the Board that resolutions for their re-appointment should be proposed at the AGM.

Succession planning

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

The Human Resources department has a wider succession development plan for senior management roles across the Group, prioritising those positions likely to require recruitment within the next five years. Bespoke development plans are in place for strong performers identified as having high potential and their progress is overseen by the Committee.

Risk mitigation for the loss of senior employees continues 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 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 more senior roles, as this assists in the ongoing maintenance of its strong culture and values. It also acknowledges the benefits which can arise from the hire of strong external candidates to add experience and bring a fresh perspective to strategic thinking. In addition, the senior leadership development programme is also focussing on increasing the diversity of the Group's talent pool in support of the overall approach to equality and diversity.

Board skills matrix

The Committee considered a revised skills matrix at its October 2020 meeting following the outputs from the Group's virtual strategy event in July 2020. This was further reviewed and updated by the Committee in February 2021 and subsequently approved by the Board.

The matrix reflects the Group's strategic aim of becoming a technology-enabled specialist bank, and the skills considered include matters such as demonstrating sound knowledge of the UK retail banking sector; understanding capital requirements and liquidity models; insight into the application of technology in a financial services environment; and customer insight and understanding the specialist lending sector.

The board skills matrix is reviewed annually by the Committee and forms the basis for continuing professional development and future succession plan requirements.

Diversity

The Group recognises the importance of diversity, including gender diversity, at all levels of the organisation. The Group strongly values diversity on the Board, not only of gender, but also of experience and background, recognising the contribution such diversity can make towards achieving the appropriate balance of skills and knowledge which an effective board of directors requires. The Board is delighted to have achieved 38.7% female representation at Board and senior management level, exceeding the original Hampton-Alexander Review targets and the Group is aligned to the ongoing objectives of the FTSE Women Leaders Review, which will build on Hampton-Alexander going forward.

When the Group signed up to HM Treasury's Women in Finance Charter initiative during 2016 its target was to achieve 35% female representation at senior management level by January 2022, increasing from 26% at the time the targets were set. The Group is proud to have met this target, and all of its other Women in Finance targets, ahead of the deadline. As well as the headline target for women in senior positions, the Women in Finance commitments also included targets on women and ethnic minorities in management roles more widely, helping to build a platform for the next phase of the initiative. The Board will review the targets for the next phase of Women in Finance during the coming year.

The Committee is pleased that so many employees provided diversity data for analysis during the year and is confident that this information will enable a more analytical approach to the Group's diversities going forward. In October 2020 the Group launched its Equality, Diversity, and Inclusion ('EDI') Network and the Committee receives regular updates on its plans and activities. The Committee has monitored the activities of the EDI Network with interest throughout its first year, and was pleased with the contribution it is already making to the Group's progress in this area.

More details of the activities delivered with the involvement of the EDI Network in its first year, including the commitments made by the Group under the Race at Work Charter and the Disability Confident Employer Scheme are provided in Section A6.3.

During the year the Committee reviewed the Group's gender pay report and supporting analysis. It carefully examined changes since the previous report and considered the underlying challenges with the reporting rules, in the management structure and in the nature of strategic developments in the Group that make closing the gender pay gap difficult, as it is for other financial services firms. This will continue to be a focus for the Committee.

The Group's diversity policies were updated during the year and are described in Section A6.3. Information on the composition of the workforce, including the gender balance of those in senior management and their direct reports is given in Section A6.3 and the Group's gender pay gap statistics are also discussed in that section.

Workforce engagement

The Committee has received regular updates on workforce engagement and board members have engaged directly with the workforce throughout the year through both formal and informal channels.

The Group has continued to run regular employee surveys during the year in response to the Covid pandemic and the People Director provides updates on the results of these to the Committee. In addition, the Group conducted a full employee engagement survey in June 2021 and 86% of employees shared their views. The results confirmed a very strong set of positive indicators, including an overall engagement score of 87%; 10 percentage points above the industry norm and 6 percentage points higher than the score achieved in the last survey, completed in December 2017.

Additionally, non-executive directors have attended People Forum meetings to discuss topics including executive pay and reward; pay and reward for the wider workforce; and how the Group has managed employees' return to the office to trial hybrid working from both customer and employee perspectives. These meetings provide employees with an opportunity to ask questions of board members and provide direct feedback. These meetings will continue to be a regular feature of the board calendar.

B6. Audit Committee

The exercise of credit judgement to determine appropriate levels of provision is crucial and the Committee has taken its role in ensuring those judgements are rigorously challenged

Alison Morris, Chair of the Audit Committee

Corporate Governance

B6.1 Statement by the Chair of the Audit Committee

Dear Shareholder

Once again, I find myself writing to you at the end of a challenging year for the Committee. The economic uncertainties arising from the ongoing Covid pandemic continue to impact on the accounting judgements the Committee has to consider. Within the business, the changes in working practices through the year and the corresponding developments in internal control processes meant that the Committee's role in promoting the strength of the control environment was vital.

As with much of the banking sector, the principal accounting challenge for the Group in the period has been the estimation of expected credit losses under IFRS 9. With models based on historic data unlikely to perform well in the unprecedented circumstances of the Covid pandemic, the exercise of credit judgement to determine appropriate levels of provision is crucial and the Committee has taken its role in ensuring that those judgements are rigorously challenged very seriously.

This has also involved a focus on the Group's economic and business forecasting more widely, including the stress testing of the Group's business plans.

I and my fellow committee members considered much detailed information on these areas and engaged with both the Group's financial and wider management and with the external auditors in order to conclude that the approach adopted was acceptable.

Adjustments to model outputs and additional overlays have been required to deal with the levels of uncertainty engendered by the current environment, and these have been a subject of particular focus for my colleagues and me.

While the current year's accounting environment was challenging, the Committee also had to address the ongoing development of the regulatory landscape surrounding reporting and governance. We considered the Group's responses to PRA reviews of accounting and disclosures on elements of IFRS 9 impairment and monitored the progress of the Group towards TCFD reporting, including the new disclosures made in this annual report.

We also considered the potential impact of the proposals on reporting and governance published by BEIS, and submitted a response to the Department, highlighting our belief that any reforms should prioritise audit quality and deliver real benefits to stakeholders. We await the final proposals with interest.

The Group's internal audit function continued to develop during the year, responding both to the challenges of new processes and ways of working and also to the continuing development of the Group's wider control framework. Change assurance was embedded as a discipline within the function and internal audit provided the Committee with assurance on key strategic projects, such as LIBOR transition.

As this is the sixth year of the current KPMG LLP ('KPMG') audit mandate, I was able to welcome a new engagement partner, Simon Ryder, and ensure that the Committee's relationship with the auditors continued to operate effectively. As required by regulation, the Committee considered its intentions for the future tendering of the audit mandate and concluded that there was no present need to retender for any year earlier than that required by law or independence requirements.

During the year I met with the team from the Financial Reporting Council's Audit Quality Review ('AQR') team, who conducted a review of the KPMG audit of the Group's 2020 financial statements during the year, as part of their normal review cycle. I received the final report shortly before the date of this report, and was pleased to note that no significant issues were raised. All matters included in the report had already been brought to the Committee's attention and discussed with KPMG. The Committee remains conscious of the AQR's reports on KPMG as a firm and in particular their approach to banking audits. These have been discussed at length with the KPMG team in the context of our own audit.

In the coming financial year ending 30 September 2022, the Committee's main priorities will include:

- Continuing to monitor the potential impacts of Covid on the Group's ECL provisioning as the effects of government interventions in the UK economy begin to diminish, and the long-term impacts of the pandemic become clearer
- Considering the continuing need for and appropriate level of post-model impairment provisioning adjustments as economic and business conditions revert to a position which can be dealt with more easily by the Group's impairment models
- Supervising the development of the Group's IFRS 9 impairment approach in line with emerging best practice, learnings from the pandemic and developments in the Group's businesses
- Analysing regulatory developments in accounting, reporting and auditing, particularly the result of the BEIS consultation, and ensuring the Group is properly positioned to respond
- Ensuring that the Group's control processes, and internal audit capabilities, continue to evolve alongside developments in the business

I would like to thank my colleagues on the Committee for their application and diligence over the year in dealing with a very full workload, and also the many people across the Group who have helped to support us in this work and, in particular, those who have helped me familiarise myself with the Group's operations and reporting in this, my first full year as Chair of the Committee.

I commend this report to shareholders and ask you to support the resolutions concerning the reappointment of KPMG as auditors and their remuneration at the AGM in March 2022.

Alison Morris

Chair of the Audit Committee

7 December 2021

B6.2 Operations of the Committee

The Audit Committee currently comprises four independent non-executive directors of the Company whose relevant experience is set out in Section B3. Peter Hill joined the Committee on 25 February 2021. In addition, Finlay Williamson was a member of the Committee until stepping down from the Board on 31 December 2020.

The terms of reference of the Committee include all matters indicated by Disclosure and Transparency Rule DTR 7.1 and the Code. These terms of reference were most recently updated in September 2021 and are available on the Group's website. The Committee's key responsibilities include:

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

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

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

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

The Committee meets at least four times a year and has an agenda linked to events in the Group's financial calendar. Meetings generally take place before the half year and year end reporting dates in March and September and before the approval of results in May and December. The Committee normally invites the Chair of the Board, the executive directors, CRO, 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 if appropriate.

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

During the year ended 30 September 2021, the Committee met four times. Its principal activities were:

- The review of the annual and half-yearly financial statements to ensure these properly present the Group's activities in accordance with accounting standards, law, regulations and market practice
- The consideration of the appropriateness and application of the Group's accounting policies for the recognition of interest income and loan impairment, amongst other significant accounting issues
- The review of other financial information published by the Group, such as Pillar III disclosures required by banking regulations
- Review of the terms of reference of the Committee and approval of revised terms
- Consideration of the Group's readiness to address other forthcoming accounting and reporting changes which will affect it
- Discussion of the AQR review of the Group's external audit for the year ended 30 September 2020, which was carried out in the year

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

From time to time, where there are major changes in the Group's accounting policies or audit arrangements in progress, the Chair of the Committee will hold meetings with shareholders.

Details of the Committee members' attendance at meetings and of the Board's evaluation of the Committee's effectiveness are given in Section B3.3.

B6.3 Significant issues addressed by the Committee in relation to the Financial Statements

The Committee considers whether the accounting policies adopted by the Group are suitable and whether significant estimates and judgements made by the management are appropriate. In evaluating the Group's financial statements for the year ended 30 September 2021 the Committee particularly considered:

- The levels of impairment provision against loan assets under IFRS 9 and, particularly, the ongoing uncertainties created by the economic impact of the Covid pandemic on both customer credit and issues faced by mechanistic provisioning methodologies in responding to these unprecedented circumstances
- The calculation of interest income under the Effective Interest Rate ('EIR') method for both internally originated and purchased loan assets and the Group's borrowings
- The requirement for any impairment provision against the purchased goodwill carried in the Group's balance sheet, based on the most recent forecasts for the businesses concerned
- The valuation of the deficit in the Group's defined benefit pension scheme
- The viability statement which the Group is required to make under the Code
- The Group's capital and funding position and the Group forecasts for future periods and their impact on the going concern assessment for the Group

In each case the Committee considered whether these matters were clearly and sufficiently disclosed in the accounts with appropriate sensitivities shown for all significant estimates.

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

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

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

Matter	Particular areas of focus
Loan impairment	IFRS 9 requires that companies provide for future ECL's on any financial asset held on the balance sheet on the amortised cost basis. Their forward-looking nature means that such provisions are heavily dependent on the use of judgement and estimation techniques to evaluate the likelihood of loss on accounts and the potential amount of that loss. In the current Covid-impacted economic environment, this consideration of ECLs is particularly complex, due to uncertainties over the impact of government interventions and the long-term effects of the pandemic. In order to satisfy itself that the process applied by the Group resulted in an appropriate level of provisioning in accordance with IFRS 9, the Committee considered particularly: • The methods used to estimate probabilities of loss and potential losses, both mechanical and judgemental • The assumptions used as inputs in these calculations • The economic projections used in deriving ECLs • The definitions of significant increase in credit risk, credit impairment and default for ECL purposes • The appropriateness of the calculated provisions in light of government interventions in the UK lending market and the economy more generally • The appropriateness of post-model adjustments made to compensate for factors not fully addressed in the modelling To substantiate these decisions, the Committee considered actual results in the year compared to those predicted by the impairment methodology and the continuing relevance of historical information used in the process based on present economic conditions, lending and account administration practices. In respect of the impact of the pandemic, the Committee considered the extent to which modelled approaches based on past history may not be relevant in current economic conditions, and the implications for impairment calculations of reliefs given to customers and other interventions by the UK Government. A particular focus continued to be given to the Group's receiver of rent portfolios and the level to which their ultimate loss levels accorded with expectations. *Further information on these estimates can be found in note 63a to the accounts, the impairment charge for the year and the movements in provision for impairment are shown in note 18.* *The Group's exposure to credit risk is discussed in note 55*

Matter	Particular areas of focus
Interest income recognition	As required by IFRS 9, the Group recognises income from loan balances on an EIR basis, which is intended to produce a constant yield throughout the behavioural life of the loan, taking account of such matters as costs of procuration, and initially fixed or discounted interest rates. The calculation therefore rests on assumptions about the future behaviour of the Group's customers. 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. For acquired assets which were considered credit impaired on purchase, where carrying value is based on expected cash flows, the potential further economic impacts of Covid on customer behaviour were carefully considered. *Further information on these estimates can be found in note 63b to the accounts, and the interest income and expense recognised on this basis is shown in notes 4 and 5*
Goodwill impairment	The Group is required to assess, at least at the end of the year, whether the carrying value of the acquired goodwill balance in its accounts, which is not subject to amortisation under IFRS, remains appropriate or whether any impairment has occurred. This includes both newly acquired goodwill and goodwill arising from previous acquisitions. Due to the impact of Covid this was also considered in full at the half year. In considering whether any impairment of goodwill had occurred the Committee particularly considered the Group's forecasts for the future cash flows of the acquired businesses and their reasonableness in light of current trading performance together with the Group's strategy for these operations. *The potential impairment of goodwill is discussed in notes 63c and 25*
Defined benefit pension obligations	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. 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. *Further information on the Plan deficit, the basis of valuation and the assumptions underlying it can be found in note 52 to the accounts, along with an analysis of sensitivities to the more significant assumptions*
Viability statement	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. The Committee considered aspects of the work of the Board and its various committees which addressed the Group's business model, risk profile, access to funds and future strategy. They also considered guidance issued by the FRC and stress testing which had been carried out in the year, particularly focussing on the impact of Covid both on the Group's business and the levels of potential variability in the forecasting. *A fuller discussion of the directors' consideration of the viability statement is set out in Section A5*

Matter	Particular areas of focus
Going concern	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. The Committee considered the Group's detailed forecasts and the implicit cash and capital requirements. It also considered internal stress testing procedures, including the ICAAP and ILAAP outputs, prepared for regulatory purposes. The Committee discussed availability of funding, potential stress events and the impact of the economic environment, including the uncertainties created by the impact of Covid on the UK economy generally and the Group's operations in particular. *A fuller discussion of the directors' consideration of the going concern statement is set out in Section A5*
Internal control and risk management	The Board is required to make statements in the Annual Report and Accounts relating to the Group's systems of internal controls and risk management. The Committee considered an evaluation prepared by the Risk function, together with the findings of internal audit reports in the year and its own engagement with the management information of the Group and the executive directors. *The Board statements on internal control and risk management are set out in Section B8 and B9*
Fair, balanced and understandable	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. The Committee considered the draft Annual Report for the financial year, as a whole, satisfying itself that the process for the preparation and review of its various sections, was appropriate. The Committee especially focussed on areas where disclosure requirements had changed or where new activities or considerations were to be reported on. For the current financial year this included particularly the presentation of the impact of Covid on the Group's business and results, particularly the impact on ECL provisions. Based on this exercise, and the Committee's own understanding of the business in the year, it determined whether the Annual Report, overall, portrayed the Group's activities, position and results properly.

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 2021 to the Board for approval.

The Committee's consideration of the financial statements for the year ended 30 September 2020, which took place in the year under review, is discussed in the Audit Committee report for that year.

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

B6.4 External Auditor

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

AQR Review

During the year the FRC AQR team conducted a review of KPMG's audit of the Group's financial statements for the year ended 30 September 2020, with the Chair of the Committee engaging with the AQR team as part of this process.

The Committee has been briefed by the KPMG team on the progress of this review as it progressed, and the final report was received shortly before the date of signing of these accounts. The AQR raised no significant issues. The Committee was satisfied by this outcome and noted that all the matters raised by the AQR had already been communicated by the external auditor. These points had been considered by the Committee and discussed with the audit team, and therefore no further action was thought to be required.

Audit tendering

The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 (the 'Order') requires that only the Committee can agree the fees and terms of service of the external auditors, initiate and supervise a tendering process or recommend the appointment of an external auditor to the Board following a tender process. The Group has complied with the requirements of the Order during the year.

KPMG were appointed as auditors, following a competitive tender process, with effect from the year ended 30 September 2016 at the AGM in February 2016. The financial year ended 30 September 2021 is the sixth reported on by KPMG. This is the first year for which Simon Ryder has served as engagement partner. Simon Clark, the previous engagement partner, has stepped down from the engagement in accordance with policy, having been involved with the Group's external audit for five years.

The Group is not subject to a legal requirement to undertake an audit tender until ten years have elapsed. However as the current financial year is the fifth for which the external audit was not subject to a formal tender process, the Committee is required to consider when it would be in the best interests of the Group and its stakeholders for the next tender to take place, and report its conclusions to shareholders.

Having considered the performance of the external auditors to date, the potential impacts on the Group's future requirements for external audit services of strategic, legal and regulatory developments, together with the resources required by any tender process, the Committee concluded that currently, on balance, it would not be beneficial to put the Group's external audit out to tender at an earlier date than required by law. The Committee therefore currently intends to conduct a tender process for external audit services for the year ending 30 September 2026 at a time that avoids any issues of independence for potential bidders.

The Committee will keep this decision under review in light of any changes in either strategic or regulatory requirements and in conjunction with its ongoing monitoring of external audit quality and will provide an update to shareholders annually in the Audit Committee Report.

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

Audit effectiveness

The Committee has considered the effectiveness of the external audit for the year ended 30 September 2021 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 2020 audit, undertaken at the time of approval of the Group's 2020 consolidated accounts, was updated once the external audit process for all Group companies had been completed. This affirmed the original conclusion, that the external audit was independent and objective and that the audit process was effective for that financial year.

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

As part of this exercise the Committee also considered the transparency report presented by the external auditor, the FRC's AQR review of the Group's 2020 external audit and the regulator's most recent audit inspection review on KPMG, published in July 2021. The Committee noted particularly the FRC's concerns regarding KPMG's auditing of banks and discussed these findings and the steps being taken by the firm to address them with the audit partner and other KPMG representatives.

As a result of these exercises the Committee concluded that it would recommend to the Board that a resolution to reappoint KPMG as external auditor for the year ending 30 September 2022 should be proposed at the forthcoming AGM.

Independence policy

Both the Committee and the external auditor have safeguards in place to avoid any compromise of the independence and objectivity of the external auditor. The Committee considers the independence of the external auditor annually and the Group has a formal policy setting out measures to ensure that independence is preserved. The policy is designed to ensure that neither the nature of the service to be provided nor the level of reliance placed on the services could impact the objectivity of the external auditor's opinion on the Group's financial statements.

The current policy, which is consistent with the FRC Ethical Standard for auditors, limits the use of the external auditor to supply non-audit services to those services where the use of the external auditor is expected or mandated by legislation or regulation. The Committee must approve any engagement of the external auditor for non-audit work, except where the fee involved is clearly trivial. The policy also sets out rules for the employment of former employees of the external auditor and procedures for monitoring such persons within the organisation.

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

Fees paid to the external auditor

Fees paid to the external auditor are shown in note 9 to the accounts. The 'other services' provided by KPMG include only services required to be provided by external auditors by legislation or regulation, including the review of half-yearly financial information and profit verification for regulatory purposes, and services expected to be provided by external auditors on capital market transactions, including work on the Group's green bond prospectus.

Audit fees of Group entities for the year have increased by 23% to £1,817,000 (2020: £1,468,000). This was a result of an increase in scope in certain areas and inflation in professional services fees more generally, particularly for more specialist resource.

The EU Audit Regulation (which is directly applicable in the UK for the time being) contains a 70% cap on non-audit fees for services provided to EEA Public Interest Entities ('PIEs'). For this purpose, non-audit services include audit-related services other than those services required by EU or national law such as reporting on interim financial information and regulatory profit confirmations, which are required by non-statutory regulations.

Non-audit fees paid to the auditor for the year ended 30 September 2021 should be no more than 70% of the average of the audit fees for 2018, 2019 and 2020. As this average was £1,327,000, the non-audit fee cap for the year was £929,000.

Fees paid to KPMG, the Group's external auditor, for non-audit services, as defined by the Regulation, during the year were £210,000 (2020: £168,000), well within the cap. All of these fees were for services related to the Group's audit, as described above.

The Group actively considers other providers for the type of non-audit services typically provided by accounting firms.

It maintains on-going relationships relating to tax, remuneration and regulatory advice with firms other than the external auditor's firm and considers discrete projects on a case-by-case basis.

The Group has engaged with a number of firms, including some outside the 'big four' largest audit firms, in considering appointments for assignments during the year, assessing each firm's appropriateness for the particular assignment before an appointment was made.

Fees paid to audit firms (excluding VAT), excluding the Group audit and related fees can be analysed as shown below.

	2021	2020
	£000	£000
Auditors – KPMG	**32**	-
Other big four firms	**2,780**	3,043
Other firms	**-**	-
	2,812	3,043

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

B6.5 Internal Audit

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

The roles and responsibilities of Internal Audit are set out in the Internal Audit Charter which is reviewed and approved by the Committee on an annual basis. A copy of the Charter is available on the Group's website.

The function is led by an Internal Audit Director who reports directly to, and has a close working relationship with, the Chair of the Committee. She attends all meetings of Performance ExCo and ERC as an observer.

Operations

During the year, the Committee considered and approved the annual internal audit plan, which is based on an assessment of the key risks faced by the Group. Progress in respect of the plan is monitored throughout the year. With the approval of the Committee, the audit plan may be revised during the year, based on the ongoing assessment of the key risks or in response to the requirements of the Group.

The Internal Audit Director provides the Committee with regular assessments of the skills required to conduct the Plan and whether the internal audit budget is sufficient to recruit and retain staff, or to procure other resources, with relevant expertise and experience. The Committee assesses, on an ongoing basis, whether the internal audit function has sufficient and appropriate skilled resources to complete the plan and, on an annual basis, formally confirms that it is satisfied that these resources are appropriate.

During the year, several technical and specialist reviews have been co-sourced under an agreement with a third-party accounting firm on a subject matter expertise basis where it was deemed by the Internal Audit Director that such skills would complement and develop those of the internal team.

The Internal Audit Director met regularly throughout the year with the Chair of the Committee to discuss progress against plan, outstanding agreed actions, and departmental resourcing. Ahead of finalisation of the audit plan for the year ending 30 September 2022, the Chair of the Committee met with the Internal Audit Director to discuss audit planning priorities, key business risks and assess current resourcing.

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

Effectiveness

The Committee assesses the effectiveness of the internal audit function by reference to standards published by the Chartered Institute of Internal Auditors. In 2021, the Committee considered the output of an internal quality assessment prepared on this basis and concluded that the function was satisfactory.

An external quality assessment ('EQA') was last commissioned in 2018 to benchmark internal audit activities against best practice and peers. As a matter of policy, the Committee intends to commission an EQA at least every five years.

B7. Remuneration Committee

> **...reflective of very strong performance outcomes in a challenging year, enhancement of the Group's capital position and the continuing development of the Group within its markets...**
>
> **Hugo Tudor,** Chair of the Remuneration Committee

This report covers the activities of the Remuneration Committee for the year ended 30 September 2021 and sets out the remuneration details for the executive and non-executive directors of the Company. It has been prepared in accordance with Schedule 8 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, as amended, and the principles of the Code.

This report consists of the Statement by the Chair of the Committee (B7.1) and the Annual Report on Remuneration (B7.2). The policy summary tables extracted from the detailed Remuneration Policy are reproduced for reference as Section B7.3.

The full Remuneration Policy is set out in the Annual Report and Accounts for the year ended 30 September 2019, a copy of which can be found at www.paragonbankinggroup.co.uk.

B7.1 Statement by the Chair of the Remuneration Committee

The information provided in this section is not subject to audit

Dear Shareholder

Business performance

Performance across the Group this year has been remarkable with underlying profit increasing by 61.8% which takes Group profits to a record level. Such an achievement is notable at any time, but is particularly so given the ongoing pandemic. Detailed analysis and commentary on performance can be seen throughout this report and particularly in the Chair of the Board's and the Chief Executive's reports in Sections A1 and A3. The balanced scorecard assessment shown later in this report records outstanding performance in all areas.

In addition to the strong financial performance achieved, the Committee noted in particular the outcomes from the future value and strategic development activities, including the record level of the mortgage pipeline and the embedded value generated from the mortgage book. I would also like to draw your attention to the launch of the Tier-2 Green Bond in March 2021 whereby Paragon became the first UK bank to issue a subordinated instrument in the sustainable finance space.

The proceeds of the bond are being allocated to green loans incentivising landlords to mitigate the impact of climate change.

Other green initiatives are being introduced in other lending areas. Similarly of note is the depth of the development finance pipeline which has increased by 74.1% from its 2020 level.

This outperformance across the Group is reflected in the annual variable remuneration outcomes of the executive directors and other employees. When considering variable remuneration awards the Committee noted that the Group's capital position was robust with the CET1 ratio at 15.4% after completing £37.8 million (including costs) of the £40.0 million share buyback announced at the time of the interim results and more detail on this is located in Section A4.3 of the financial results. The Group's approach to risk management was also recognised during the year by a material reduction in the PRA's assessment of its capital requirement, with the regulatory surplus rising to £410.1 million at 30 September 2021.

Variable pay earned in the year

Both executive directors are being awarded an annual bonus of 96.1% of the total opportunity, which is reflective of the delivery of very strong performance outcomes in a challenging year, enhancement of the Group's capital position and the continuing development of the Group within its markets in the current economic climate.

The PSP granted in December 2018 vested at 97.0% of the maximum award, similarly reflecting the strong performance over the performance period. This included TSR performance above the upper quartile of the peer group, resulting in full vesting for this element of the award (50% weighting). The Committee applied discretion to the EPS outcome, which represented 25% of the metrics. When the target and stretch levels were set, they assumed future reductions in UK corporation tax rates, which were subsequently reversed by the UK Government and also assumed that a lower proportion of the Group's taxable activity in 2021 would take place in Paragon Bank PLC than actually occurred.

The transfer of assets to Paragon Bank contributed materially to the capital surplus enhancement during the year, facilitating the second half share buy-back but led to a higher proportion of earnings arising in Paragon Bank which are subject to the banking tax surcharge. The EPS outcome was therefore adjusted.

The Committee determined that the management team should not be penalised for taking actions that are clearly in shareholders' best interests and consequently the underlying results should be adjusted to reflect these impacts. As a result the overall vesting level was 97.0% rather than 90.45% which would have been the vesting level if EPS on a reported basis had been used.

Group's remuneration philosophy

Our remuneration philosophy remains unchanged in seeking to recognise fairly the contribution of all employees, and whilst this report focuses on the executive directors, it can be seen from the comparison of 'Annual change in directors' pay with the average employee' table that the variable remuneration for all employees has increased this year, reflecting strong Group performance. During the year, as noted in last year's report, the Committee undertook a review related to the fair pay agenda which confirmed its view that the Group is a fair pay employer. A fair pay section has been specifically included in the report this year to provide additional context for shareholders.

Work of the Committee during the year

In 2021 no changes were made to the remuneration structures of the executive directors or senior management. During the current year the Committee has considered the gender pay gap reporting together with the CEO pay ratio analysis undertaken as part of the year end processes in 2020 and it will continue to consider executive director remuneration and the fair pay agenda in light of these analyses going forward. These differentials will be regularly monitored and should over time provide an additional benchmark for all employee remuneration packages.

Over the year discussions have been held with proxy advisors regarding remuneration matters. These meetings were attended by myself, the Chair of the Board and the People Director. I have also met with the People Forum to discuss both executive and all employee remuneration. Both of these interactions contributed to ensuring that the views and reflections of stakeholders are incorporated into the Committee's processes and reflections.

Regulatory regime

As previously anticipated in the Policy, as of 1 October 2021 the Group passed the asset threshold to be identified as a Level 2 bank under the remuneration regulations set by the PRA and FCA. As a result, some changes will be made to the remuneration arrangements of the executive directors, in particular the length of deferral period will be extended and there will be restrictions on the award of dividend equivalents; however, these changes will apply from next year (the financial year ending 30 September 2022 bonus and PSP).

In addition, over the course of this year the Committee has reviewed the remuneration arrangements for below board Material Risk Takers ('MRTs') to ensure these will meet the regulatory requirements going forward, making amendments as required.

Previously the Committee had primarily considered the impact of becoming a Level 2 bank on the packages of the executive directors. The Committee determined that a relatively small number of remuneration packages for MRTs below executive director level needed to be restructured, in the financial year ending 30 September 2022, to reflect the impact of the transition to Level 2. Embedding of the Level 2 requirements will continue throughout the year and be monitored and reviewed by the Committee on an ongoing basis.

Deferral of annual bonus, when in excess of £30,000, was introduced in the last financial year to a wider grouping of senior management than had previously been the case. This requirement is being maintained for the majority of MRTs in advance of needing to meet the regulatory requirement for deferral at the financial year ending 30 September 2022.

Remuneration for the year ending 30 September 2022

There are no changes to the structure of remuneration for the financial year ending 30 September 2022. Executive director salaries have been increased by 5% from 1 October 2021 in line with the wider workforce. Additionally, the total shareholder return ('TSR') comparator group, within the PSP, has been reviewed and amended to reflect changes in the financial services sector with the EPS measure being updated, as is usual, to reflect the current macro-economic environment. Further to ensure transparency the customer element of the risk metric has been removed as customer complaints are reflected within the customer metric.

Work of the Committee in 2022

A new policy will be put to shareholders at the AGM in 2023 with detailed considerations of any changes to the current policy being discussed by the Committee in the early part of the calendar year 2022 and followed up with conversations with shareholders and other stakeholders should those proposed changes be of a substantive nature. As part of that policy review the Committee will be considering how the new Policy should reflect the developing ESG strategy of the Group and reviewing the level of executive directors' pension supplements to take account of changing shareholder expectations in this area.

Conclusion

I hope that shareholders support how the Group has implemented its remuneration philosophy across all employees, including senior employees and the executive directors, and that it reflects the record performance of the business in the year ended 30 September 2021. I commend this report to shareholders and ask you to support the resolution to approve it which is being put to the AGM in March 2022.

Hugo Tudor

Chair of the Remuneration Committee

7 December 2021

B7.2 Annual Report on Remuneration

Contents:
The annual remuneration report includes: • The Remuneration Committee, key responsibilities and advisers (B7.2.1) • Directors' remuneration for the year ended 30 September 2021 (B7.2.2) • Application of remuneration policy for the year ending 30 September 2022 (B7.2.3) • Other information including Fair Pay (B7.2.4)

Remuneration summary

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

Aligning remuneration to our strategy during the year ended 30 September 2021:

Strategic priorities and the success factors on which these priorities are based	**Translation into remuneration structures**	
Strategic priority: *success factor*	**Bonus**	**Performance share plan**
Capital management: *credit quality*	Risk measures and future value of new business	Risk assessment and EPS
Growth and specialisation: *margins*	Future value of new business and financial performance	EPS and relative TSR
Diversification and capital management: *liquidity*	Risk measures and financial performance	EPS, relative TSR and risk assessment
Sustainability: *sustainable earnings*	Financial performance	Relative TSR, EPS and risk assessment
Capital management and sustainability: *capital strength and efficiency*	Risk measures	Relative TSR and risk assessment
Capital management and sustainability: *cost controls*	Profit measures and personal objectives	EPS
Sustainability: *a customer and people focussed culture*	Personal objectives include ensuring good customer outcomes and support for Paragon's customers	From the July 2020 grant customer and people metrics were adopted Customer metrics focus on the views of customers across their Paragon lifecycle People metrics focus on the employee journey

B7.2.1 The Remuneration Committee, key responsibilities and advisers

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

Committee membership

The Committee during the whole of the year comprised three independent non-executive directors of the Company (being Hugo Tudor, Chair of the Committee and Alison Morris and Graeme Yorston) and the Chair of the Board (Fiona Clutterbuck) whose relevant experience is set out in Section B3.1.

Information on the number of Committee meetings held and the individual attendance of members is given in section B3.3.

None of the Committee members has any personal financial interest (other than as a shareholder) or conflict of interest arising from cross-directorships or day-to-day involvement in running the business. The Committee is mindful of conflicts of interest arising in the operation of the Remuneration Policy and has measures in place to address this such as no individual being present when decisions are made on their own remuneration.

Key responsibilities

The Committee:

- Decides the Company's policy on executive remuneration, including pension rights and compensation payments of the executive directors
- Sets the remuneration for each of the executive directors, the Chair of the Board, the Company Secretary and all MRTs under the rules of the PRA/FCA which includes all members of the Executive Committee, the Internal Audit Director and CRO
- Review's workplace remuneration and related policies and the alignment of incentives and rewards with culture; and when setting the policy for executive director remuneration, takes into account those matters
- Considers the group-wide Internal Remuneration Policy for all employees (excluding executive directors) and considers and approves the identification of the Group's MRTs under financial services regulatory remuneration rules

Attendees

The CEO, People Director, CRO, General Counsel and Company Secretary, Director of External Relations, other non-executive directors (including the Chair of the Risk and Compliance Committee) and external remuneration advisors attend by invitation.

Advisors

During the year, the Committee considered advice from:

- Independent advisors – Deloitte LLP ('Deloitte') until May 2021 and PricewaterhouseCoopers LLP ('PwC') from that date
- The CEO, the Chair of the Risk and Compliance Committee, the People Director, the CRO and the Director of External Relations in determining remuneration for the year for executive directors and senior management

Independent advisors: additional information

- **Appointment process** – both Deloitte and PwC were appointed by the Committee following review processes and are members of the Remuneration Consultants Group and as such voluntarily operate 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
- **Fees** – the total fees paid to Deloitte for advice to the Committee during the year amounted to £54,660 (including VAT) on a time and materials basis. Deloitte provided other professional services to the Group during the year including share scheme and tax advice, regulatory support, customer contact support, securitisation and co-sourced internal audit services

  The total fees paid to PwC for advice to the Committee during the year amounted to £61,920 (including VAT) on a part fixed fee and part time and materials basis. PwC provided other professional services to the Group during the year including regulatory support and support for the Group's IRB application
- **Connections to the Group** – the Committee is satisfied that both the PwC team and formerly the Deloitte team providing remuneration advice to the Committee does not, or in the case of Deloitte did not, have any connection with the Group, or any individual director, that may impair its independence and/or objectivity

  The Committee, when making this statement in reference to PwC, notes that Alison Morris (Chair of the Audit Committee) is a former partner at PwC. Alison, who left PwC in 2019, declared her interest at the time of PwC's appointment and did not participate in the selection interviews leading up to their appointment. The Committee is satisfied that its appointment of PwC was made in an independent and objective manner and that PwC's independence and objectivity remains unimpaired

Statement of voting at Annual General Meeting

The table below sets out actual voting in respect of the resolution to approve the Annual Report on Remuneration at the Company's AGM on 24 February 2021.

The table also details the outcome for the resolution to approve the Remuneration Policy at the AGM on 13 February 2020. Information on the Committee's response to this vote in 2020, which was deemed a significant vote against under the Code, can be found in the Annual Report and Accounts 2020 page 107.

Resolution	Votes for	% for	Votes against	% against	Total votes cast	Votes withheld
Annual Report on Remuneration	202,448,059	98.01%	4,110,792	1.99%	206,558,851	4,587,039
Remuneration Policy	157,352,402	74.33%	54,331,483	25.67%	211,683,885	3,082

B7.2.2 Directors' remuneration for the year ended 30 September 2021

The information provided in this section of the Directors' Remuneration Report has been audited

Single total figure of remuneration for executive directors

Year ended 30 September 2021	N S Terrington	R J Woodman	J A Heron[2]	Total
	£000	£000	£000	£000
Fixed remuneration				
Salaries and fees	**599**	**377**		**976**
Allowances and benefits	**14**	**12**		**26**
Role based allowance	**140**	**90**		**230**
Pension allowance	**120**	**75**		**195**
Total fixed remuneration	**873**	**554**		**1,427**
Variable remuneration				
Bonus	**863**	**544**		**1,407**
Dividend on vested deferred bonus	**-**	**-**		**-**
Share awards[1]	**1,335**	**841**		**2,176**
Total variable remuneration	**2,198**	**1,385**		**3,583**
Total	**3,071**	**1,939**		**5,010**

Year ended 30 September 2020	N S Terrington	R J Woodman	J A Heron[2]	Total
	£000	£000	£000	£000
Fixed remuneration				
Salaries and fees	**563**	**354**	**69**	**986**
Allowances and benefits	**26**	**12**	**10**	**48**
Role based allowance	**88**	**56**	**-**	**144**
Pension allowance	**160**	**101**	**31**	**292**
Total fixed remuneration	**837**	**523**	**110**	**1,470**
Variable remuneration				
Bonus	**594**	**374**	**-**	**968**
Dividend on vested deferred bonus	**-**	**43**	**-**	**43**
Share awards[1]	**743**	**468**	**274**	**1,485**
Total variable remuneration	**1,337**	**885**	**274**	**2,496**
Total	**2,174**	**1,408**	**384**	**3,966**

[1] The PSP value for the year ended 30 September 2021 has been determined using the average closing share price for the three months ended 30 September 2021 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 2021 following the Preliminary Results announcement.

The share awards value for the year ended 30 September 2020 has been restated to reflect the market value of the shares under the PSP that vested on 3 December 2020 as at that date.

[2] J A Heron retired from the Board on 6 January 2020 and the remuneration shown in the 2020 table above is in respect of his service to that date. He received no additional remuneration for cessation of office.

Additional information in respect of the constituents of the above noted single figure tables for executive directors is provided below using the sections noted in the table as headings. The further information is included from the heading 'Allowances and benefits' immediately below until, but not including, 'Chair of the Board and non-executive director fees'.

Allowances and benefits

Included within this total in the single figure tables are private health cover and a company car allowance (£10,000 to £12,000). Also included is a reimbursement from the Company in respect of certain travel costs incurred in connection with the performance of executive director duties which constitutes a taxable benefit in kind. The amounts included represent the travel payments HMRC treats as taxable together with an allowance to cover the tax. The Group provides the amount required to cover the tax liability. This amount will vary with the amount of travel undertaken by the executive director.

Role based allowance ('RBA')

This allowance was introduced following the AGM in 2020. The fixed pay allowance is paid quarterly in shares and released over five years in equal tranches. The RBA is not subject to performance conditions.

Pension allowance

Both Nigel Terrington and Richard Woodman received a cash allowance in lieu of pension of 20% of salary. Newly appointed executive directors will receive a maximum pension contribution of 10% of salary, which is the same maximum level as for the majority of the workforce who are members of the Group's defined contribution pension scheme.

The Committee considers that the executive directors' pension contribution is aligned to the workforce average contribution as well as reflecting other employees whose service to the Group is of equivalent longevity who were members of the Paragon Pension Plan (the 'Plan'). The Plan was restructured during the year to enable de-escalation of the risks associated with a defined benefit plan together with continuity of future accrual for employees and closer alignment of pension contributions across the Group. Employees within the Plan have from August 2021 received an employer contribution of 25% of salary. A small number of former members of the Plan receive a cash supplement of 45% of salary for having left the Plan.

The Committee reiterates its commitment made last year to reviewing the executive directors' pension contributions as part of the triennial policy review and will take into account the changing stakeholder landscape both internal and external when considering this matter.

Bonus

Bonus opportunity during the year was, in line with policy, 150% of salary.

In respect of the annual bonus for the year ended 30 September 2021:

- A bonus of 96.1% of maximum opportunity was awarded to each of the executive directors
- Deferral will be 50% of amounts over £50,000 for three years and is subject to malus and clawback

How the bonus was determined and is split between cash and deferred shares is as shown below:

Executive director	Financial performance	Future value and strategy	Risk	Personal performance	Total	Total	Cash	Share value
						£000	£000	£000
N S Terrington	30.0%	28.6%	17.5%	20.0%	96.1%	863	456	407
R J Woodman	30.0%	28.6%	17.5%	20.0%	96.1%	544	297	247

The Committee determined that the formulaic outcomes under the bonus framework were fair and appropriate in light of the very strong financial and non-financial performance and exemplary leadership shown over the period, therefore it was decided that no discretion should be applied to outcomes.

Outturn was based on performance measures as detailed in the assessment below:

Balanced scorecard assessment

Measure	Weighting	Threshold	Target	Maximum	Actual	Outcome
Financial performance	**30.0%**					**30.0%**
Operating profit	12.0%	£132.9m	£139.9m	£148.3m	£194.2m	12.0%
RoTE (underlying)	9.0%	9.9%	10.9%	12.1%	14.7%	9.0%
NIM progression	3.0%	+0bp	+3bp	+7bp	+14bp	3.0%
Cost: income ratio	3.0%	45.2%	44.4%	43.5%	41.7%	3.0%
CET1 (adjusted for buybacks)	3.0%	14.8%	15.4%	16.0%	16.0%	3.0%

Measure	Weighting	How measured	Outcome
Future value and strategy	**30.0%**	Qualitative assessment by the Remuneration Committee of:	**28.6%**
Development activities	7.5%	Digital systems launches and enhancements such as: - Commercial Lending portal and auto decisioning - Embedding Mambu operating platform for Savings - Single payment platform - Surveyors' digital system IRB phase 2 application was submitted to the regulator on time	6.8%
Pipeline	7.5%	Record levels for buy-to-let mortgages of £1.01 billion and development finance of £298.6 million	7.5%
Embedded value	7.5%	Net loan book increases exceeding plan by 80% with stronger than planned originations and enhanced retention while widening margins	6.8%
Liability management	7.5%	Launch of the first UK Green Tier-2 Bond Refinancing of Paragon Mortgages (Nos. 11, 13, 14 and 15) PLC TFSME £1.84bn drawn as planned Savings grew to £9.3 billion Warehouse facility renegotiated	7.5%
Risk	**20.0%**	Qualitative assessment by the Remuneration Committee of:	**17.5%**
		Further embedding of the Group's principal risk framework Portfolio performance throughout the pandemic (evidenced through arrears and losses) was strong Group's capital management framework was robust which led to reduced regulatory requirements	
Personal performance	**20.0%**	Qualitative assessment by the Remuneration Committee of:	**20.0%**
		Individual targets as detailed below for each director:	100.0%

	Individual targets	Actual performance
Nigel Terrington	Strong leadership to deliver the Group's business plan and financial performance, upholding our values and always delivering good customer outcomes	Record profit before tax of £213.7 million increased by 80.5% from 2020 Savings expansion to £9.3 billion with margin enhancements of 14bp The Group regularly surveys its intermediaries and customers, and levels of satisfaction were broadly maintained from 2020 despite the ongoing pandemic and with significant levels of virtual working by employees. Surveys showed that: • 91% of intermediaries were satisfied with the ease of obtaining a response from the Group (2020: 91%) • 89% of savings customers would 'probably' or 'definitely' take a second product (2020: 90%)
	Review the Group's strategy in light of changing capital availability and requirements	Capital benefits from securitisation refinancing routed back to shareholders through a PRA approved buyback Continued proactive assessment of a number of potential opportunities to diversify the Group's strategy
	Continue to focus the Group's presence as a leading UK specialist lender in its core markets of buy-to-let, development finance and SME lending	Strong buy-to-let pipeline at year end £1.01 billion Commercial Lending division originations up 22.9% and strong year end pipeline in place in development finance
	Continue with technology development to digitalise the business for our customers, with improved service delivery, faster decision making and improved cost efficiencies	The technology roadmap for core systems has delivered significant progress in the period including: • Asset finance portal and auto decisioning launched • Mambu embedded as a core operating system supporting the savings platform relationships • Single payment platform utilising cloud based technology for Group payments was successfully implemented to provide enhanced levels of operational resilience • Surveyors' system enhanced and embedded providing time and cost saving efficiencies
	Continue to develop the Group's savings strategy, expanding the addressable market and over time, utilising technology, including open banking, to broaden the customer reach	Onboarded Raisin (a digital savings platform), facilitating the launch of products with Aviva, AJ Bell and Willis Owen Expanded the Revolut offering to a broader range of customers Launched SME deposit-taking
	Focus on rebuilding profitability measured by RoTE back towards 15% or above in the medium term	Underlying 14.7% achieved for the year, reported RoTE 16.2%
	Further develop the Group's risk management framework to continuously improve resilience, deliver good customer outcomes and embed the risk culture	Significant progress made through investment in technology, cyber security, change governance, business continuity planning, supplier assurance and data governance to increase the Group's overall resilience Operational resilience framework in place and aligned to the ERMF
	Continue to build a succession plan pipeline for Executive Committee roles	Appointment of four senior roles, of which 75% were female, reporting directly into ExCo members to support the senior talent pipeline Third cohort of high performers commenced the senior leadership development programme

	Individual targets	Actual performance
Richard Woodman	Strong leadership to deliver the Group's business plan and financial performance, upholding our values and always delivering good customer outcomes	Outperformance against all aspects of corporate plan; margins, volumes, cost efficiency and credit performance
	Ensure the Group's funding position and access to TFSME allows it to support our customers and provide credit to the economy	Full TFSME usage accessed (£2.75bn) following successful securitisation refinancing and collateral management programme SME lending supported through CBILS, BBLS and RLS
	Prioritise and embed IRB to boost the Group's risk capability and longer term capital efficiency	Strong progress made on IRB with Phase 2 submitted to the PRA Development finance slotting model embedded
	Maintain highly prudent capital, liquidity and funding buffers to allow the Group to support its customers and other stakeholders in stress	Capital position enhanced through securitisation re-financing programme and reductions in regulatory requirements from the PRA following a detailed ICAAP process Collateral management enhances liquidity options, and the liquidity position has been managed at or above the target operating range throughout the year Capital benefits from securitisation refinancing routed back to shareholders through a PRA approved buyback
	Further develop the Group's thinking on the impact from climate change and embed the management of climate related risks within the Group's strategic plans and risk appetites	Issued Tier-2 bond replacement as a green bond, with an associated green bond framework demonstrating that sustainability and climate change are at the top of the Group's agenda Sustainability Committee established and launched in the year
	Oversee the Group's transition away from LIBOR and provide monthly updates to the Board in terms of project governance, conduct risk oversight and treasury management	All business lines have transitioned to non-LIBOR alternatives or are well progressed to achieve this ahead of the required deadline The Group's largest asset portfolio migrated to a term SONIA basis in June / July and main liability elements resolved through securitisation refinancing
	Continue to provide oversight and management of the investor relations programme	Effective shareholder and analyst interactions held throughout the year given the switch to virtual engagements Interim reports and transparency of (in particular) the Group's impairment approach positively received

Dividend on vested deferred bonus

This section details the accrued dividends to the date of exercise paid on deferred bonuses which were exercised during the relevant year. Under the policy, dividends will accrue to the point of vesting on deferred share awards made in respect of the year ended 30 September 2016 and thereafter.

Other information

In 2021 Sharesave awards vested for Nigel Terrington and Richard Woodman. The SAYE is an all-employee share plan with the option price for the 2016 grant of £2.4944 per award. SAYE awards are not subject to tax or national insurance and the option price is funded by monthly saving from salary. The option price is based on a 20% discount to market price at grant equating to a £7,000 benefit in respect of this grant for each director. This has not been included in the above table, in order to ensure that year on year comparison of the single figure table is consistent as SAYE exercises are not annual occurrences.

Share awards: Paragon Performance Share Plan

Awards vesting in respect of the year ended 30 September 2021

Awards granted in December 2018 under the Group's PSP are subject to performance conditions measured over the three financial years ended 30 September 2021.

Performance condition	Weighting	Threshold vesting for 25% of maximum award	Maximum vesting	Actual performance	Vesting outcome
Relative TSR	50.0%	Median performance (being: (10.8%))	Upper quartile performance (being: 24.8%)	Upper quartile performance (being: 27%)	100.0%
EPS	25.0%	60 pence	68 pence or more	68.1 pence (adjusted)	100.0%
Risk	25.0%	n/a	n/a	88%	88.0%
Total as a % of maximum award					**97.0%**
Total as a % of salary at grant					**194.0%**

There is straight-line vesting between the threshold and maximum for the TSR and EPS conditions and no reward below threshold performance.

The target and stretch position for the EPS vesting condition were based upon anticipated reductions in corporation tax rates that were in turn reversed by the Government. Further, to facilitate the refinancing of the legacy securitisations and deliver the associated capital benefits, a higher proportion of Group earnings arose in Paragon Bank, attracting a higher tax surcharge.

The transfer of assets to Paragon Bank contributed materially to the capital surplus enhancement during the year, facilitating the second half share buyback but led to a higher proportion of earnings arising in Paragon Bank which are subject to the banking tax surcharge.

The Committee determined that the management team should not be penalised for taking actions that are clearly in shareholders' best interests and consequently the underlying results should be adjusted to reflect these impacts. As a result the EPS element of the grant vested at 100% rather than the 73.8% that would have arisen on a reported basis.

The risk metric measures the Group's performance against six equally weighted risk categories – material regulatory breaches, customer service, management of liquidity and capital risk, credit losses against risk appetite, management of conduct risk and material risk events over the performance period. The performance of the Group against these metrics was independently assessed by the Committee, supported by the Chair of the Risk and Compliance Committee and the Group's CRO, and the outcome reflects the strong level of performance over this period.

Performance in all risk areas discussed and reviewed by the Committee was strong throughout the performance period, in particular the Committee noted that during the period:

- There had been no material regulatory breaches
- The capital base was robust and regulatory compliant
- Credit performance has been strong across all portfolios
- Complaints, the main measure for customer service, were within risk appetite for the majority of the period with customer service levels being maintained admirably during the pandemic
- Operational risk outcomes were reflective of the Group's exemplary resilience shown in the pandemic and the improvements made to the Group's operational resilience framework over the period

Vesting was also subject to the Committee's determination that individual performance and the underlying financial performance of the Group were satisfactory given the level of vesting. In respect of both these points the Committee concluded that the vesting level was appropriate for all participants.

Details of the shares which will vest in December 2021, following the announcement of the Preliminary Results, are set out below. The table also shows that the vesting value in 2021, determined as noted below, reflected a 24% increase in the share price between grant and vesting.

	Total shares granted	Grant basis	Vesting outcome	Vested shares	Share price[1]	PSP value[2]	Impact of share price appreciation
		£			£	£000	£
2018 PSP awards							
N S Terrington	227,156	4.43	97.0%	220,341	5.4926	1,335	234,129
R J Woodman	143,059	4.43	97.0%	138,767	5.4926	841	147,451
	370,215						**381,580**

[1]The PSP value has been estimated using the average closing share price for the three months ended 30 September 2021. The actual value of the awards will not be known until the awards vest in December 2021, as it will be based on closing share price at that date.

[2]In accordance with the rules of the PSP, participants are entitled on exercise to additional value equal to the dividends that would have been paid on vested shares in respect of dividend record dates between the grant date and vesting date. Accordingly, the share award values also include £0.5670 per vested share in respect of such dividends.

Awards which vested in respect of the year ended 30 September 2020: impact of the share price on vested awards

The final vesting value of the awards which vested in respect of the 2017 PSP showed a 5% decline from date of grant. The Committee did not apply discretion on the vesting outcome. This table has been restated from that shown in the 2020 Annual Report and Accounts using the closing price on the date of vest. Previously the average closing share price for the three months ended 30 September 2020 had been used.

	Total shares granted	Grant basis	Vesting outcome	Vested shares	Share price[1]	Impact of share price depreciation[3]
		£			£	£
2017 PSP awards						
N S Terrington	205,192	4.7614	72.0%	147,738	4.5140	(36,550)
R J Woodman	129,227	4.7614	72.0%	93,043	4.5140	(23,019)
J A Heron[2]	109,401	4.7614	72.0%	54,547	4.5140	(13,495)
Total	**443,820**					**(73,064)**

[1]The PSP value has been restated based on the market value on the date of vesting being 3 December 2020.

[2]The vested shares for J A Heron's 2017 PSP awards shown above have been calculated at the pro-rata amount.

[3]As part of the December 2017 PSP award, each executive director was granted a tax-qualifying option under the Company Share Option Plan ('CSOP') which vested at 4,186 shares at a per share exercise price of £4.7776. The CSOP option is subject to similar performance conditions to the main PSP award. If a CSOP option is exercised at a gain, the number of shares the director will receive under the PSP will be reduced by the same value, to ensure that the total pre-tax benefit is not increased by the grant of the CSOP options. Therefore, the value of each award, in aggregate, is equivalent to that of a PSP award and the CSOP options have been disregarded in determining the value.

Awards granted during the year ended 30 September 2021

On 11 December 2020 the following awards were granted, as nil-cost options, under the PSP with a face value of 180% of salary in line with Policy.

Executive director	Salary	Percentage grant	Face value of grant	Share price[1]	Number of shares
	£000		£000	£	
N S Terrington	599	180%	1,078	4.554	236,661
R J Woodman	377	180%	679	4.554	149,046

[1]Based on the average closing mid-market price of the Company's shares on each of the five dealing days following the announcement of the Company's results for the year ended 30 September 2020, being the price used to determine the number of shares in accordance with the Directors' Remuneration Policy.

The PSP awards granted in December 2020 are subject to the following performance conditions, with a performance period of three years, from 1 October 2020, ending on 30 September 2023. The executive directors' awards, which are tested over the three-year performance period, will vest after five years, following the end of a two year holding period.

Performance measure	Weighting	Threshold vesting for 25% of maximum award	Maximum vesting
Relative TSR	25.0%	Median performance	Upper quartile performance
Basic EPS	25.0%	58 pence	66 pence or more
Risk	25.0%	50% weighting on an assessment from the CRO of the six key elements of the Group's risk appetite: regulatory breaches, customer service, conduct, operational, capital and liquidity and credit losses 50% weighting on a strategic risk assessment to reflect the management of risk with regard to the delivery of the Group's medium-term strategy	
Customer	12.5%	Consideration will be given to (i) customer insight feedback on key product lines, (ii) customer complaints relative to risk appetite levels and (iii) average overturn rate for customer complaints relative to the FOS's reported rates	
People	12.5%	Consideration will be given to (i) employee engagement, (ii) voluntary attrition compared to industry averages and (iii) gender diversity of senior management	

There is straight-line vesting between threshold and maximum and no reward for below threshold performance. In addition, prior to any awards vesting, the Committee must be satisfied that the individual performance and underlying financial performance of the Group are satisfactory given the level of vesting.

Relative TSR measure

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

Amigo Holdings PLC	**Arrow Global Group PLC**	**Barclays PLC**
Close Brothers Group PLC	**Funding Circle Holdings PLC**	**Lloyds Banking Group PLC**
Metro Bank PLC	**NatWest Group PLC**	**OSB Group PLC**
Provident Financial PLC	**Secure Trust Bank PLC**	**S&U PLC**
Virgin Money UK PLC		

Chair of the Board and non-executive director fees

	Year ended 30 September 2021			Year ended 30 September 2020		
	Fees	**Benefits[1]**	**Total**	Fees	Benefits[1]	Total
	£000	**£000**	**£000**	£000	£000	£000
Chair of the Board						
F J Clutterbuck	**255**	**14**	**269**	255	14	269
Non-executive directors						
P J N Hartill[2]	**-**	**-**	**-**	87	-	87
P A Hill[3]	**76**	**-**	**76**	-	-	-
A C M Morris[4]	**85**	**-**	**85**	44	-	44
B A Ridpath	**65**	**-**	**65**	65	-	65
H R Tudor[5]	**95**	**-**	**95**	87	-	87
F F Williamson	**21**	**-**	**21**	85	-	85
G H Yorston	**65**	**-**	**65**	65	-	65
Total	**662**	**14**	**676**	688	14	702

[1]F J Clutterbuck receives a company car allowance and is eligible for private health cover on an individual or family basis in the same way as the executive directors

[2]P J N Hartill resigned from the Board on 30 September 2020, ceased to be Audit Committee Chair on 10 June 2020 and Senior Independent Director on 23 July 2020

[3]P A Hill was appointed to the board on 27 October 2020

[4]A C M Morris was appointed to the Board on 26 March 2020

[5]H R Tudor became Senior Independent Director on 23 July 2020

Payments to past directors

J A Heron retired from the Board on 6 January 2020. He remains entitled, under the usual 'good leaver' provisions, to awards received under the PSP and Deferred Share Bonus Plan ('DSBP') when a director. In respect of the PSP, these will vest, subject to performance, on a pro-rata basis (from the date of grant to the date of cessation of employment) at the end of the relevant vesting period and for the DBSP these will vest in full once the vesting period has elapsed. Both PSP and DSBP remain subject to malus and clawback provisions.

Consequently, for the PSP grant that is due to vest in December 2021 (the 2018 grant) J A Heron will receive 41,589 shares (being his original grant of 121,117 PSP awards vesting at 97.0% and pro-rated to his date of leaving).

Payments for loss of office

No payments for loss of office were made during the year ended 30 September 2021.

Directors' share interests

The interests of the executive directors in the shares of the Company at 30 September 2021 (including those held by their connected persons) were:

	N S Terrington	R J Woodman
	Number	Number
Unvested awards subject to performance conditions		
PSP	549,090	345,809
Unvested awards not subject to performance conditions		
DSBP	225,078	139,658
Sharesave	4,245	4,245
Total unvested awards	778,413	489,712
Vested but unexercised awards		
PSP[1 2]	510,169	389,356
DSBP	254,780	52,259
Total vested but unexercised awards	764,949	441,615
Shares beneficially held[3]	841,816	271,408
Total interest in shares	**2,385,178**	**1,202,735**

Awards exercised in the year		
PSP	-	-
DSBP	-	-
Sharesave[4]	12,026	12,026
Total awards exercised in the year	**12,026**	**12,026**

Awards under the PSP and DSBP schemes noted above were granted in the form of nil cost options.

[1] As part of the December 2017 PSP award, each executive director was granted a tax-qualifying option under the CSOP which vested at 4,186 shares at a per share exercise price of £4.7776.
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. Determining the number of awards that will be exercised is dependent on the share price at date of exercise and, as this is not certain until that date, the above table includes the 2017 award at the maximum number of PSP awards that could be exercised.

[2] For the purposes of the table above the awards granted in December 2018, to Nigel Terrington and Richard Woodman are assumed to be vested but unexercised in respect of the percentage which it is estimated will vest, 97.0%, and to have lapsed in respect of the balance.

[3] Shares beneficially held include shares obtained under the RBA, being for Nigel Terrington 28,521 shares and for Richard Woodman 18,331 shares. These shares are not subject to performance conditions but are subject to restrictions related to disposal.

[4] The SAYE awards were exercised by Nigel Terrington on 30 September 2021 and Richard Woodman on 18 August 2021. The SAYE is an all-employee share plan and the option price for the 2016 grant was £2.4944 per award. The closing share price on the date of exercise was £5.46 for Mr Terrington and £5.633 for Mr Woodman. SAYE awards are not subject to tax or national insurance.

The interests of the Chair of the Board and the non-executive directors at 30 September 2021, which consist entirely of ordinary shares, beneficially held, were as follows:

	2021
F J Clutterbuck	**8,372**
P A Hill	**2,459**
A C M Morris	**4,000**
B A Ridpath	**4,358**
H R Tudor	**70,000**
G H Yorston	**7,517**

As at 3 December 2021, 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

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 shares which count towards the aggregate shares held by each director for the purposes of this calculation are:

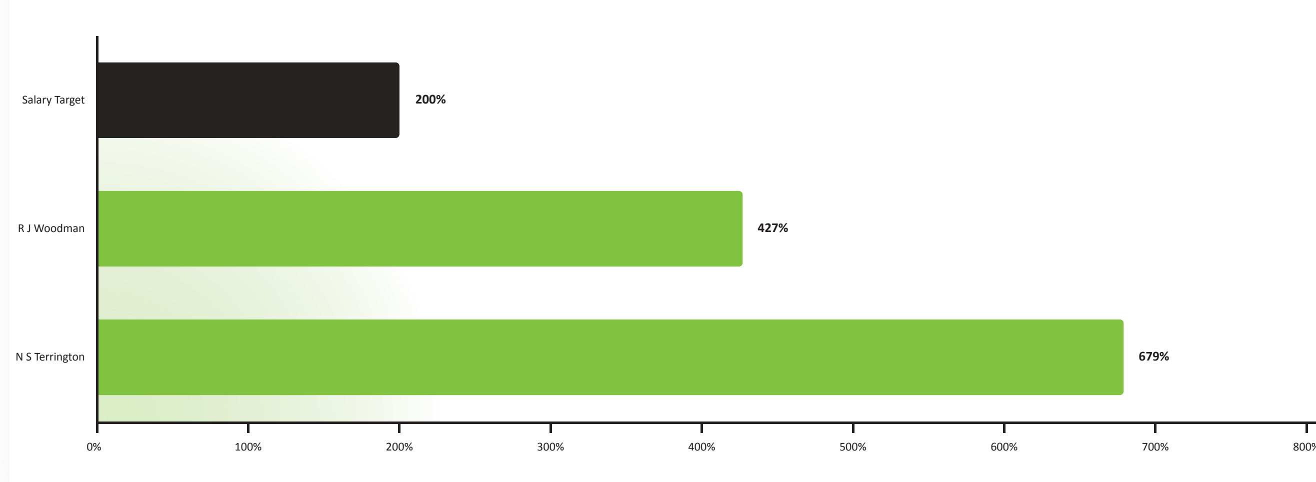
1. Unexercised but vested share awards
2. Share awards with no performance conditions attached such as the DSBP and RBA and share awards with performance conditions no longer attached such as PSP awards once the performance conditions have been tested
3. Shares purchased with own funds where those shares are unconnected to a share award exercise
4. Other beneficially owned shares such as exercised and retained share awards and shares held in the name of spouses etc

The valuation is calculated on a net of income tax and national insurance basis where relevant.

The chart below compares the executive directors' holdings at 30 September 2021 to those required by the guidelines, expressed in value terms as a percentage of salary.

Directors' shareholding guidelines

30 September 2020



At 30 September 2021, the holdings of executive directors were in accordance with guideline levels.

Post-employment shareholding requirement

With effect from the approval of the Remuneration Policy in February 2020 the Committee adopted a post-cessation shareholding requirement. This requires that for two years following cessation of employment, based on their immediately pre-cessation salary, an executive director must retain such of their 'relevant' shares as have a value (as at cessation) equal to the shareholding guideline, or (if lower) the number of shares actually held at the date of departure.

'Relevant' shares are shares acquired under items 1 and 2 above. They may also include shares noted under item 4 above if such shares were originally derived from a share exercise. It does not include shares acquired under item 3 above.

No former directors are subject to these guidelines.

B7.2.3 Application of remuneration policy for the year ending 30 September 2022

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

Overview

Any changes to the application of the Remuneration Policy for the year ending 30 September 2022 are, as noted above, expected to be limited.

Executive directors

Base salary

The salaries of the executive directors were increased by 5%, in line with the wider workforce, from 1 October 2021.

	Salary with effect from	
	1 October 2021	1 October 2020
	£	£
N S Terrington	**628,695**	598,754
R J Woodman	**395,945**	377,087

Allowances and benefits and pension contributions

No change from the stated policy.

Annual bonus

In line with the policy, the bonus opportunity for the financial year 2022 will be 150% of salary.

The Committee has determined that performance will be assessed against a balanced scorecard of measures consisting of: financial performance (30%) including core profit and RoTE, together with a range of other metrics derived from the Group's financial plans; future value and strategic development (30%); risk management (20%); and personal performance (20%). The two core measures of underlying profit and underlying RoTE comprise 70% of the financial performance award, but the Committee annually determines the appropriate secondary measures by reference to the strategic focus for the year. For 2022 the secondary measures will continue to be underlying NIM progression, CET1 and cost:income ratio.

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

Deferral requirements will reflect the regulatory requirements for a Level 2 bank in the year ending 30 September 2022 (as detailed in the Policy Summary at the end of this report).

PSP awards

PSP award levels for executive directors are 180% of base salary. The performance conditions and weightings (in respect of TSR, EPS, risk and customer and people metrics), individual performance and Group underlying performance requirements are as noted below.

Performance measure	Weighting	Threshold vesting for 25% of maximum award	Maximum vesting
Relative TSR	25.0%	Median performance	Upper quartile performance
Basic EPS	25.0%	63.0 pence	72.0 pence or more
Risk	25.0%	50% weighting on an assessment from the CRO of the five key elements of the Group's risk appetite: regulatory breaches, conduct, operational, capital and liquidity and credit losses 50% weighting on a strategic risk assessment to reflect the management of risk with regard to the delivery of the Group's medium-term strategy	
Customer	12.5%	Consideration will be given to (i) customer insight feedback on key product lines, (ii) customer complaints relative to risk appetite levels and (iii) average overturn rate for customer complaints relative to the FOS's reported rates	
People	12.5%	Consideration will be given to (i) employee engagement, (ii) voluntary attrition compared to industry averages and (iii) gender diversity of senior management	

The TSR grouping has been updated to reflect changes in the Group's listed peers and consists of the companies below.

Amigo Holdings PLC	**Arbuthnot Banking Group PLC**	**Barclays PLC**
Close Brothers Group PLC	**Funding Circle Holdings PLC**	**LendInvest PLC**
Lloyds Banking Group PLC	**Metro Bank PLC**	**NatWest Group PLC**
OSB Group PLC	**Provident Financial PLC**	**Secure Trust Bank PLC**
S&U PLC	**Virgin Money UK PLC**	

The EPS metric has been updated to reflect the current macro-economic climate whilst maintaining an appropriate level of stretch compared to the Group's financial forecasts. The Group's Covid response saw impairments inflate materially in 2020, with a correction then seen in 2021. When considering the degree of stretch in the targets, the Committee considered them both in relation to the internal targets and to a normalised figure for the year ended 30 September 2021 of 55.1p, based on the 2019 cost of risk, to take account of the unusual pattern of impairments in the financial years ended 2020 and 2021. On this basis, the Committee was satisfied that the targets represent a very strong performance if achieved and are therefore appropriately stretching.

The risk and customer metrics have been updated to ensure that customer complaints are only counted within the customer metric.

There is straight-line vesting between threshold and maximum for the TSR and EPS measures and no reward for below threshold performance. In addition, prior to any awards vesting, the Committee must be satisfied that the individual performance and underlying financial performance of the Group are satisfactory given the level of vesting.

Chair of the Board and non-executive director fees

The Board reviewed and approved an increase to non-executive director base fees by £5,000 per annum, effective from 1 October 2021, to maintain alignment to the market. No other changes were made in respect of non-executive director or Chair of the Board's fees.

	Fee with effect from	
	1 October 2021	1 October 2020
	£000	£000
Chair of the Board's fee	**255**	255
Base fee for non-executive directors	**70**	65
Additional fee for Senior Independent Director	**10**	10
Additional fee for chairs of committees[1]	**20**	20

[1]The additional fee for chairing a committee is currently payable to the Chairs of the Remuneration, Audit, and Risk and Compliance Committees but not the Nomination Committee and would be payable for the chairing of such additional committees as might be authorised by the Board.

B7.2.4 Other information

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

This section provides various items of information related to remuneration within the Group. This includes information that shows the overall approach to all employee remuneration at the Group and how directors' remuneration aligns and compares with other employees and shareholders.

Fair pay

Fair pay: groupwide remuneration philosophy

Paragon is committed to rewarding all of its employees fairly for their contribution, whilst ensuring they are motivated to always deliver the best outcomes for its customers. The Group's approach to remuneration reflects its culture, vision and values and supports its purpose whilst being aligned to the long term interests of the Group and helping to deliver fair customer outcomes.

This commitment to fair pay is reflected in Paragon's:

- Support since 2016 for the minimum wage payable to all employees being that stated by the Living Wage Foundation (which from 1 November 2021 will be £19,500 per annum)
- Payment of PRP to around 85% of the workforce
- Share schemes being available at both an all employee and senior management level which help to align employees' interests with shareholders
- Alignment between executive pay and that of other senior managers as well as other employees
- People Forum providing an additional arena for discussion and feedback on executive and all employee remuneration structures

Further information on the above points can be found in the remainder of this section. In addition, the commitment to fair pay is reflected in Paragon's commitment to various sustainability related matters which support and enhance fair pay and the remuneration philosophy and are detailed in Section A6.

How our pay principles aligned to the Code during the year ended 30 September 2021:

Principle	Application	Example
Clarity	The executive director and Group remuneration policies are clearly communicated to directors and all employees The Remuneration Committee Chair and Chair of the Board regularly consult with our major shareholders as part of our commitment to a transparent and open relationship	The Remuneration Report in this document is available to all employees as is the group-wide Internal Remuneration Policy Details on the application of the Directors' Remuneration Policy, including incentive outcomes for the current year as well as proposed performance measures and targets for future years, are clearly set out in this report. The internal policy details the available remuneration structures which are aligned across the Group and consist of salary; pension; variable cash bonuses; share schemes and benefits
Simplicity	Straightforward remuneration structures apply to all levels of the Group's employees The Committee has sought to ensure that the Directors' Remuneration Policy and outcomes under the Policy are easy to understand for both participants and shareholders	Discussion on executive remuneration and how it aligns to the workforce forms part of the regular People Forum discussions with the Committee Chair
Proportionality	Bonus awards reflect annual performance and PSP awards reflect performance over the longer term with performance measures and targets clearly linked to strategy The Committee also has the discretion to override formulaic outturns to ensure outcomes do not reward poor performance	The links between awards and delivery of strategy and performance are shown in the table above Performance conditions require a minimum level of performance to be achieved before any pay-out under variable pay schemes is considered
Predictability	Minimum, target and maximum levels of award for executive directors are shown in this report within the summary of our Remuneration Policy	See Section B7.3 for the summary policy and the full policy in the 2019 Annual Report and Accounts
Alignment to culture	Paragon's strong culture is reflected throughout its pay structures through consideration of the demonstration of the Group's values. This applies when determining incentive outcomes for all employees as well as through its commitments to EDI policies and the Living Wage Foundation The Remuneration Policy is fully aligned with our pay principles	Demonstration of the Group's values underpins our variable incentive frameworks, in addition 25% of PSP awards for executive directors and other senior managers are assessed against Customer and People metrics Paragon has paid the Living Wage Foundation rate for a number of years as part of its commitment to workforce equality and is committed to reducing its gender pay gap (see the remainder of this Section B7.2.4 for more details and Section A6)
Risk	The pay arrangements for executive directors are consistent with and promote effective risk management through alignment with the Group's risk appetite Risk conditions are included within variable remuneration arrangements to align with regulatory expectations and shareholder interests All members of the Remuneration Committee are also members of the Risk Committee, ensuring that risk is appropriately taken into account when determining remuneration policy and its outturns	The risk conditions in the annual and long term incentives are tested annually by the Committee. The Committee has discretion to override formulaic outcomes Both annual bonus and PSP outcomes are subject to malus and clawback provisions

How the Committee considers the views of all employees

The People Forum considers the relationship between executive remuneration and pay and reward across the Group on a regular basis. Discussions with the Chair of the Committee on executive remuneration and remuneration across the wider workforce took place during September 2021 and will be a regular part of the Forum's calendar in future years as well.

Additionally, employees have the opportunity to make comments on any aspects of the Group's activities through surveys and the views of employees are taken into account by Human Resources. One of the duties of the People Director is to brief the Board on employee views and, as a regular invitee to committee meetings, this also helps to ensure that decisions are made with appropriate insight to employees' views.

How all employee remuneration is aligned with stakeholders' interests

Within the Policy Summary (Section B7.3) information is provided on how the remuneration packages for executive directors' link to strategy; how they operate; maximum opportunity and any performance conditions. Noted below is the equivalent information for all employees in respect of base salary, benefits and retirement benefits. The purpose and link to strategy that is detailed for the executive directors' remuneration components is the same for all employees and is consequently not repeated here. Further the following points should be noted:

- **RBA** – in the year ended 30 September 2021 RBA were only available to executive directors
- **Sharesave** – opportunities to participate in Sharesave are the same for all employees and therefore the information provided in the executive director table equally applies to all employees. Paragon's Sharesave scheme has operated for many years, usually on an annual basis, and encourages employees to become shareholders in the Group through this tax efficient mechanism. Take-up in currently outstanding SAYE grants is about 65% of eligible employees reflecting the continued and ongoing alignment between employees and shareholders and employee commitment to the growth of the Group.

Operation	Maximum opportunity	Performance conditions
Base salary		
Same as executive directors (see Policy Summary Section B7.3)	The Committee agrees the salaries of all MRTs salaries for MRTs and all other employees are determined in line with performance, culture, external market conditions and retention factors. The Committee is made aware of the outcomes of salary reviews across the Group before it determines those of the executive directors and other MRTs. As it has done for a number a years, the Living Wage Foundation rate is the minimum that is paid to all employees, as well as contractors' staff employed at Paragon sites such as cleaners and security personnel who are not on a training rate of pay (for example apprenticeships).	Same as executive directors (see Policy Summary Section B7.3)

Operation	Maximum opportunity	Performance conditions
Benefits		
Provision of market competitive benefits (contractual and voluntary) designed to promote financial and emotional wellbeing and which allows individuals to tailor benefits to suit their lifestyle. This includes the choice of private healthcare on the same basis as the executive directors for senior employees. A number of legacy arrangements exist.	Private healthcare is provided on the same basis as it is for the executive directors and this is also the case for other benefits (contractual and voluntary) that an employee chooses to receive. The maximum level of benefits for all employees is determined on the same basis as the executive directors.	None
Retirement benefits		
The majority of employees can join the Paragon Worksave Pension Plan, the Group's defined contribution pension plan. In this plan employee contributions are matched equally by percent by the employer up to 6% of salary; employee contributions from 6% upwards are matched by an employer contribution of 10% of salary. A number of legacy arrangements exist including the Paragon Pension Plan.	Maximum contribution for Paragon Worksave Pension Plan is 10% of salary. Maximum contribution to Paragon Pension Plan is 25% of salary. Maximum cash supplement contribution (where a former member of the Paragon Pension Plan has left the Plan) is 45% of salary.	None

In respect of Annual bonus and Paragon Performance Share Plan ('PSP') the comparison is made between the executive directors and senior employees with the purpose and link to strategy being the same as for the executive directors and so not repeated below:

Operation	Maximum opportunity	Performance conditions
Annual bonus		
This operates for senior management as it does for the executive directors except that malus and clawback and deferral* apply to a small number of senior management and MRTs only.	Maximum bonus potential varies across the Group depending on role and experience and for a limited and small number of roles maximum can be in excess of that noted for the executive directors, however awards of this level are rarely received. Bonus awards are usually made to senior management but can be made in certain circumstances to other employees.	Objectives which are used to help determine bonuses are set on a regular basis for all employees and reflect the employee's role and seniority level.

**Deferral*
All senior management (excluding the executive directors) will have 25% of their bonus above £30,000 deferred in 2021 in advance of the regulatory deferral requirements resulting from Paragon Bank becoming a Level 2 firm (in 2020 Executive Committee members excluding the executive directors had 50% of their bonus above £30,000 deferred and for most other senior managers 25% of their award above £30,000 was deferred).

Operation	Maximum opportunity	Performance conditions
Paragon Performance Share Plan ('PSP')		
Same as executive directors (see Policy Summary Section B7.3)	The maximum award level (except in exceptional circumstances) outside of the executive directors is 100% of salary which is generally only granted to members of the Executive Committee.	Same as executive directors (see Policy summary Section B7.3)

Other variable pay opportunities

The Group provides other variable pay opportunities to certain groups of employees:

- **Profit related pay** – for many years a cash-based PRP distribution of 1% of group profits, has been paid and forms a part of the Group's culture of ensuring a strong connection between the outcomes of the business and employees. Employees below director and head of function level are eligible to participate in this scheme, which pays out a flat sum to all eligible employees
- **£1,000 share award** – in December 2020, in recognition of the efforts by the Group's employees during the pandemic and the need to manage costs carefully with a group-wide salary freeze, a one-off award of £1,000 (gross) of shares was made to all employees (below executive committee and their senior direct reports) utilising the DSBP scheme. The award was granted to all of the Group's people employed on 3 December 2020, subject to minimum performance. The award has a three year vesting period and will be delivered at the end of that period, excepting 'good leavers' whose awards will vest on leaving. As the population for the award included a small number of employees who are MRTs, malus and clawback provisions will be applicable
- **Discretionary bonus** – all employees whose performance has exceeded expectations are eligible for a discretionary bonus
- **Other** – in addition to the above noted certain employees below management level are eligible for overtime pay. Further there are a few financial incentive schemes, separate to the annual variable bonus noted above, which operate in certain operational areas of the business from time to time. All such schemes are required to be approved by the People Director, CFO and Conduct and Compliance Director before implementation and then reviewed at least annually

Remuneration comparisons

Comparison of annual change in directors' pay with the average employee

The table below shows the percentage change in the salary, benefits and bonuses of each of the directors compared against the percentage change in each of those components of pay for an average employee.

	2021			2020		
	Salaries and fees	**Allowances and benefits**	**Bonus**	Salaries and fees	Allowances and benefits	Bonus
	%	**%**	**%**	%	%	%
N S Terrington	**6.4**	**(46.2)**	**45.29**	11.9	4.0	(33.93)
R J Woodman	**6.5**	**-**	**45.46**	11.7	-	(33.93)
J A Heron	**n/a**	**n/a**	**n/a**	(74.3)	(63.0)	(100.0)
F J Clutterbuck	**-**	**-**	**-**	-	-	-
P J N Hartill	**n/a**	**n/a**	**n/a**	(8.4)	-	-
P A Hill	**n/a**	**n/a**	**n/a**	-	-	-
A C M Morris	**93.2**	**-**	**-**	n/a	n/a	n/a
B A Ridpath	**-**	**-**	**-**	-	-	-
H R Tudor	**9.2**	**-**	**-**	2.3	-	-
F F Williamson	**n/a**	**n/a**	**n/a**	-	-	-
G H Yorston	**-**	**-**	**-**	-	-	-
Average employee	**1.0**	**(5.9)**	**101.7**	8.5	19.2	(25.7)

Further information in respect of the constituents of the above noted comparison of annual change in directors' pay with the average employee table is provided below using the sections noted in the table as titles:

- '**Salaries and fees**' – these are calculated using the 'Salaries and fees' data provided in the single figure table for executive directors above and in the 'Chair of the Board's and non-executive directors' fees' table also above. It does not include 'Pension allowance' or the RBA. Whilst the 'Pension allowance' and RBA are fixed pay, and are detailed as such in the single figure table for the executive directors, they are not included in this table to enable a more direct comparison with the average employee information

  The above compares total amounts of salary paid during the year rather than the salary payable at the year end. Therefore, it reflects that the salary review implemented in October 2019 was, for the executive directors unlike most employees, effective for only part of 2020 (from 14 February 2020). There was no increase in their base salary for the salary review implemented in October 2020 as was the case for most employees

- '**Allowances and benefits**' – these are calculated using the data provided in the single figure table above for executive director's and in the 'Chair of the Board's and non-executive directos' fees' table also above

The significant changes shown in the 'Allowances and benefits' for N S Terrington is due to a decrease in travel and related accommodation in 2021 due to Covid. As noted previously 'Allowances and benefits' include a reimbursement from the Company in respect of certain travel costs incurred in connection with the performance of executive director duties which constitutes a taxable benefit in kind. The amounts included represent the travel payments HMRC treats as taxable together with an allowance to cover the tax. The Group provides the amount required to cover the tax liability.

The changes in the average employee section of the table for this item in cash terms are due to a decrease of less than £150 between 2021 and 2020.

- **Not applicable ('n/a')** – this is used where a director was not a director in the noted financial year or in the case of Peter Hill and Alison Morris in the prior financial year and so a comparative is not appropriate or helpful
- **Director changes** – the changes shown to the fee levels for Alison Morris and Hugo Tudor are reflective of part year changes in appointments. In Alison Morris's case to the Board and in Hugo Tudor's as Senior Independent Director
- **Bonuses** – the decline in bonus for employees and directors in 2020 is reflective of the initial stages of the Covid pandemic and the increase in 2021 of the macro-economic changes since the early part of the pandemic

Overall, the comparisons shown in the table reflect the substantially different approach to remuneration and the resulting outcomes to remuneration awards that occurred in 2020 arising from the early stages of the Covid pandemic when compared to those taken / arising in prior years. A reversion to an approach equivalent to 2019 and also to strong award outcomes in 2021 mean that 2019 is a closer equivalent to 2021 than 2020. It is difficult from the information to draw conclusions that would be expected to remain valid in themselves in the upcoming years.

CEO pay comparatives over 10 years

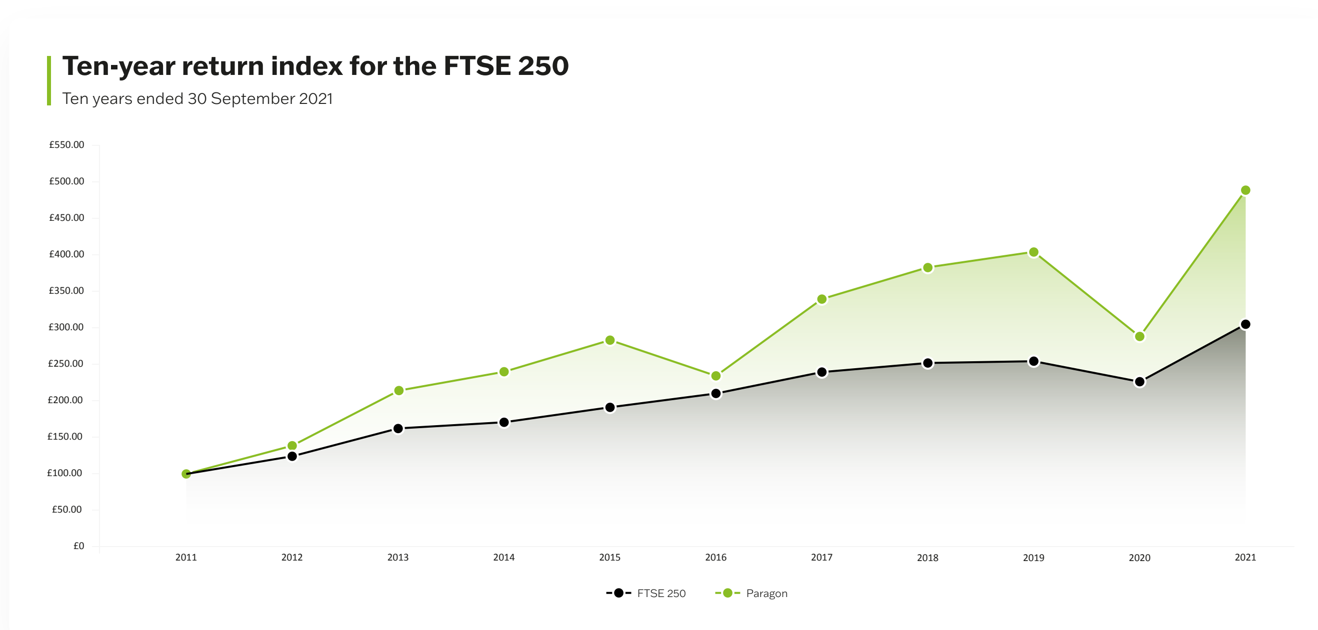
The following table shows the total remuneration, as included in the single figure table, and the amount vesting under short-term and long-term incentives as a percentage of the maximum that could have been achieved, in respect of the CEO, Nigel Terrington, over the past ten years.

	Single figure of total remuneration	Annual bonus earned against maximum opportunity	Long-term incentive vesting outcome against maximum opportunity
	£000	%	%
2021	3,070	96.1	97.00
2020	2,174	66.1	72.00
2019	3,001	89.4	95.44
2018	2,426	90.0	72.47
2017	2,305	90.0	63.51
2016	1,956	75.0	50.00
2015	2,546	100.0	100.00
2014	3,113	100.0	100.00
2013	2,655	85.0	100.00
2012	2,565	87.5	100.00

Performance graph and table

Historically the Company's TSR performance was considered relative to the FTSE All Share General Financial Sector index; however, in light of this index having been discontinued, this has been replaced with the FTSE 250 index. This index has been selected as it is the broad market index in which the Group's shares are included.

The following graph shows the Company's TSR performance compared with the performance of the FTSE 250 index. This graph shows the value, by 30 September 2021, of £100 invested in Paragon Banking Group PLC on 30 September 2011, compared with £100 invested in the FTSE 250 index.



CEO pay ratio

The table below sets out the CEO pay ratio compared to the 25th, median and 75th percentile employee within the Group. In each of the years reported the Group used Option A as defined in The Companies (Miscellaneous Reporting) Regulations 2018, as this calculation methodology was considered to be the most accurate method. This option is calculated in accordance with the single figure table methodology as at 30 September 2021.

The 25th, median and 75th percentile pay ratios were calculated using the full-time equivalent remuneration (prepared in the same manner as those for the single figure table) for all UK employees during the financial year. Certain employees participate in discretionary bonus schemes and long-term incentive schemes.

Remuneration decisions for all employees, including the executive directors, are made taking into account the Group's remuneration philosophy. The CEO pay ratio, as an outcome of those decisions, is therefore reflective of the Group's reward and progression policies.

Year	Method	25th percentile pay ratio	Median pay ratio	75th percentile pay ratio
2021	Option A	116:1	85:1	52:1
2020	Option A	88:1	64:1	37:1
2019	Option A	125:1	95:1	55:1

	2021			2020		
	25th percentile pay	Median pay	75th percentile pay	25th percentile pay	Median pay	75th percentile pay
Base salary	**£22,000**	**£33,000**	**£53,000**	£23,000	£28,000	£36,000
Total remuneration	**£27,000**	**£36,000**	**£60,000**	£25,000	£34,000	£58,000

Base salaries and total remuneration shown above are the details relating to the relevant identified employees in each year.

Change in CEO pay ratios

The changes shown in CEO pay ratios between 2020 and 2021 are reflective of the substantially different approach to remuneration and the resulting outcomes to remuneration awards that occurred in 2020 arising from the early stages of the Covid pandemic. As can be seen from the year-on-year comparative table 2021 and 2019 are more aligned than 2020.

Further, changes in the CEO pay ratio from year to year also reflect the difference in the remuneration package of the CEO relative to the wider employee population. In particular, the higher variable opportunity which is not replicated across the wider employee population.

As a result, it is expected that the CEO pay ratio will be volatile from year to year, reflective of the bonus and PSP outcomes in any year.

Gender pay

Details of the Group's gender pay gap analysis are shown in Section A6.3 Corporate Responsibility. Gender pay review and reporting are overseen by the Nomination Committee as part of its responsibilities in respect of diversity.

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	**2021**	2020	Change
		£m	£m	£m
Wages and salaries	*49*	**65.1**	64.0	1.1
Dividend paid	*40*	**54.6**	35.9	18.7
Share buybacks	*39*	**37.7**	-	37.7
Loan advances and investment in portfolios		**2,601.5**	2,050.5	551.0
Corporation tax paid	*41*	**48.3**	46.1	2.2

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.

Other information

Notice periods and terms of engagement

The executive directors hold one year rolling contracts in line with current market practice and the Committee reviews the terms of these contracts regularly. The current service contracts for the executive directors are dated as follows:

Director	Contract date
N S Terrington	1 September 1990 (as amended 7 January 1993, 16 February 1993, 30 October 2001 and 10 March 2010)
R J Woodman	8 February 1996 (amended 10 March 2010)

All new executive directors will have service contracts that are terminable by the Company on a maximum of twelve months' notice.

Chair and non-executive director appointments are for three years unless terminated earlier by, and at the discretion of, the director or the Company. The required notice period is one year for the Chair and three months for the non-executive directors. Current terms of engagement for the Chair and non-executive directors apply for the following periods:

Director	Original appointment date	Current letter of appointment end date
F J Clutterbuck	10 May 2018*	10 September 2022
P A Hill	27 October 2020	26 October 2023
A C M Morris	26 March 2020	25 March 2023
B A Ridpath	20 September 2017	19 September 2023
H R Tudor	24 November 2014	23 November 2023
G H Yorston	20 September 2017	19 September 2023

*F J Clutterbuck was originally appointed as a non-executive director on 12 September 2012.

B7.3 Policy Summary

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

Introduction

This part of the Directors' Remuneration Report sets out the Directors' Remuneration Policy that was adopted at the AGM on 13 February 2020. However, this is a summary only, included here for ease of reading the Annual Report on Remuneration, and these pages do not constitute a Policy Statement in accordance with the Regulations. From 1 October 2021, Paragon has become a Level 2 bank and therefore a number of the changes noted in the Remuneration Policy will come into effect for the year ending 30 September 2022. For the full Policy Report, including information relating to the impact of becoming a Level 2 bank, please refer to the Annual Report and Accounts for the year ended 30 September 2019 available at www.paragonbankinggroup.co.uk.

Changes to the executive directors' salaries and pensions together with the introduction of role-based allowances were originally scheduled to take effect from 1 October 2019. Following shareholder engagement these changes were introduced on the day after their approval at the 2020 AGM. There have been no other changes to the policy put to the AGM in 2020.

Elements of the remuneration policy for executive directors

The executive directors receive a combination of fixed and performance-related elements of remuneration. Fixed remuneration consists of salary, benefits, pension scheme contributions or alternative retirement benefit provision and a role-based allowance. Performance-related remuneration consists of participation in the annual bonus plan (including deferral) and the award of shares under the PSP. The performance-related elements of remuneration are intended to represent an appropriate proportion of executive directors' potential total remuneration.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Base salary			
To provide a competitive, fixed cash component that reflects the scope of individual responsibilities and recognises sustained individual performance in the role.	Remunerate fairly for individual performance, having regard to the importance of motivation. Base salaries are typically reviewed annually, taking into account a number of factors including (but not limited to) the value of the individual, the scope of their role, their skills and experience and their performance. The Committee also takes into account pay and conditions of employees in the Group as a whole, business performance and prevailing market conditions.	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. Increases above the level awarded for the rest of the organisation may be awarded in appropriate circumstances.	Whilst no formal performance conditions apply, an individual's performance in role is taken into account in determining any salary increase.
Benefits			
To provide market levels of benefits on a cost-effective basis.	Private health cover for the executive and their family, life insurance cover of up to seven times' salary and company car or cash alternative. Other benefits may be offered from time to time taking into account individual circumstances.	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. Whilst no absolute maximum level of benefits has been set, the level of benefits provided is determined taking into account individual circumstances, overall cost to the business and market practice.	None.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Retirement benefits			
To provide competitive post-retirement benefits.	Executive directors receive an annual contribution to the Company defined contribution pension scheme or a cash supplement in lieu of contribution (or a combination thereof).	Maximum 20% of salary for incumbent executive directors and 10% of salary for newly recruited executive directors.	None.
Fixed role-based allowance			
To maintain a competitive remuneration package with an appropriate balance of fixed and variable remuneration, with delivery in shares for shareholder alignment.	Annual allowance paid quarterly or at any other frequency that the Committee deems appropriate following approval at the 2020 AGM, on the basis that the after tax value is delivered in shares which are released to the executive director on a pro-rata basis over a five year period (or such other period as may be determined by the Committee from time to time). The role-based allowance is non-pensionable and is not taken into account for annual bonus and PSP purposes. The Committee retains the discretion to amend the retention period and/or pay the fixed role-based allowance in cash if required to do so to meet any regulatory requirements.	The fixed role-based allowances are determined based on the role, skills and responsibility of each individual and taking into account market competitiveness of total remuneration. The maximum role-based allowance is £140,000 per annum for the CEO and £90,000 per annum for the CFO. Any other executive director (including those appointed during the period for which this policy applies) may be eligible for a role-based allowance of up to 25% of salary.	None.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Annual bonus			
To incentivise executives to achieve specific, predetermined goals that drive delivery of the Company's operational objectives. To reward individual performance. To encourage retention and alignment with shareholders' interests through deferral of a proportion of bonus, awarded in shares.	Each executive director's annual bonus is based on a mix of financial and non-financial performance measures measured over one year. The annual bonus is non-pensionable. Malus and clawback apply to the annual bonus as described in the full Remuneration Policy in the Annual Report and Accounts 2019. A portion of the annual bonus may be deferred and / or may be paid in shares, dependent on the regulatory status of the bank and at the discretion of the Committee. Awards under the DSBP can take the form of a nil-cost option with a ten-year life, a conditional award of shares or an award of forfeitable shares. The use of this deferral is described below.	Maximum annual bonus potential is 150% of salary in respect of any given financial year. For target performance, a bonus of 50% of maximum potential will be awarded, with additional amounts being awarded for exceptional performance. If a bonus is based on a strategic measure or personal objective, the Committee will determine the extent of vesting between 0% and 100% based on its assessment of the extent to which the measure or objective has been achieved. For performance below threshold, no bonus is payable.	The performance targets are set by the Committee at the start of the year with input, as appropriate, from the Chair of the Board and Chief Executive. Performance measures and their weightings are reviewed annually to maintain appropriateness and relevance. Performance is assessed against a range of measures, with at least 50% relating to financial metrics and any balance reflecting non-financial measures (including risk) and / or achievement of key personal and strategic measures.

Implementation as a Level 2 bank:

The Group became a Level 2 bank for regulatory purposes on 1 October 2021 and consequently, the PSP will be the primary vehicle for meeting the deferral requirements under the PRA remuneration requirements, although the Committee retains the right to defer such portion of an annual bonus award and over such deferral period as it determines to ensure that regulatory requirements are met.

50% of the bonus earned will be paid in cash, and 50% will be paid in shares. Any shares delivered will normally be immediately vested and may take the form of shares which must be retained for at least 12 months, or a right to acquire shares at the end of the holding period. In the former scenario, the executive director may sell shares to cover the tax liability arising on the award. In the latter scenario, the award may include the right to receive a dividend equivalent in respect of dividend record dates over the holding period. Where an award is subject to a deferral period and does not benefit from dividends or dividend equivalents to meet regulatory requirements, the number of shares to be awarded may be determined using a share price discounted for the expected dividend yield.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Paragon Performance Share Plan ('PSP')			
To incentivise executives to achieve enhanced returns for shareholders. To encourage long-term retention of key executives. To align the interests of executives and shareholders.	An annual award of shares subject to continued service and performance conditions assessed over a three-year performance period. The performance conditions used are reviewed on an annual basis to ensure they remain appropriate. Awards are structured as nil cost options with a ten-year life, a conditional award of shares or an award of forfeitable shares. Implementation of the vesting rules is described below the table. Malus and clawback apply to the PSP as described in the full Remuneration Policy in the Annual Report and Accounts 2019.	Maximum award is 180% of salary in respect of any financial year. 25% of the awards will vest for threshold performance, with full vesting taking place for equalling or exceeding the maximum performance target. 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. Where awards do not receive dividends or dividend equivalents to meet regulatory requirements, the number of shares to be awarded may be determined using a share price discounted for the expected dividend yield.	The Committee will take into consideration prior performance when assessing the value of the PSP grant. Forward-looking performance is measured against a long-term scorecard of challenging performance measures that reflect the Company's strategic priorities. Performance conditions may include financial measures (eg adjusted EPS and / or relative TSR), and non-financial measures which may include risk-based, people and / or customer measures. Performance measures and their weightings, where multiple measures are used, are reviewed annually to maintain appropriateness and relevance.

Implementation as a Level 2 bank:

From 1 October 2021, when the Group becomes a Level 2 bank for regulatory purposes, at the end of a performance period, the performance outcome will be used to assess the percentage of the awards that will vest. These shares will then normally vest in five equal tranches, with the first vesting on or around the third anniversary of the grant date and the last instalment vesting on or around the seventh anniversary of the grant date, in accordance with the PRA remuneration rules.

Each vested tranche will be subject to an additional one year holding period, taking the form of shares which must be retained for at least the holding period, or a right to acquire shares at the end of the holding period. In the former scenario, the executive director may sell shares to cover the tax liability arising on award. In the latter scenario, the award may include the right to receive a dividend equivalent in respect of dividend record dates over the holding period.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Sharesave Plan			
To provide all employees with the opportunity to become shareholders on similar terms.	Periodic invitations are made to participate in the Company's Sharesave Plan. 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. The option is granted at a discount to the share price at the time of grant of up to 20%. The Sharesave Plan provides tax benefits in the UK subject to satisfying certain HMRC requirements and is operated on an 'all employee' basis.	HMRC monthly savings limits apply.	None.

Elements of the remuneration policy for the Chair and non-executive directors

The Chair receives a fee, a company car or cash alternative and is eligible for private health cover on an individual or family basis in the same way as the executive directors. Non-executive directors are remunerated solely by fees. Neither the Chair nor the non-executive directors are eligible to participate in any of the Company's fixed role-based allowance, incentive or pension schemes and they are not entitled to receive compensation for early termination of their terms of engagement.

Benefits may also be provided to non-executive directors related to the performance of their duties (for example, travel and subsistence).

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Salary and fees			
To ensure that the Group can attract and retain the appropriate number and mix of non-executive directors with the correct experience to provide balance, oversight and challenge.	Non-executive director fees are reviewed on a periodic basis and are subject to the Articles of Association. The Chair's fee is set by the Committee, whilst the non-executive directors' fees are determined by the Board. The Board will exercise judgement in determining the extent to which non-executive directors' fees are altered in line with market practice, given the requirement to attract and retain the appropriate skills and given the expected time commitments. Non executive directors are paid an annual base fee with additional fees for additional roles (for example, Senior Independent Director or chair of a board committee) Non-executive directors may be eligible to receive benefits such as travel and other reasonable expenses.	The Board will review fees periodically to assess whether they remain competitive and appropriate in light of changes in roles, responsibilities and / or time commitment of the non-executive directors. Increases above those awarded for the rest of the organisation may be made to reflect the periodic nature of any review. The Articles of Association of the Company contain a maximum level of fees that can be paid annually to non-executive directors (currently £2.0 million). This is reviewed by the Board from time to time. Where benefits are provided to non-executive directors, they will be provided at a level considered to be appropriate, taking into account individual circumstances.	None.

B7.4 Approval of Director’s Remuneration Report

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

This Directors’ Remuneration Report, Section B7 of the Annual Report and Accounts, including the Statement by the Chair of the Committee, the Annual Report on Remuneration and the Policy Summary, has been prepared in accordance with Schedule 8 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 as amended and has been approved by the Board of Directors.

Signed on behalf of the Board of Directors

Hugo Tudor

Chair of the Remuneration Committee

7 December 2021

B8. Risk management

> **...the impact of Covid has dominated the Committee's agenda and the future trajectory remains uncertain, however I have been very impressed with the way the Group has and continues to deal with the challenges it brings.**
>
> **Peter Hill,** Chair of the Risk and Compliance Comittee

B8.1 Statement by the Chair of the Risk and Compliance Committee

Dear Shareholder

I am pleased to write to you as Chair of the Risk and Compliance Committee to explain how we, as a Committee, have discharged our responsibilities in the last year. This is my first report as Chair of the Committee, having taken over the role as of 31 December 2020 during a period of significant disruption to the UK economy and the Group's operating environment due to the Covid pandemic. Clearly the impact of Covid has dominated the Committee's agenda and the future trajectory remains uncertain, however I have been very impressed with the way the Group has and continues to deal with the challenges it brings.

As we gradually move out of the pandemic and into new ways of working, the Committee's focus will undoubtedly shift to broader risk issues. My priority as Chair of the Committee is to ensure that we remain a forward-looking body and continue to consider those emerging risks which may impact the strategy or operating capability of the Group.

The ability of the Group to react in an agile and effective way to Covid and to emerging risks more generally, has been facilitated through the development of its risk management capabilities. Significant work has been undertaken over the last year to enhance the ERMF. The evolution of this framework to ensure it is commensurate with the size and complexity of the Group's operations is a key strategic priority, and since I joined the Committee, I have been pleased to see the good progress that has been made. This has included the recruitment of experienced risk resource and enhancements to the risk policy framework. A strong ERMF is key to enabling the Committee to effectively discharge its responsibilities and ensure that it is able to focus on matters of greatest significance to the Group.

Intrinsic to risk management across the Group is the necessity for a strong risk aware culture. Excellent progress has been made in the maturity of risk across the Group and in embedding risk considerations in day-to-day decision making.

Over the next year and beyond a priority for the Committee is to oversee the further development of the risk culture, ensuring it supports the Board's overall risk strategy and appetite, and becomes further embedded in the Group's operations.

The primary responsibility of the Committee continues to be the maintenance of oversight of the effectiveness of the Group's risk management framework and of its systems and controls for compliance with statutory and regulatory obligations. This oversight is enabled through strong and evolving governance structures. In particular, the enhancements made during 2020 with the introduction of the monthly ERC, have enabled the Committee to maintain its focus on the key material and strategic risk issues that the Group faces.

Given the challenges of Covid and their impact on the risk profile, the Committee's agenda during the last year has continued to focus on the ongoing oversight of the regulatory, economic and people-related impacts resulting directly from the pandemic. In particular, the Committee has regularly reviewed:

- The ongoing impacts of working arrangements for employees given the further UK lockdowns in November 2020 and January 2021
- The roll-off of payment holidays and implementation of other forbearance strategies, ensuring customer treatment remains at the forefront of our considerations
- The impact of UK Government relief programmes including the issuance of CBILS, BBLS and RLS on the Group's risk profile, including the associated credit risk, financial crime and processing risks

The Committee continues to monitor the implications of these changes together with developments in regulatory requirements to manage customer and prudential risks arising from Covid. It is encouraging to see how effectively these risks have been managed by the Group. In particular, revisions to credit policies made in response to the initial impact of Covid, have resulted in minimal credit related losses to date, despite the scale of the economic challenges involved.

The Committee has continued to balance the need to provide close oversight of the developing situation in respect of the pandemic with non-pandemic specific risk issues including:

- Monitoring the progress of the Group in managing exposures to LIBOR as the primary sterling interest rate benchmark as this is phased out, ensuring customer outcomes remain a key priority
- Continued oversight of the Group's project to implement an IRB approach for credit risk including the submission of Phase 2 of the buy-to-let application in March 2021
- Overseeing the Group's progress on responding to the increasing challenges posed by climate change and addressing any impacts this may have on its risk profile, including the consideration of its lending and operational strategy in light of wider global imperatives and initiatives
- Review of the Group's ongoing approach to Operational Resilience following the final guidance published by the regulators at the end of March 2021
- Assessment of the existing risk exposure posed by the Group's historic lending on buildings with potential cladding issues and ensuring appropriate controls to mitigate future exposure

Overall, I am pleased to confirm that in the last year the Committee has again, in my view, met its key objectives and carried out its role effectively.

As I look to the year ahead there remain significant challenges which the Group will continue to face. It is clear that the economic, political and regulatory environment is highly dependent on the trajectory of the pandemic which remains uncertain. However, I have been impressed with the way that the Group has and continues to respond. The new ways of working that were introduced in the face of the UK lockdown have proven to be sustainable and the flexibility and innovation as a result have increased the Group's resilience and strengthened the risk mitigation capability. Control frameworks that have been introduced as a result of initiatives such as payment holidays and government reliefs have proven effective with extremely low levels of operational events.

In addition, the Group will continue to monitor significant non-Covid specific challenges within the operating environment that could materially impact its risk profile. The uncertainties that were prevalent following the UK's departure from the EU are still manifesting themselves. The nature of these risks continues to evolve as has been seen in the recent disruptions to supply across the likes of fuel, consumables and other raw materials.

The Committee's principal areas of focus for the financial year ending 30 September 2022 will continue to form key agenda items for the coming year. Other priorities for the Committee will include:

- Ongoing oversight of the longer-term risk implications of Covid, and any further Government or regulatory measures that are implemented
- Continuing to review the potential impacts on the Group of the consequences of the UK's withdrawal from the EU and any changes to the regulatory regime this may entail
- Consideration of potential impacts on the Group from emerging supply chain issues which are affecting the distribution of energy and other commodities across the UK, particularly given the inherent inflationary pressures that are beginning to manifest themselves
- Ongoing oversight of the Group's response to the 'Dear CEO' letter on financial crime systems and controls
- Evaluating the challenges posed by Government proposals to improve energy efficiency of both owner-occupied and privately rented homes by mandating minimum EPC ratings
- Reviewing the Group's progress in enhancing its ERMF, including ensuring risk appetites remain consistent with the delivery of its strategic objectives, and proposing any required changes in risk appetite to the Board
- Continuing its focus on ensuring that customers receive fair outcomes, including monitoring the treatment of vulnerable customers, and ensuring that the management of conduct risk remains a key priority for the Group
- Driving the embedding of the Group's risk culture across the Group, further enabling the Committee to focus on high materiality matters and developing its horizon scanning capability
- Undertaking deep dives in relation to specific risk categories and business areas on both a rolling and ad hoc basis

I am confident that the Group has the skills and experience to manage the risks it is likely to encounter in the year ahead, but it is critical that the Group continues to anticipate any potential impact and remains agile in the event circumstances change materially capabilities that were ably demonstrated during the pandemic.

In looking back over my first nine months, I would like to take the opportunity to thank Finlay Williamson, the previous Chair of the Committee, for his leadership over the previous three years. During his tenure the Committee matured in terms of both reporting and discussion, ensuring that it provides effective oversight of the complex risk landscape within the Group despite the backdrop of ever-changing regulation. I wish Finlay all the best for the future. The transition in leadership has been seamless and I would like to thank my fellow directors and the Group's Risk function for their support in this. I very much look forward to working with them over the year to come, as we look to the new challenges of a post-pandemic world.

Peter Hill

Chair of the Risk and Compliance Committee

7 December 2021

B8.2 Risk governance

The Group's approach to governance and the committee structures are described in Section B4. The risk committee structure and lines of oversight in place throughout the year are set out below.

Risk and Compliance Committee

The Risk and Compliance Committee assists the Board in fulfilling its responsibilities for risk management. It comprises the independent non-executive directors and the Chair of the Board. The terms of reference, which were reviewed and approved by the Board in October 2020 and again in October 2021, after the end of the year, include all matters indicated by the 2018 Code.

The Committee's responsibilities include reviewing:

- Recommendations and matters for escalation from the ERC
- The effectiveness of the Group's risk management framework and the extent to which risks inherent in the Group's business activities and strategic objectives are controlled within the risk appetite established by the Board
- The effectiveness of the Group's systems and controls for compliance with statutory and regulatory obligations
- The appropriateness of the Group's risk culture, to ensure it supports the Group's stated risk appetite
- The effectiveness of the Group in addressing issues requiring remedial attention to ensure actions are completed in a timely manner and minimise the potential for risk appetite thresholds to be exceeded

The Committee provides ultimate oversight and challenge to the Group's enterprise-wide risk management arrangements, which are managed through the ERC. It also retains oversight responsibility for model risk within the Group. The Risk and Compliance Committee delegates day-to-day oversight for model risk to the MRC.

The Risk and Compliance Committee meets at least four times a year and normally invites the executive directors, CRO, Chief Operating Officer and Internal Audit Director to attend its meetings. However, it reserves the right to request any of these individuals to withdraw or to request the attendance of any other Group employee.

The Committee aims to meet annually with the CRO, without the presence of executive management, to discuss his remit and any issues arising from it.

The Committee also has the power to requisition a meeting with the Internal Audit Director and / or the external auditor without the presence of executive management to discuss any matters that any of these parties believe should be discussed privately.

Standing items covered in each meeting of the Committee have included:

- Reviews of the principal risks facing the Group, which included a comprehensive refresh of the risks during the year
- Consideration of new or emerging risks and regulatory developments and their impact on the Group
- Consideration and challenge of management's rating of the various risk categories to which the Group is exposed
- Consideration of the root causes and impact of material risk events and the adequacy of actions undertaken by management to address them

In addition, during the last year, the Committee:

- Reviewed the Group's risk appetite to ensure it remained consistent with the delivery of the Group's strategic objectives, proposing any required changes to the Board
- Continued to monitor progress in respect of the Group's application for regulatory approval of its IRB approach to credit risk management
- Monitored the Group's progress on transitioning away from LIBOR including project progress, risks and issues and potential impacts on the fair treatment of customers
- Conducted deep dive reviews into targeted risk areas, including the potential impact on the Group of negative interest rates, rising inflation and the prospect of potential interest rate rises
- Provided ongoing oversight of the Group's exposure to issues relating to properties with defective cladding and its review of underwriting guidelines in relation to this risk
- Considered regular focussed reviews of key risk areas including credit risk, capital risk, liquidity and market risk, climate change risk, conduct risk and across the different categories of operational risk
- Continued to monitor the progress of the Group in addressing its approach to operational resilience following the issuance of final rules in March 2021, including a significant focus on services provided by third parties
- Reviewed, challenged and approved the Management Responsibilities Map
- Reviewed, challenged and approved the terms of reference of the MRC
- Reviewed, challenged and approved the Compliance Monitoring Plan ('the Compliance Plan') and subsequent updates to the Compliance Plan
- Reviewed, challenged and approved the Money Laundering Reporting Officer's annual report
- Considered and challenged reports in relation to ICAAP, ILAAP and Recovery Plan recommending approval to the Board
- Challenged and approved various key risk policies

Executive Risk Committee ('ERC')

The purpose of the ERC is to assist the CEO in designing and embedding the Group's risk management framework, monitoring adherence to risk appetite statements and identifying, assessing and controlling the principal risks within the Group. It includes all Executive Committee members, with the Internal Audit Director attending as an observer, and reports to the CEO. The ERC monitors the interaction and integration of the Group's business objectives, strategy and business plans with the Group's risk appetite and risk strategy and escalates breaches and significant matters to the Risk and Compliance Committee, recommending changes as appropriate.

Key areas of focus for the ERC include:

- Developing and, at least annually, reviewing the appropriateness and effectiveness of the overall risk management framework to manage and mitigate risk
- Reviewing the Group's approach to controlling each principal risk and its capability to identify and manage such risks
- Reviewing emerging risks as they arise, including consideration of their potential impact on the Group's business objectives, strategy and business plans, as well as risk choices, appetite and thresholds
- Periodically reviewing the effectiveness of the Group's internal control and risk systems including the Group's material outsourced arrangements and risks associated therewith, particularly where they might impact customers
- Ensuring compliance with relevant PRA and FCA regulations (excluding the SMCR, which is overseen by the Executive Committee)
- Reviewing the process and outcome of the Group's ICAAP, ILAAP, Recovery Plan and Resolution Pack together with recommendations to the Risk and Compliance Committee and Board for approval
- Considering the implications of any proposed legislative or regulatory changes that may be material to the Group's risk appetite, risk exposure, risk management and regulatory compliance

The ERC is supported by an Asset and Liability Committee, Customer and Conduct Committee, Credit Committee, and Operational Risk Committee, which focus on specific aspects of the Group's risk profile. Each of these executive committees operates within terms of reference formally approved by the ERC. Their primary functions are described below.

The ERC retains direct responsibility for those principal risk areas which impact across multiple aspects of the Group's operations, including climate change and strategic risk.

Asset and Liability Committee ('ALCO')

ALCO comprises heads of relevant functions and is chaired by the Balance Sheet Risk Director.

The principal purpose of ALCO is to monitor and review the financial risk management of the Group's balance sheet. As such, it is responsible for overseeing all aspects of market risk, liquidity risk and capital management as well as the treasury control framework. ALCO operates within clearly delegated authorities, monitoring exposures and providing recommendations on actions required. It also monitors performance against appetite on an on-going basis and makes recommendations for revisions to risk appetites through ERC to the Risk and Compliance Committee.

Customer and Conduct Committee ('CCC')

The CCC comprises heads of relevant functions and is chaired by the Conduct and Compliance Director.

The CCC is responsible for overseeing the Group's conduct risk and compliance arrangements. The Committee considers conduct risk information such as details of conduct breaches; systems and procedures for delivering fair outcomes to customers (such as in relation to customer vulnerability); the product governance framework; and monitoring reports. It also considers product reviews from a customer perspective. With respect to compliance, the CCC is responsible for overseeing the maintenance of effective systems and controls to meet conduct-related regulatory obligations. It is also responsible for reviewing the quality, adequacy, resources, scope and nature of the work of the Compliance function, including the annual Compliance Monitoring Plan.

Credit Committee

The Credit Committee comprises senior managers from the risk, finance and collections functions and is chaired by the Credit Risk Director.

The Credit Committee approves credit risk policies in respect of customer exposures and defines risk grading and underwriting criteria for the Group. It also provides guidance and makes recommendations in order to implement the Group's strategic plans for credit. The committee oversees the management of the credit portfolios, the post-origination risk management processes and the management of past due or impaired credit accounts. It also monitors performance against appetite on an on-going basis and makes recommendations for revisions to the credit risk appetites through ERC to the Risk and Compliance Committee. The Committee also operates the Group's most senior lending mandate.

Operational Risk Committee ('ORC')

The ORC comprises heads of relevant functions and is chaired by the Enterprise Risk Director.

The ORC is responsible for overseeing the Group's operational risk and resilience arrangements, including those systems and controls intended to counter the risk that the Group might be used to further financial crime. The Committee remit includes risks arising from personnel, technology and environmental matters within the business. The Committee considers key operational risk information such as key risk indicators, themes within risk registers, emerging risks, loss events, control failures, and operational resilience measures. It also monitors performance against appetite on an on-going basis.

Model Risk Committee ('MRC')

The MRC reports directly to the Risk and Compliance Committee and comprises senior managers from Risk, Finance and the main business areas. It is chaired by the CRO and attended by Hugo Tudor, a non-executive director. The role of the MRC is to review and make recommendations on all material aspects of the rating and estimation processes in relation to key credit and finance models. The MRC also acts as the 'Designated Committee' for IRB purposes, approving all material aspects of IRB rating systems.

B8.3 Risk management culture

The Board is committed to establishing and maintaining a strong risk culture as a fundamental element of the Group's corporate culture. This risk culture promotes effective risk management that is consistent and commensurate with the nature, complexity and risk profile of the business.

The importance of risk management is embedded at all levels of the business and all employees are expected to understand and have accountability for the risks they take. Appropriate risk management and the behaviours expected to deliver this, are core to the Group's performance management process.

The Group's strong risk culture is embedded through various practices which support and protect the Group's wider strategic goals and are essential to protecting the Group's customers, shareholders, creditors, and its reputation.
In particular:

- The fair treatment of customers and the delivery of fair outcomes, particularly for those customers considered to be vulnerable, is central to the Group's risk management approach
- Robust risk management, conducted within an open and transparent environment, remains at the heart of all decision-making
- Business is carried out only where the potential risk to the Group and its customers has been evaluated together with the potential reward and where the residual risk exposure remains within defined risk appetites
- The risk management framework ensures that risks are owned and managed in a consistent way

The Group's risk culture has been central in ensuring historically low levels of credit and operational losses and the absence of any material conduct issues affecting customers.

B8.4 Risk management framework

Introduction

The Group's enterprise risk management framework ('ERMF') is designed to enable management to identify and focus attention on the risks most significant to its objectives and to provide an early warning of events that put those objectives at risk. The framework and the associated governance arrangements are designed to ensure there that there is a clear organisational structure with distinct, transparent and consistent lines of responsibility in the facilitation of risk management.

Effective risk management is core to the execution of the Group's strategy. The Group continues to ensure that the framework evolves to reflect the changing business, regulatory and economic landscape and emerging threats. Therefore, the Group is committed to ongoing investment and enhancement in its enterprise-wide risk management system. Core to this approach is ensuring that tools for effective risk identification, assessment, treatment and monitoring are appropriate and embedded at all levels of the Group's businesses.

During the past twelve months further work has been undertaken to develop the framework to support the Group's strategic aspirations, building on foundations laid in the previous financial year. Central to this has been the recruitment of experienced risk resource to further mature the core risk processes, with a detailed ongoing programme of work to support this, which will extend through the coming financial year. Priority activities include further refinement of risk appetites across all risk categories, a more comprehensive and standardised risk policy framework, and enhanced tools and techniques for assessing and embedding risk culture, thereby ensuring improved alignment to performance and reward.

Enterprise risk management framework

The ERMF 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 ERMF are to:

- Determine a defined strategy for the Group's attitude to risk, including outlining the approach taken to setting qualitative statements and quantitative metrics to define and assess the Group's tolerance and appetite for risk
- Establish a consistent risk taxonomy, describing the principal risk categories and the more granular aspects of each of these categories
- Promote an appropriate risk culture across the Group, ensuring that risk is considered as part of all key strategic and business decision making
- Establish standards for the consistent identification, measurement, monitoring, management and reporting of risk exposure and loss experience
- Promote risk management techniques to proactively reduce the frequency and severity of risk events, driving control improvements where necessary
- Facilitate adherence to regulatory requirements, including threshold conditions, capital standards and support the regulatory requirements associated with the ICAAP, ILAAP and the Recovery Plan
- Provide senior management and relevant committees with risk reporting that is relevant and appropriate, enabling timely action to be taken in response
- Define risk policies which align to the Group's principal risks and identify the key controls to measure and manage these risks

Three lines of defence model

The Group employs a 'three lines of defence model' to delineate responsibilities in the management of risk ensuring adequate segregation in the oversight and assurance of risk as follows:

The three lines of defence		
Line 1	**Line 2**	**Line 3**
Risk management processes within operational areas	*Risk and Compliance function overseeing the ERMF and providing support and challenge*	*Internal Audit function assessing effectiveness of risk management*

- The *first line of defence* ('Line 1'), comprising executive directors, together with managers and employees in operational and support areas. Line 1 has day-to-day responsibility for:
    - o Risk identification, assessment, treatment, monitoring and reporting
    - o Control and ongoing monitoring of operations
    - o Escalation and reporting of risk issues against stated appetites

  Risk Champions are appointed within all business areas to support the embedding of an effective risk culture across the Group
- The *second line of defence* ('Line 2') is provided by the independent risk and compliance function. This division is headed by the CRO, who is a member of the Group's Executive Committee. The function is overseen by the Risk and Compliance Committee and its supporting executive committees. Line 2 provides support and independent challenge on all risk related issues specifically:
    - o Developing and maintaining the ERMF across the Group
    - o Developing and maintaining supporting risk processes within that framework, ensuring these are consistent with the Board's risk appetite
    - o Ensuring that risks identified by line 1 are measured, monitored, controlled and reported on a timely basis
    - o Maintaining open and constructive engagement with the regulatory authorities

  The CRO attends meetings of the Risk and Compliance Committee and the Board to report directly to the directors on risk issues and has a close working relationship with the Chair of the Risk and Compliance Committee, an independent non-executive director.

- The *third line of defence* ('Line 3') 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 and led by the Internal Audit Director who reports directly to the Audit Committee. Internal Audit provides independent assurance on:
    - Line 1 and Line 2 risk management activities
    - The appropriateness and effectiveness of internal controls
    - Effectiveness of policy implementation

  Further information on the work of the Internal Audit function is given in the report of the Audit Committee (Section B6).

Risk appetite framework

The risk appetite framework outlines the Group's approach to setting and monitoring risk appetite. The framework stipulates the approach to setting risk appetites, reporting requirements and escalation obligations and the frequency of review. The framework is subject to annual board approval.

The following principles are integral in determining the Group's risk appetite:

- Alignment to principal risks
- Alignment to strategic objectives
- Appropriateness of calibration to drive timely action
- Facilitation of ongoing monitoring of the risk profile

The Group has developed a tiered approach to setting and monitoring of risk appetite. A set of board-owned (Level 1) metrics has been established. These are monitored on an ongoing basis and any threshold breaches in respect of these are immediately escalated to the Board. Executive committees are responsible for reviewing more extensive (Level 2) metrics. Any breaches of Level 2 metrics are escalated to the ERC which determines whether these are sufficiently material to be reported to the Board.

Risk appetite is central to the effective implementation and operation of the ERMF. The ongoing evolution of the risk appetite framework and refinement of the Group's risk appetites for all principal risks is a priority activity in the further maturing of the ERMF. Work has taken place in the year and continues to be undertaken to ensure that:

- All principal risks have strategically aligned qualitative and quantitative appetites
- There are appropriate Level 1 and 2 appetite metrics monitored on an ongoing basis
- Calibration of appetite is appropriate and drives timely management action

In particular, work is progressing to designate appropriate Level 1 and Level 2 risk metrics and risk appetites for climate change related risks across all areas of the business.

B8.5 Principal risks and mitigations

The Group is exposed to a number of principal risks and uncertainties that arise from the operation of its business model and strategy. A summary of those risks and uncertainties which could prevent the achievement of the Group's strategic objectives, how the Group seeks to mitigate those risks and the change in the perceived level of each risk in the last financial year are described below. These risks are discussed in more granular detail in the Group's Pillar III report, published on the Group website.

This analysis represents the Group's gross risk position as presented to, and discussed by, the Risk and Compliance Committee as part of its ongoing monitoring of the Group's risk profile.

The risks are set out in accordance with the Group's amended classification of its principal risks, approved by the Board in the year. The principal risks remain consistent from the previous financial year, except that pension obligation risk is no longer deemed a principal risk for the Group given the diminishing deficit, changes in the scheme to mitigate future risk and ongoing management of the risk through the triennial valuation process, as described in Note 52. No further changes were proposed.

The changes in the perceived level of each risk during the last financial year are indicated using the symbols shown below:

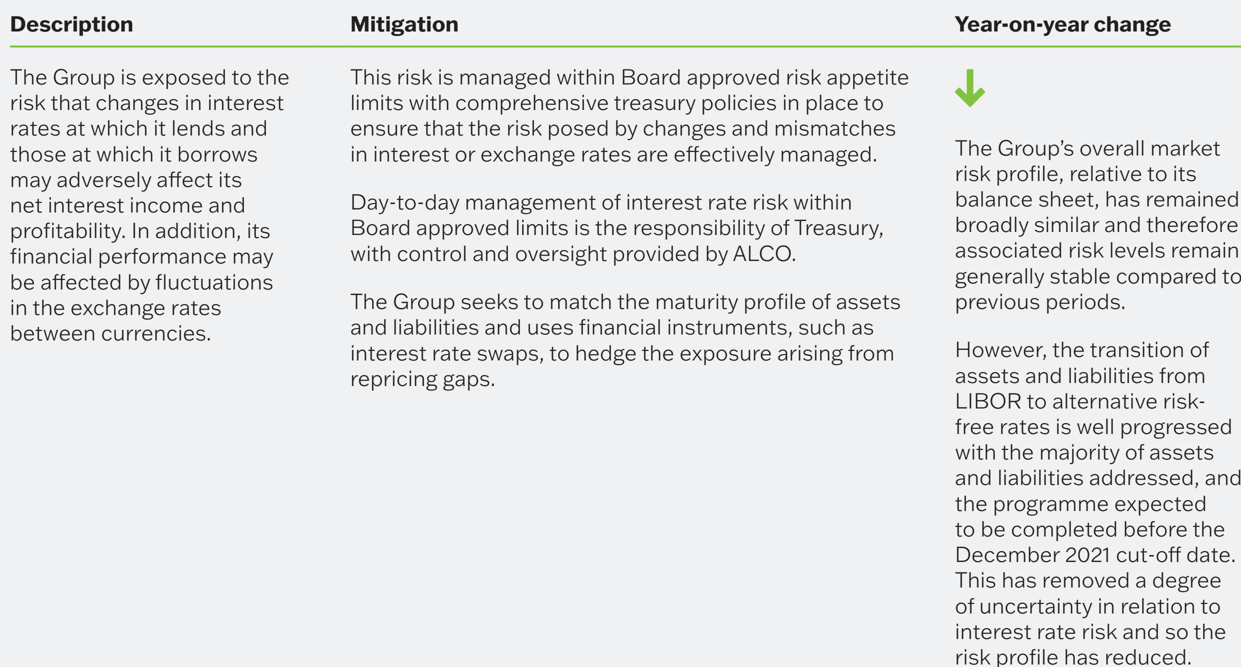
Risk increasing	Risk decreasing	Risk stable

Capital Risk

Description	Mitigation	Year-on-year change
The Group faces the risk of insufficient capital to operate effectively including meeting minimum regulatory requirements, operating within Board approved risk appetite and supporting the Group's strategic goals. The BCBS has set 1 January 2023 as the implementation date for its revisions to the Basel III framework, including increases in risk weights for residential real estate exposures. There is therefore a risk that the Group's capital requirements will be increased to some extent.	A robust process exists over Pillar 1 capital reporting, both internally and to the PRA, with a comprehensive annual ICAAP assessment including all material capital risks. An internal capital buffer is maintained in excess of minimum regulatory requirements to protect against unexpected losses or risk-weighted asset growth. The Group submitted the second stage of its application for the accreditation of its IRB approach to buy-to-let credit risk for capital adequacy purposes to the PRA in March 2021. The project continues to progress to plan, and work will continue through the next financial year.	↓ While there has been little impact on the overall capital risk framework in the financial year and the Group's assessment of the likely impact of these changes, the progress made in the Group's balance sheet management, its IRB development programme and the positive results of the most recent PRA assessment of the Group's risk profile mean that it is better placed to meet these challenges than it was a year ago.

Liquidity and Funding Risk

Description	Mitigation	Year-on-year change
The Group is exposed to the risk that it has insufficient funds to meet its obligations as they fall due. Retail deposit taking is central to the Group's funding plans and therefore changes in market conditions could impact the ability of the business to maintain the level of funding required to sustain normal business activity.	The Group maintains a diversified range of both retail and wholesale medium and long-term funding sources to cover future business requirements and liquidity to cover shorter term funding needs. Internally, comprehensive treasury policies are in place to ensure sufficient liquid assets are maintained and that all financial obligations can be met as they fall due, even under stressed conditions. The Group has a dedicated Treasury function which is responsible for the day-to-day management of its overall liquidity and wholesale funding arrangements. The Board, through the delegated authority provided to the ALCO, sets limits as to the level, composition and maturity of liquidity resources.	← → The Group remains well placed to access funding from a wide range of sources to meet its future funding requirements. During the year a second fully retained securitisation was completed, boosting, contingent funding options and the TFSME, which remained open for drawings until 31 October 2021, was accessed. In addition, access to the retail savings market has broadened with new routes to market and the launch of an SME deposit product.



Market Risk

Description

The Group is exposed to the risk that changes in interest rates at which it lends and those at which it borrows may adversely affect its net interest income and profitability. In addition, its financial performance may be affected by fluctuations in the exchange rates between currencies.

Mitigation

This risk is managed within Board approved risk appetite limits with comprehensive treasury policies in place to ensure that the risk posed by changes and mismatches in interest or exchange rates are effectively managed.

Day-to-day management of interest rate risk within Board approved limits is the responsibility of Treasury, with control and oversight provided by ALCO.

The Group seeks to match the maturity profile of assets and liabilities and uses financial instruments, such as interest rate swaps, to hedge the exposure arising from repricing gaps.

Year-on-year change

↓

The Group's overall market risk profile, relative to its balance sheet, has remained broadly similar and therefore associated risk levels remain generally stable compared to previous periods.

However, the transition of assets and liabilities from LIBOR to alternative risk-free rates is well progressed with the majority of assets and liabilities addressed, and the programme expected to be completed before the December 2021 cut-off date. This has removed a degree of uncertainty in relation to interest rate risk and so the risk profile has reduced.

Credit Risk

Description

Credit risk elements which could expose the Group to the risk of unexpected material losses include:

- Customer risks through failure to screen potential borrowers, and manage repayments
- Concentration risk in credit portfolios through an uneven distribution of exposures of borrowers, asset classes, sectors or geographies
- Reduction in value of collateral owned by the Group, or secured against debt owed to it
- Wholesale counterparty risk
- Outsourcer default risk

Mitigation

The Group has a robust limit framework supported by comprehensive policies in place that set out detailed criteria which must be met before loans are approved. Exceptions to credit policies require approval by the Credit Risk function, operating under a mandate from the Credit Committee.

The Group uses a range of sources to inform expectations of key external factors such as interest rate movements and house price inflation which are in turn used to guide policy and underwriting.

The Group also continues to exploit opportunities to diversify the range of its activities and income streams, consistent with its strategic objective of operating as a prudent, risk focussed specialist lender.

The majority of the Group's loans by value continue to be secured against UK residential property at conservative loan-to-value levels. The primary collateral therefore forms part of a highly mature, liquid, sustainable market demonstrated over many decades of operation.

Exposure to wholesale counterparty credit risk is limited to counterparties that meet specific credit rating criteria per the Group's comprehensive treasury policies. Exposure to approved counterparties is monitored daily by senior management within the Group's Treasury function with all exposure managed within ALCO approved limits.

Ongoing monitoring of the credit rating and financial performance of all outsourced relationships and critical suppliers is undertaken.

Year-on-year change

↓

Prudent credit tightening and pro-active customer contact strategy throughout the Covid pandemic, have combined with the Group's consistently high lending standards to ensure that customers have maintained repayments and that arrears and losses have been minimised.

The Group has returned to lending criteria that are generally in line with that in place pre-pandemic.

Performance levels, both for the Group and the financial services sector more generally, coupled with a more positive outlook for the UK economy, including steadily rising house prices, and the progress of the Covid pandemic, indicate that this risk has reduced compared to 30 September 2020.

Model Risk

Description	Mitigation	Year-on-year change
Models are used across the Group to inform financial decision making and hence it is imperative that the environment in which the models are designed, implemented and operate is subject to appropriate rigour.	As the use of internally developed models has increased across the Group, a robust framework and governance has been developed to manage the associated risks. This includes the MRC which oversees the development, implementation and ongoing monitoring of models across the Group. The Model Governance Framework provides a structured and disciplined approach to the management of model risk. This includes clear development, implementation and ongoing oversight principles together with the requirements for independent validation based on model materiality criteria.	← → It is recognised that the increasing use of internally developed models will drive a commensurate risk to the Group. However, given the strength of the framework and oversight processes, model risk remains within appetite and the outlook remains stable.

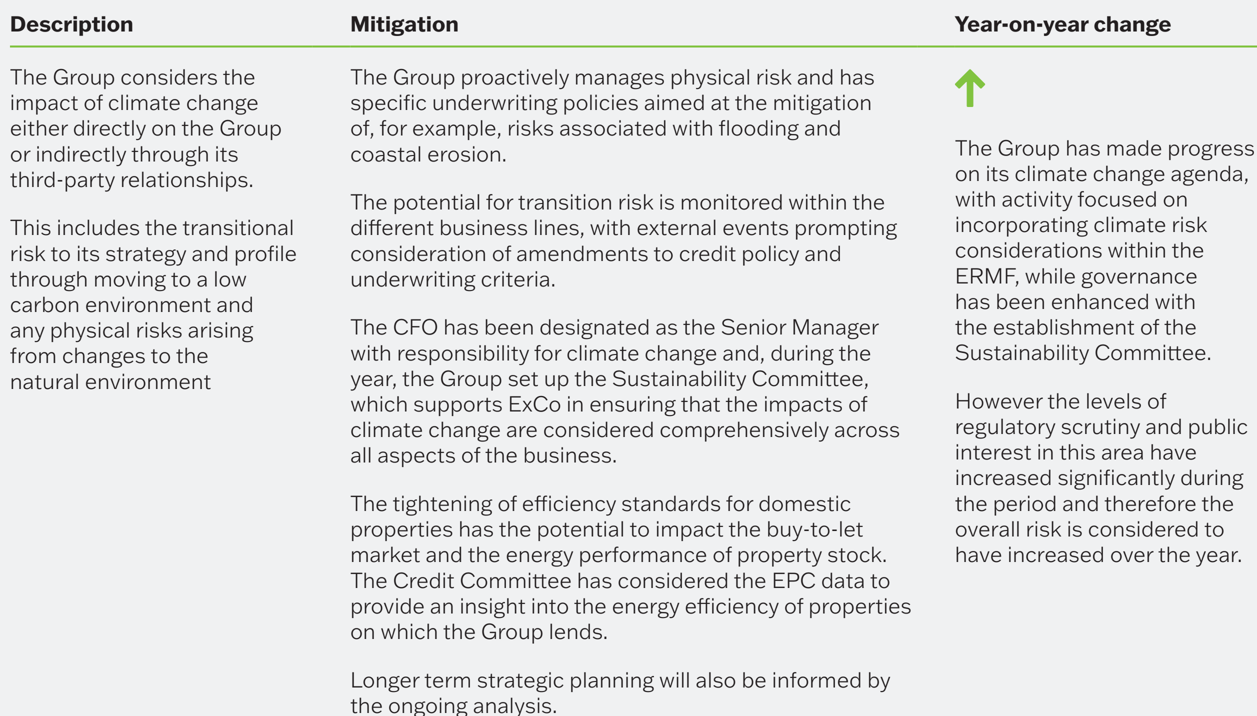
Reputational Risk

Description	Mitigation	Year-on-year change
Maintenance of a strong reputation across all business lines and operational activities is core to the Group's philosophy. Detrimental reputational impacts may result from crystallisation of other principal risks, but also through failure to safeguard the integrity of the brand or failing to meet external expectations in conducting business practices.	The reputational impacts of any changes to strategy, pricing or processes are explicitly considered in the decision-making process and are reviewed by the Director of External Relations, and the Group will not undertake any activity it considers might be damaging to its reputation. The Group has an experienced External Relations function which manages all Group communications and ensures that the reputational profile of the Group remains protected at all times. All material risk events are reviewed for reputational impact and mitigating actions are initiated as appropriate.	← → The Group continues to manage its reputation effectively in all its dealings. This has been particularly important given the potential impact of the Covid pandemic over the year. Whilst it is mindful that the threat to reputation can emanate from many sources, the Group remains well-placed to respond quickly and efficiently to any reputational issue.

Strategic Risk

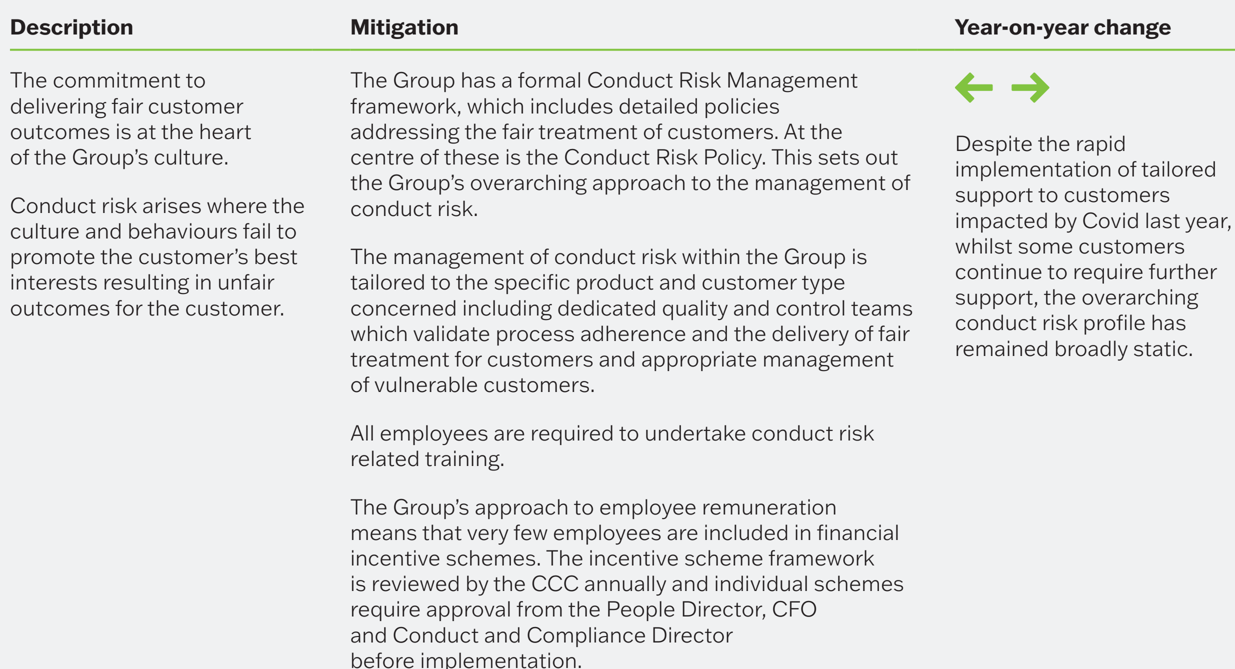
Description	Mitigation	Year-on-year change
The Group's strategy as a specialist lender is key to its operating model and business planning. However, there is a risk that changes to the business model or macroeconomic, geopolitical, regulatory, competitive or other factors may impact delivery of strategic objectives.	The Group closely monitors economic developments in the UK and overseas, with support from leading independent macro-economic and other advisors. Stress testing is performed to assess its expected performance under a range of operating conditions. This provides the Board with an informed understanding and appreciation of the Group's capacity to withstand shocks of varying severities. The Group continues to exploit opportunities to diversify the range of its activities and income streams, consistent with its strategic objective of operating as a prudent, risk focussed lender.	← → Prospects for UK economic performance remains unusually uncertain. The medium and longer-term impacts of Covid, together with the implications of the UK's new trading relationships post-Brexit, are still to be determined. Whilst the Group has continued to remain resilient throughout the pandemic, and activity levels have been strong, the potential for future waves of the virus and associated lockdowns still present a risk.

Climate Risk

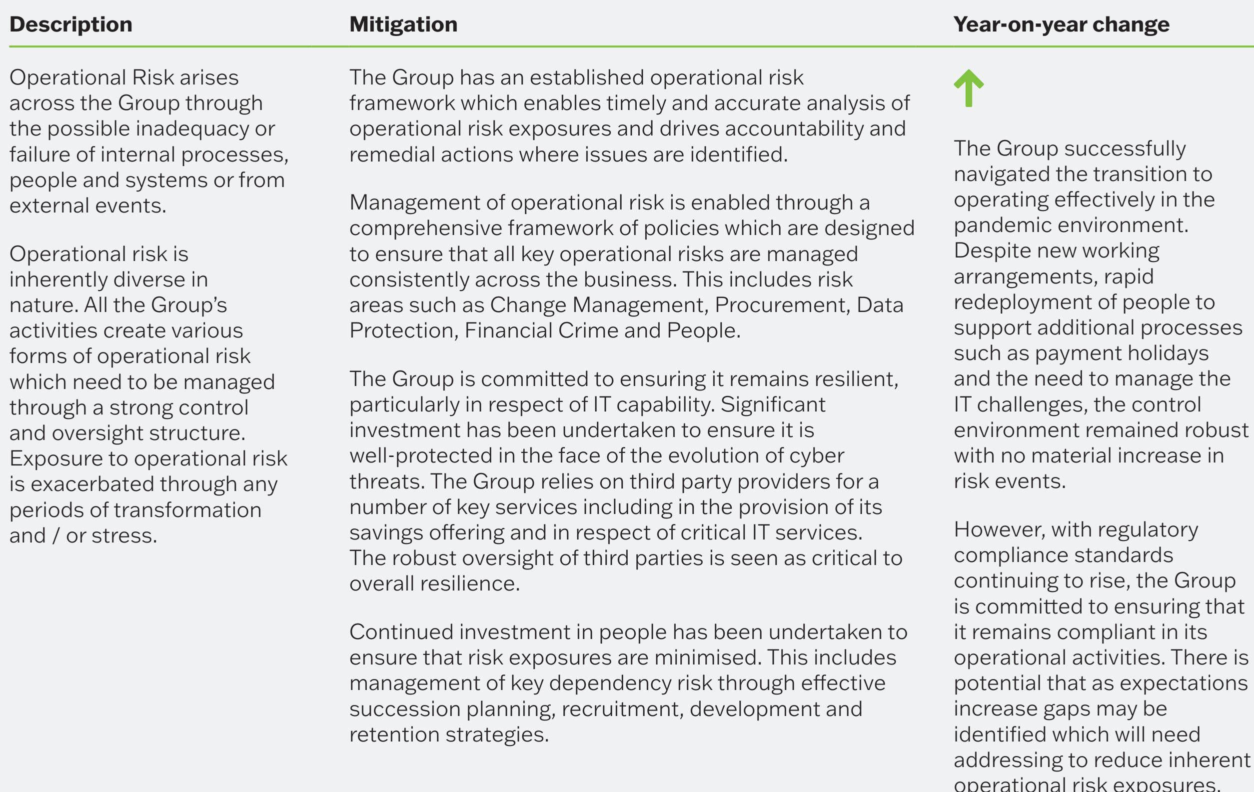


Description	Mitigation	Year-on-year change
The Group considers the impact of climate change either directly on the Group or indirectly through its third-party relationships. This includes the transitional risk to its strategy and profile through moving to a low carbon environment and any physical risks arising from changes to the natural environment	The Group proactively manages physical risk and has specific underwriting policies aimed at the mitigation of, for example, risks associated with flooding and coastal erosion. The potential for transition risk is monitored within the different business lines, with external events prompting consideration of amendments to credit policy and underwriting criteria. The CFO has been designated as the Senior Manager with responsibility for climate change and, during the year, the Group set up the Sustainability Committee, which supports ExCo in ensuring that the impacts of climate change are considered comprehensively across all aspects of the business. The tightening of efficiency standards for domestic properties has the potential to impact the buy-to-let market and the energy performance of property stock. The Credit Committee has considered the EPC data to provide an insight into the energy efficiency of properties on which the Group lends. Longer term strategic planning will also be informed by the ongoing analysis.	↑ The Group has made progress on its climate change agenda, with activity focused on incorporating climate risk considerations within the ERMF, while governance has been enhanced with the establishment of the Sustainability Committee. However the levels of regulatory scrutiny and public interest in this area have increased significantly during the period and therefore the overall risk is considered to have increased over the year.

Conduct Risk



Description	Mitigation	Year-on-year change
The commitment to delivering fair customer outcomes is at the heart of the Group's culture. Conduct risk arises where the culture and behaviours fail to promote the customer's best interests resulting in unfair outcomes for the customer.	The Group has a formal Conduct Risk Management framework, which includes detailed policies addressing the fair treatment of customers. At the centre of these is the Conduct Risk Policy. This sets out the Group's overarching approach to the management of conduct risk. The management of conduct risk within the Group is tailored to the specific product and customer type concerned including dedicated quality and control teams which validate process adherence and the delivery of fair treatment for customers and appropriate management of vulnerable customers. All employees are required to undertake conduct risk related training. The Group's approach to employee remuneration means that very few employees are included in financial incentive schemes. The incentive scheme framework is reviewed by the CCC annually and individual schemes require approval from the People Director, CFO and Conduct and Compliance Director before implementation.	← → Despite the rapid implementation of tailored support to customers impacted by Covid last year, whilst some customers continue to require further support, the overarching conduct risk profile has remained broadly static.



Operational Risk

Description	Mitigation	Year-on-year change
Operational Risk arises across the Group through the possible inadequacy or failure of internal processes, people and systems or from external events. Operational risk is inherently diverse in nature. All the Group's activities create various forms of operational risk which need to be managed through a strong control and oversight structure. Exposure to operational risk is exacerbated through any periods of transformation and / or stress.	The Group has an established operational risk framework which enables timely and accurate analysis of operational risk exposures and drives accountability and remedial actions where issues are identified. Management of operational risk is enabled through a comprehensive framework of policies which are designed to ensure that all key operational risks are managed consistently across the business. This includes risk areas such as Change Management, Procurement, Data Protection, Financial Crime and People. The Group is committed to ensuring it remains resilient, particularly in respect of IT capability. Significant investment has been undertaken to ensure it is well-protected in the face of the evolution of cyber threats. The Group relies on third party providers for a number of key services including in the provision of its savings offering and in respect of critical IT services. The robust oversight of third parties is seen as critical to overall resilience. Continued investment in people has been undertaken to ensure that risk exposures are minimised. This includes management of key dependency risk through effective succession planning, recruitment, development and retention strategies.	↑ The Group successfully navigated the transition to operating effectively in the pandemic environment. Despite new working arrangements, rapid redeployment of people to support additional processes such as payment holidays and the need to manage the IT challenges, the control environment remained robust with no material increase in risk events. However, with regulatory compliance standards continuing to rise, the Group is committed to ensuring that it remains compliant in its operational activities. There is potential that as expectations increase gaps may be identified which will need addressing to reduce inherent operational risk exposures.

B9. Directors' report

The directors of Paragon Banking Group PLC (registered number 2336032) submit their Report prepared in accordance with Schedule 7, which also includes additional disclosures made in accordance with the listing and disclosure rules of the FCA.

Certain information required by these requirements is included in other sections of this Annual Report and incorporated in this Directors' Report by reference. These items are discussed in detail at the end of this report.

Directors

The names of the directors of the company at the date of this report, together with biographical details, are given in Section B3.1. All the directors listed in that section were directors of the company throughout the year, apart from Peter Hill, who was appointed as a director on 27 October 2020. In addition, Finlay Williamson stepped down from the Board on 31 December 2020.

Directors' interests

The directors' interests in the shares of the Company are disclosed in the Directors' Remuneration Report in Section B7. There have been no changes in the directors' interests in the share capital of the Company since 30 September 2021.

Other than as outlined in the Directors' Remuneration Report in Section B7, the directors had no interests in securities issued by the Company. The directors have no interests in the shares or debentures of the Company's subsidiary companies.

A director has a statutory duty to avoid a situation in which he or she has, or can have, an interest that conflicts or possibly may conflict with the interests of the Company. A director will not be in breach of that duty if the relevant matter has been authorised in accordance with the Articles of Association of the Company (the 'Articles') by the other directors. The Articles include the relevant authorisation for directors to approve such conflicts.

None of the directors had, either during or at the end of the year, any material interest in any contract of significance with the Company or its subsidiaries. Further details on the directors' remuneration and service contracts / appointment letters can be found in the Directors' Remuneration Report in Section B7.

Directors' powers and appointment of directors

The appointment and replacement of the Company's directors is governed by the Articles, the Code, the Companies Act 2006 and related legislation, and the individual service contracts and terms of appointment of the directors. The powers of the directors, and their service contracts and terms of appointment, are described in the Corporate Governance section, Section B4.

The Articles may only be amended by special resolution of the Company's shareholders in a general meeting and were last amended in 2021. The Company's Articles set out the powers of the directors and rules governing the appointment and removal of directors. The Articles can be viewed at the Group's website at www.paragonbankinggroup.co.uk.

Under Article 83 of the Articles, all directors are required to submit themselves for reappointment annually, in accordance with the Code. Accordingly, all current directors 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.

Directors' indemnity and insurance

Under Article 169 of the Articles, the Company has qualifying third party indemnity provisions for the benefit of its directors, for the purposes of section 234 of the Companies Act 2006, which were in place throughout the year and which remain in force at the date of this report, in the form of directors' and officers' liability insurance. The directors' and officers' liability insurance covers directors of all the Company's subsidiary entities.

Share capital and distributions

Share capital

Details of the issued share capital of the Company, together with details of movements in its issued share capital in the year, are given in note 37 to the accounts. The Company has one class of ordinary shares which carries no right to fixed income. Each ordinary share carries the right to one vote at general meetings of the Company. The rights and obligations attaching to ordinary shares are set out in the Articles.

There are no specific restrictions on the size of a member's holding or on the transfer of shares. Both of these matters are governed by the general provisions of the Articles and prevailing legislation. The directors are not aware of any agreements between holders of the Company's shares in respect of voting rights or which might result in restrictions on the transfer of securities.

Details of employee share schemes are set out in note 51 to the accounts. Votes attaching to shares held by the Group's employee benefit trust are not exercised at general meetings of the Company.

The Company presently has the authority to issue ordinary shares up to a value of £85.5 million and to make market purchases of up to 25.6 million £1 ordinary shares. These authorities expire at the conclusion of the forthcoming AGM on 2 March 2022 and resolutions will be put to that meeting proposing that they be renewed.

Purchase of own shares

The existing authority under section 724 of the Companies Act 2006, referred to above, given to the Company at the AGM on 24 February 2021 enables it to purchase treasury shares (a Company's own shares purchased by it to be held in treasury) of up to 10% of its issued share capital.

This authority will expire at the conclusion of the next AGM, and the Board considers it would be appropriate to renew this authority. It therefore intends to seek shareholder approval to purchase treasury shares of up to 10% of its issued share capital at the forthcoming AGM in line with current investor sentiment. Details of the resolution renewing the authority will be included in the Notice of AGM. Shares held as treasury shares can in the future be cancelled, re-sold or used to provide shares for employee share schemes.

On 8 June 2021 the Group announced a share buy-back programme of up to £40.0 million. The reasons for this purchase were set out in Section 3.3 of the Half-Yearly Report for the six months ended 31 March 2021. During the year 6,882,132 £1 ordinary shares (2020: nil) having an aggregate nominal value of £6,882,132 (2020: £nil), were purchased under this programme. Total consideration paid in the year was £37.7 million, including costs (2020: £nil). The Group anticipates that this programme will be completed following the announcement of the results for the year.

The number of treasury shares held at 30 September 2021 was 12,100,834 (2020: 5,218,702), representing 4.83% of the issued share capital excluding treasury shares (2020: 2.03%). The holdings at 30 September 2021 and 30 September 2020 represented the maximum holdings in the years then ended. The highest proportion of issued share capital excluding treasury shares held during the year was 4.83% (2020: 2.04%).

On 24 November 2021, after the year end, all these treasury shares were cancelled.

Dividends

The directors recommend a final dividend of 18.9 pence per share (2020: 14.4 pence per share) which would give a total dividend for the year of 26.1 pence per share (2020: 14.4 pence per share). An interim dividend of 7.2 pence per share was paid during the year (2020: nil pence per share).

Major shareholdings

Notifications of the following major voting interests in the Company's ordinary share capital, notifiable in accordance with Chapter 5 of the FCA's Disclosure and Transparency Rules, had been received by the Company as at 30 September 2021.

Shareholder	% Held	Notification date
M&G PLC	**6.6000**	22/10/19
Royal London Asset Management	**5.9980**	16/06/21
Liontrust Investment Partners LLP	**5.0700**	21/09/20
Dimensional Funds Advisors LP	**5.0020**	21/07/21
Franklin Templeton Fund Management	**5.0016**	02/08/21
Pendal Group (formerly J O Hambro Capital Management Limited)	**4.9809**	20/08/21

The percentages quoted above were calculated by reference to the Company's issued share capital at the date the holding was disclosed.

On 17 November 2021 Janus Henderson Group PLC notified the Company that it had increased its interest to 5.0000%.

As at 7 December 2021, no further changes had been notified to the Company.

Significant agreements

A change of control of the Company, following a takeover bid, may cause a number of agreements to which the Company is a party to take effect, alter or terminate. These include certain insurance policies and employee share plans.

The Company does not have any agreements with any director or employee that would provide compensation for loss of office or employment resulting from a takeover of the Company, except that provisions of the Company's share based remuneration arrangements may cause outstanding awards and options to vest and become exercisable on a change of control, subject, where applicable, to the satisfaction of any performance conditions at that time and any required pro-rating of awards.

Research and Development

During the year, the Group undertook certain projects to develop its IT capabilities which met the definition of research and development set out in the guidelines issued by the Department of Business Innovation and Skills in 2010. Claims in respect of these activities were made in the Group's tax returns. The amounts involved were modest in the context of the Group accounts.

Political expenditure

During the year ended 30 September 2021 no political donations were made by any Group company (2020: £nil).

Auditors

The directors have taken all reasonable steps to make themselves and the Company's auditors, KPMG, aware of any information needed in preparing the audit of the Annual Report and Financial Statements for the year, and, as far as each of the directors is aware, there is no relevant audit information of which the auditors are unaware. This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

The directors, having considered the requirements for rotation of auditors, the length of service of KPMG and the conduct of the audit concluded there was no present need to retender the audit. Therefore, a resolution for the reappointment of KPMG, who have expressed their willingness to continue in office, as the auditors of the Company is to be proposed at the forthcoming AGM, as well as a resolution to give the directors the authority to determine the auditors' remuneration.

The full text of the relevant resolutions is set out in the Notice of AGM accompanying this Annual Report. The evaluation process is described more fully in the Audit Committee Section B6.

Annual General Meeting

The AGM of the Company will take place on 2 March 2022 in London. A notice convening the AGM and outlining the resolutions to be proposed at the AGM is being circulated to shareholders with this Annual Report and Accounts.

In the event that Covid restrictions on gatherings or travel are imposed, the Group will make appropriate arrangements to comply with any such restrictions while ensuring that shareholders are able to participate in the meeting.

More information is set out in the Notice of AGM and further updates will be provided in due course, if necessary.

Listing Rule LR9.8.4

There are no matters which the Company is required to report under Listing Rule LR9.8.4, other than certain matters concerning its employee share ownership trust (note 39).

The Paragon Banking Group PLC Employee Trust is an independent trust which holds shares for the benefit of employees and former employees of the Group in order to satisfy awards under employee share plans. The Company funds the trust from time to time, to enable it to acquire shares to satisfy these awards. During the year, the trust made market purchases of 0.8 million ordinary shares (2020: 1.5 million). As the shares included in these arrangements are held on the consolidated balance sheet, this has no effect on the amounts reported by the Group.

The trustee will only vote on those shares in accordance with the instructions given to the trustee and in accordance with the terms of the trust deed. The trustee has waived the trust's right to dividends on all shares held within the trust.

Details of the shares held by the trust are set out in note 39 and details of the share-based remuneration arrangements are given in note 51.

Information presented in other sections

Certain information required to be included in a directors' report by Schedule 7 can be found in the other sections of the Annual Report, as described below. All of the information presented in these sections is incorporated by reference into this Directors' Report and is deemed to form part of this report. Readers are also referred to the cautionary statement on page 2.

- The Group's business activities, together with commentary on the likely future developments in the business of the Group (including the factors likely to affect future development and performance) and its summarised financial position is included in the Strategic Report (Section A)
- A description of the Group's financial risk management objectives and policies, including hedging policies, and its exposure to risks (including price / credit / liquidity / cash flow risk) arising from its use of financial instruments are set out in note 54 to the accounts and related notes
- Information concerning directors' contractual arrangements and entitlements under share-based remuneration arrangements is given in Section B7, the Directors' Remuneration Report
- An explanation of the Board's activities in relation to assessing and monitoring how the company has aligned with its stated purpose and culture can be found in Sections B1 and B3.3
- Information concerning employment practices, employee engagement, the Group's approach to diversity, the employment of disabled persons and the involvement of employees in the business, is given in Section A6.3 – 'People'
- Information on the Group's business relationships and how the directors have had regard to the need to foster these relationships with suppliers, customers and other stakeholders, and the effect of that regard, including on the principal decisions taken by the Group during the financial year (which is crucial to the long-term sustainability of the business), can be found in Section B4.3 of the Corporate Governance Report and in Section A6 of the Strategic Report
- Disclosures concerning greenhouse gas emissions are given in Section A6.4 – 'Environmental Issues'
- Disclosures concerning events taking place after the balance sheet date are set out in note 29 to the accounts
- Disclosures concerning the Group's ability to continue to adopt the going concern basis of accounting and the Group's viability statement are given in Section A5

Rule DTR7.2.1 of the Disclosure Guidance and Transparency Rules requires the Group's disclosures on Corporate Governance to be included in the Directors' Report. This information is presented in Sections B2, B3, B4, B5, B6, B7 and B8 and the information in these sections is incorporated by reference into this Directors' Report and is deemed to form part of this report.

Rule DTR4.1.5 of the Disclosure Guidance and Transparency Rules requires that the annual report of a listed company contains a management report containing certain prescribed information. This Directors' Report, including the other sections of the Annual Report incorporated by reference, comprises a management report for the Group for the year ended 30 September 2021, for the purposes of the Disclosure Guidance and Transparency Rules.

This section B9 of this Annual Report, together with the other sections of the Annual Report incorporated by reference, comprise a directors' report for the Company which has been drawn up and presented in accordance with, and in reliance upon, applicable English company law and the liabilities of the directors in connection with this report shall be subject to the limitations and restrictions provided by such law.

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

Marius van Niekerk

Company Secretary

7 December 2021

B10. Statement of directors' responsibilities

in respect of financial statements

The directors are responsible for preparing this Annual Report, including the consolidated and company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare consolidated financial statements for the Group and separate financial statements for the Company in respect of each financial year. In respect of the financial statements for the year ended 30 September 2021, that law includes the Companies Act 2006 ('the Companies Act'). That law requires the directors to prepare the consolidated financial statements in accordance with IFRS in conformity with the requirements of the Companies Act and they have also elected to prepare the financial statements of the Company on the same basis.

In addition the UK Disclosure and Transparency Rules ('DTR') of the FCA requires that the consolidated financial statements for the current year are prepared in accordance with IFRS adopted pursuant to EU Regulation (EC) No 1606/2002 (the 'IAS Regulation') as it applies in the EU.

IAS 1 – 'Presentation of Financial Statements' requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's ('IASB') 'Framework for the Preparation and Presentation of Financial Statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRS.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Company and the Group's profit or loss for the year. In preparing each of the consolidated and company financial statements the directors are also required to:

- Select suitable accounting policies and apply them consistently
- Make judgements and estimates that are reasonable, relevant and reliable
- State whether the consolidated and company financial statements have been prepared in accordance with IFRS in conformity with the requirements of the Companies Act
- State whether the consolidated financial statements have been prepared in accordance with IFRS as adopted by the EU pursuant to the IAS Regulation
- Assess the ability of the Group and the Company to continue as a going concern, disclosing, as applicable, matters related to going concern
- Use the going concern basis of accounting unless they intend to liquidate the Company and / or the Group or to cease operation or they have no realistic alternative to doing so
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information
- Provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance

The directors are responsible for keeping adequate accounting records for the Company that are sufficient to record and explain its transactions, disclose with reasonable accuracy at any time its financial position and enable them to ensure that its financial statements comply with the requirements of the Companies Act.

They are responsible for the implementation of such internal control processes as they deem necessary to enable the preparation of financial statements which are free from material misstatements, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for the preparation of a strategic report, directors' report, directors' remuneration report and corporate governance statement, which comply with that law and those regulations.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website (www.paragonbankinggroup.co.uk). Legislation in the UK governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

Confirmation by the Board of Directors

The Board of Directors currently comprises:

F S Clutterbuck (Chair of the Board)	B A Ridpath (Non-executive director)
N S Terrington (CEO)	G H Yorston (Non-excutive director)
R J Woodman (CFO)	A C M Morris (Non-executive director)
H R Tudor (Senior Independant Director)	P A Hill (Non-executive director)

Each of the directors named above confirms that, to the best of their knowledge:

- The financial statements, prepared in accordance with applicable accounting standards, 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 DTR, and includes a fair review of the development and performance of the business and the consolidated position of the Group taken as a whole, together with a description of the principal risks and uncertainties that it faces
- The Annual Report (including the consolidated and company financial statements), taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position, performance, business model and strategy

Approved by the Board of Directors as the persons responsible within the Company.

Signed on behalf of the Board

Marius van Niekerk

Company Secretary

7 December 2021

As part of our Pride at Paragon celebrations, employees walked together at the 2021 Birmingham Pride Carnival Parade in support of LGBTQ+ colleagues.

C. Independent Auditor's Report

Report by the independent auditor of the Company, KPMG LLP, on the financial statements

P164 **C1. Independent Auditor's Report to the members of Paragon Banking Group PLC**
Report by the independent auditor of the Company, KPMG LLP, on the financial statements

C1. Independent auditor’s report

To the members of Paragon Banking Group PLC

1. Our opinion is unmodified

We have audited the financial statements of Paragon Banking Group PLC (‘the Company’) for the year ended 30 September 2021 which comprise the:

- Consolidated Statement of Profit or Loss
- Consolidated Statement of Comprehensive Income
- Consolidated and Company Balance Sheets
- Consolidated and Company Cash Flow Statements
- Consolidated and Company Statements of Changes in Equity
- Related notes, including the accounting policies in note 61 other than the disclosures labelled as unaudited in note 53

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 2021 and of the Group’s profit for the year then ended
- the Group financial statements have been properly prepared in accordance with International Accounting Standards in conformity with the requirements of the Companies Act 2006
- the Parent Company financial statements have been properly prepared in accordance with International Accounting Standards in conformity with the requirements of, and as applied in accordance with the provisions of, the Companies Act 2006
- 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 to the extent applicable

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 six financial years ended 30 September 2021. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed public interest entities. No non-audit services prohibited by that standard were provided.

2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

Key audit matter

Impairment allowances on loans to customers

Risk vs 2020: ← →

(£60.9 million; 2020: £81.8 million)

Refer to the Audit Committee Report, accounting policy note 61 and note 18 (financial disclosures).

Subjective estimate

The measurement of ECL involves significant judgements and estimates. A heightened risk of material misstatement of ECL arises in the current year due to the increased judgement and estimation uncertainty as a result of Covid. The key areas where we identified greater levels of management judgement and therefore increased levels of audit focus in the Group's estimation of ECL are:

Economic scenarios – IFRS 9 requires the Group to measure ECL on a forward-looking basis reflecting a range of future economic conditions. Significant management judgement is applied to determine the economic scenarios used, particularly in the context of Covid, and the probability weightings assigned to each economic scenario.

Qualitative adjustments – Management's adjustments to the model-driven ECL results to address issues relating to model responsiveness or emerging trends relating to Covid. Such adjustments are inherently subjective and significant management judgement is involved in estimating these amounts.

Significant Increase in Credit Risk ('SICR') – The criteria selected to identify a significant increase in credit risk is a key area of judgement within the Group's ECL calculation as these criteria determine whether a 12-month or lifetime provision is recorded. Increased judgement continues to exist relating to the treatment of those customers who were granted one or more Covid payment reliefs.

Model estimations – Inherently judgmental modelling is used to estimate ECLs which involves determining Probabilities of Default ('PD'), Loss Given Default ('LGD'), and Exposures at Default ('EAD'). The LGD models used in the portfolios are the key drivers of the Group's ECL results and are therefore the most significant judgmental aspect of the Group's ECL modelling approach.

The effect of these matters is that, as part of our risk assessment, we determined that the impairment of loans to customers has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. The financial statements disclose the sensitivities estimated by the Group (note 18).

Disclosure quality

The disclosures regarding the Group's application of IFRS 9 are important in explaining the key judgements and material inputs to the IFRS 9 ECL results.

Our response

We performed the following audit procedures rather than seeking to rely on the Group's controls because the nature of the balance is such that we would expect to obtain audit evidence primarily through the detailed procedures described:

- **Test of details:** Key aspects of our testing involved:
  - We tested the key inputs and assumptions impacting the Group's overall ECL calculation to assess their reasonableness. This included performing sensitivity analysis to understand the significance of certain assumptions; benchmarking procedures to compare the Group's key assumptions to comparable peer group organisations; and assessing the key assumptions against the Group's historical experience; and
  - We performed recalculations of the ECL measured on each of the Group's loan portfolios

- **Our economic scenario expertise:** We involved our own economic specialists to assist us in assessing the appropriateness of the Group's methodology for determining the economic scenarios used and the probability weightings applied to them. We assessed the overall reasonableness of the economic forecasts by comparing the Group's forecasts to our own modelled forecasts. As part of this work, we assessed the reasonableness of the Group's considerations of the economic uncertainty relating to Covid.

- **Qualitative adjustments:** For each of the adjustments to the model-driven ECL results we assessed the reasonableness of the adjustments by challenging, the key assumption, inspecting the calculation methodology and tracing a sample of data used back to source data.

- **SICR:** We assessed the ongoing predictability of the SICR criteria and independently recalculated the loans' stage for 100% of Paragon's loans and receivables. In addition, we assessed the reasonableness of management's treatment of Covid payment relief customers from a SICR perspective.

- **Our financial risk modelling expertise:** We involved our own financial risk modelling specialists in evaluating certain IFRS 9 models. We used our knowledge of the Group and our experience of the industry that the Group operates in to independently assess the appropriateness of the Group's IFRS 9 models and key components.

- **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the Group's overall ECL. As a part of this, we assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the key judgments and assumptions made was sufficiently clear.

Our results

The results of our testing were satisfactory, and we considered the ECL charge, provision recognised and the related disclosures to be acceptable (2020: acceptable).

Key audit matter

Interest receivable on originated loan accounts

Risk vs 2020: ← →

(£440.0 million; 2020: £440.4 million)

Refer to the Audit Committee Report, accounting policy note 61 and note 4 (financial disclosures).

Subjective estimate

The recognition of interest receivable on originated loan accounts under the Effective Interest Rate ('EIR') method requires management to apply judgement, with the most critical estimate being the loans' expected behavioural life for originated assets.

The expected life assumptions utilise repayment profiles which represent how customers are expected to pay. These profiles extend significantly into the future which creates a high degree of estimation uncertainty and subjects the judgement to future market changes. The Group makes its expected life assumptions based on its forecasting process which incorporates both historical experience and judgemental overlays by management.

The cohorts of loans and advances for which the expected behavioural life is most significant are buy-to-let products which were originated by the Group post-2010.

The effect of these matters is that, as part of our risk assessment, we determined that interest receivable on originated loan accounts has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole. The financial statements disclose the sensitivities estimated by the Group (note 63).

We continue to perform procedures over the interest receivable on acquired loan accounts. However, following our assessment of the level of audit effort required in this area, 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.

Our response

We performed the following audit procedures rather than seeking to rely on the Group's controls because the nature of the balance is such that we would expect to obtain audit evidence primarily through the detailed procedures described:

- **Historical comparison:** We critically assessed the Group's analysis and key assumptions over the repayment profiles by comparing them to the Group's historical trends and actual portfolio behaviour. This included considering the impact of uncertainties arising from Covid in the current behavioural life forecasts.

- **Our sector experience:** We critically assessed key assumptions behind the Group's expected behavioural lives against our own knowledge of industry experience and trends, and challenged the appropriateness of the level of segmentation applied to the loan portfolios by management.

- **Sensitivity analysis:** We performed sensitivity analysis over the repayment profiles by applying alternative profiles based upon the above procedures.

- **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the Group's EIR adjustments and interest receivable. As a part of this, we assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the critical estimates and assumptions made was sufficiently clear.

Our results

The results of our testing were satisfactory, and we found the resulting estimate of interest receivable on originated loan accounts and the related disclosures to be acceptable (2020: acceptable).

Key audit matter	Our response
Recoverability of goodwill Risk vs 2020: ← → (£164.4 million; 2020: £164.4 million) *Refer to the Audit Committee Report, accounting policy note 61 and note 24 (financial disclosures).* **Forecast-based valuation:** The carrying amount of goodwill is significant to the financial statements and at risk of irrecoverability due to changes in market factors since acquisition. The estimated recoverable amount is subjective due to the inherent uncertainty involved in forecasting future cash flows and deriving an appropriate discount rate to reflect the time value of money. In calculating the recoverable amount, management make assumptions over key inputs, being forecast future cash flows and the discount rate. The effect of these matters is that, as part of our risk assessment, we determined that the recoverable amount has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole. The financial statements (note 24) disclose the sensitivity estimated by the Group.	We performed the following audit procedures rather than seeking to rely on the Group's controls because the nature of the balance is such that we would expect to obtain audit evidence primarily through the detailed procedures described: • **Historical comparisons:** We compared the Group's previous forecasting with actual results to assess forecasting accuracy. • **Benchmarking assumptions:** We compared the Group's assumptions to externally derived data in relation to key inputs such as discount rates and challenged management on the forecast business performance. This included considering the impact of uncertainties arising from Covid in the current forecasts. • **Our industry experience:** We used our knowledge of the Group and our experience of the industry that the Group operates in to independently assess the appropriateness of the key assumptions, including the discount rate and cashflow forecasts. • **Sensitivity analysis:** We performed breakeven analysis and applied alternative scenarios based on the assumptions noted above • **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the estimated recoverable amount. As a part of this, we assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the key judgments and assumptions made was sufficiently clear. **Our results** The results of our testing were satisfactory, and we found the resulting carrying amount of goodwill and the related disclosures to be acceptable (2020: acceptable).

Key audit matter

Valuation of the defined benefit pension scheme obligation

Risk vs 2020: ← →

(£155.6 million, 2020: £154.9 million)

Refer to the Audit Committee Report, accounting policy note 61 and note 52 (financial disclosures).

Subjective estimate

The Group operates a defined benefit pension scheme which has been closed to new members for several years. At year-end, the Group holds a net defined benefit pension scheme liability on the balance sheet, which includes gross pension obligations.

Small changes in the assumptions and estimates used to value the Group's pension obligation (before deducting scheme assets) would have a significant effect on the Group's net defined benefit obligation.

The effect of these matters is that, as part of our risk assessment, we determined that the valuation of the defined benefit pension scheme obligation has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole. The financial statements disclose the sensitivity estimated by the Group (note 53).

Our response

We performed the following audit procedures rather than seeking to rely on the Group's controls because the nature of the balance is such that we would expect to obtain audit evidence primarily through the detailed procedures described:

- **Evaluation of actuary:** We evaluated the competence, independence and objectivity of the Group's actuary in assessing management's reliance upon their expert valuation services.
- **Benchmarking assumptions:** We critically assessed, using our own actuarial specialists, the key assumptions applied, such as the discount rate, inflation rate and mortality / life expectancy against externally derived data and internal experience.
- **Assessing transparency:** We assessed the adequacy of the Group's disclosures in respect of the sensitivity of the obligation to the actuarial assumptions.

Our results

The results of our testing were satisfactory, and we found the valuation of the defined benefit scheme obligation and the related disclosures to be acceptable (2020: acceptable).

Key audit matter

Recoverability of Parent Company's investment in subsidiaries

Risk vs 2020: ← →

(£978.5 million; 2020: £1,030.1 million)

Refer to the accounting policy note 61 and note 25 (financial disclosures).

Low risk, high value

The carrying amount of the Parent Company's investments in subsidiaries represents 90.0% (2020: 90.0%) of the Parent Company's total assets.

Their recoverability is not at a high risk of significant misstatement or subject to significant judgement. However, due to their materiality in the context of the Parent Company financial statements, this is the area that had the greatest effect on our overall Parent Company audit.

Our response

We performed the following audit procedures rather than seeking to rely on the Group's controls because the nature of the balance is such that we would expect to obtain audit evidence primarily through the detailed procedures described:

- **Tests of detail:** We compared the carrying amount of 100% of investments with the relevant subsidiary draft balance sheet to identify whether their net assets, being an approximation of their minimum recoverable amount, were in excess of their carrying amount and assessing whether those subsidiaries have historically been profit-making.

Our results

The results of our testing were satisfactory, and we found the resulting carrying amount of the investments in subsidiaries to be acceptable (2020: acceptable).

We continue to perform procedures over going concern. However, following the more favourable Covid macroeconomic outlook as at 30 September 2021, 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 £8.1 million (2020: £6.5 million), determined with reference to a benchmark of group profit before tax, of which it represents 3.7% (2020: 4.4%). In 2020 we normalised profit before tax by averaging over three years due to the impact of Covid on financial performance.

Materiality for the parent company financial statements as a whole was set at £3.9 million (2020: £3.9 million), determined with reference to a benchmark of current year net assets, of which it represents 0.6% (2020: 0.6%).

In line with our audit methodology, our procedures on individual account balances and disclosures were performed to a lower threshold, performance materiality, so as to reduce to an acceptable level the risk that individually immaterial misstatements in individual account balances add up to a material amount across the financial statements as a whole.

Performance materiality was set at 75% (2020: 75%) of materiality for the financial statements as a whole, which equates to £6.1 million (2020: £4.9 million) for the Group and £2.9 million (2020: £2.9 million) for the parent company. We applied this percentage in our determination of performance materiality because we did not identify any factors indicating an elevated level of risk.

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.40 million (2020: £0.33 million), in addition to other identified misstatements that warranted reporting on qualitative grounds.

Of the Group's two (2020: two) reporting components, we subjected two (2020: two) to full scope audits for group purposes. The components within the scope of our work accounted for 100.0% (2020: 100.0%) of total group revenue, 100.0% (2020: 100.0%) of group profit before tax, and 100.0% (2020: 100.0%) of group total assets. The work on the two components was performed by the group team.

4. Going concern

The directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Group or the Company or to cease their operations, and as they have concluded that the Group's and the Company's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over their ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

We used our knowledge of the Group, its industry, and the general economic environment to identify the inherent risks to its business model and analysed how those risks might affect the Group's and Company's financial resources or ability to continue operations over the going concern period. The risks that we considered most likely to adversely affect the Group's and Company's available financial resources over this period were:

- the availability of funding and liquidity in the event of a market wide stress scenario including the impact in which the global Covid pandemic continues to unfold; and
- the impact on regulatory capital requirements in the event of an economic slowdown or recession.

We considered whether these risks could plausibly affect the liquidity in the going concern period by comparing severe, but plausible downside scenarios that could arise from these risks individually and collectively against the level of available financial resources indicated by the Group's financial forecasts.

We considered whether the going concern disclosure in note 64 to the financial statements gives a full and accurate description of the directors' assessment of going concern.

Our conclusions based on this work:

- we consider that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate;
- we have not identified, and concur with the directors' assessment that there is not, a material uncertainty related to events or conditions that, individually or collectively, may cast significant doubt on the Group's or Company's ability to continue as a going concern for the going concern period;
- we have nothing material to add or draw attention to in relation to the directors' statement in note 64 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 the going concern period, and we found the going concern disclosure in note 64 to be acceptable; and
- the related statement under the Listing Rules set out on page 57 is materially consistent with the financial statements and our audit knowledge.

However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the above conclusions are not a guarantee that the Group or the Company will continue in operation.

5. Fraud and breaches of laws and regulations - ability to detect

Identifying and responding to risks of material misstatement due to fraud

To identify risks of material misstatement due to fraud ('fraud risks') we assessed events or conditions that could indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.

Our risk assessment procedures included:

- Enquiring of directors, Internal Audit and inspection of policy documentation as to the Group and Parent Company's high-level policies and procedures to prevent and detect fraud, including the Internal Audit function, and the Group and Parent Company's channel for 'whistleblowing', as well as whether they have knowledge of any actual, suspected or alleged fraud.
- Inspecting Board, Audit Committee and Risk Committee minutes.
- Considering remuneration incentive schemes and performance targets for management and directors.
- Using analytical procedures to identify any unusual or unexpected relationships.

We communicated identified fraud risks throughout the audit team and remained alert to any indications of fraud throughout the audit.

As required by auditing standards and taking into account possible pressures to meet profit targets and our overall knowledge of the control environment, we perform procedures to address the risk of management override of controls, and the risk of fraudulent revenue recognition, in particular the risk that the EIR adjustment on interest income may be misstated and the risk that group management may be in a position to make inappropriate accounting entries and the risk of bias in accounting estimates and judgements, including the recoverablility of goodwill and loan loss provisioning.

We performed procedures including:

- Identifying journal entries to test based on risk criteria and comparing the identified entries to supporting documentation
- Assessing significant accounting estimates for bias

Identifying and responding to risks of material misstatement due to non-compliance with laws and regulations

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience, through discussion with the directors and other management (as required by auditing standards), and from inspection of the Group's regulatory and legal correspondence and discussed with the directors and other management the policies and procedures regarding compliance with laws and regulations.

As the Group is regulated, our assessment of risks involved gaining an understanding of the control environment including the entity's procedures for complying with regulatory requirements.

We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the Group is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies legislation), distributable profits legislation and taxation legislation and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Group is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of the Group's licence to operate. We identified the following areas as those most likely to have such an effect: specific areas of regulatory capital and liquidity, conduct, money laundering and financial crime and certain aspects of company legislation recognising the financial and regulated nature of the Group's activities. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. Therefore if a breach of operational regulations is not disclosed to us or evident from relevant correspondence, an audit will not detect that breach.

Context of the ability of the audit to detect fraud or breaches of law or regulation

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it.

In addition, as with any audit, there remained a higher risk of non-detection of fraud, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. Our audit procedures are designed to detect material misstatement. We are not responsible for preventing non-compliance or fraud and cannot be expected to detect non-compliance with all laws and regulations.

6. 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
- in our opinion those reports have been prepared in accordance with the Companies Act 2006

Directors' remuneration report

In our opinion the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Disclosures of emerging and principal risks and longer-term viability

We are required to perform procedures to identify whether there is a material inconsistency between the directors' disclosures in respect of emerging and principal risks and the viability statement, and the financial statements and our audit knowledge.

Based on those procedures, we have nothing material to add or draw attention to in relation to:

- the directors' confirmation within 'Future Prospects' section (A5) that they have carried out a robust assessment of the emerging and principal risks facing the Group, including those that would threaten its business model, future performance, solvency and liquidity
- the Principal Risks disclosures describing these risks and how emerging risks are identified, and explaining how they are being managed and mitigated

- 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.

We are also required to review the Viability Statement set out on pages 54 to 56 under the Listing Rules. Based on the above procedures, we have concluded that the above disclosures are materially consistent with the financial statements and our audit knowledge.

Our work is limited to assessing these matters in the context of only the knowledge acquired during our financial statements audit. As we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of anything to report on these statements is not a guarantee as to the Group's and Company's longer-term viability.

Corporate governance disclosures

We are required to perform procedures to identify whether there is a material inconsistency between the directors' corporate governance disclosures and the financial statements and our audit knowledge.

Based on those procedures, we have concluded that each of the following is materially consistent with the financial statements and our audit knowledge:

- 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
- the section of the annual report describing the work of the Audit Committee, including the significant issues that the Audit Committee considered in relation to the financial statements, and how these issues were addressed
- the section of the annual report that describes the review of the effectiveness of the Group's risk management and internal control systems

We are required to review the part of the Corporate Governance Statement relating to the Group's compliance with the provisions of the UK Corporate Governance Code specified by the Listing Rules for our review. We have nothing to report in this respect.

7. 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.

8. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out in Section B10, the directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and Parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the Parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or 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 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.

9. 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 Ryder (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
66 Queen Square
Bristol
BS1 4BE
7 December 2021

During Black History Month in October, we were proud to exhibit work by artist Olivia Glasgow at our Head Office in Solihull.

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

P174 **D1. Primary Financial Statements**

P174 D1.1 Consolidated statement of profit or loss

P175 D1.2 Consolidated statement of comprehensive income

P176 D1.3 Consolidated balance sheet

P177 D1.4 Company balance sheet

P178 D1.5 Consolidated cash flow statement

P178 D1.6 Company cash flow statement

P179 D1.7 Consolidated statement of movements in equity

P180 D1.8 Company statement of movements in equity

P181 **D2. Notes to the Accounts**

P181 D2.1 Analysis

P245 D2.2 Employment costs

P257 D2.3 Capital and financial risk

P283 D2.4 Basis of preparation

D1. Primary Financial Statements

D1.1 Consolidated statement of profit or loss

For the year ended 30 September 2021

	Note	2021 £m	2021 £m	2020 £m	2020 £m
Interest receivable	*4*		**484.2**		491.7
Interest payable and similar charges	*5*		**(173.7)**		(213.6)
Net interest income			**310.5**		278.1
Other leasing income	*6*	**20.4**		19.2	
Related costs	*6*	**(16.9)**		(16.2)	
Net operating lease income		**3.5**		3.0	
Other income	*7*	**10.9**		14.0	
Other operating income			**14.4**		17.0
Total operating income			**324.9**		295.1
Operating expenses	*8*		**(135.4)**		(126.8)
Provisions for losses	*18*		**4.7**		(48.3)
Operating profit before fair value items			**194.2**		120.0
Fair value net gains / (losses)	*10*		**19.5**		(1.6)
Operating profit being profit on ordinary activities before taxation			**213.7**		118.4
Tax charge on profit on ordinary activities	*11*		**(49.2)**		(27.1)
Profit on ordinary activities after taxation for the financial year			**164.5**		91.3

	Note	2021	2020
Earnings per share			
- basic	*13*	**65.2p**	36.0p
- diluted	*13*	**63.0p**	35.6p

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 2021

	Note	**2021**	**2021**	2020	2020
		£m	**£m**	£m	£m
Profit for the year			**164.5**		91.3
Other comprehensive income					
Items that will not be reclassified subsequently to profit or loss					
Actuarial gain / (loss) on pension scheme	*52*	**8.2**		(7.4)	
Tax thereon		**(0.9)**		2.1	
			7.3		(5.3)
Items that may be reclassified subsequently to profit or loss					
Cash flow hedge (losses) taken to equity	*19*	**(3.0)**		(0.6)	
Tax thereon		**0.5**		0.1	
			(2.5)		(0.5)
Other comprehensive income / (expenditure) for the year net of tax			**4.8**		(5.8)
Total comprehensive income for the year			**169.3**		85.5

D1.3 Consolidated balance sheet

30 September 2021

	Note	**2021**	2020	2019
		£m	£m	£m
Assets				
Cash – central banks	*14*	**1,142.0**	1,637.1	816.4
Cash – retail banks	*14*	**218.1**	287.9	409.0
Loans to customers	*15*	**13,408.2**	12,741.1	12,250.3
Derivative financial assets	*19*	**44.2**	463.3	592.4
Sundry assets	*20*	**69.2**	128.0	92.8
Current tax assets	*36*	**-**	5.7	-
Deferred tax assets	*21*	**14.4**	6.2	6.2
Property, plant and equipment	*22*	**70.4**	66.1	57.3
Intangible assets	*23*	**170.5**	170.1	171.1
Total assets		**15,137.0**	15,505.5	14,395.5
Liabilities				
Short-term bank borrowings		**0.3**	0.4	1.0
Retail deposits	*26*	**9,297.4**	7,867.0	6,395.8
Derivative financial liabilities	*19*	**43.9**	132.4	80.5
Asset backed loan notes	*27*	**516.0**	3,270.5	4,419.4
Secured bank borrowings	*28*	**730.0**	657.8	787.5
Retail bond issuance	*29*	**237.1**	296.8	296.5
Corporate bond issuance	*30*	**149.0**	149.8	149.6
Central bank facilities	*31*	**2,819.0**	1,854.4	994.4
Sundry liabilities	*32*	**90.7**	100.0	112.7
Current tax liabilities	*36*	**1.4**	-	15.2
Retirement benefit obligations	*52*	**10.3**	20.4	34.5
Total liabilities		**13,895.1**	14,349.5	13,287.1
Called up share capital	*37*	**262.5**	261.8	261.6
Reserves	*38*	**1,056.1**	932.0	887.3
Own shares	*39*	**(76.7)**	(37.8)	(40.5)
Total equity		**1,241.9**	1,156.0	1,108.4
Total liabilities and equity		**15,137.0**	15,505.5	14,395.5

Approved by the Board of Directors on 7 December 2021.

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 2021

	Note	2021	2020	2019
		£m	£m	£m
Assets				
Cash – retail banks	*14*	**19.6**	12.6	14.1
Sundry assets	*20*	**73.1**	84.6	107.3
Current tax assets	*36*	**-**	-	2.8
Property, plant and equipment	*22*	**16.0**	17.4	-
Investment in subsidiary undertakings	*25*	**978.5**	1,030.1	940.7
Total assets		**1,087.2**	1,144.7	1,064.9
Liabilities				
Retail bond issuance	*29*	**237.1**	296.8	296.5
Corporate bond issuance	*30*	**149.0**	149.8	149.6
Sundry liabilities	*32*	**41.9**	43.1	27.4
Deferred tax liabilities	*21*	**1.8**	1.8	1.6
Total liabilities		**429.8**	491.5	475.1
Called up share capital	*37*	**262.5**	261.8	261.6
Reserves	*38*	**455.6**	414.4	351.2
Own shares	*39*	**(60.7)**	(23.0)	(23.0)
Total equity		**657.4**	653.2	589.8
		1,087.2	1,144.7	1,064.9

Approved by the Board of Directors on 7 December 2021.

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 2021

	Note	**2021**	2020
		£m	£m
Net cash generated by operating activities	*41*	**878.1**	1,028.7
Net cash (utilised) by investing activities	*42*	**(4.3)**	(2.8)
Net cash (utilised) by financing activities	*43*	**(1,438.6)**	(325.7)
Net (decrease) / increase in cash and cash equivalents		**(564.8)**	700.2
Opening cash and cash equivalents		**1,924.6**	1,224.4
Closing cash and cash equivalents		**1,359.8**	1,924.6
Represented by balances within:			
Cash	*14*	**1,360.1**	1,925.0
Short-term bank borrowings		**(0.3)**	(0.4)
		1,359.8	1,924.6

D1.6 Company cash flow statement

For the year ended 30 September 2021

	Note	**2021**	2020
		£m	£m
Net cash generated by operating activities	*41*	**115.9**	129.8
Net cash (utilised) by investing activities	*42*	**47.3**	(94.7)
Net cash (utilised) by financing activities	*43*	**(156.2)**	(36.6)
Net increase / (decrease) in cash and cash equivalents		**7.0**	(1.5)
Opening cash and cash equivalents		**12.6**	14.1
Closing cash and cash equivalents		**19.6**	12.6
Represented by balances within:			
Cash	*14*	**19.6**	12.6
Short-term bank borrowings		-	-
		19.6	12.6

D1.7 Consolidated statement of movements in equity

For the year ended 30 September 2021

	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	-	-	-	-	-	**164.5**	-	**164.5**
Other comprehensive income	-	-	-	-	**(2.5)**	**7.3**	-	**4.8**
Total comprehensive income	-	-	-	-	**(2.5)**	**171.8**	-	**169.3**
Transactions with owners								
Dividends paid (note 40)	-	-	-	-	-	**(54.6)**	-	**(54.6)**
Own shares purchased	-	-	-	-	-	-	**(42.2)**	**(42.2)**
Exercise of share awards	**0.7**	**1.4**	-	-	-	**(3.3)**	**3.3**	**2.1**
Charge for share based remuneration (note 49)	-	-	-	-	-	**8.9**	-	**8.9**
Tax on share based remuneration	-	-	-	-	-	**2.4**	-	**2.4**
Net movement in equity in the year	**0.7**	**1.4**	-	-	**(2.5)**	**125.2**	**(38.9)**	**85.9**
Opening equity	**261.8**	**68.7**	**50.3**	**(70.2)**	**2.5**	**880.7**	**(37.8)**	**1,156.0**
Closing equity	**262.5**	**70.1**	**50.3**	**(70.2)**	-	**1,005.9**	**(76.7)**	**1,241.9**

For the year ended 30 September 2020

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Cash flow hedging reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m
Transactions arising from								
Profit for the year	-	-	-	-	-	91.3	-	91.3
Other comprehensive income	-	-	-	-	(0.5)	(5.3)	-	(5.8)
Total comprehensive income	-	-	-	-	(0.5)	86.0	-	85.5
Transactions with owners								
Dividends paid (note 40)	-	-	-	-	-	(35.9)	-	(35.9)
Own shares purchased	-	-	-	-	-	-	(5.2)	(5.2)
Exercise of share awards	0.2	0.4	-	-	-	(7.7)	7.9	0.8
Charge for share based remuneration (note 49)	-	-	-	-	-	2.7	-	2.7
Tax on share based remuneration	-	-	-	-	-	(0.3)	-	(0.3)
Net movement in equity in the year	0.2	0.4	-	-	(0.5)	44.8	2.7	47.6
Opening equity	261.6	68.3	50.3	(70.2)	3.0	835.9	(40.5)	1,108.4
Closing equity	261.8	68.7	50.3	(70.2)	2.5	880.7	(37.8)	1,156.0

D1.8 Company statement of movements in equity

For the year ended 30 September 2021

	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	-	-	-	-	**85.5**	-	**85.5**
Other comprehensive income	-	-	-	-	-	-	-
Total comprehensive income	-	-	-	-	**85.5**	-	**85.5**
Transactions with owners							
Dividends paid (note 40)	-	-	-	-	**(54.6)**	-	**(54.6)**
Own shares purchased	-	-	-	-	-	**(37.7)**	**(37.7)**
Exercise of share awards	**0.7**	**1.4**	-	-	-	-	**2.1**
Charge for share based remuneration (note 49)	-	-	-	-	**8.9**	-	**8.9**
Net movement in equity in the year	**0.7**	**1.4**	-	-	**39.8**	**(37.7)**	**4.2**
Opening equity	**261.8**	**68.7**	**50.3**	**(23.7)**	**319.1**	**(23.0)**	**653.2**
Closing equity	**262.5**	**70.1**	**50.3**	**(23.7)**	**358.9**	**(60.7)**	**657.4**

For the year ended 30 September 2020

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m
Transactions arising from							
Profit for the year	-	-	-	-	96.0	-	96.0
Other comprehensive income	-	-	-	-	-	-	-
Total comprehensive income	-	-	-	-	96.0	-	96.0
Transactions with owners							
Dividends paid (note 40)	-	-	-	-	(35.9)	-	(35.9)
Own shares purchased	-	-	-	-	-	-	-
Exercise of share awards	0.2	0.4	-	-	-	-	0.6
Charge for share based remuneration (note 49)	-	-	-	-	2.7	-	2.7
Net movement in equity in the year	0.2	0.4	-	-	62.8	-	63.4
Opening equity	261.6	68.3	50.3	(23.7)	256.3	(23.0)	589.8
Closing equity	261.8	68.7	50.3	(23.7)	319.1	(23.0)	653.2

D2. Notes to the Accounts

For the year ended 30 September 2021

1. General information

Paragon Banking Group PLC is a company domiciled in the United Kingdom and incorporated in England and Wales under the Companies Act 2006 with company number 2336032. The address of the registered office is 51 Homer Road, Solihull, West Midlands, B91 3QJ. The nature of the Group's operations and its principal activities are set out in the Strategic Report in Section A2.

These financial statements are presented in pounds sterling, which is the currency of the economic environment in which the Group operates.

The remaining notes to the accounts are organised into four sections:

- Analysis – providing further analysis and information on the amounts shown in the primary financial statements
- Employment costs – providing information on employee and key management remuneration arrangements including share schemes and pension arrangements
- Capital and Financial Risk – providing information on the Group's management of operational and regulatory capital and its principal financial risks
- Basis of preparation – providing details of the Group's accounting policies and of how they have been applied in the preparation of the financial statements

D2.1 Notes to the Accounts – Analysis

For the year ended 30 September 2021

The notes set out below give more detailed analysis of the balances shown in the primary financial statements and further information on how they relate to the operations, results and financial position of the Group and the Company.

2. Segmental information

The Group analyses its operations, both for internal management reporting and external financial reporting, on the basis of the markets from which its assets are generated. The segments used are described below:

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

Dedicated financing and administration costs of each of these businesses are allocated to the segment. Shared central costs are not allocated between segments, nor is income from central cash balances or the carrying costs of unallocated savings balances.

Gains on derecognition of financial assets have not been allocated to segment results.

Loans to customers and operating lease assets are allocated to segments as are dedicated securitisation funding arrangements and their related cross-currency basis swaps and cash balances.

Retail deposits and their related costs are allocated to the segments based on the utilisation of those deposits. Retail deposits raised in advance of lending are not allocated.

Other assets and liabilities are not allocated between segments.

All 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 2021

	Mortgage Lending	Commercial Lending	Idem Capital	Unallocated items	Total Segments
	£m	£m	£m	£m	£m
Interest receivable	**345.8**	**114.2**	**22.7**	**1.5**	**484.2**
Interest payable	**(126.6)**	**(19.7)**	**(2.5)**	**(24.9)**	**(173.7)**
Net interest income	**219.2**	**94.5**	**20.2**	**(23.4)**	**310.5**
Other operating income	**6.1**	**8.0**	**0.3**	**-**	**14.4**
Total operating income	**225.3**	**102.5**	**20.5**	**(23.4)**	**324.9**
Operating expenses	**(17.4)**	**(23.9)**	**(5.1)**	**(89.0)**	**(135.4)**
Provisions for losses	**5.9**	**(2.9)**	**1.7**	**-**	**4.7**
	213.8	**75.7**	**17.1**	**(112.4)**	**194.2**

Year ended 30 September 2020

	Mortgage Lending	Commercial Lending	Idem Capital	Unallocated items	Total Segments
	£m	£m	£m	£m	£m
Interest receivable	344.9	112.9	30.4	3.5	491.7
Interest payable	(154.9)	(30.8)	(4.3)	(23.6)	(213.6)
Net interest income	190.0	82.1	26.1	(20.1)	278.1
Other operating income	6.5	9.9	0.6	-	17.0
Total operating income	196.5	92.0	26.7	(20.1)	295.1
Operating expenses	(16.4)	(24.4)	(6.3)	(79.7)	(126.8)
Provisions for losses	(25.8)	(21.7)	(0.8)	-	(48.3)
	154.3	45.9	19.6	(99.8)	120.0

The segmental profits disclosed above reconcile to the group results as shown below.

	2021	2020
	£m	£m
Results shown above	**194.2**	120.0
Fair value items	**19.5**	(1.6)
Operating profit	**213.7**	118.4

The assets and liabilities attributable to each of the segments at 30 September 2021, 30 September 2020 and 30 September 2019 on the basis described above were:

	Note	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Total Segments £m
30 September 2021					
Segment assets					
Loans to customers	*15*	**11,608.7**	**1,568.8**	**225.2**	**13,402.7**
Operating lease assets	*22*	**-**	**39.3**	**-**	**39.3**
Cross-currency basis swaps	*19*	**-**	**-**	**-**	**-**
Securitisation cash	*14*	**123.3**	**-**	**-**	**123.3**
		11,732.0	**1,608.1**	**225.2**	**13,565.3**
Segment liabilities					
Allocated deposits		**10,759.0**	**1,896.9**	**188.5**	**12,844.4**
Securitisation funding		**1,246.0**	**-**	**-**	**1,246.0**
		12,005.0	**1,896.9**	**188.5**	**14,090.4**

	Note	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Total Segments £m
30 September 2020					
Segment assets					
Loans to customers	15	10,819.5	1,514.8	297.1	12,631.4
Operating lease assets	22	-	39.5	-	39.5
Cross-currency basis swaps	19	445.3	-	-	445.3
Securitisation cash	14	223.4	-	-	223.4
		11,488.2	1,554.3	297.1	13,339.6
Segment liabilities					
Allocated deposits		7,692.2	1,882.2	236.1	9,810.5
Securitisation funding		3,928.3	-	-	3,928.3
		11,620.5	1,882.2	236.1	13,738.8

	Note	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Total Segments £m
30 September 2019					
Segment assets					
Loans to customers	*15*	10,344.1	1,452.1	389.9	12,186.1
Operating lease assets	*22*	-	36.3	-	36.3
Cross-currency basis swaps		582.7	-	-	582.7
Securitisation cash	*14*	353.1	-	-	353.1
		11,279.9	1,488.4	389.9	13,158.2
Segment liabilities					
Allocated deposits		5,367.2	1,822.5	303.1	7,492.8
Securitisation funding		5,206.9	-	-	5,206.9
		10,574.1	1,822.5	303.1	12,699.7

An analysis of the Group's financial assets by type and segment is shown in note 15. All 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 £13.0m (2020: £12.9m) in assets held for leasing under operating leases. These are 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.

	2021	2020
	£m	£m
Total segment assets	**13,565.3**	13,339.6
Unallocated assets		
Central cash and investments	**1,236.8**	1,701.6
Unallocated derivatives	**44.2**	18.0
Operational property, plant and equipment	**31.1**	26.6
Intangible assets	**170.5**	170.1
Other	**89.1**	249.6
Total assets	**15,137.0**	15,505.5

	2021	2020
	£m	£m
Total segment liabilities	**14,090.4**	13,738.8
Unallocated liabilities		
Unallocated retail deposits	**(3,544.0)**	(1,953.9)
Derivative financial instruments	**43.9**	132.4
Central borrowings	**3,205.4**	2,301.4
Tax liabilities	**1.4**	-
Retirement benefit obligations	**10.3**	20.4
Other	**87.7**	110.4
Total liabilities	**13,895.1**	14,349.5

3. Revenue

	Note	**2021**	2020
		£m	£m
Interest receivable	*4*	**484.2**	491.7
Operating lease income	*6*	**20.4**	19.2
Other income	*7*	**10.9**	14.0
Total revenue		**515.5**	524.9
Arising from:			
Mortgage Lending		**351.9**	351.4
Commercial Lending		**139.1**	139.0
Idem Capital		**23.0**	31.0
Total revenue from segments		**514.0**	521.4
Unallocated revenue		**1.5**	3.5
Total revenue		**515.5**	524.9

4. Interest receivable

	2021 £m	2020 £m
Interest receivable in respect of		
Loans and receivables	**440.0**	440.4
Finance leases	**40.4**	44.3
Factoring income	**2.3**	2.4
Interest on loans to customers	**482.7**	487.1
Other interest receivable	**1.5**	4.6
Total interest on financial assets	**484.2**	491.7

The above interest arises from:

	2021 £m	2020 £m
Financial assets held at amortised cost	**443.8**	447.4
Finance leases	**40.4**	44.3
	484.2	491.7

5. Interest payable and similar charges

	Note	2021 £m	2020 £m
On retail deposits		**120.5**	129.7
On asset backed loan notes		**17.9**	42.2
On bank loans and overdrafts		**6.6**	5.4
On corporate bonds		**9.3**	10.9
On retail bonds		**15.4**	18.5
On central bank facilities		**2.2**	4.5
On repurchase agreements		**0.1**	-
Total interest on financial liabilities		**172.0**	211.2
On pension scheme deficit	*52*	**0.3**	0.4
Discounting on contingent consideration	*33*	**0.3**	0.4
Discounting on lease liabilities		**0.2**	0.2
Other finance costs		**0.9**	1.4
		173.7	213.6

All interest payable on financial liabilities relates to financial liabilities carried at amortised cost.

6. Net operating lease income

	Note	2021 £m	2020 £m
Income			
Operating lease rentals		**15.2**	14.5
Maintenance income		**5.2**	4.7
Total operating lease income		**20.4**	19.2
Costs			
Depreciation of lease assets	*22*	**(8.9)**	(8.3)
Maintenance salaries	*49*	**(2.3)**	(2.1)
Other maintenance costs		**(5.7)**	(5.8)
Total operating lease costs		**(16.9)**	(16.2)
Net operating lease income		**3.5**	3.0

7. Other income

	2021 £m	2020 £m
Loan account fee income	**5.1**	5.7
Broker commissions	**1.9**	1.7
Third party servicing	**3.5**	5.0
Other income	**0.4**	1.6
	10.9	14.0

All loan account fee income arises from financial assets held at amortised cost.

8. Operating expenses

	Note	2021 £m	2020 £m
Employment costs	*49*	**87.9**	77.6
Auditor remuneration	*9*	**2.3**	2.0
Amortisation of intangible assets	*23*	**2.0**	2.0
Depreciation of operational assets	*22*	**4.3**	3.5
Other administrative costs		**38.9**	41.7
		135.4	126.8

The Group incurred no costs in respect of short-term operating leases in the year (2020: none).

9. 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.

	2021	2020
	£m	£m
Audit fee of the company	**0.7**	0.5
Other services		
Audit of subsidiary undertakings pursuant to legislation	**1.0**	1.0
Total audit fees	**1.7**	1.5
Audit related assurance services		
Interim review	**0.2**	0.1
Other	-	0.1
Total fees	**1.9**	1.7
Irrecoverable VAT	**0.4**	0.3
Total cost to the Group (note 8)	**2.3**	2.0

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.

10. Fair value net gains / (losses)

	2021	2020
	£m	£m
Ineffectiveness of fair value hedges (note 19)		
Portfolio hedges of interest rate risk		
Deposit hedge	**(0.3)**	0.2
Loan hedge	**6.6**	0.1
	6.3	0.3
Ineffectiveness of cash flow hedges	-	-
Other hedging movements	**9.9**	(2.9)
Net gains / (losses) on other derivatives	**3.3**	1.0
	19.5	(1.6)

The fair value net gain / (loss) represents the accounting volatility on derivative instruments which are matching risk exposures 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.

11. Tax charge on profit on ordinary activities

(a) Analysis of charge in the year

	2021	2020
	£m	£m
Current tax		
UK Corporation Tax on profits of the period	**54.4**	25.5
Adjustment in respect of prior periods	**1.7**	0.5
Total current tax	**56.1**	26.0
Deferred tax	**(6.9)**	1.1
Tax charge on profit on ordinary activities	**49.2**	27.1

The standard rate of corporation tax in the UK applicable to the Group in the year was 19.0% (2020: 19.0%), based on currently enacted legislation. During the year ended 30 September 2020, legislation was substantively enacted reversing the reduction in the tax rate to 17.0% which had been due to come into effect from April 2020. The effects of the increases in the standard rate for the year ended 30 September 2020 from 18.0% to 19.0%, and the expected rate in subsequent years from 17.0% to 19.0% on deferred tax balances were accounted for in the year ended 30 September 2020.

During the current financial year, the UK Government enacted legislation increasing the standard rate of corporation tax in the UK to 25.0% from April 2023. The impact of this change on deferred tax balances has been accounted for in these accounts.

The Bank Corporation Tax Surcharge subjects any taxable profits arising in the Group's banking subsidiary, Paragon Bank PLC (and no other Group entity), to an additional 8.0% of tax to the extent these profits exceed £25.0m. The effect of the surcharge shown in note (c) below.

When the increase in UK corporation tax to 25% with effect from 1 April 2023 was announced, the UK Government also announced that they would be undertaking a review of the Banking Surcharge. In October 2021 the UK Government announced its intention to reduce the level of the Banking Surcharge from 8% to 3% and increase the threshold above which it applies from £25.0m to £100.0m with effect from 1 April 2023. However this change had not been legislated for at the year end and hence temporary differences in Paragon Bank PLC which are expected to reverse in the year ending 30 September 2023 and thereafter have been recognised on the basis of a tax rate of up to 33%, notwithstanding the anticipated legislative changes.

(b) Deferred tax (credit) / charge for the year

The deferred tax (credit) / charge in the income statement comprises the following temporary differences:

	2021	2020
	£m	£m
Accelerated tax depreciation	**(2.1)**	(0.4)
Retirement benefit obligations	**1.3**	1.2
Loans and derivatives	**(4.1)**	1.4
Share based payments	**(1.5)**	0.5
Utilisation / (creation) of tax losses	**0.9**	(0.9)
Other timing differences	**(0.4)**	(0.3)
Deferred tax (credit) / charge for the year	**(5.9)**	1.5
Prior period adjustment	**(1.0)**	(0.4)
Deferred tax (credit) / charge (note 21)	**(6.9)**	1.1

Classifications of deferred tax movements have been reanalysed in the year to provide better information to users. The disclosure for 2020 shown above has been restated for comparison.

The expected impact on deferred tax balances of the increase in the rate of UK Corporation Tax to 25.0% from April 2023 is included in the charge for the current year.

The expected impact on deferred tax balances of the withdrawal of the reduction in the rate of Corporation Tax to 17.0% described above was accounted for in the year ended 30 September 2020, the effect of the expected change having been accounted for when originally enacted.

(c) Factors affecting tax charge for the year

Accounting standards require companies to explain the relationship between tax expense and accounting profit. This may be demonstrated by reconciling the tax charge to the product of the accounting profit and the 'applicable rate', generally the domestic rate of tax levied on corporate income in the jurisdiction in which the entity operates.

The Group operates wholly in the UK and all the Group's income arises in UK resident companies. Consequently, it is appropriate to use the prevailing UK corporation tax rate as the comparator to the effective tax rate. As noted in (a) above, the UK corporation tax rate applicable to the Group for the year was 19.0% (2020: 19.0%).

The impact of the Banking Surcharge is shown as a difference between tax at this rate and the actual tax charge in the table below.

	2021	2020
	£m	£m
Profit on ordinary activities before taxation	**213.7**	118.4
Profit on ordinary activities multiplied by the UK standard rate of corporation tax	**40.6**	22.5
Effects of:		
Permanent differences		
Recurring disallowable expenditure and similar items	**(1.1)**	0.1
Mismatch in timing differences	**(0.3)**	0.2
Change in rate of taxation on deferred tax assets and liabilities	**(0.5)**	0.1
Bank Corporation Tax Surcharge	**9.7**	4.0
Prior year charge	**0.8**	0.2
Tax charge for the year	**49.2**	27.1

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.

Had the reduction in the Bank Surcharge referred to above been enacted at the same time as the other changes coming into force on 1 April 2023, the tax charge for the year would have been reduced by £0.5m, with a corresponding increase in the deferred tax asset.

(d) Factors affecting future tax charges

The impact of the increase in the standard rate of corporation tax in the UK means that the element of the Group's profit not subject to the Bank Surcharge will be taxed at a rate of 22% for the year ending 30 September 2023 and 25% thereafter. The Group's overall future effective tax rate will also be impacted by the future level of the Surcharge and by the proportion of its taxable profit subject to it, with the proposed reduction in the surcharge and increase in the threshold at which it applies likely to narrow the differential between the Group's effective tax rate and the standard rate of corporation tax.

The Group includes various asset leasing businesses within its Commercial Lending division. Whilst such businesses do not, in general, have significant permanent differences, the taxable profits in a given accounting period are usually significantly different from the accounting profits due to temporary differences. As taxable profits arising in 2022,2023 and 2024 will be taxed at 19%, 22% and 25% respectively and new temporary differences will arise in those periods, there will be some volatility in the effective tax rate over this period.

At the balance sheet date there were no material tax uncertainties and no significant open matters with the UK tax authorities. The Group has no material exposure to any other tax jurisdiction.

As a wholly UK based business the Group does not expect to be significantly impacted by the OECD project on Base Erosion and Profit Shifting ('BEPS').

12. Profit attributable to members of Paragon Banking Group PLC

The Company's profit after tax for the financial year amounted to £85.5m (2020: £96.0m). A separate income statement has not been prepared for the Company under the provisions of section 408 of the Companies Act 2006.

The Company has no other items of comprehensive income for the years ended 30 September 2021 or 30 September 2020.

13. Earnings per share

Earnings per ordinary share is calculated as follows:

	2021	2020
Profit for the year (£m)	**164.5**	91.3
Basic weighted average number of ordinary shares ranking for dividend during the year (million)	**252.3**	253.6
Dilutive effect of the weighted average number of share options and incentive plans in issue during the year (million)	**8.9**	2.5
Diluted weighted average number of ordinary shares ranking for dividend during the year (million)	**261.2**	256.1
Earnings per ordinary share		
- basic	**65.2p**	36.0p
- diluted	**63.0p**	35.6p

14. Cash and cash equivalents

'Cash and Cash Equivalents' includes current bank balances, money market placements and fixed rate sterling term deposits with London banks, and balances with the Bank of England. It is analysed as set out below.

	2021	2020	2019
	£m	£m	£m
Deposits with the Bank of England	**1,142.0**	1,637.1	816.4
Balances with central banks	**1,142.0**	1,637.1	816.4
Deposits with other banks	**218.1**	287.9	409.0
Balances with other banks	**218.1**	287.9	409.0
Cash and cash equivalents	**1,360.1**	1,925.0	1,225.4

Not all of the Group's cash is immediately available for its general purposes, including liquidity management. Cash received in respect of loan assets funded through warehouse facilities and securitisations is not immediately available, due to the terms of those arrangements.

Cash held by the Trustee of the Group's employee share ownership plan ('ESOP') may only be used to invest in the shares of the Company, pursuant to the aims of that plan.

The total consolidated 'Cash and Cash Equivalents' balance may be analysed as shown below.

	2021	2020	2019
	£m	£m	£m
Available cash	**1,236.5**	1,701.1	872.1
Securitisation cash	**123.3**	223.4	353.1
ESOP cash	**0.3**	0.5	0.2
	1,360.1	1,925.0	1,225.4

The 'Cash and Cash Equivalents' amount of £19.6m (2020: £12.6m, 2019: £14.1m) shown in the Company balance sheet is not subject to restrictions.

Cash and cash equivalents are classified as Stage 1 exposures (see note 18) for the purposes of impairment provisioning. The probabilities of default have been assessed to be so low as to require no significant impairment provision.

15. Loans to customers

	Note	**2021**	2020	2019
		£m	£m	£m
Loan accounts	*16*	**12,682.4**	11,907.0	11,394.3
Finance lease receivables	*17*	**720.3**	724.4	791.8
Loans to customers		**13,402.7**	12,631.4	12,186.1
Fair value adjustments from portfolio hedging	*19*	**5.5**	109.7	64.2
		13,408.2	12,741.1	12,250.3

The Group's loans to customers at 30 September 2021, analysed between the segments described in note 2 are as follows:

	Mortgage Lending	**Commercial Lending**	**Idem Capital**	**Total**
	£m	**£m**	**£m**	**£m**
At 30 September 2021				
First mortgages	**11,460.6**	**-**	**-**	**11,460.6**
Consumer loans	**148.1**	**-**	**220.9**	**369.0**
Motor finance	**-**	**224.9**	**4.3**	**229.2**
Asset finance	**-**	**468.7**	**-**	**468.7**
Development finance	**-**	**608.2**	**-**	**608.2**
Other commercial loans	**-**	**267.0**	**-**	**267.0**
Loans to customers	**11,608.7**	**1,568.8**	**225.2**	**13,402.7**

	Mortgage Lending	**Commercial Lending**	**Idem Capital**	**Total**
	£m	**£m**	**£m**	**£m**
At 30 September 2020				
First mortgages	10,636.9	-	-	10,636.9
Consumer loans	182.6	-	281.6	464.2
Motor finance	-	256.9	15.5	272.4
Asset finance	-	478.0	-	478.0
Development finance	-	609.0	-	609.0
Other commercial loans	-	170.9	-	170.9
Loans to customers	10,819.5	1,514.8	297.1	12,631.4

	Mortgage Lending	**Commercial Lending**	**Idem Capital**	**Total**
	£m	**£m**	**£m**	**£m**
At 30 September 2019				
First mortgages	10,172.5	-	-	10,172.5
Consumer loans	171.6	-	352.3	523.9
Motor finance	-	281.3	37.6	318.9
Asset finance	-	492.2	-	492.2
Development finance	-	506.5	-	506.5
Other commercial loans	-	172.1	-	172.1
Loans to customers	10,344.1	1,452.1	389.9	12,186.1

The Group's purchased loan portfolios are analysed below.

	2021	2020
	£m	£m
First mortgage loans	**13.4**	15.0
Consumer loans	**171.8**	220.3
Motor finance loans	**4.3**	15.5
	189.5	250.8

Information on the Estimated Remaining Collections ('ERCs'), the undiscounted forecast collectible amounts, for first mortgages and consumer loans is given in note 55. All other loans above are internally generated or arise from acquired operations.

16. Loan accounts

Loan accounts at 30 September 2021, 30 September 2020 and 30 September 2019, which are all denominated and payable in sterling, were:

	2021	2020	2019
	£m	£m	£m
First mortgage loans	**11,460.6**	10,636.9	10,172.5
Second charge mortgage loans	**281.7**	354.5	389.2
Other unsecured consumer loans	**87.3**	109.7	134.7
Development finance loans	**608.2**	609.0	506.5
Other secured commercial lending	**168.0**	134.4	125.9
Other commercial loans	**76.6**	62.5	65.5
	12,682.4	11,907.0	11,394.3

First mortgages are secured on residential property within the UK; second charge mortgage loans enjoy second charges on UK residential property.

Other secured commercial lending includes structured lending, aviation mortgages and invoice finance.

Other commercial loans includes principally professions finance, discounted receivables, term loans issued under the RLS, CBILS and BBLS schemes, and other short term commercial balances.

The amounts of the loan assets above pledged as collateral under the central bank facilities described in note 32 or under the securitisation and warehouse funding arrangements described in notes 28 and 29 are shown below. These include notes retained by the Group described in note 56. 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 2021				
In respect of:				
Asset backed loan notes	**2,414.5**	**-**	**-**	**2,414.5**
Warehouse facilities	**1,041.1**	**-**	**-**	**1,041.1**
Central bank facilities	**2,901.0**	**-**	**-**	**2,901.0**
Total pledged as collateral	**6,356.6**	**-**	**-**	**6,356.6**
Prepositioned with Bank of England	**3,190.1**	**-**	**-**	**3,190.1**
Other assets not pledged as collateral	**1,913.9**	**369.0**	**852.8**	**3,135.7**
	11,460.6	**369.0**	**852.8**	**12,682.4**

	First Mortgages	Consumer Finance	Other	Total
	£m	£m	£m	£m
30 September 2020				
In respect of:				
Asset backed loan notes	4,106.5	-	-	4,106.5
Warehouse facilities	881.9	-	-	881.9
Central bank facilities	2,875.3	-	-	2,875.3
Total pledged as collateral	7,863.6	-	-	7,863.6
Prepositioned with Bank of England	1,072.3	-	-	1,072.3
Other assets not pledged as collateral	1,701.0	464.2	805.9	2,971.1
	10,636.9	464.2	805.9	11,907.0
30 September 2019				
In respect of:				
Asset backed loan notes	4,338.3	-	-	4,338.3
Warehouse facilities	948.1	-	-	948.1
Central bank facilities	1,734.4	-	-	1,734.4
Total pledged as collateral	7,020.8	-	-	7,020.8
Prepositioned with Bank of England	1,873.7	-	-	1,873.7
Other assets not pledged as collateral	1,278.0	523.9	697.9	2,499.8
	10,172.5	523.9	697.9	11,394.3

17. Finance lease receivables

The Group's finance leases can be analysed as shown below.

	2021	2020	2019
	£m	£m	£m
Motor finance	**229.2**	272.4	318.9
Asset finance	**440.5**	452.0	472.9
RLS and CBILS	**50.6**	-	-
Carrying value	**720.3**	724.4	791.8

With effect from 1 October 2019, the Group's finance leases have been accounted for in accordance with IFRS 16 (note 59). Balances shown at 30 September 2019 are accounted for in accordance with IAS 17, however both standards require the same accounting treatment.

The minimum lease payments due under these loan agreements are:

	2021	2020	2019
	£m	£m	£m
Amounts receivable			
Within one year	**255.5**	269.5	292.9
Within one to two years	**220.3**	221.5	256.8
Within two to three years	**164.8**	163.6	177.2
Within three to four years	**105.0**	104.1	101.6
Within four to five years	**50.5**	43.2	31.1
After five years	**41.6**	41.6	40.2
	837.7	843.5	899.8
Less: future finance income	**(96.3)**	(103.4)	(101.4)
Present value	**741.4**	740.1	798.4

The present values of those payments, net of provisions for impairment, carried in the accounts are:

	2021	2020	2019
	£m	£m	£m
Amounts receivable			
Within one year	**225.0**	236.5	255.8
Within two to five years	**480.2**	467.1	506.6
After five years	**36.2**	36.5	36.0
Present value	**741.4**	740.1	798.4
Allowance for uncollectible amounts	**(21.1)**	(15.7)	(6.6)
Carrying value	**720.3**	724.4	791.8

None of the Group's finance lease receivables were pledged as collateral for liabilities at 30 September 2021 or 30 September 2020.

18. Impairment provisions on loans to customers

This note sets out information on the Group's impairment provisioning under IFRS 9 for the loans to customers balances set out in note 15, including both finance leases, accounted for under IFRS 16, and loans held at amortised cost, accounted for under IFRS 9, as both groups of assets are subject to the IFRS 9 impairment requirements.

The disclosures are set out under the following headings:

(a) Basis of provision

(b) Impairments by stage and division

(c) Movements in impairment provision in the year

(d) Impairments charged to income

(e) Economic inputs to provision calculations

(f) Sensitivity analysis

(a) Basis of provision

IFRS 9 requires that impairment is evaluated on an expected credit loss ('ECL') basis. ECLs are based on an assessment of the probability of default ('PD') and loss given default ('LGD'), discounted to give a net present value. The estimation of ECL should be unbiased and probability weighted, considering all reasonable and supportable information, including forward looking economic assumptions and a range of possible outcomes. The provision may be based on either twelve month or lifetime ECL, dependent on whether an account has experienced a significant increase in credit risk ('SICR').

The Group's process for determining its provisions for impairments is summarised below. This includes:

i. The methods used for the calculation of ECL

ii. How it defines SICR

iii. How it defines default

iv. How it identifies which loans are credit impaired, as defined by IFRS 9

v. How the ECL estimation process is monitored and controlled

vi. How the Group develops and enhances the models it uses in the ECL estimation process

vii. How the Group uses post-model adjustments ('PMAs') to ensure all elements of credit risk are fully addressed

i) Calculation of expected credit loss ('ECL')

For the majority of the Group's loan assets, the ECL is generated using statistical models applied to account data to generate PD and LGD components.

PD on both a twelve month and lifetime basis is estimated based on statistical models for the Group's most significant asset classes. The PD calculation is a function of current asset performance, customer information and future economic assumptions. The structure of the models was derived through analysis of correlation in historic data, which identified which current and historical customer attributes and external economic variables were predictive of future loss. PD measures are calculated for the full contractual lives of loans with the models deriving probabilities that, at a given future date, a loan will be in default, performing or closed. The Group utilised all reasonably available information in its possession for this exercise.

LGD for each account is derived by calculating a value for exposure at the point of default (which will include consideration of future interest, account charges and receipts) and reducing this for security values, net of likely costs of recovery. These calculations allow for the Group's potential case management activities. This evaluation includes the potential impact of economic conditions at the time of any future default or enforcement. The derivation of the significant assumptions used in these calculations is discussed below.

In certain asset classes a fully modelled approach is not possible. This is generally where there are few assets in the class, where there is insufficient historical data on which to base an analysis or where certain measures, such as days past due are not useful (including cases where the loan agreement does not require regular payments of pre-determined amounts). In these cases, which represent a small proportion of the total portfolio, alternative approaches are adopted. These rely on internal credit monitoring practices and professional credit judgement.

Notwithstanding the mechanical procedures discussed above, the Group will always consider whether the process generates sufficient provision for particular loans, especially large exposures, and will provide additional amounts as appropriate.

In extreme or unprecedented economic conditions, such as the Covid pandemic, it is likely that mechanical models will be less predictive of outcomes as the historical data used for modelling will be insufficiently representative of present conditions. In these circumstances, management carefully review all outputs to ensure provision is adequate.

At 30 September 2021 the impact of reduced economic activity in the UK from the Covid crisis had not yet been evidenced in customer credit performance and defaults, due to the lagging effect of government policy interventions. Where customers were given payment reliefs, arrears and adverse credit indicators were not recorded by the Group or other lenders, meaning that both internal credit metrics and external credit bureau data might not accurately reflect the customer's credit position leading to modelled PDs being underestimated.

During the year the trend of economic performance has been generally upward, albeit from a low level, meaning that the principal economic indicators are more positive than at 30 September 2020, though still more depressed than pre-Covid levels. The economic forecasts indicate continued recovery, but this upward trend will reduce calculated probabilities of default, even where the absolute levels of metrics remain low and where underlying credit issues on accounts have not emerged, which may result in rising defaults as government support initiatives unwind.

These factors have led management to conclude that in the current economic conditions, the Group's models do not fully represent loss expectations, and PMA's have been made to compensate for these weaknesses.

ii) Significant Increase in Credit Risk ('SICR')

Under IFRS 9, SICR is not defined solely by account performance, but on the basis of the customer's overall credit position, and this evaluation should include consideration of external data. The Group's aim is to define SICR to correspond, as closely as possible, to that population of accounts which are subject to enhanced administrative and monitoring procedures operationally.

The Group assesses SICR in its modelled portfolios primarily on the basis of the relative difference in an account's lifetime PD between origination and the reporting date. The levels of difference required to qualify as a SICR may differ between portfolios and will depend, to some extent, on the level of risk originally perceived and are monitored on an ongoing basis to ensure that this calibrates with actual experience.

It should be noted that the use of the current PD, which includes external factors such as credit bureau data, means that all relevant information in the Group's hands concerning the customers' present credit position is included in the evaluation, as well as the impact of future economic expectations.

For non-modelled portfolios, the SICR assessment is based on the credit monitoring position of the account in question and for all portfolios a number of qualitative indicators which provide evidence of SICR have been considered.

In determining whether an account has a SICR in the Covid environment the granting of Covid related reliefs, including payment holidays and similar arrangements, may mean that a SICR may exist without this being reflected in either arrears performance or credit bureau data. The Group has accepted the advice of UK regulatory bodies that the grant of initial Covid relief did not, of itself, indicate a SICR, but has carefully considered internal credit and customer data to determine whether there might be any accounts with SICR not otherwise identified by the process.

When reviewing the subsequent payment patterns of accounts that have been granted Covid-related reliefs, it has been evident that there is higher payment volatility (both in terms of account improvement and deterioration) in these cases, particularly in cases where an extension to the payment holiday has been granted. This indicates an increased credit risk, though the impact is not significant in scale in all cases. As a result of this analysis the accounts of customers who have been granted extended payment reliefs have been placed in Stage 2, regardless of other indicators. This aligns the Group's approach to regulatory guidance which suggested that while initial payment reliefs should not automatically be taken as a indication of a SICR, an extension to such a relief was more likely to be so.

The effect of this override is to transfer accounts with gross balances of £599.8m (2020: £576.3m) to Stage 2. The additional provision on transfer is included within PMAs.

This overall approach remains consistent with that taken at 30 September 2020. In reviewing account performance during the current year the Group has not yet identified any positive evidence which would cause it to begin to unwind this position. It will be reviewed going forward as other government economic interventions are scaled back and the post-relief credit characteristics of such accounts become more evident.

iii) Definitions of default

As the IFRS 9 definition of ECL is based on PD, default must be defined for this purpose. The Group's definitions of default for its various portfolios are broadly aligned to its internal operational procedures and the regulatory definitions of default used internally. In particular the Group's receiver of rent cases are defined as defaulted for modelling purposes as the behaviour of the case after that point is significantly influenced by internal management decisions.

IFRS 9 provides a rebuttable presumption that an account is in default when it is 90 days overdue and this was used as the basis of the Group's definition. A combination of qualitative and quantitative measures were used in developing the definitions. These include account management activities and internal statuses.

iv) Credit Impaired loans

IFRS 9 defines a credit impaired account as one where an account has suffered one or more events which have had a detrimental effect on future cash flows. It is thus a backward-looking definition, rather than one based on future expectations.

Credit impaired assets are identified either through quantitative measures or by operational status. Designations of accounts for regulatory capital purposes are also taken into account. Assets may also be assigned to Stage 3 if they are identified as credit impaired as a result of management review processes.

All loans which are in the process of enforcement, from the point where this becomes the administration strategy, are classified as credit impaired.

Loans are retained in Stage 3 for three months after the point where they cease to exhibit the characteristics of default. After this point, they may move to Stage 2 or Stage 1 depending on whether a SICR trigger remains.

All default cases are considered to be credit impaired, including all receiver of rent cases and all cases with at least one payment more than 90 days overdue, even where such cases are being managed in the expectation of realising all of the carrying balance.

In order to provide better information for users, additional analysis of credit impaired accounts has been presented below distinguishing between probationary accounts, receiver of rent accounts, accounts subject to realisation / enforcement procedures and long term managed accounts, all of which are treated as credit impaired. While other indicators of default are in use, the categories shown account for the overwhelming majority of Stage 3 cases.

v) Monitoring of ECL estimation processes

The Group's ECL models are compiled on the basis of the analysis of relevant historical data. Before a model is adopted for use its operations and outputs are examined to ensure that it is expected to be appropriately predictive and, if it is an updated model, expected to be more predictive than any existing model. Before a new model is adopted the changes and impacts will be considered by the CFO, alongside any advice from the Group's independent model review functions.

The performance of all models is reviewed on an ongoing basis, by senior finance and risk management, including the CFO. Monitoring packs comparing actual and predicted loss levels are produced at regular intervals, set on the basis of the materiality of each model. The continuing appropriateness of model assumptions is also reviewed as part of this process.

Models are revisited on a regular basis to ensure that they continue to reflect the most recent data as the available information increases over time.

On a monthly basis all model outputs, model overlays and provisions calculated for non-modelled books are reviewed by senior finance management including the CFO in conjunction with the latest credit risk operational and economic metrics to ensure that the impairment provision by asset type remains appropriate. This exercise will be the subject of particular focus at year end and the half year.

This information is summarised for the Audit Committee on a biannual basis, and they have regard to this data in forming their conclusions on the appropriateness of provisioning levels.

vi) Model development

The models used by the Group are updated from time to time to allow for changes in the business, developments in best practice and the availability of additional data with the passing of time. During the year ended 30 September 2021 a major update to the buy-to-let PD model took place.

All revised models and model enhancements are carefully reviewed and tested before adoption, and are subject to a governance process for their approval.

As a result of the reanalysis of updated historical data, the economic inputs identified as most predictive of future PD performance were changed, with the UK unemployment rate being substituted for UK GDP in the model as the indicator of general UK economic activity levels.

The impacts of the adoption of the new PD model on the calculated provision were not significant.

vii) Post Model Adjustments ('PMA's)

Where management has identified a requirement to amend the calculated provision as a result of either model deficiencies or idiosyncratic behaviour in part of the portfolio, PMAs are applied to the modelled outputs so that the ECL recognised corresponds to expert judgement, taking into account the widest possible range of current information, which might not be factored into the modelling process.

In normal circumstances the Group's objective is to develop its modelling to the point where the level of PMAs required is minimal, but in economic conditions where previous relevant experience is limited or non-existent, as with Covid, some form of PMA is always likely to be necessary.

The current model behaviour and the potential for unobserved credit issues have meant that the requirement for such adjustments at 30 September 2021 was significant. Evidence considered by management included internal performance data, customer feedback, evidence on the wider economy and quantitative and qualitative data and statements from industry, government and regulatory bodies. These were combined to form a broad estimate of the level of provision required across the Group.

The total amounts of PMAs provided across the Group are set out below by segment.

	2021	2020
	£m	£m
Mortgage Lending	**8.9**	14.0
Commercial Lending	**11.2**	5.8
Idem Capital	**0.3**	-
	20.4	19.8

Other than the behaviour of extended payment relief cases noted above, this analysis found no evidence of particular concentrations of credit risk below portfolio level. Given this, and the high level nature of the PMA exercise, the PMAs have been allocated on a broad brush basis to individual cases.

The Group will continue to monitor the requirement for these PMAs as the economic situation develops and the impact of government interventions recedes.

(b) Impairments by stage and division

IFRS 9 calculations and related disclosures require loan assets to be divided into three stages, with accounts which were credit impaired on initial recognition representing a fourth class.

The three classes comprise: those where there has been no SICR since advance or acquisition (Stage 1); those where there has been a SICR (Stage 2); and loans which are impaired (Stage 3).

- On initial recognition, and for assets where there has not been a SICR, provisions will be made in respect of losses resulting from the level of credit default events expected in the twelve months following the balance sheet date
- Where a loan has experienced a SICR, whether or not the loan is considered to be credit impaired, provisions will be made based on the ECLs over the full life of the loan
- For credit impaired assets, provisions will also be made on the basis of lifetime ECLs

For assets which were 'Purchased or Originated as Credit Impaired' ('POCI') accounts (those considered as credit impaired at the point of first recognition), such as certain of the Group's acquired assets in Idem Capital, the carrying valuation is based on expected cash flows discounted by the EIR determined at the point of acquisition.

An analysis of the Group's loan portfolios between the stages defined above is set out below.

	Stage 1	Stage 2*	Stage 3*	POCI	Total
	£m	£m	£m	£m	£m
30 September 2021					
Gross loan book					
Mortgage Lending	**10,303.7**	**1,206.4**	**120.0**	**13.4**	**11,643.5**
Commercial Lending	**1,504.2**	**66.4**	**19.0**	**6.9**	**1,596.5**
Idem Capital	**92.5**	**6.3**	**25.3**	**104.0**	**228.1**
Total	**11,900.4**	**1,279.1**	**164.3**	**124.3**	**13,468.1**
Impairment provision					
Mortgage Lending	**(1.7)**	**(10.2)**	**(22.9)**	**-**	**(34.8)**
Commercial Lending	**(12.9)**	**(1.0)**	**(13.6)**	**(0.2)**	**(27.7)**
Idem Capital	**(0.4)**	**(0.1)**	**(2.4)**	**-**	**(2.9)**
Total	**(15.0)**	**(11.3)**	**(38.9)**	**(0.2)**	**(65.4)**
Net loan book					
Mortgage Lending	**10,302.0**	**1,196.2**	**97.1**	**13.4**	**11,608.7**
Commercial Lending	**1,491.3**	**65.4**	**5.4**	**6.7**	**1,568.8**
Idem Capital	**92.1**	**6.2**	**22.9**	**104.0**	**225.2**
Total	**11,885.4**	**1,267.8**	**125.4**	**124.1**	**13,402.7**
Coverage ratio					
Mortgage Lending	**0.02%**	**0.85%**	**19.08%**	**-**	**0.30%**
Commercial Lending	**0.86%**	**1.51%**	**71.58%**	**2.90%**	**1.74%**
Idem Capital	**0.43%**	**1.59%**	**9.49%**	**-**	**1.27%**
Total	**0.13%**	**0.88%**	**23.68%**	**0.16%**	**0.49%**

* Stage 2 and 3 balances are analysed in more detail below.

	Stage 1 £m	Stage 2* £m	Stage 3* £m	POCI £m	Total £m
30 September 2020					
Gross loan book					
Mortgage Lending	9,822.6	903.2	127.0	15.0	10,867.8
Commercial Lending	1,384.2	132.3	20.2	6.7	1,543.4
Idem Capital	122.9	9.9	28.9	140.3	302.0
Total	11,329.7	1,045.4	176.1	162.0	12,713.2
Impairment provision					
Mortgage Lending	(5.0)	(12.6)	(30.7)	-	(48.3)
Commercial Lending	(17.0)	(3.0)	(8.2)	(0.4)	(28.6)
Idem Capital	(0.2)	(0.2)	(4.5)	-	(4.9)
Total	(22.2)	(15.8)	(43.4)	(0.4)	(81.8)
Net loan book					
Mortgage Lending	9,817.6	890.6	96.3	15.0	10,819.5
Commercial Lending	1,367.2	129.3	12.0	6.3	1,514.8
Idem Capital	122.7	9.7	24.4	140.3	297.1
Total	11,307.5	1,029.6	132.7	161.6	12,631.4
Coverage ratio					
Mortgage Lending	0.05%	1.40%	24.17%	-	0.44%
Commercial Lending	1.23%	2.27%	40.59%	5.97%	1.85%
Idem Capital	0.16%	2.02%	15.57%	-	1.62%
Total	0.20%	1.51%	24.65%	0.25%	0.64%

* Stage 2 and 3 balances are analysed in more detail below.

Finance leases included above, analysed by staging, were:

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
30 September 2021					
Gross loan book	**704.9**	**14.9**	**17.3**	**4.3**	**741.4**
Impairment provision	**(7.9)**	**(0.5)**	**(12.7)**	**-**	**(21.1)**
Net loan book	**697.0**	**14.4**	**4.6**	**4.3**	**720.3**
Coverage Ratio	**1.12%**	**3.36%**	**73.41%**	**-**	**2.85%**
30 September 2020					
Gross loan book	676.6	33.6	14.4	15.5	740.1
Impairment provision	(9.3)	(0.9)	(5.5)	-	(15.7)
Net loan book	667.3	32.7	8.9	15.5	724.4
Coverage Ratio	1.37%	2.68%	38.19%	-	2.12%

In terms of the Group's credit management processes, Stage 1 cases will fall within the appropriate customer servicing functions and Stage 2 cases will be subject to account management arrangements. Stage 3 cases will include both those subject to recovery or similar processes and those which, though being managed on a long-term basis, are included with defaulted accounts for regulatory purposes. However, these broad categorisations may vary between different product types.

POCI balances included in the Commercial Lending segment arise principally from acquired businesses, where those assets were identified as credit impaired at the point of acquisition when the acquired portfolios as a whole were evaluated. Additional provision arising on these assets post-acquisition is shown as 'Impairment Provision' above.

Idem Capital loans include acquired consumer and motor finance loans together with legacy (originated pre-2010) second charge mortgage and unsecured consumer loans. Legacy assets and acquired loans which were performing on acquisition are included in the staging analysis above.

Acquired portfolios within the Mortgage Lending and Idem Capital segments which were largely non-performing at acquisition, and which were purchased at a deep discount to face value are shown as POCI assets above. Although no provision is shown above for such assets, the effect of the discount on purchase is included in the gross value ensuring that the carrying value is substantially less than the current balances due from customers and the level of cover is considerable.

Analysis of Stage 2 loans

The table below analyses the accounts in Stage 2 between those not more than one month in arrears where an SICR has nonetheless been identified from other information and accounts more than one month in arrears.

Cases which have been greater than one month in arrears in the last three months, but which are not at the balance sheet date are shown as ‘recent arrears’ in the tables below. These cases have been analysed separately for the first time in the current year.

In all cases accounts which are more than one month in arrears, where this is a meaningful measure, are considered to have a SICR. However, in certain loan portfolios, regular monthly payments of pre-set amounts are not required and hence this criterion cannot be used.

Levels of Stage 2 assets increased substantially during the early part of the Covid outbreak, and have been broadly stable over the course of the year. The largest part of the Stage 2 balance at 30 September 2021 related to extended payment holiday accounts transferred from Stage 1. These are shown in the < 1 month arrears column in the table below. As fewer extensions were granted after 30 September 2020, the rate of increase of such Stage 2 cases has been much reduced in the period.

Coverage levels in Stage 2 across the portfolios have reduced since 30 September 2020, with an improved economic outlook and increasing security values. However, these remain higher than those seen pre-pandemic, due to the impact of PMAs, particularly on ‘<1 month arrears’ cases. Coverage ratios of ‘> 1 < = 3 months arrears’ cases have been varied due to the composition of the relatively small balances, particularly in the Commercial Lending and Idem Capital divisions.

	< 1 month arrears	Recent arrears	> 1 <= 3 months arrears	Total
	£m	£m	£m	£m
30 September 2021				
Gross loan book				
Mortgage Lending	**1,184.8**	**8.0**	**13.6**	**1,206.4**
Commercial Lending	**61.1**	**0.2**	**5.1**	**66.4**
Idem Capital	**2.9**	**0.7**	**2.7**	**6.3**
Total	**1,248.8**	**8.9**	**21.4**	**1,279.1**
Impairment provision				
Mortgage Lending	**(9.9)**	**(0.1)**	**(0.2)**	**(10.2)**
Commercial Lending	**(0.9)**	**-**	**(0.1)**	**(1.0)**
Idem Capital	**-**	**-**	**(0.1)**	**(0.1)**
Total	**(10.8)**	**(0.1)**	**(0.4)**	**(11.3)**
Net loan book				
Mortgage Lending	**1,174.9**	**7.9**	**13.4**	**1,196.2**
Commercial Lending	**60.2**	**0.2**	**5.0**	**65.4**
Idem Capital	**2.9**	**0.7**	**2.6**	**6.2**
Total	**1,238.0**	**8.8**	**21.0**	**1,267.8**
Coverage ratio				
Mortgage Lending	**0.84%**	**1.25%**	**1.47%**	**0.85%**
Commercial Lending	**1.47%**	**-**	**1.96%**	**1.51%**
Idem Capital	**-**	**-**	**3.70%**	**1.59%**
Total	**0.86%**	**1.12%**	**1.87%**	**0.88%**

	< 1 month arrears	Recent arrears	> 1 <= 3 months arrears	Total
	£m	£m	£m	£m
30 September 2020				
Gross loan book				
Mortgage Lending	879.9	5.9	17.4	903.2
Commercial Lending	113.2	10.5	8.6	132.3
Idem Capital	4.8	1.6	3.5	9.9
Total	997.9	18.0	29.5	1,045.4
Impairment provision				
Mortgage Lending	(12.0)	(0.2)	(0.4)	(12.6)
Commercial Lending	(2.5)	(0.1)	(0.4)	(3.0)
Idem Capital	(0.1)	-	(0.1)	(0.2)
Total	(14.6)	(0.3)	(0.9)	(15.8)
Net loan book				
Mortgage Lending	867.9	5.7	17.0	890.6
Commercial Lending	110.7	10.4	8.2	129.3
Idem Capital	4.7	1.6	3.4	9.7
Total	983.3	17.7	28.6	1,029.6
Coverage ratio				
Mortgage Lending	1.36%	3.39%	2.30%	1.40%
Commercial Lending	2.21%	0.95%	4.65%	2.27%
Idem Capital	2.08%	-	2.86%	2.02%
Total	1.46%	1.67%	3.05%	1.51%

Analysis of Stage 3 loans

The table below analyses the accounts in Stage 3 between those:

- In the process of sale or other enforcement procedures ('Realisations')
- Where a receiver of rent ('RoR') has been appointed by the Group to manage the property on the customers' behalf
- Which are being managed on a long-term basis and where full recovery is possible, but which are considered to meet regulatory default criteria at the balance sheet date ('>3 month arrears')
- Which no longer meet regulatory default criteria but which are being retained in Stage 3 for a probationary period ('Probation')

Where an account meets two of the criteria, it will be assigned to the category shown first in the list above.

In these disclosures probation accounts have been analysed separately for the first time, in order to provide better information for users.

RoR accounts in Stage 3 may be fully up-to-date with full recovery possible. These accounts are included in Stage 3 as they are classified as defaulted for regulatory purposes.

The impact of Covid on the number and value of Stage 3 accounts has been limited so far. Payment reliefs have prevented arrears being recorded and other enforcement activities have been limited by government intervention. This particularly impacts on cases analysed as 'realisations'.

The completion of payment relief periods has led to some increases in > 3 month arrears cases, particularly in the Mortgage Lending business, while credit reviews have identified at risk cases in other areas. This increase is, however, offset by the continuing realisations from the receiver of rent portfolio as long-term cases are managed out.

Coverage levels have generally reduced a little from 30 September 2020 as a result of increased security values, while remaining substantially in excess of pre-Covid levels. The coverage ratio for Commercial Lending is subject to fluctuations as the number of cases is relatively low and the ratio can be significantly influenced by individual larger cases.

	Probation	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m	£m
30 September 2021					
Gross loan book					
Mortgage Lending	**7.3**	**20.7**	**80.9**	**11.1**	**120.0**
Commercial Lending	**0.6**	**11.4**	**-**	**7.0**	**19.0**
Idem Capital	**0.7**	**21.3**	**-**	**3.3**	**25.3**
Total	**8.6**	**53.4**	**80.9**	**21.4**	**164.3**
Impairment provision					
Mortgage Lending	**(0.3)**	**(0.9)**	**(17.4)**	**(4.3)**	**(22.9)**
Commercial Lending	**(0.1)**	**(10.3)**	**-**	**(3.2)**	**(13.6)**
Idem Capital	**-**	**(1.0)**	**-**	**(1.4)**	**(2.4)**
Total	**(0.4)**	**(12.2)**	**(17.4)**	**(8.9)**	**(38.9)**
Net loan book					
Mortgage Lending	**7.0**	**19.8**	**63.5**	**6.8**	**97.1**
Commercial Lending	**0.5**	**1.1**	**-**	**3.8**	**5.4**
Idem Capital	**0.7**	**20.3**	**-**	**1.9**	**22.9**
Total	**8.2**	**41.2**	**63.5**	**12.5**	**125.4**
Coverage ratio					
Mortgage Lending	**4.11%**	**4.35%**	**21.51%**	**38.74%**	**19.08%**
Commercial Lending	**16.67%**	**90.35%**	**-**	**45.71%**	**71.58%**
Idem Capital	**-**	**4.69%**	**-**	**42.42%**	**9.49%**
Total	**4.65%**	**22.85%**	**21.51%**	**41.59%**	**23.68%**

	Probation	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m	£m
30 September 2020					
Gross loan book					
Mortgage Lending	6.5	12.9	86.7	20.9	127.0
Commercial Lending	3.2	11.2	-	5.8	20.2
Idem Capital	1.0	24.3	-	3.6	28.9
Total	10.7	48.4	86.7	30.3	176.1
Impairment provision					
Mortgage Lending	(0.3)	(1.5)	(20.8)	(8.1)	(30.7)
Commercial Lending	(0.9)	(4.1)	-	(3.2)	(8.2)
Idem Capital	-	(2.8)	-	(1.7)	(4.5)
Total	(1.2)	(8.4)	(20.8)	(13.0)	(43.4)
Net loan book					
Mortgage Lending	6.2	11.4	65.9	12.8	96.3
Commercial Lending	2.3	7.1	-	2.6	12.0
Idem Capital	1.0	21.5	-	1.9	24.4
Total	9.5	40.0	65.9	17.3	132.7
Coverage ratio					
Mortgage Lending	4.62%	11.63%	23.99%	38.76%	24.17%
Commercial Lending	28.12%	36.61%	-	55.17%	40.59%
Idem Capital	-	11.52%	-	47.22%	15.57%
Total	11.21%	17.36%	23.99%	42.90%	24.65%

The security values available to reduce exposure at default in the calculation shown above for Stage 3 accounts are set out below. The estimated value of the security represents, for each account, the lesser of the valuation estimate and the exposure at default in the central scenario. Security values are based on the most recent valuation of the relevant asset held by the Group, indexed or depreciated as appropriate.

	2021	2020
	£m	£m
First mortgages	**74.7**	71.9
Second mortgages	**15.4**	17.3
Asset finance	**4.7**	6.7
Motor finance	**2.0**	1.5
	96.8	97.4

The RoR managed accounts are being managed to ensure the optimal resolution for landlords, tenants and lenders and this long-term, stable situation underpinned their treatment as not impaired under IAS 39, but the existence of the RoR arrangement causes the accounts to be treated as defaulted for regulatory purposes. The Group's RoR arrangements are described in more detail below.

Idem Capital balances with over three months arrears comprise principally second charge mortgage accounts originated over ten years ago which have been over three months in arrears for some time. These accounts are generally making regular payments and have significant levels of equity in the underlying property which reduces the required provision to the value shown above. It is expected that a high proportion of these accounts will eventually redeem naturally, either on the sale of the property or by the satisfaction of the amount due through instalment payments.

Buy-to-let receiver of rent cases (Stage 3)

Where a buy-to-let mortgage customer in England or Wales falls into arrears on their account the Group has the power to appoint a receiver of rent under the Law of Property Act. The receiver will then manage the property on behalf of the customer, collecting rents and remitting them to make payments on the account. While the receiver has the power to sell the property, in many cases they will operate it as a buy-to-let on at least a short to medium term basis, potentially longer, depending on the individual circumstances of the case. This causes less disruption to the tenants and may result in the mortgage account returning to performing status and the property being handed back to the customer.

The following table analyses the number and gross carrying value of RoR managed accounts shown above by the date of the receivers' appointment, illustrating this position.

	30 September 2021		30 September 2020	
	No.	**£m**	No.	£m
Managed accounts				
Appointment date				
2010 and earlier	**333**	**56.3**	369	62.4
2011 to 2013	**56**	**9.1**	72	12.4
2014 to 2016	**24**	**3.3**	29	4.2
2016 and later	**86**	**12.2**	46	7.7
Total managed accounts	**499**	**80.9**	516	86.7
Accounts in the process of realisation	**54**	**10.2**	104	19.7
	553	**91.1**	620	106.4

Receiver of rent accounts in the process of realisation at the period end are included under that heading in the Stage 3 tables above.

In addition to the cases analysed above, no POCI mortgage accounts also had a receiver of rent appointed (2020: 3), making a total of 553 (2020: 623).

(c) Movements in impairment provision in the year

The movements in the impairment provision calculated under IFRS 9, analysed by business segments, are set out below.

	Mortgage Lending	**Commercial Lending**	**Idem Capital**	**Total**
	£m	**£m**	**£m**	**£m**
At 30 September 2020	48.3	28.6	4.9	81.8
(Released) / provided in period (note 18(d))	(5.9)	4.0	(1.2)	(3.1)
Amounts written off	(7.6)	(4.9)	(0.8)	(13.3)
At 30 September 2021	**34.8**	**27.7**	**2.9**	**65.4**
At 30 September 2019	26.8	10.7	4.4	41.9
Provided in period (note 18(d))	25.8	22.7	1.3	49.8
Amounts written off	(4.3)	(4.8)	(0.8)	(9.9)
At 30 September 2020	48.3	28.6	4.9	81.8

Accounts are considered to be written off for accounting purposes if a balance remains once standard enforcement processes have been completed, subject to any amount retained in respect of expected salvage receipts. This has no effect on the net carrying value, only on the amounts reported as gross loan balances and accumulated impairment provisions.

At 30 September 2021, enforceable contractual balances of £8.8m (2020: £5.5m) were outstanding on non-POCI assets written off in the period. This excludes those accounts where a full and final settlement was agreed and those where the contractual terms do not permit any further action. Enforceable balances are kept under review for operational purposes, but no amounts are recognised in respect of such accounts unless further cash is received or there is a strong expectation that it will be.

A more detailed analysis of these movements by IFRS 9 stage on a consolidated basis for the year ended 30 September 2021 and 30 September 2020 is set out below.

These tables, and the matching tables analysing movements in gross balances, have been compiled by comparing opening and closing balances on each account and analysing the movements between them.

Changes due to credit risk includes all changes in model parameters whether related to account performance, external credit data or model assumptions, including economic scenarios and weightings.

There have been no changes in models creating significant movements in balances in the year.

	Stage 1	Stage 2	Stage 3	POCI	Total
	£m	£m	£m	£m	£m
Loss allowance at 30 September 2020	**22.2**	**15.8**	**43.4**	**0.4**	**81.8**
New assets originated or purchased	**8.1**	-	-	-	**8.1**
Changes in loss allowance					
Transfer to Stage 1	**4.7**	**(2.6)**	**(2.1)**	-	-
Transfer to Stage 2	**(1.4)**	**2.1**	**(0.7)**	-	-
Transfer to Stage 3	**(0.2)**	**(0.7)**	**0.9**	-	-
Changes on stage transfer	**(3.8)**	**1.8**	**3.1**	-	**1.1**
Changes due to credit risk	**(14.6)**	**(5.1)**	**7.6**	**(0.2)**	**(12.3)**
Write offs	-	-	**(13.3)**	-	**(13.3)**
Loss allowance at 30 September 2021	**15.0**	**11.3**	**38.9**	**0.2**	**65.4**
Loss allowance at 30 September 2019	6.0	3.7	32.2	-	41.9
New assets originated or purchased	10.2	-	-	-	10.2
Changes in loss allowance					
Transfer to Stage 1	0.9	(0.7)	(0.2)	-	-
Transfer to Stage 2	(1.2)	1.3	(0.1)	-	-
Transfer to Stage 3	(0.5)	(0.4)	0.9	-	-
Changes on stage transfer	(0.5)	7.5	6.2	-	-
Changes due to credit risk	7.3	4.4	14.3	0.4	26.4
Write offs	-	-	(9.9)	-	(9.9)
Loss allowance at 30 September 2020	22.2	15.8	43.4	0.4	81.8

The principal movements in the impairment provision in the year were downwards, with a more benign economic outlook reducing both the estimated likelihood of losses and the expected loss on defaulted cases as security values improved. However coverage levels still remain in excess of those pre-Covid, with PMAs in place to compensate for the potential impact of credit issues not apparent in the data.

While less accounts have been granted payment holiday extensions in the year than in the year ended 30 September 2020, this has driven further transfers from Stage 1 to Stage 2. Transfers to Stage 3 reflect principally a small number of realisation cases and other cases identified through credit review. Write offs largely relate to the realisation of already provided losses on cases being worked out on a long-term basis.

In the year ended 30 September 2020 the principal factor generating the increase in the loss allowance in the period was the impact of the Covid crisis, which led to increased loss expectations across all of the Group's portfolios, primarily as a result of the forecast deterioration in key economic variables and their impact on the Group's customers. The broad availability of payment holidays was also reflected, with extended payment holiday accounts transferred to Stage 2 and PMAs made to allow for the potential delay in the recognition of credit issues due to reliefs.

The movements in the Loans to Customers balances in respect of which these loss allowances have been made are set out below.

	Stage 1	Stage 2	Stage 3	POCI	Total
	£m	£m	£m	£m	£m
Balance at 30 September 2020	**11,329.7**	**1,045.4**	**176.1**	**162.0**	**12,713.2**
New assets originated or purchased	**2,419.4**	**-**	**-**	**-**	**2,419.4**
Changes in staging					
Transfer to Stage 1	**158.5**	**(149.5)**	**(9.0)**	**-**	**-**
Transfer to Stage 2	**(514.2)**	**519.6**	**(5.4)**	**-**	**-**
Transfer to Stage 3	**(23.7)**	**(21.6)**	**45.3**	**-**	**-**
Redemptions and repayments	**(1,884.9)**	**(158.6)**	**(35.7)**	**(53.1)**	**(2,132.3)**
Write offs	**-**	**-**	**(13.3)**	**-**	**(13.3)**
Other changes	**415.6**	**43.8**	**6.3**	**15.4**	**481.1**
Balance at 30 September 2021	**11,900.4**	**1,279.1**	**164.3**	**124.3**	**13,468.1**
Loss allowance	**(15.0)**	**(11.3)**	**(38.9)**	**(0.2)**	**(65.4)**
Carrying value	**11,885.4**	**1,267.8**	**125.4**	**124.1**	**13,402.7**
Balance at 30 September 2019	11,382.6	458.5	167.9	219.0	12,228.0
New assets originated or purchased	2,071.4	-	-	-	2,071.4
Changes in staging					
Transfer to Stage 1	202.3	(200.1)	(2.2)	-	-
Transfer to Stage 2	(846.2)	849.2	(3.0)	-	-
Transfer to Stage 3	(42.6)	(20.5)	63.1	-	-
Redemptions and repayments	(1,488.3)	(54.1)	(42.0)	(78.1)	(1,662.5)
Write offs	-	-	(9.9)	-	(9.9)
Other changes	50.5	12.4	2.2	21.1	86.2
Balance at 30 September 2020	11,329.7	1,045.4	176.1	162.0	12,713.2
Loss allowance	(22.2)	(15.8)	(43.4)	(0.4)	(81.8)
Carrying value	11,307.5	1,029.6	132.7	161.6	12,631.4

Other changes includes interest and similar charges.

(d) Impairments charged to income

The amounts charged to the profit and loss account in the period are analysed as follows.

	Mortgage Lending	Commercial Lending	Idem Capital	Total
	£m	£m	£m	£m
30 September 2021				
(Released) / provided in period	**(5.9)**	**4.0**	**(1.2)**	**(3.1)**
Recovery of written off amounts	**-**	**(1.1)**	**(0.5)**	**(1.6)**
	(5.9)	**2.9**	**(1.7)**	**(4.7)**
Of which				
Loan accounts	**(5.9)**	**(2.1)**	**(1.7)**	**(9.7)**
Finance leases	**-**	**5.0**	**-**	**5.0**
	(5.9)	**2.9**	**(1.7)**	**(4.7)**
30 September 2020				
Provided in period	25.8	22.7	1.3	49.8
Recovery of written off amounts	-	(1.0)	(0.5)	(1.5)
	25.8	21.7	0.8	48.3
Of which				
Loan accounts	25.8	9.5	0.8	36.1
Finance leases	-	12.2	-	12.2
	25.8	21.7	0.8	48.3

(e) Economic inputs to provision calculations

Impairment provision under IFRS 9 is calculated on a forward-looking ECL basis, based on expected economic conditions in multiple internally coherent scenarios. While the provision calculation is intended to address all possible future economic outcomes, the Group, in common with most other lenders, uses a small number of differing scenarios as representatives of this universe of potential outturns.

The Group uses four distinct economic scenarios chosen to represent the range of possible outcomes and allow for the impact of economic asymmetry in the calculations. Each scenario comprises a number of economic parameters and while models for different portfolios may not use all of the variables, the set, as a whole, is defined for the Group and must be consistent.

As the Group does not have an internal economics function, in developing its economic scenarios it considers analysis from reputable external sources to form a general market consensus which informs its central scenario. These sources include data and forecasts produced by the Office of Budget Responsibility ('OBR') and the PRA as well as private sector economic research bodies. The Group also takes account of public statements from bodies such as the Bank of England and the UK Government to inform its final position.

The central scenario used for IFRS 9 impairment purposes is the same scenario which forms the basis of the Group's business planning and forecasting and will therefore generally carry the highest probability weighting. In its September 2021 forecasting cycle (the 'October forecast'), the Group has adopted a central economic scenario derived using a broadly equivalent approach to that used in September 2020, with the starting point of the scenario updated to reflect the actual movements of economic variables in the year. The general trend of the Group's central forecast is consistent with the monetary forecast published by the Bank of England in August 2021.

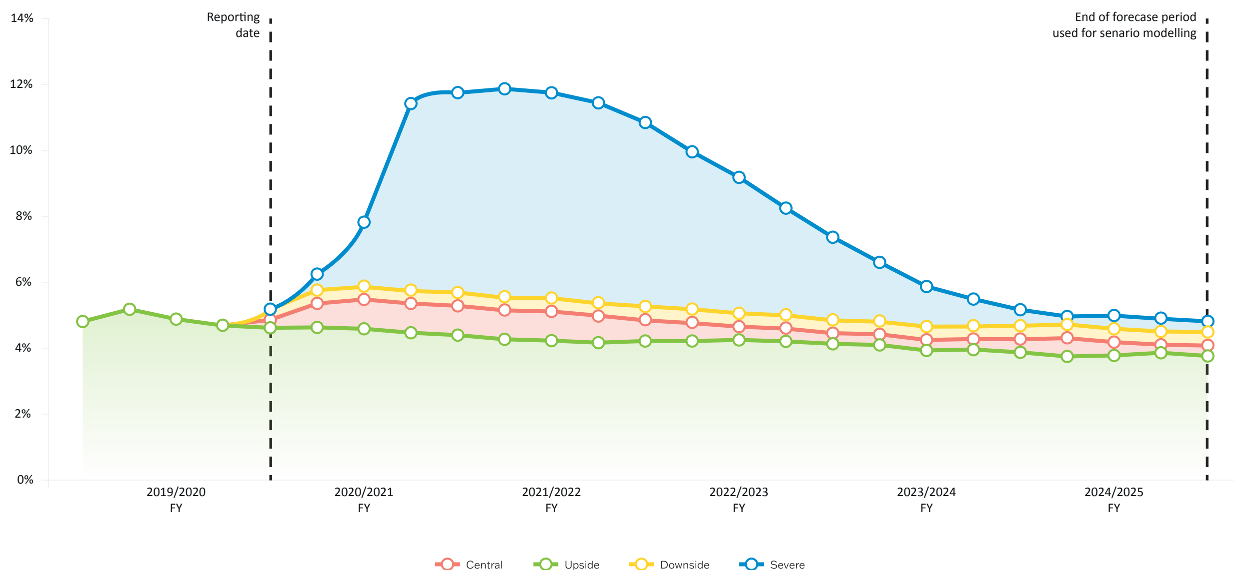
Compared to the central scenario adopted at 30 September 2020, the new central forecast is broadly similar across the five year period, but more optimistic as to short term prospects. This 2021/2022 upgrade is a result of the opening position being better than implied in the 2020 central scenario, progress made to date in combatting the pandemic in the UK, including the success of the vaccination programme, and a more positive outlook from economists generally.

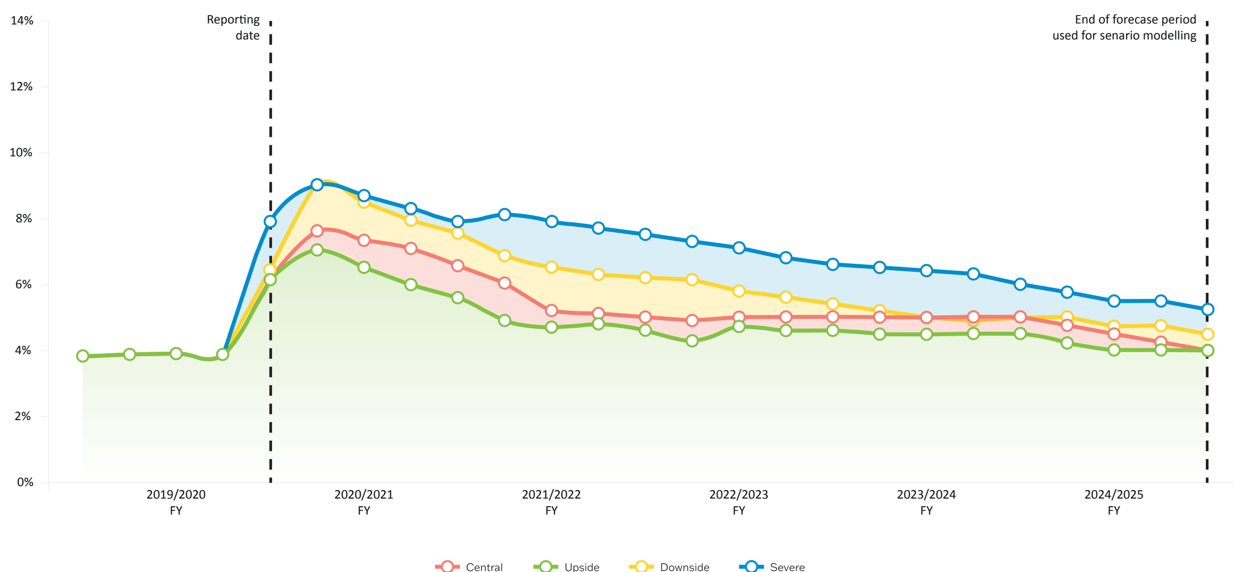
The upside and downside scenarios continue to be derived from the central scenario, as they have been in previous periods. However, these scenarios are not as markedly different in shape as those used at September 2020 nor as widely divergent from the central position, with a greater level of consensus as to the shape and timing of the post-Covid trajectory of the UK economy emerging amongst analysts and commentators. It should be noted that the 2020 scenarios converged towards the latter part of the five-year period, as Covid impacts receded. Therefore, a less divergent starting point for the 2021 scenarios is in line with this expectation.

The severe scenario has been derived from the stress testing scenarios published by the Bank of England, as in previous periods. The stress testing scenario published in January 2021 was used in this iteration of the Group's forecasts. This is a more severe scenario than that published for 2020. The Bank of England scenario includes a house price projection based on a sharp decline and a rapid bounce back, which would have a limited impact on expected losses. As house prices have a significant impact on the Group's modelling of losses, it was determined that the impact of a more protracted slump, would better represent a severe downturn and the Bank of England scenario was adjusted accordingly.

The overall shape of the scenarios adopted, and the change in the forecasts year-on-year is illustrated by the forecasts of the UK's unemployment rate set out in the charts below. The unemployment rate has been presented as it is the principal indicator of general economic activity used in modelling losses in the Group's buy-to-let mortgage portfolio.

In the accounts for the year ended 30 September 2020, a chart of UK GDP was presented as that was the principal indicator of general economic activity in the buy-to-let ECL model then in use (see above).





Following a review of the weightings of the different scenarios, set against the overall potential for variability in the future economic outlook, the Group decided to maintain the scenario weightings used at 30 September 2020.

The weightings attached to each scenario are set out below.

	2021	2020
Central scenario	**40%**	40%
Upside scenario	**10%**	10%
Downside scenario	**35%**	35%
Severe scenario	**15%**	15%
	100%	100%

The Group's economic scenarios comprise seven variables based on standard publicly available metrics for the UK. These variables are:

- Year-on-year change in Gross Domestic Product ('GDP') as measured by the Office of National Statistics ('ONS')
- Year-on-year change in the House Price Index ('HPI') as measured by the Nationwide Building Society
- Bank Base Rate ('BBR'), as set by the Bank of England
- Consumer Price Inflation ('CPI') rate, as measured by the ONS
- Unemployment rate, as measured by the ONS
- Annual change in secured lending, as measured by the Bank of England 'mortgage advances' data series
- Annual change in consumer credit, as measured by the Bank of England 'unsecured advances' data series

The projected average annual values of each of these variables in each of the first five financial years of the forecast period are set out below.

30 September 2021

Gross Domestic Product ('GDP') (year-on-year change)

	2022	2023	2024	2025	2026
Central scenario	7.2%	2.0%	1.3%	1.6%	1.9%
Upside scenario	8.6%	2.5%	2.1%	1.8%	1.9%
Downside scenario	3.9%	3.4%	2.1%	1.9%	1.9%
Severe scenario	(3.7)%	8.9%	4.9%	2.6%	2.0%

House Price Index ('HPI') (year-on-year change)

	2022	2023	2024	2025	2026
Central scenario	0.7%	2.1%	2.7%	3.2%	3.0%
Upside scenario	4.0%	3.9%	4.5%	4.7%	2.6%
Downside scenario	(4.9)%	(5.9)%	-	2.1%	2.1%
Severe scenario	(10.9)%	(11.6)%	(7.9)%	(1.8)%	0.7%

Bank Base Rate ('BBR') (rate)

	2022	2023	2024	2025	2026
Central Scenario	0.1%	0.1%	0.4%	0.7%	0.8%
Upside Scenario	0.1%	0.5%	0.9%	1.0%	1.0%
Downside Scenario	0.1%	0.1%	0.2%	0.3%	0.5%
Severe Scenario	-	(0.1)%	-	-	0.1%

Consumer Price Inflation ('CPI') (rate)

	2022	2023	2024	2025	2026
Central scenario	3.8%	2.3%	1.9%	2.0%	2.0%
Upside scenario	3.0%	2.1%	2.0%	2.0%	2.0%
Downside scenario	4.2%	3.0%	2.1%	2.0%	2.0%
Severe scenario	0.9%	0.4%	0.9%	1.5%	1.9%

Unemployment (rate)

	2022	2023	2024	2025	2026
Central scenario	5.4%	5.1%	4.7%	4.3%	4.2%
Upside scenario	4.6%	4.3%	4.3%	4.0%	3.8%
Downside scenario	5.8%	5.5%	5.1%	4.7%	4.6%
Severe scenario	9.4%	11.5%	8.7%	5.8%	4.9%

Secured lending (annual change)

	2022	2023	2024	2025	2026
Central scenario	4.4%	3.6%	3.1%	3.2%	3.3%
Upside scenario	5.3%	4.8%	4.3%	3.8%	3.8%
Downside scenario	3.3%	2.8%	2.9%	3.6%	3.9%
Severe scenario	1.5%	(2.4)%	(1.0)%	1.3%	2.5%

Consumer credit (annual change)

	2022	2023	2024	2025	2026
Central scenario	**2.6%**	**4.4%**	**5.5%**	**6.1%**	**6.2%**
Upside scenario	**4.3%**	**6.5%**	**7.3%**	**8.0%**	**8.3%**
Downside scenario	**2.3%**	**2.0%**	**2.0%**	**2.0%**	**2.3%**
Severe scenario	**0.6%**	**5.1%**	**1.2%**	**1.7%**	**4.0%**

30 September 2020

Gross Domestic Product ('GDP') (year-on-year change)

	2021	2022	2023	2024	2025
Central scenario	4.9%	5.7%	2.2%	1.5%	1.4%
Upside scenario	6.0%	5.4%	2.4%	1.5%	1.5%
Downside scenario	2.1%	9.3%	2.9%	1.3%	1.5%
Severe scenario	0.2%	9.5%	2.2%	1.4%	1.3%

House Price Index ('HPI') (year-on-year change)

	2021	2022	2023	2024	2025
Central scenario	(0.8)%	0.3%	4.0%	4.0%	3.8%
Upside scenario	1.3%	1.3%	3.0%	3.3%	3.8%
Downside scenario	(3.5)%	(7.0)%	(0.1)%	3.8%	3.8%
Severe scenario	(11.8)%	(13.8)%	(5.3)%	1.5%	3.8%

Bank Base Rate ('BBR') (rate)

	2021	2022	2023	2024	2025
Central scenario	0.1%	0.1%	0.4%	0.8%	0.8%
Upside scenario	0.1%	0.4%	0.7%	0.9%	1.0%
Downside scenario	0.1%	0.1%	0.1%	0.3%	0.8%
Severe scenario	0.0%	(0.2)%	0.1%	0.2%	0.6%

Consumer Price Inflation ('CPI') (rate)

	2021	2022	2023	2024	2025
Central scenario	0.9%	1.7%	2.2%	2.1%	2.1%
Upside scenario	1.2%	2.1%	2.1%	2.2%	2.1%
Downside scenario	0.7%	1.3%	1.8%	2.1%	2.0%
Severe scenario	(0.1)%	0.7%	1.5%	2.0%	2.0%

Unemployment (rate)

	2021	2022	2023	2024	2025
Central scenario	7.1%	5.3%	5.0%	5.0%	4.4%
Upside scenario	6.3%	4.8%	4.6%	4.5%	4.1%
Downside scenario	8.2%	6.5%	5.7%	5.0%	4.8%
Severe scenario	8.5%	7.8%	7.0%	6.3%	5.5%

Secured lending (annual change)

	2021	2022	2023	2024	2025
Central Scenario	3.6%	3.7%	3.8%	3.9%	3.9%
Upside Scenario	4.7%	4.5%	4.2%	4.1%	4.0%
Downside Scenario	1.8%	2.3%	3.2%	3.7%	3.8%
Severe Scenario	(0.9)%	0.2%	2.3%	3.4%	3.7%

Consumer credit (annual change)

	2021	2022	2023	2024	2025
Central Scenario	6.0%	**6.1%**	**6.1%**	**6.3%**	**6.3%**
Upside Scenario	8.7%	**8.2%**	**7.3%**	**6.9%**	**6.7%**
Downside Scenario	1.8%	**2.8%**	**4.3%**	**5.4%**	**5.7%**
Severe Scenario	(4.6)%	**(2.3)%**	**1.6%**	**4.0%**	**4.8%**

After the end of the initial five year period, the final rate or rate of change (as appropriate) is assumed to continue into the future in each scenario.

To illustrate the levels of non-linearity in the various scenarios, the maximum and minimum quarterly levels for each variable over the five year period commencing on the balance sheet date are set out below.

30 September 2021

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max	Min	Max	Min	Max	Min	Max	Min
	%	%	%	%	%	%	%	%
Economic driver								
GDP	**11.5**	**1.1**	**13.3**	**1.6**	**7.3**	**0.9**	**14.3**	**(5.9)**
HPI	**6.1**	**(4.0)**	**7.7**	**0.6**	**2.9**	**(9.8)**	**2.4**	**(16.9)**
BBR	**0.8**	**0.1**	**1.0**	**0.1**	**0.5**	**0.1**	**0.2**	**(0.1)**
CPI	**4.0**	**1.8**	**3.8**	**1.8**	**4.5**	**1.8**	**2.0**	**0.2**
Unemployment	**5.5**	**4.1**	**4.7**	**3.8**	**5.9**	**4.5**	**11.9**	**4.8**
Secured lending	**4.8**	**3.0**	**5.5**	**3.5**	**4.0**	**2.5**	**3.1**	**(2.5)**
Consumer credit	**6.4**	**0.4**	**8.5**	**1.9**	**4.6**	**(0.1)**	**9.2**	**(8.9)**

30 September 2020

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max	Min	Max	Min	Max	Min	Max	Min
	%	%	%	%	%	%	%	%
Economic driver								
GDP	18.0	(7.6)	18.8	(5.9)	17.8	(15.1)	20.5	(17.9)
HPI	5.0	(4.0)	4.0	0.0	4.0	(10.0)	4.0	(20.0)
BBR	0.8	0.1	1.0	0.1	1.0	0.1	0.8	(0.4)
CPI	2.4	0.6	2.3	0.7	2.3	0.2	2.3	(0.3)
Unemployment	7.6	4.0	7.0	4.0	9.0	4.5	9.0	5.3
Secured lending	3.9	3.5	4.8	4.0	3.8	1.7	3.7	(1.2)
Consumer credit	6.3	6.0	8.8	6.7	5.7	1.5	4.8	(5.2)

The asymmetry in the models is demonstrated by comparing the calculated impairment provision with that which would have been produced using the Central scenario alone, 100% weighted.

	2021	2020
	£m	£m
Provision using central scenario 100% weighted		
Mortgage Lending	**24.6**	37.2
Commercial Lending	**26.0**	26.7
Idem Capital	**2.1**	3.5
	52.7	67.4
Calculated impairment provision	**65.4**	81.8
Effect of multiple economic scenarios	**12.7**	14.4

(f) Sensitivity

The calculation of impairment provisions under IFRS 9 is subject to a variety of uncertainties arising from assumptions, forecasts and expectations about future events and conditions. To illustrate the impact of these uncertainties, sensitivity calculations have been performed for some of the most significant.

These sensitivities are intended as mathematical illustrations of the impacts of the various assumptions on the Group's modelling. They do not necessarily represent alternative potential impairment values as other factors might also need to be considered in arriving at a final provision figure if circumstances differed from those at the balance sheet date.

Economic conditions

To illustrate the potential impact of differing future economic scenarios on the total impairment, the provision which would be calculated if each of the economic scenarios were 100% weighted are shown below.

Scenario	**2021**		2020	
	Provision	**Difference**	Provision	Difference
	£m	**£m**	£m	£m
Central	**52.7**	**(12.7)**	67.4	(14.4)
Upside	**47.1**	**(18.3)**	58.0	(23.8)
Downside	**68.1**	**2.7**	82.4	0.6
Severe	**106.1**	**40.7**	134.3	52.5

The weighted average of these 100% weighted provisions need not equal the weighted average ECL due to the impact of the differing PDs on staging. However due to the impact of post-model stage adjustments at 30 September 2020, the effect on the PD SICR test of 100% weighting has not been taken into account in the calculations at that date

Scenario weightings

In order to illustrate the impact of scenario weightings on the outcomes, the impairment provision requirements were sensitised using alternative weightings. The sensitivity is based on the weightings used at IFRS 9 transition on 1 October 2018. The use of the 2018 weighting is intended to represent a more settled outlook than has been evident at either of the two most recent year ends. PMAs are assumed to remain constant

The weightings used, and the results of applying this sensitivity to the 30 September 2021 scenarios are set out below.

	Weighting				**Impairment**	**Difference**
	Central	**Upside**	**Downside**	**Severe**	**£m**	**£m**
As reported	40%	10%	35%	15%	65.4	-
Sensitivity	40%	30%	25%	5%	57.6	(7.8)

Significant increase in credit risk

The most important driver of SICR is relative PD. If all PDs across the Group's principal buy-to-let mortgage book were increased by 10%, loans with a gross value of £99.0m would transfer from Stage 1 to Stage 2 (2020: £53.3m), and the total provision would increase by £1.1m from the combined effects of higher PDs on expected losses and the impact of providing for expected lifetime losses, rather than 12-month losses on the additional Stage 2 cases (2020: £1.6m).

Value of security

The principal assumptions impacting on LGD are the estimated security values. If the rate of growth in house prices assumed by the model after the forecast minimum were halved, ignoring any PD effects, then the provision for the Group's first and second mortgage assets under the central scenario would increase by £3.3m (2020: £5.9m).

Receiver of rent

The majority of receiver of rent cases, which are included in Stage 3, are managed long-term and therefore their assumed realisation date has an important impact on the provision calculation. If the assumed rate of realisations was increased by 20%, the impairment provision in the central scenario would increase by £0.6m (2020: £0.8m).

19. Derivative financial instruments and hedge accounting

Introduction

The Group uses derivative financial instruments such as interest rate swaps for risk management purposes only. Each such derivative contract is entered into for economic hedging purposes to manage a particular identified risk (as described in notes 55 to 58) and any gains or losses arising are incidental to this objective. No trading in derivative financial instruments is undertaken.

Hedge accounting is applied where appropriate, though some derivatives, while forming part of an economic hedge relationship, do not qualify for this accounting treatment under the IAS 39 rules, particularly where the hedged risk relates to an off balance sheet item. In other cases, hedge accounting has not been adopted either because natural accounting offsets are expected or because complying with the IAS 39 hedge accounting rules would be particularly onerous.

The Group's hedging arrangements can be analysed for accounting purposes between:

- Fair value hedges of portfolio interest rate risk, which are used to manage the interest rate risk inherent in fixed rate lending and deposit taking
- Cash flow hedges, which were used during the year to manage the foreign exchange and interest rate risk inherent in its currency borrowings

An economic hedge of the interest rate risk in fixed rate lending must also address pipeline exposures, where future lending at a given fixed rate is anticipated. However, such arrangements do not qualify as hedges for accounting purposes.

In addition, the Group utilises currency derivatives to hedge its exposure on the small amount of its lending denominated in foreign currencies. These are not treated as hedges for accounting purposes due to the low level of exposure.

The analysis below splits derivatives between those accounted for within portfolio fair value hedges, or as cash flow hedges and those which, despite representing an economic hedge, are not accounted for as hedges. There were no individual interest rate risk hedging arrangements in place either in the year ended 30 September 2021 or the preceding year.

	2021 Assets £m	**2021 Liabilities £m**	2020 Assets £m	2020 Liabilities £m
Derivatives in hedge accounting relationships				
Fair value hedges				
Interest rate swaps				
Fixed to floating	**35.9**	**(35.8)**	-	(130.0)
Floating to fixed	**2.8**	**(5.9)**	14.4	-
	38.7	**(41.7)**	14.4	(130.0)
Cash flow hedges				
Cross-currency basis swaps				
Dollar-sterling	**-**	**-**	213.2	-
Euro-sterling	**-**	**-**	232.1	-
	-	**-**	445.3	-
Total derivatives in hedge accounting relationships	**38.7**	**(41.7)**	459.7	(130.0)
Other derivatives				
Interest rate swaps	**5.5**	**(2.0)**	3.4	(2.4)
Currency futures	**-**	**(0.2)**	0.2	-
Total recognised derivative assets/(liabilities)	**44.2**	**(43.9)**	463.3	(132.4)

The credit risk inherent in the derivative financial assets shown above is discussed in note 55.

(a) Fair value hedges

Background and hedging objectives

The Group's fair value hedges of portfolios of interest rate risk ('macro hedges') arise from its management of the interest rate risk inherent in its fixed rate lending and deposit taking activities. These activities would expose the Group to movement in market interest rates if not hedged.

This position arises naturally where fixed rate loans are funded with floating or variable rate borrowings, as in the Group's securitisation transactions, but may also arise where retail deposit funding is used. Where possible the Group takes advantage of natural hedging between fixed rate assets and deposits, but it is unlikely that a precise match for value and tenor of the instruments could be achieved leaving unmatched items on both sides. This is referred to as repricing or duration risk and is controlled within limits under the Group's interest rate risk management process, described in note 57. In order to manage these exposures, they are hedged with financial derivatives and form part of the Group's portfolio hedging arrangements. Duration risk is monitored regularly to ensure mismatches or gaps remain within limits set by policy.

Responsibility to direct and oversee structural interest rate risk management has been delegated by the Board to the Executive Risk Committee ('ERC') and by ERC to the Asset and Liability Committee ('ALCO'). A hedging strategy is developed for each fixed product considering behavioural characteristics, such as whether a customer is likely to prepay before contractual maturity. This is reviewed from time to time with any changes agreed with ALCO.

In order to manage potential exposure to changes in interest rates between the point at which fixed rate products are priced and the advance date, it may be necessary to undertake hedging of assets in the pipeline. Interest rate swaps used to hedge pipeline loan exposures, which are not yet recognised on the balance sheet, can cause unmatched fair value costs or credits to arise until both sides of the hedge can be recognised within the interest rate portfolio hedging arrangement, generally a few months after the inception of the derivative contract.

In managing interest rate exposure, Treasury may use interest rate swaps, forward rate agreements, swaptions or interest rate caps and floors. However, interest rate swaps are the most generally used instruments.

This policy creates two macro hedges:

- The 'loan hedge' matching fixed rate buy-to-let mortgage assets, or other fixed rate assets, with interest rate swaps to convert the interest receivable to a floating rate
- The 'deposit hedge' matching fixed rate deposits with interest rate swaps which operates in the opposite direction, converting the fixed rate interest payable to floating rate amounts

The Group is in the process of changing the principal sterling reference rate used in its interest rate risk management framework from LIBOR to SONIA and all new interest rate swap agreements since 1 February 2020 have referenced SONIA.

This means that each of these macro hedges can be divided into two sections, one referencing LIBOR and one SONIA. Through the year, as assets and deposits matured and were replaced by new business, the LIBOR-linked element of the hedges reduced, and the SONIA-linked element increased.

All interest rate hedging arrangements for fixed rate assets or liabilities are executed with SONIA as a reference rate. In addition, hedging related to fixed rate assets funded in the most recent securitisation transactions, PM26, PM27 and PM28, where the funding rate is SONIA-linked, was also undertaken with reference to SONIA.

During the year the Group has continued to hedge interest rate risk on fixed rate CBILS and BBLS exposures using SONIA-linked basis guarantee swaps, which are included in the loan hedge.

As part of an agreement reached with the noteholders of PM25, described in note 28, to transition that transaction to a SONIA-linked basis, all LIBOR-linked derivatives owned by that entity will transition to SONIA on an agreed basis by 15 February 2022, with the final reset of each falling in or before December 2021.

There remains a back book of swaps referencing three-month LIBOR, which is currently running off as the instruments reach maturity. Certain of these swaps have a maturity after December 2021, when LIBOR is scheduled to become unavailable. The ISDA, the trade organisation for derivatives, have released a protocol which incorporates fallback provisions to facilitate transition to SONIA when LIBOR ceases and the Group expects to transition its remaining LIBOR-linked derivatives in accordance with the protocol before LIBOR cessation.

The designation of the two macro hedges is updated, on a month-by-month basis, using software which compares the overall tenor, value and rate positions to match the expected fair value movement of the swaps with the expected interest rate risk related movement in the fair value of the relevant assets or liabilities over the designation period as closely as possible. The software applies regression analysis techniques to the potential impact of changes in expected interest rates over the designation period to maximise expected hedge effectiveness on a prospective basis. The value of the portfolio of loans or deposits selected is then designated, as a monetary amount of interest rate risk, as the hedged item, while the portfolio of swaps selected are designated as the hedging instruments.

Any swaps not selected in this process are disclosed as derivatives not in hedging relationships.

At the end of each designation period the Group will assess the effectiveness of each hedge retrospectively, based on fair value movements (relating to interest rate risk components only) which have occurred in the period. Movements are compared to pre-determined test thresholds using regression techniques to determine whether the hedge was effective in the period.

Ineffectiveness

The Group has identified the following possible sources of hedge ineffectiveness in its portfolio hedges of interest rate risk:

- The maturity profile of the hedging instruments may not exactly match that of the hedged items, particularly where hedged items settle early
- The use of derivatives as a hedge of interest rate risk additionally exposes the Group to the derivative counterparties' credit risk, which is not matched in the hedged item. This risk is minimised by transacting only with high quality counterparties and through collateralisation arrangements (as described in note 55)
- The use of different discounting curves in measuring fair value changes in the hedged items and hedging instruments
- Difference in the timing of interest payments on the hedged items and settlements on the hedging instruments

These sources of ineffectiveness are minimised by the portfolio matching process, which seeks to match the terms of the items as closely as possible.

In addition to the hedging ineffectiveness described above, group profit will also be affected by the fair value movements of interest rate swap agreements which were entered into as part of the Group's interest rate risk hedging strategy but failed to find a match in the hedging portfolio.

Hedging Instruments

The hedging portfolios at 30 September 2021 and 30 September 2020 consist of a large number of sterling denominated swaps. In addition, there are a small number of Balance Guarantee Swaps ('BGS') in place at both dates. Settlement on all swaps is generally quarterly (monthly for BGS) where:

- One payment is calculated based on a fixed rate of interest and the nominal value of the swap
- An opposite payment is calculated based on the same nominal value but using a floating interest rate set at a fixed margin over a reference rate, LIBOR or SONIA

On the BGS the nominal value of the swap is linked to the principal value of a pool of assets and reduces in line with redemptions and repayments until maturity. Other interest rate swaps have a fixed nominal value throughout their lives.

The Group pays fixed rate and receives floating when hedging exposures from fixed rate assets (in the loan hedge). Conversely, the Group pays floating rate and receives fixed rate when hedging fixed rate deposits, in the deposit hedge.

The principal terms of the hedging instruments are set out below, analysed between the two directions of the swap.

	2021		2020	
	Deposit hedge	**Loan hedge**	Deposit hedge	Loan hedge
Average fixed notional interest rate	**0.16%**	**0.69%**	0.42%	0.91%
Average notional margin over LIBOR	**-**	**-**	-	-
Average notional margin over SONIA	**-**	**-**	-	-
	£m	**£m**	£m	£m
Notional principal value				
LIBOR swaps	**471.5**	**3,121.4**	1,147.5	3,968.8
SONIA BGS	**-**	**62.6**	-	25.2
Other SONIA swaps	**2,415.0**	**2,876.2**	1,043.0	1,317.3
	2,886.5	**6,060.2**	2,190.5	5,311.3
Maturing				
Within one year	**2,224.5**	**920.7**	1,287.5	531.5
Between one and two years	**422.0**	**1,712.7**	669.0	1,012.1
Between two and five years	**240.0**	**3,421.3**	234.0	3,731.0
More than five years	**-**	**5.5**	-	36.7
	2,886.5	**6,060.2**	2,190.5	5,311.3
Fair value	**(3.1)**	**0.1**	14.3	(129.9)

The value included above for BGS are analysed by their contractual maturity dates although, due to the terms of the instruments, it is likely that the balance outstanding will reduce more quickly.

The increased levels of hedging shown above arise from the growth in both the loan and deposit books. The changes in fair value are a result of moves in market implied interest rates compared to the rates on the fixed legs of the swaps.

Accounting impacts

Movements affecting the portfolio fair value hedges during the year are set out below.

	2021		2020	
	Deposit hedge	**Loan hedge**	Deposit hedge	Loan hedge
	£m	**£m**	£m	£m
Hedging instruments				
Interest rate swaps				
Included in derivative financial assets	**2.8**	**35.9**	14.3	-
Included in derivative financial liabilities	**(5.9)**	**(35.8)**	-	(129.9)
	(3.1)	**0.1**	14.3	(129.9)
Notional principal value	**2,886.5**	**6,060.2**	2,190.5	5,311.3
Change in fair value used in calculating hedge ineffectiveness	**(15.4)**	**128.6**	6.6	(48.1)

	2021		2020	
	Deposit hedge	**Loan hedge**	Deposit hedge	Loan hedge
	£m	**£m**	£m	£m
Hedged items				
Fixed rate deposits				
Monetary amount of risk relating to Retail Deposits	**2,730.4**	-	2,083.9	-
Fixed rate loans				
Monetary amount of risk relating to Loans to Customers	**-**	**6,120.7**	-	5,353.4
Accumulated amount of fair value hedge adjustments included on balance sheet (notes 15 and 26)*	**3.0**	**5.5**	(10.4)	109.7
Of which: amounts related to discontinued hedging relationships being amortised	**(1.7)**	**6.9**	-	(11.6)
Change in fair value used in recognising hedge ineffectiveness	**15.1**	**(122.0)**	(6.4)	48.2
Hedge ineffectiveness recognised				
Included in fair value gains / (losses) in the profit and loss account	**(0.3)**	**6.6**	0.2	0.1

* Under the IAS 39 rules relating to fair value hedge accounting for portfolios of interest rate risk, the change in the fair value of the hedged items attributable to the hedged risk is shown as 'fair value adjustments from portfolio hedging' next to the carrying value of the hedged assets or liabilities in the appropriate note.

(b) Cash flow hedging

Background and hedging objectives

The Group has historically entered into cross-currency basis swap agreements which formed part of certain of its securitisation arrangements, providing an economic hedge against financial risks inherent in the deal structures, as described below. The last of these arrangements terminated during the year ended 30 September 2021. These hedging relationships were designated as cash flow hedges for accounting purposes.

In any securitisation where asset backed floating rate notes ('FRNs') are issued in currency (US dollars or Euros ('EUR')), a currency and interest rate mismatch between assets and liabilities would exist, exposing the securitisation and the Group to both foreign exchange and interest basis risk.

This would preclude such a deal from attaining a AAA rating for its senior debt. To address that issue, in each deal a bespoke cross-currency basis swap was written, with the swap being an asset or liability of the relevant SPV company.

The effect of these swaps is to translate the required currency payments, both principal and interest to sterling payments, based on a fixed rate of exchange. They also translate the reference rate of interest on the notes from a dollar LIBOR or Euro Interbank Offered Rate ('EURIBOR') basis to a sterling LIBOR basis. This effectively eliminates the foreign exchange and interest rate basis risks with respect to these instruments.

In order to achieve a AAA rating for the deal, the swaps must themselves be capable of this level of rating. Therefore, the deal conditions specify that only high quality counterparties may be used, and that where there is a deterioration in credit quality of the counterparty, collateral must be posted. The collateral requirement is supervised by the independent third-party rating agencies.

Hedging instruments

Under these swap agreements

- The Group made quarterly payments of principal and floating rate interest in sterling and received equivalent amounts of principal and floating rate interest, in currency (either US dollars or euros), translated at an exchange rate fixed on inception
- Settlement of both the cross-currency basis swaps and the notes to which they relate took place on the same date. The Group made a single payment in sterling to the swap provider who then made the corresponding swap payment in currency to the external principal paying agent. The principal paying agent then used the funds immediately upon receipt to make the payments required on the currency notes
- The nominal amount of the swaps was adjusted automatically, quarter by quarter, such that it always amortised in line with the quarterly payments of principal made on the currency notes (a 'balance guarantee' feature)
- Floating rate interest on the sterling (pay) leg of the swaps was set with reference to three-month sterling LIBOR, with floating rate interest on the currency (receive) legs set by reference to equivalent currency rates
- The payment and repricing dates were the same (to the day) for the swaps as for their underlying notes
- The swaps had to remain in place for as long as the notes were outstanding

The principal terms of the hedging instruments (the cross-currency basis swaps) are summarised below.

	2021		2020	
	Swap currency		Swap currency	
	USD	**EUR**	USD	EUR
Average fixed exchange rate	-	-	2.0	1.5
Average margin over LIBOR on interest payable	-	-	0.23%	0.48%
Average margin over US dollar LIBOR / EURIBOR on interest receivable	-	-	0.19%	0.54%
Notional principal value (£m)	-	-	397.0	687.5
Fair value (£m)	-	-	213.2	232.1
Average remaining term (years)	-	-	20	21

Although the average remaining contractual term is as shown above, the link between the notional principal of the swaps and the balance outstanding on the notes means that the lives were, in practice, much shorter.

The absolute value of these swaps was relatively large as the majority of the instruments dated from before the 2008 credit crisis, when a major dislocation in rates occurred, creating significant market value in the instruments. However, economically, this was offset by the corresponding increase in the carrying value of the currency denominated notes. All the balances shown above related to swaps with inception dates in 2008 or earlier and all were terminated in the course of the year when the related borrowings were repaid.

Sources of potential ineffectiveness

All cross-currency basis swap agreements were designated as cash flow hedges in line with their economic effect and the critical terms, such as interest and exchange rates, pricing dates and principal balances of the designated hedging instruments exactly matched those of the hedged currency denominated FRNs. This resulted in a critical terms match for IAS 39 purposes and hence no ineffectiveness could arise from sources other than credit risk.

In respect of credit risk, the hedging instruments could be partially collateralised, depending on the rating of the counterparties from time to time. Additional collateral was conditionally available, as described in note 55, under the terms of the instruments. This generated a small potential credit valuation adjustment associated with the derivative asset representing the credit risk of the receivable future cash flows that make up the derivative fair value. However, IAS 39 requires that Other Comprehensive Income ('OCI') is adjusted by the lower of the cumulative gain or loss on the derivative or the hedged item (as proxied by a hypothetical derivative). As the derivative bears credit risk of the counterparty (for the uncollateralised portion) it has a lower fair value than the hypothetical derivative. The result is that the full fair value of the derivative is taken to OCI as it is the lower of the two amounts and no ineffectiveness arises.

Accounting impacts

Movements affecting the cash flow hedge relationships in the year are set out below.

	2021		2020	
	Swap currency		Swap currency	
	USD	**EUR**	USD	EUR
	£m	**£m**	£m	£m
Hedging Instruments				
Cross-currency basis swaps				
Included in derivative financial assets	**-**	**-**	213.2	232.1
Included in derivative financial liabilities	**-**	**-**	-	-
	-	**-**	213.2	232.1
Notional principal value	**-**	**-**	397.0	687.5
Change in fair value used in calculating hedge ineffectiveness	**(29.1)**	**(28.3)**	(29.5)	(42.6)
Hedged Items				
Floating rate notes				
Included in Asset Backed Loan Notes	**-**	**-**	397.0	687.5
Changes in fair value used in calculating hedge ineffectiveness	**(29.1)**	**(28.3)**	(29.5)	(42.6)
Cash flow hedging reserve before tax	**-**	**-**	0.7	2.3

The table below summarises the amounts which have affected total comprehensive income as a result of the cash flow hedges described above.

	2021	2020
	£m	£m
Change of value in hedging instrument recognised in cash flow hedge reserve		
US dollar swaps	**(29.1)**	(29.5)
EUR swaps	**(28.3)**	(42.6)
	(57.4)	(72.1)
Amount reclassified from cash flow hedge reserve to profit, recognised as foreign exchange differences and interest on notes, both included within interest payable		
US dollar swaps	**(28.4)**	(29.0)
EUR swaps	**(26.0)**	(42.5)
	(54.4)	(71.5)
Net amount recognised in Other Comprehensive Income before tax	**(3.0)**	(0.6)

All amounts reclassified to profit in the financial year have been transferred because the hedged item has affected profit or loss.

(c) Derivatives not in a hedge accounting relationship

The Group's other derivatives comprise:

- Interest rate swaps which are economically part of the Group's portfolio hedging arrangements but failed to find a match in the hedge designation, including swaps hedging interest rate risk on the new lending pipeline
- Currency futures, economically hedging exposures on lending denominated in currency, where hedge accounting has not been adopted due to the size of the exposure

The principal terms of these derivatives are set out below.

Interest rate swaps

	2021		2020	
	Pay fixed	**Pay floating**	Pay fixed	Pay floating
Average fixed notional interest rate	**0.49%**	**0.35%**	0.28%	0.23%
Average notional margin over LIBOR	-	-	-	-
Average notional margin over SONIA	-	-	-	-
	£m	**£m**	£m	£m
Notional principal value				
LIBOR swaps	**86.1**	**98.5**	145.7	237.0
SONIA swaps	**595.5**	**585.0**	422.0	698.0
	681.6	**683.5**	567.7	935.0
Maturing				
Within one year	**83.6**	**270.5**	128.1	715.0
Between one and two years	**85.5**	**331.0**	60.6	47.0
Between two and five years	**265.0**	**82.0**	182.0	173.0
More than five years	**247.5**	-	197.0	-
	681.6	**683.5**	567.7	935.0
Fair value	**4.2**	**(0.7)**	3.4	(2.4)

Currency futures

	2021	2020
US dollar futures		
Average future exchange rate	**1.36**	1.27
	£m	£m
Notional principal value	**11.9**	14.1
Maturing		
Within one year	**11.9**	14.1
Between one and two years	-	-
Between two and five years	-	-
	11.9	14.1
Fair value	**(0.2)**	0.2

20. Sundry assets

(a) The Group

	Note	**2021**	2020	2019
		£m	£m	£m
Current assets				
Accrued interest income		**-**	0.1	0.4
Trade receivables		**1.3**	3.2	3.6
CSA assets		**36.6**	103.5	72.2
CRDs		**23.7**	15.1	11.4
Sovereign receivables		**0.9**	0.2	-
Other receivables		**3.2**	3.2	2.7
Sundry financial assets	*65*	**65.7**	125.3	90.3
Prepayments		**3.5**	2.7	2.1
Other tax		**-**	-	0.4
		69.2	128.0	92.8

Cash ratio deposits ('CRDs') are non-interest-bearing deposits lodged with the Bank of England, based on the value of the Bank's eligible liabilities. These are required to comply with regulatory rules.

CSA assets are deposits placed with highly rated banks to act as security for the Group's derivative financial liabilities.

Neither of these balances is accessible by the Group at the balance sheet date. Therefore, they are included in sundry assets rather than cash balances.

Sovereign receivables includes amounts receivable from the UK Government under the CBILS and BBLS schemes.

CRDs, CSA assets, sovereign receivables and accrued interest are considered to be Stage 1 assets for IFRS 9 impairment purposes. The probabilities of default of the obligor institutions (the UK Government, Bank of England and major banks) have been assessed and are considered to be so low as to require no significant impairment provision.

(b) The Company

	2021	2020	2019
	£m	£m	£m
Current assets			
Amounts owed by Group companies	**73.0**	84.0	106.6
Accrued interest income	**0.1**	0.6	0.7
	73.1	84.6	107.3

The amounts owed to the Company by other group entities are considered to be Stage 1 balances for IFRS 9 impairment purposes. The PD of the subsidiaries has been assessed in the context of the Group's overall funding and asset position, and is considered to be so low as to require no significant impairment provision.

21. Deferred tax

(a) The Group

The movements in the net deferred tax asset / (liability) are as follows:

	Note	**2021**	2020	2019
		£m	£m	£m
Opening net asset / (liability)				
As previously reported		**6.2**	6.2	(5.6)
Change of accounting policy	59	**-**	-	5.0
Restated		**6.2**	6.2	(0.6)
Derecognition		**-**	-	1.8
Acquisitions		**-**	-	0.5
Income statement credit / (charge)	11	**6.9**	(1.1)	2.3
Credit to equity		**1.3**	1.1	2.2
Closing net asset		**14.4**	6.2	6.2

The net deferred tax asset for which provision has been made is analysed as follows:

	2021	2020	2019
	£m	£m	£m
Accelerated tax depreciation	**5.9**	2.9	2.3
Retirement benefit obligations	**4.4**	6.7	5.9
Loans and derivatives	**(0.7)**	(5.2)	(3.8)
Share based payments	**5.2**	1.7	2.9
Tax losses	**0.4**	1.3	0.4
Other timing differences	**(0.8)**	(1.2)	(1.5)
Net deferred tax asset	**14.4**	6.2	6.2

Classification of deferred tax amounts has been updated in the year to provide better information for users. Comparative amounts have been restated for consistency.

As stated in note 11, legislation in the year has increased the rate of corporation tax in the UK to 25.0% from April 2023. This change has been reflected in the deferred tax balance. The temporary differences shown above have been provided at the rate prevailing when the Group anticipates these temporary differences to reverse. In the event that the temporary differences actually reverse in different periods a credit or charge will arise in a future period to reflect the difference. The timing of reversal of temporary differences will be affected by both matters within the Group's control (eg the timing and nature of the refinancing of certain portfolios) and matters outside the Group's control (eg the level of redemptions of finance leases).

If temporary differences reverse within Paragon Bank PLC in a period in which it is subject to the banking surcharge, then the impact of the reversal will be at an effective tax rate that includes the banking surcharge to some extent. While the UK Government announced a reduction in the banking surcharge in its October 2021 budget, as this had not been substantially enacted at the balance sheet date, no account is taken of it in these accounts.

In addition to the temporary differences, the Group has tax losses of £4.0m (2020: £2.3m) in entities whose current taxable profits are insufficient to support the recognition of a deferred tax asset.

(b) The Company

The movements in the net deferred tax liability are as follows:

	2021	2020	2019
	£m	£m	£m
Opening net liability	**1.8**	1.6	1.8
Income statement charge / (credit)	**-**	0.2	(0.2)
Closing net liability	**1.8**	1.8	1.6

The net deferred tax liability for which provision has been made is analysed as follows:

	2021	2020	2019
	£m	£m	£m
Other timing differences	**1.8**	1.8	1.6
Net deferred tax liability	**1.8**	1.8	1.6

22. Property, plant and equipment

(a) The Group

	Leased assets	**Land and buildings**	**Plant and machinery**	**Total**
	£m	**£m**	**£m**	**£m**
Cost				
At 30 September 2019	52.7	22.8	10.6	86.1
Adoption of IFRS 16 (note 59)	-	6.0	1.0	7.0
Additions	12.9	0.7	1.5	15.1
Disposals	(7.5)	-	(0.6)	(8.1)
At 30 September 2020	58.1	29.5	12.5	100.1
Additions	13.0	7.1	1.8	21.9
Disposals	(8.2)	(0.8)	(0.9)	(9.9)
At 30 September 2021	**62.9**	**35.8**	**13.4**	**112.1**
Accumulated depreciation				
At 30 September 2019	16.4	4.1	8.3	28.8
Charge for the year	8.3	1.8	1.7	11.8
On disposals	(6.1)	-	(0.5)	(6.6)
At 30 September 2020	18.6	5.9	9.5	34.0
Charge for the year	8.9	2.7	1.6	13.2
On disposals	(3.9)	(0.8)	(0.8)	(5.5)
At 30 September 2021	**23.6**	**7.8**	**10.3**	**41.7**
Net book value				
At 30 September 2021	**39.3**	**28.0**	**3.1**	**70.4**
At 30 September 2020	39.5	23.6	3.0	66.1
At 30 September 2019	36.3	18.7	2.3	57.3

Land and buildings and plant and machinery shown above are used within the Group's business. Leased assets includes £26.8m in respect of assets leased under operating leases (2020: £27.0m) and £12.5m of assets available for hire (2020: £12.5m).

The carrying values of right of use of assets, in respect of leases where the Group is the lessee, included in property, plant and equipment are set out below.

	Land and buildings	Plant and machinery	Total
	£m	£m	£m
Cost			
At 30 September 2019	-	-	-
Adoption of IFRS 16 (note 59)	6.0	1.0	7.0
Additions	-	0.3	0.3
Disposals	-	(0.1)	(0.1)
At 30 September 2020	6.0	1.2	7.2
Additions	6.1	0.9	7.0
Disposals	(0.6)	(0.6)	(1.2)
At 30 September 2021	**11.5**	**1.5**	**13.0**
Accumulated depreciation			
At 30 September 2019	-	-	-
Charge for the year	1.4	0.6	2.0
On disposals	-	(0.1)	(0.1)
At 30 September 2020	1.4	0.5	1.9
Charge for the year	2.2	0.6	2.8
On disposals	(0.6)	(0.4)	(1.0)
At 30 September 2021	**3.0**	**0.7**	**3.7**
Net book value			
At 30 September 2021	**8.5**	**0.8**	**9.3**
At 30 September 2020	4.6	0.7	5.3
At 30 September 2019	-	-	-

During the year ended 30 September 2018, the Group entered into a transaction with the Paragon Pension Plan, effectively granting a first charge over its freehold head office building as security for its agreed contributions under the recovery plan. The carrying value of the assets subject to this charge was £17.4m (2020: £17.7m).

(b) The Company

The property, plant and equipment balance of the Company represents a right of use asset in respect of a building leased from a fellow group entity. The carrying value of this asset is set out below.

	Land and buildings £m
Cost	
At 30 September 2019	-
Adoption of IFRS 16 (note 59)	18.8
Additions	-
Disposals	-
At 30 September 2020	18.8
Additions	-
Disposals	-
At 30 September 2021	**18.8**
Accumulated depreciation	
At 30 September 2019	-
Charge for the year	1.4
On disposals	-
At 30 September 2020	1.4
Charge for the year	1.4
On disposals	-
At 30 September 2021	**2.8**
Net book value	
At 30 September 2021	**16.0**
At 30 September 2020	17.4
At 30 September 2019	-

23. Intangible assets

	Goodwill (note 24)	Computer software	Other intangible assets	Total
	£m	£m	£m	£m
Cost				
At 30 September 2019	170.4	11.4	10.6	192.4
Additions	-	1.0	-	1.0
At 30 September 2020	170.4	12.4	10.6	193.4
Additions	-	2.4	-	2.4
At 30 September 2021	**170.4**	**14.8**	**10.6**	**195.8**
Accumulated amortisation and impairment				
At 30 September 2019	6.0	9.0	6.3	21.3
Amortisation charge for the year	-	1.2	0.8	2.0
At 30 September 2020	6.0	10.2	7.1	23.3
Amortisation charge for the year	-	1.2	0.8	2.0
At 30 September 2021	**6.0**	**11.4**	**7.9**	**25.3**
Net book value				
At 30 September 2021	**164.4**	**3.4**	**2.7**	**170.5**
At 30 September 2020	164.4	2.2	3.5	170.1
At 30 September 2019	164.4	2.4	4.3	171.1

Other intangible assets comprise brands and the benefit of business networks recognised on the acquisition of businesses.

24. Goodwill

The goodwill carried in the accounts is attributable to three cash generating units ('CGU's), which have not changed in the year. The balance is as analysed below:

	2021	2020
	£m	£m
CGU		
SME lending	**113.0**	113.0
Development finance	**49.8**	49.8
TBMC	**1.6**	1.6
	164.4	164.4

(a) SME lending

The goodwill carried in the accounts relating to the SME lending CGU was recognised on acquisitions in the years ended 30 September 2016 and 30 September 2018.

An impairment review undertaken at 30 September 2021 indicated that no write down was required.

The recoverable amount of the SME lending CGU used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board in November 2021 covering a five-year period. These forecasts reflect the projected trajectory of the business recovery from the Covid pandemic with the five year average growth rate beginning to normalise following the initial bounce back phase in 2021, as well as the Group's current strategy for the business.

The key assumptions underlying the value in use calculation for the SME lending CGU are:

- Level of business activity, based on management expectations. The forecast assumes a compound annual growth rate ('CAGR') for new business over the five-year period of 13.9%, compared with 19.7% used in the calculation at 30 September 2020. Cash flows beyond the five-year budget are extrapolated using a constant growth rate of 1.6% (2020: 1.5%) which does not exceed the long term average growth rates for the markets in which the business is active

  Management have concluded that the levels of activity assumed for the purpose of this forecast are reasonable, based on past experience and the current economic environment

- Discount rate, which is based on third party estimates of the implied industry cost of capital. The pre-tax discount rate applied to the cash flow projection is 13.4% (2020: 15.0%)

As an illustration of the sensitivity of this impairment test to movements in the key assumptions, the Group has calculated that a 0% growth rate combined with a 15.0% reduction in profit levels and a 159 basis point increase in the pre-tax discount rate would eliminate the headroom in the projection. A 0% growth rate combined with a 20.7% reduction in profit levels and a 125 basis point increase in the pre-tax discount rate would generate a write down of £10.0m.

In the testing carried out at 30 September 2020, a 10.0% reduction in profit levels coupled with a 100 basis point increase in the pre-tax discount rate would eliminate the headroom.

(b) Development finance

The goodwill carried in the accounts relating to the development finance CGU was first recognised on a business acquisition in the year ended 30 September 2018.

An impairment review undertaken at 30 September 2021 indicated that no write down was required.

The recoverable amount of the development finance CGU used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board in November 2021 covering a five-year period. These forecasts show growth slower than that originally forecast for 2021 which was inflated by the impact of the initial post Covid bounce back.

The key assumptions underlying the value in use calculation for the development finance CGU are:

- Level of business activity, based on management expectations. The forecast assumes a CAGR for drawdowns over the five-year period of 13.2%, compared with 16.9% used in the calculation at 30 September 2020. Cash flows beyond the five-year budget are extrapolated using a constant growth rate of 1.6% (2020: 1.5%) which does not exceed the long-term average growth rate for the UK economy

  Management have concluded that the levels of activity assumed for the purpose of this forecast are reasonable, based on past experience and the current economic environment

- Discount rate, which is based on third party estimates of the implied industry cost of capital. The pre-tax discount rate applied to the cash flow projection is 13.2% (2020: 14.2%)

Management believes any reasonably possible change in the key assumptions above would not cause the recoverable amount of the development finance CGU to fall below the balance sheet carrying value. This was also the case in the testing carried out at 30 September 2020.

(c) TBMC

The goodwill carried in the accounts relating to the TBMC CGU was recognised on an acquisition in December 2008 and impaired by £6.0m in 2009.

An impairment review was undertaken at 30 September 2021 which indicated no further impairment. The recoverable amount of the TBMC CGU used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board covering a five year period. The pre-tax discount rate applied to the cash flow projection is 4.94% (2020: 4.41%) and cash flows beyond the five year budget are extrapolated using a 1.6% (2020: 1.6%) growth rate, being the average long term growth rate in the UK economy over a twenty year period.

The key assumptions underlying the value in use calculation for the TBMC business are:

- Level of business activity, based on management expectations. Management have concluded that the levels of activity assumed for the purpose of this forecast are reasonable, based on past experience and the current economic environment

- Discount rate, which is based on market rates of interest plus a margin appropriate to the risk profile of the TBMC business as an investment

The directors believe that no reasonably possible change in any of the key assumptions above would cause the recoverable value of the CGU to fall below its balance sheet carrying value. This was also the case at 30 September 2020.

25. Investment in subsidiary undertakings

	Shares in group companies	Loans to group companies	Loans to ESOP Trusts	Total
	£m	£m	£m	£m
At 30 September 2019	640.5	300.0	0.2	940.7
Capital distributions	(15.6)	-	-	(15.6)
Loans advanced	-	90.0	4.7	94.7
Loans repaid	-	-	-	-
Provision movements	14.7	-	(4.4)	10.3
At 30 September 2020	639.6	390.0	0.5	1,030.1
Capital distributions	(0.7)	-	-	(0.7)
Loans advanced	-	256.0	3.9	259.9
Loans repaid	-	(306.5)	-	(306.5)
Provision movements	(0.2)	-	(4.1)	(4.3)
At 30 September 2021	**638.7**	**339.5**	**0.3**	**978.5**

During the years ended 30 September 2021 and 30 September 2020, the Group carried out capital reductions in various non-trading subsidiaries. Dividends were paid, or capital was distributed to the parent and the investments above were written off as a result of the reduction in these entities' net assets.

During the year ended 30 September 2021 the Company received £97.8m in dividend income from its subsidiaries (2020: £113.9m) and £22.5m of interest on loans to group companies (2020: £18.2m).

The Company's subsidiaries, and the nature of its interest in them, are shown in note 66.

26. Retail deposits

The Group's retail deposits, held by Paragon Bank PLC, were received from customers in the UK and are denominated in sterling. The deposits comprise principally term deposits, and notice and easy access accounts. The method of interest calculation on these deposits is analysed as follows:

	2021	2020	2019
	£m	£m	£m
Fixed rate	**5,466.0**	4,975.9	4,154.4
Variable rates	**3,834.4**	2,880.7	2,237.5
	9,300.4	7,856.6	6,391.9

The weighted average interest rate on retail deposits at 30 September 2021, analysed by charging method, was:

	2021	2020	2019
	%	%	%
Fixed rate	**1.25**	1.69	2.02
Variable rates	**0.42**	0.72	1.43
All deposits	**0.91**	1.34	1.81

The contractual maturity of these deposits is analysed below.

	2021	2020	2019
	£m	£m	£m
Amounts repayable			
In less than three months	**789.0**	565.0	466.6
In more than three months, but not more than one year	**3,105.4**	2,725.6	2,088.4
In more than one year, but not more than two years	**1,580.1**	1,541.6	1,158.0
In more than two years, but not more than five years	**507.4**	664.8	900.9
Total term deposits	**5,981.9**	5,497.0	4,613.9
Repayable on demand	**3,318.5**	2,359.6	1,778.0
	9,300.4	7,856.6	6,391.9
Fair value adjustments for portfolio hedging (note 19)	**(3.0)**	10.4	3.9
	9,297.4	7,867.0	6,395.8

27. Asset backed loan notes

The Group's asset backed loan notes ('Notes') are rated and publicly listed and are secured on portfolios comprising variable and fixed rate mortgages. The maturity date of the Notes matches the maturity date of the underlying assets. The Notes can be prepaid in part from time to time, but such prepayments are limited to the net capital received from borrowers in respect of the underlying assets. There is no requirement for the Group to make good any shortfall on the Notes out of general funds. It is likely that a substantial proportion of the Notes will be repaid within five years.

The Group also has an option to repay all the Notes on any issue at an earlier date (the 'call date'), at their outstanding principal amount.

During the year ended 30 September 2021 interest was payable at a fixed margin above:

- LIBOR on notes denominated in sterling, other than notes issued by Paragon Mortgages (No. 26) PLC, Paragon Mortgages (No. 27) PLC and Paragon Mortgages (No. 28) PLC
- The compounded Sterling Overnight Interbank Average Rate ('SONIA') on notes denominated in sterling issued by Paragon Mortgages (No. 26) PLC, Paragon Mortgages (No. 27) PLC and Paragon Mortgages (No. 28) PLC
- EURIBOR on notes denominated in EUR
- The London Interbank Offered Rate ('US dollar LIBOR') on notes denominated in US dollars

At 30 September 2021 all notes remaining in issue paid interest at rates referencing SONIA, other than those issued by Paragon Mortgages (No. 25) PLC, where LIBOR was used. An agreement for the transition of this arrangement to a SONIA basis was completed in the year, and is described below.

The Group therefore has no remaining loan note liabilities which will be affected by the withdrawal of IBOR rates, including LIBOR.

All payments in respect of the Notes are required to be made in the currency in which they are denominated.

The Group publishes detailed information on the performance of all its note issues on the Bond Investor Reporting section of its website at www.paragonbankinggroup.co.uk. A more detailed description of the securitisation structure under which these Notes are issued is given in note 56.

On 11 November 2020, a group company, Paragon Mortgages (No. 28) PLC, issued £703.1m of sterling mortgage backed floating rate notes, analysed below, at par.

Class	Fitch rating	Moody's rating	Interest margin above compounded SONIA	Principal value £m
A	AAA	Aaa	0.95%	623.8
B	AA	Aa1	1.35%	39.7
C	A	Aa3	1.65%	21.6
D	BBB	Baa1	1.95%	18.0
				703.1

All the above notes were retained by the Group.

Notes in issue at 30 September 2020 and 30 September 2019, net of any held by the Group, were:

Issuer	Maturity date	Call date	Principal outstanding		Average interest margin	
			2021	2020	**2021**	2020
Sterling notes			**£m**	£m	**%**	%
Interest based on LIBOR						
Paragon Mortgages (No. 11) PLC	15/10/41	15/04/10	-	221.1	-	0.15
Paragon Mortgages (No. 13) PLC	15/01/39	15/10/10	-	416.4	-	0.27
Paragon Mortgages (No. 14) PLC	15/09/39	15/03/11	-	390.0	-	0.23
Paragon Mortgages (No. 15) PLC	15/12/39	15/06/11	-	108.5	-	0.30
Paragon Mortgages (No. 25) PLC	15/05/50	15/05/23	**338.9**	379.4	**0.73**	0.72
Interest based on SONIA						
Paragon Mortgages (No. 26) PLC	15/05/45	15/08/24	**179.2**	231.3	**1.05**	1.05
Paragon Mortgages (No. 27) PLC†	15/04/47	15/10/25	-	-	-	-
Paragon Mortgages (No. 28) PLC†	15/12/47	15/12/25	-	-	-	-
US dollar notes			**$m**	$m	**%**	%
Paragon Mortgages (No. 13) PLC	15/01/39	15/10/10	-	134.6	-	0.18
Paragon Mortgages (No. 14) PLC	15/09/39	15/03/11	-	150.7	-	0.20
Paragon Mortgages (No. 15) PLC	15/12/39	15/06/11	-	502.1	-	0.19
EUR notes			**€m**	€m	**%**	%
Paragon Mortgages (No. 11) PLC	15/10/41	15/04/10	-	**182.4**	-	**0.54**
Paragon Mortgages (No. 13) PLC	15/01/39	15/10/10	-	**268.3**	-	**0.42**
Paragon Mortgages (No. 14) PLC	15/09/39	15/03/11	-	**317.0**	-	**0.48**
Paragon Mortgages (No. 15) PLC	15/12/39	15/06/11	-	**244.0**	-	**0.73**

† All notes issued by Paragon Mortgages (No. 27) and Paragon Mortgages (No. 28) were retained by the Group (see note 56)

The details of the assets backing these securities are given in note 16.

On 25 August 2021 an agreement was reached with the senior noteholders of Paragon Mortgages (No. 25) PLC to transition to a SONIA-linked basis for interest charging, effective from the interest payment date on 15 February 2022. From that date the notes will bear interest calculated with reference to SONIA rather than LIBOR and the note margins will be increased by 0.12% in line with the ISDA fallback adjustment rate. Other terms of the notes remain unchanged. The agreement also provided for the transition of hedging arrangements in the securitisation to a SONIA basis.

During the year, the Group redeemed all of the outstanding notes of the following securitisations at par:

- Paragon Mortgages (No. 11) PLC on 15 October 2020
- Paragon Mortgages (No. 13) PLC on 15 April 2021
- Paragon Mortgages (No. 14) PLC on 15 June 2021
- Paragon Mortgages (No. 15) PLC on 15 December 2020

The underlying assets were subsequently funded by other group companies.

On 26 June 2019, the Group disposed of its beneficial interest in the Paragon Mortgages (No. 12) PLC securitisation. At that point, the FRN liabilities were derecognised by the Group, although the notes remain in issue. The Group's continuing involvement in the transaction is described in note 45.

28. Bank borrowings

New first mortgage loans may be financed by a secured bank loan, referred to as a 'warehouse facility'. The Group's warehouse facilities may also be used to acquire accounts from other group companies to be held on a temporary basis as part of the Group's overall management of funding and liquidity. Such internal transfers are on a no gain / no loss basis.

These facilities are drawn on the completion or acquisition of a mortgage and repayment of the facilities is restricted to the principal cash received in respect of the funded mortgages. Loans held 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 56 and details of assets held within the warehouse facilities are given in note 16. Details of the Group's bank borrowings are set out below.

		2021			2020	
	Principal value	**Maximum available facility**	**Carrying value**	Principal value	Maximum available facility	Carrying value
	£m	**£m**	**£m**	£m	£m	£m
i) Paragon Second Funding	**529.0**	**529.0**	**529.0**	657.8	657.8	657.8
ii) Paragon Seventh Funding	**201.0**	**400.0**	**201.0**	-	400.0	-
	730.0	**929.0**	**730.0**	657.8	1,057.8	657.8

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 was payable monthly at 0.675% above LIBOR until 26 February 2021 and at 0.704% above SONIA thereafter.

ii) On 14 November 2018, a £200.0m warehouse funding facility was agreed between Paragon Seventh Funding Limited and Bank of America Merrill Lynch. The facility is secured over all the assets of Paragon Seventh Funding Limited, with a 12 month commitment period. This was renewed for 12 months on 24 October 2019 and was increased to £400.0m and renewed for a further 18 month commitment on 25 September 2020. Interest was payable at 0.95% over three month LIBOR up to 25 September 2020, 1.05% over three month LIBOR between that date and 25 March 2021 and 0.60% over three month LIBOR thereafter. The renewal also included terms on which the reference rate would be transitioned to SONIA during the commitment period.

On 8 November 2021, after the year end, revisions to the facility were agreed extending the commitment period for an initial 13-month period with the ability to extend monthly until a potential final maturity date of 24 November 2024. The maximum drawing was increased to £450.0m and the interest rate payable was transitioned to 0.5% above SONIA.

29. 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**	**2021**	2020
				£m	£m
5 December 2020	6.000% p.a. fixed	par	GBP	**-**	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
				237.5	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 £237.1m (2020: £296.8m), of which £125.0m falls due within one year (2020: £60.0m).

30. Corporate bonds

On 25 March 2021 the Company issued £150.0m of Fixed Rate Callable Subordinated Tier-2 Notes due 2031 at par. These Notes bear interest at a rate of 4.375% per annum until 25 September 2026 after which interest will be payable at a reset rate which is 3.956% over that payable on UK Government bonds of similar duration at that time. These Notes are callable at the option of the Company between 25 June 2026 and 25 September 2026 and may be called at any time in the event of certain tax or regulatory changes. The Notes are unsecured and subordinated to all creditors of the Company. The Notes are rated BB+ by Fitch. The proceeds of the Notes are utilised in accordance with the Group's Green Bond Framework, which is available on its investor website.

At the same time as this issuance the Group purchased £130.9m of nominal value of its 2016 Tier-2 Notes by market tender for a total consideration of £134.6m. These Notes were derecognised and the premium paid taken to profit and loss as interest payable and similar charges. The remaining 2016 Bonds were redeemed at par at their call date in September 2021.

The redeemed notes were issued on 9 September 2016 and comprised £150.0m of 7.25% Fixed Rate Reset Callable Subordinated Tier-2 Notes due 2026 at par, issued to provide long term capital for the Group. These bonds bore interest at a fixed rate of 7.25% per annum until 9 September 2021, after which interest would have been payable at a fixed rate which was 6.731% over the sterling 5-year mid-market swap rate at that time. These bonds were unsecured and subordinated to any other creditors of the Company. At 30 September 2019 the Notes were rated BBB- by Fitch and, during the year ended 30 September 2020, the Notes were downgraded to BB+ following the application of updated bank rating criteria.

The carrying value of corporate bonds in the accounts of the Group and the Company at 30 September 2021 was £149.0m (2020: £149.8m).

31. 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 PLC ('Paragon Bank' or 'the Bank') on the security of designated pools of the Bank's first mortgage assets and/or the retained Notes described in note 56, with the amount available based on the value of the security given, subject, where appropriate, to a haircut.

Drawings under the Term Funding Scheme for SMEs ('TFSME') have a maturity of four years and bear interest at BBR. The average remaining maturity of the Group's drawings is 40 months (2020: 46 months). As these drawings were provided at rates below those available commercially, by a government agency, they were accounted for under IAS 20.

Drawings under the original Term Funding Scheme ('TFS') have a maturity of four years and bear interest at BBR. The average remaining maturity of the Group's drawings at 30 September 2021 was 4 months (2020: 9 months). As these drawings were provided at rates below those available commercially, by a government agency, they were accounted for under IAS 20. The TFS is no longer available for new drawings.

Drawings under the Indexed Long-Term Repo Scheme ('ILTR') have a maturity of six months and a rate of interest set in an auction process. While the Group did not access the ILTR during the year, it retains access to this programme for liquidity purposes.

During the year ended 30 September 2020, the Group also accessed the Contingent Term Repo Facility ('CTRF'), which was a temporary short-term facility for collateralised drawings introduced by the Bank of England in response to the Covid pandemic.

Drawings under the Funding for Lending Scheme ('FLS') were used to provide off balance sheet liquidity and formed part of the Bank's High Quality Liquid Assets ('HQLA'). Fees were charged under the FLS at 0.25% of the market value of the liquidity drawn and the facility expired in June 2020.

The amounts drawn under these facilities are set out below.

	2021	2020
	£m	£m
TFSME	**2,750.0**	910.0
TFS	**69.0**	944.4
ILTR	**-**	-
Total central bank facilities	**2,819.0**	1,854.4

At 30 September 2021 £69.0 million of TFS borrowings were due within one year (2020: £700.0m). All TFSME borrowings fall due after more than one year.

Following the year end all the TFSME borrowings were repaid and redrawn, extending the maturity date to 21 October 2025.

Further first mortgage assets of the Bank have been pre-positioned with the Bank of England for future use in such schemes and eligible retained Notes can also be used to support this funding (note 56). The mortgage assets pledged in support of these drawings are set out in note 16.

The balances arising from the TFSME and TFS carried in the Group accounts are shown below.

	2021	2021	2020	2020
	£m	£m	£m	£m
TFSME at IAS 20 carrying value	**2,657.8**		874.1	
Deferred government assistance	**92.2**		35.9	
		2,750.0		910.0
TFS at IAS 20 carrying value	**68.7**		937.5	
Deferred government assistance	**0.3**		6.9	
		69.0		944.4
		2,819.0		1,854.4

32. Sundry liabilities

(a) The Group

	2021	2020	2019
	£m	£m	£m
Current liabilities			
Accrued interest	**22.2**	29.2	37.4
Trade creditors	**1.4**	1.6	0.9
Other accruals	**33.1**	29.5	29.7
Sundry financial liabilities at amortised cost	**56.7**	60.3	68.0
Contingent consideration (note 33)	**4.6**	3.2	2.2
Sundry financial liabilities	**61.3**	63.5	70.2
Lease payables (note 34)	**1.5**	1.5	-
Deferred income	**3.3**	1.0	1.3
Conduct (note 35)	**-**	-	-
Other taxation and social security	**2.5**	3.3	2.4
	68.6	69.3	73.9
Non-current liabilities			
Accrued interest	**9.5**	14.3	14.9
Other accruals	**-**	-	0.2
Sundry financial liabilities at amortised cost	**9.5**	14.3	15.1
Contingent consideration (note 33)	**2.9**	10.3	21.5
Sundry financial liabilities	**12.4**	24.6	36.6
Lease payables (note 34)	**8.0**	4.1	-
Deferred income	**1.7**	2.0	2.2
	22.1	30.7	38.8
Total sundry financial liabilities at amortised cost	**66.2**	74.6	83.1
Total sundry financial liabilities at fair value	**7.5**	13.5	23.7
Total other sundry liabilities	**17.0**	11.9	5.9
Total sundry liabilities	**90.7**	100.0	112.7

(b) The Company

	2021	2020	2019
	£m	£m	£m
Current liabilities			
Amounts owed to Group companies	**22.6**	22.7	23.8
Accrued interest	**2.0**	2.9	3.6
Other financial liabilities	**1.0**	-	-
Sundry financial assets at amortised cost	**25.6**	25.6	27.4
Lease payables (note 34)	**1.3**	1.2	-
	26.9	26.8	27.4
Non-current liabilities			
Lease payables (note 34)	**15.0**	16.3	-
Total sundry liabilities	**41.9**	43.1	27.4

33. Contingent consideration

The contingent consideration represents consideration payable in respect of corporate acquisitions which is dependent on the performance of the acquired businesses. Movements in the balance are set out below.

	2021	2020
	£m	£m
At 1 October 2020	**13.5**	23.7
Payments	**(2.5)**	(4.4)
Revaluation	**(3.8)**	(6.2)
Unwind of discounting (note 5)	**0.3**	0.4
At 30 September 2021 (note 32)	**7.5**	13.5

The write down is a result of the reconsideration of future business volumes following the impact of Covid, and the impact of the speed of post-Covid recovery on the contingent consideration calculation.

34. Lease payables

The Group's lease liabilities arise under the leasing arrangements described in note 46. Related right of use assets are shown in note 22.

	The Group		The Company	
	2021	2020	2021	2020
	£m	£m	£m	£m
Leasing liabilities falling due:				
In more than five years	**2.3**	0.6	**9.6**	11.0
In more than two but less than five years	**3.8**	2.4	**4.1**	4.0
In more than one year but less than two years	**1.9**	1.1	**1.3**	1.3
In more than one year (note 32)	**8.0**	4.1	**15.0**	16.3
In less than one year (note 32)	**1.5**	1.5	**1.3**	1.2
	9.5	5.6	**16.3**	17.5

35. 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.

The regulatory environment continues to develop, through regulatory policies, legislative rules and court rulings, and while the Group's assessment is that it currently has no further potential liability for conduct issues, this is based on our current interpretation of requirements and hence further liabilities may arise as these develop over time.

36. Current tax liabilities / assets

Current tax in the Group and the Company represents UK corporation tax owed or recoverable.

37. 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:

	2021	2020
	Number	Number
Ordinary shares		
At 1 October 2020	**261,777,972**	261,573,351
Shares issued	**717,213**	204,621
Shares cancelled	**-**	-
At 30 September 2021	**262,495,185**	261,777,972

During the year, the Company issued 717,213 shares (2020: 204,621) to satisfy options granted under Sharesave schemes for a consideration of £2,196,934 (2020: £585,315).

On 24 November 2021, after the year end 12,100,834 shares, held in treasury at 30 September 2021 were cancelled.

38. Reserves

(a) The Group

	2021	2020	2019
	£m	£m	£m
Share premium account	**70.1**	68.7	68.3
Capital redemption reserve	**50.3**	50.3	50.3
Merger reserve	**(70.2)**	(70.2)	(70.2)
Cash flow hedging reserve (note 19)	**-**	2.5	3.0
Profit and loss account	**1,005.9**	880.7	835.9
	1,056.1	932.0	887.3

(b) The Company

	2021	2020	2019
	£m	£m	£m
Share premium account	**70.1**	68.7	68.3
Capital redemption reserve	**50.3**	50.3	50.3
Merger reserve	**(23.7)**	(23.7)	(23.7)
Profit and loss account	**358.9**	319.1	256.3
	455.6	414.4	351.2

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.

39. Own shares

	The Group		The Company	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Treasury shares				
At 1 October 2020	**23.0**	23.0	**23.0**	23.0
Shares purchased	**37.7**	-	**37.7**	-
Shares cancelled	**-**	-	**-**	-
At 30 September 2021	**60.7**	23.0	**60.7**	23.0
ESOP shares				
At 1 October 2020	**14.8**	17.5	**-**	-
Shares purchased	**4.5**	5.2	**-**	-
Options exercised	**(3.3)**	(7.9)	**-**	-
At 30 September 2021	**16.0**	14.8	**-**	-
Balance at 30 September 2021	**76.7**	37.8	**60.7**	23.0
Balance at 1 October 2020	**37.8**	40.5	**23.0**	23.0

At 30 September 2021 the number of the Company's own shares held in treasury was 12,100,834 (2020: 5,218,702). These shares had a nominal value of £12,100,834 (2020: £5,218,702). These shares do not qualify for dividends. All these shares were cancelled on 24 November 2021, after the year end.

The 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 PSP and Deferred Share Bonus Plan. The trustees' costs are included in the operating expenses of the Group.

At 30 September 2021, the trust held 3,732,324 ordinary shares (2020: 3,636,218) with a nominal value of £3,732,324 (2020: £3,636,218) and a market value of £20,359,827 (2020: £12,108,606). Options, or other share-based awards, were outstanding against all of these shares at 30 September 2021 (2020: all). The dividends on all these shares have been waived (2020: all).

40. Equity dividend

Amounts recognised as distributions to equity shareholders in the Group and the Company in the period:

	2021	2020	**2021**	2020
	Per share	Per share	**£m**	£m
Equity dividends on ordinary shares				
Final dividend for the previous year	**14.4p**	14.2p	**36.5**	35.9
Interim dividend for the current year	**7.2p**	-	**18.1**	-
	21.6p	14.2p	**54.6**	35.9

Amounts paid and proposed in respect of the year:

	2021	2020	**2021**	2020
	Per share	Per share	**£m**	£m
Interim dividend for the current year	**7.2p**	-	**18.1**	-
Proposed final dividend for the current year	**18.9p**	14.4p	**46.6**	36.4
	26.1p	14.4p	**64.7**	36.4

The proposed final dividend for the year ended 30 September 2021 will be paid on 4 March 2022, subject to approval at the AGM, with a record date of 28 January 2022. The dividend will be recognised in the accounts when it is paid.

41. Net cash flow from operating activities

(a) The Group

	2021	2020
	£m	£m
Profit before tax	**213.7**	118.4
Non-cash items included in profit and other adjustments:		
Depreciation of operating property, plant and equipment	**4.3**	3.5
Profit on disposal of operating property, plant and equipment	**0.1**	-
Amortisation of intangible assets	**2.0**	2.0
Movements related to asset backed loan notes denominated in currency	**(442.3)**	(136.8)
Other non-cash movements on borrowings	**2.5**	1.5
Impairment losses on loans to customers	**(4.7)**	48.3
Charge for share based remuneration	**8.9**	2.7
Net (increase) / decrease in operating assets:		
Assets held for leasing	**0.2**	(3.2)
Loans to customers	**(766.6)**	(493.6)
Derivative financial instruments	**419.1**	129.1
Fair value of portfolio hedges	**104.2**	(45.5)
Other receivables	**58.8**	(35.6)
Net increase / (decrease) in operating liabilities:		
Retail deposits	**1,443.8**	1,464.7
Derivative financial instruments	**(88.5)**	51.9
Fair value of portfolio hedges	**(13.4)**	6.5
Other liabilities	**(15.7)**	(39.1)
Cash generated by operations	**926.4**	1,074.8
Income taxes (paid)	**(48.3)**	(46.1)
	878.1	1,028.7

Cash flows relating to plant and equipment held for leasing under operating leases are classified as operating cash flows.

(b) The Company

	2021	2020
	£m	£m
Profit before tax	**84.0**	93.7
Non-cash items included in profit and other adjustments:		
Depreciation on property, plant and equipment	**1.4**	1.4
Non-cash movements on borrowings	**4.3**	0.5
Impairment provision / (release) on investments in subsidiaries	**4.3**	5.3
Charge for share based remuneration	**8.9**	2.7
Net decrease in operating assets:		
Other receivables	**11.5**	22.7
Net (decrease) in operating liabilities:		
Other liabilities	**-**	(1.8)
Cash generated by operations	**114.4**	124.5
Income taxes received	**1.5**	5.3
	115.9	129.8

42. Net cash flow from investing activities

	The Group		**The Company**	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Proceeds from sales of operating property, plant and equipment	**-**	0.1	**-**	-
Purchases of operating property, plant and equipment	**(1.9)**	(1.9)	**-**	-
Purchases of intangible assets	**(2.4)**	(1.0)	**-**	-
Movement in loans to subsidiary undertakings	-	-	**47.3**	(94.7)
Net cash (utilised) / generated by investing activities	**(4.3)**	(2.8)	**47.3**	(94.7)

43. Net cash flow from financing activities

	The Group		**The Company**	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Shares issued (note 37)	**2.1**	0.6	**2.1**	0.6
Dividends paid (note 40)	**(54.6)**	(35.9)	**(54.6)**	(35.9)
Issue of Tier-2 bond	**148.9**	-	**148.9**	-
Repayment of asset backed floating rate notes	**(2,313.1)**	(1,013.3)	-	-
Repayment of Tier-2 bond	**(153.7)**	-	**(153.7)**	-
Repayment of retail bond	**(60.0)**	-	**(60.0)**	-
Movement on central bank facilities	**964.6**	860.0	-	-
Movement on other bank facilities	**71.9**	(130.1)	-	-
Capital element of lease payments	**(2.5)**	(2.0)	**(1.2)**	(1.3)
Purchase of shares (note 39)	**(42.2)**	(5.2)	**(37.7)**	-
Sale of shares	-	0.2	-	-
Net cash (utilised) by financing activities	**(1,438.6)**	(325.7)	**(156.2)**	(36.6)

44. Reconciliation of net debt

(a) The Group

		Cash flows		Non-cash movements			
	Opening debt	Debt issued	Other	Recognition	Currency loan notes	Other	Closing debt
	£m	£m	£m	£m	£m	£m	£m
30 September 2021							
Asset backed loan notes	**3,270.5**	-	**(2,313.1)**	-	**(442.3)**	**0.9**	**516.0**
Bank borrowings	**657.8**	-	**71.9**	-	-	**0.3**	**730.0**
Corporate bonds	**149.8**	**148.9**	**(153.7)**	-	-	**4.0**	**149.0**
Retail bonds	**296.8**	-	**(60.0)**	-	-	**0.3**	**237.1**
Central bank borrowings	**1,854.4**	-	**964.6**	-	-	**-**	**2,819.0**
Lease liabilities	**5.6**	-	**(2.5)**	-	-	**6.4**	**9.5**
Bank overdrafts	**0.4**	-	**(0.1)**	-	-	-	**0.3**
Gross debt	**6,235.3**	**148.9**	**(1,492.9)**	-	**(442.3)**	**11.9**	**4,460.9**
Cash	**(1,925.0)**	**(148.9)**	**713.8**	-	-	-	**(1,360.1)**
Net debt	**4,310.3**	-	**(779.1)**	-	**(442.3)**	**11.9**	**3,100.8**
30 September 2020							
Asset backed loan notes	4,419.4	-	(1,013.3)	-	(136.8)	1.2	3,270.5
Bank borrowings	787.5	-	(130.1)	-	-	0.4	657.8
Corporate bonds	149.6	-	-	-	-	0.2	149.8
Retail bonds	296.5	-	-	-	-	0.3	296.8
Central bank borrowings	994.4	-	860.0	-	-	-	1,854.4
Lease liabilities	-	-	(2.0)	7.3	-	0.3	5.6
Bank overdrafts	1.0	-	(0.6)	-	-	-	0.4
Gross debt	6,648.4	-	(286.0)	7.3	(136.8)	2.4	6,235.3
Cash	(1,225.4)	-	(699.6)	-	-	-	(1,925.0)
Net debt	5,423.0	-	(985.6)	7.3	(136.8)	2.4	4,310.3

Other cash movements relating to currency loan notes shown above relate to the settlement and translation of asset backed loan notes denominated in US dollars and euros (note 27), which are cashflow hedged under the arrangements described in note 19(b). The effect of these borrowings is described further in note 58. None of these notes remained outstanding at 30 September 2021.

Other non-cash changes shown above represent:

- EIR adjustments relating to the spreading of initial costs of the facilities concerned
- Premiums on redemptions of corporate bonds
- Inception of new lease assets under IFRS 16

Non-cash movements arising from recognition in the year ended 30 September 2020 include amounts recognised on transition to IFRS 16.

(b) The Company

		Cash flows		Non-cash movements		
	Opening debt	Debt issued	Other	Recognition	Other	Closing debt
	£m	£m	£m	£m	£m	£m
30 September 2021						
Corporate bonds	**149.8**	**148.9**	**(153.7)**	**-**	**4.0**	**149.0**
Retail bonds	**296.8**	**-**	**(60.0)**	**-**	**0.3**	**237.1**
Lease liabilities	**17.5**	**-**	**(1.2)**	**-**	**-**	**16.3**
Gross debt	**464.1**	**148.9**	**(214.9)**	**-**	**4.3**	**402.4**
Cash	**(12.6)**	**(148.9)**	**141.9**	**-**	**-**	**(19.6)**
Net debt	**451.5**	-	**(73.0)**	**-**	**4.3**	**382.8**
30 September 2020						
Corporate bonds	149.6	-	-	-	0.2	149.8
Retail bonds	296.5	-	-	-	0.3	296.8
Lease liabilities	-	-	(1.3)	18.8	-	17.5
Gross debt	446.1	-	(1.3)	18.8	0.5	464.1
Cash	(14.1)	-	1.5	-	-	(12.6)
Net debt	432.0	-	0.2	18.8	0.5	451.5

Other non-cash changes shown above represent EIR adjustments relating to the spreading of initial costs of the bonds and premium paid on redemption. Recognition includes amounts recognised on transition to IFRS 16 in the year ended 30 September 2020.

45. Unconsolidated structured entities

Following the Group's disposal of its residual interest in the Paragon Mortgages (No. 12) PLC securitisation in June 2019, it ceased to consolidate the assets and liabilities of the entity. The external securitisation borrowings remain in place with their terms unchanged and the Group continues to act as administrator, for which it charges a fee. It has no other exposure to the profitability of the deal, no exposure to credit risk, other than on the recoverability of its quarterly fee, and no obligation to make further contribution to the entity.

Fee income from servicing arrangements of £1.6m is included in third party servicing fees (note 7) (2020: £1.9m) and £0.3m is included in other debtors in respect of unpaid fees at the year end (2020: £0.3m). Outstanding collection monies due to the structured entity of £0.3m are included in other creditors at 30 September 2021 (2020: £0.4m).

46. Leasing arrangements

(a) As Lessor

The Group, through its motor finance and asset finance businesses, leases assets under both finance and operating leases. In respect of certain of these assets, the Group also provides maintenance services to the lessee.

Disclosures in respect of these balances are set out in these financial statements as follows

Disclosure	Note
Investment in finance leases	**17**
Finance income on net investment in finance leases	**4**
Assets leased under operating leases	**22**
Operating lease income	**6**

The undiscounted future minimum lease payments receivable by the Group under operating lease arrangements may be analysed as follows:

	2021	2020
	£m	£m
Amounts falling due:		
Within one year	**11.4**	12.4
Within one to two years	**6.8**	6.8
Within two to three years	**4.8**	4.3
Within three to four years	**3.3**	2.9
Within four to five years	**1.9**	1.7
After more than five years	**1.0**	1.3
	29.2	29.4

(b) As Lessee

The Group's use of leases as a lessee relates to the rental of office buildings and company cars. Under IFRS 16 these have been accounted for as right of use assets and corresponding lease liabilities.

The average term of the current building leases from inception or acquisition is 9 years (2020: 9 years) with rents subject to review every five years, while the average term of the vehicle leases is 3 years (2020: 3 years).

The Company's use of leases as lessee is limited to the rental of an office building from a subsidiary entity. The lease term from inception is 15 years.

Disclosures relating to these leases are set out in these financial statements as follows.

Disclosure	**Note**
Depreciation on right of use assets	**22**
Interest expense on lease liabilities	**5**
Expense relating to short-term leases	**8**
Additions to right of use assets	**22**
Carrying amount of right of use assets	**22**
Maturity analysis of lease liabilities	**56**

There was no subleasing of any right of use asset and the total cash flows relating to leasing as a lessee were £2.0m (2020: £2.2m).

47. Related party transactions

(a) The Group

During the year, certain non-executive directors of the Group were beneficially interested in savings deposits made with Paragon Bank, on the same terms as were available to members of the public. Deposits of £16,000 were outstanding at the year-end (2020: £301,000), and the maximum amount outstanding during the year was £301,000 (2020: £500,000).

The Paragon Pension Plan ('the Plan') is a related party of the Group. Transactions with the Plan are described in note 52.

The Group had no other transactions with related parties other than the key management compensation disclosed in note 50.

(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 51.

Details of the Company's investments in subsidiaries and the income derived from them are shown in notes 25 and 66.

Outstanding current account balances with subsidiaries are shown in notes 20 and 32.

During the year the Company incurred interest costs of £0.8m in respect of borrowings from its subsidiaries (2020: £1.0m).

The Company leased an office building from a subsidiary entity (note 46). Finance charges recognised in respect of this lease were £0.5m (2020: £0.5m).

48. Country-by-country reporting

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 came into effect on 1 January 2014 and place certain reporting obligations on financial institutions that are within the scope of CRD IV. The objective of the country-by-country reporting requirements is to provide increased transparency regarding the source of the financial institution's income and the locations of its operations.

Paragon Banking Group PLC is a UK registered entity. Details of its subsidiaries are given in note 66 and the activities of the Group are described in Section A2.1.

The activities of the Group, described as required by the Regulations for the year ended 30 September 2021 were:

	United Kingdom
	£m
Year ended 30 September 2021	
Total operating income	**324.9**
Profit before tax	**213.7**
Corporation tax paid	**48.3**
Public subsidies received	-
Average number of full time equivalent employees	**1,327**

	United Kingdom
	£m
Year ended 30 September 2020	
Total operating income	**295.1**
Profit before tax	**118.4**
Corporation tax paid	**46.1**
Public subsidies received	**-**
Average number of full time equivalent employees	**1,285**

The Group's participation in Bank of England funding schemes is set out in note 31.

D2.2 Notes to the Accounts – Employment costs

For the year ended 30 September 2021

The notes set out below give information on the Group's employment costs, including the disclosures on share based payments and pension schemes required by accounting standards.

49. Employees

The average number of persons (including directors) employed by the Group during the year was 1,426 (2020: 1,385). The number of employees at the end of the year was 1,441 (2020: 1,391).

Costs incurred during the year in respect of these employees were:

	2021	**2021**	2020	2020
	£m	**£m**	£m	£m
Share based remuneration	**8.9**		2.7	
Other wages and salaries	**65.1**		64.0	
Total wages and salaries		**74.0**		66.7
National Insurance on share based remuneration	**2.4**		(0.1)	
Other social security costs	**8.3**		8.0	
Total social security costs		**10.7**		7.9
Defined benefit pension cost	**1.8**		2.0	
Other pension costs	**3.7**		3.1	
Total pension costs		**5.5**		5.1
Total employment costs		**90.2**		79.7
Of which				
Included in operating expenses (note 8)		**87.9**		77.6
Included in maintenance costs (note 6)		**2.3**		2.1
		90.2		79.7

Details of the pension schemes operated by the Group are given in note 52.

The Company has no employees. Details of the directors' remuneration are given in note 50.

50. Key management remuneration

The remuneration of the directors, who are the key management personnel of the Group and the Company, is set out below in aggregate in accordance with IAS 24 – 'Related Party Transactions'. Further information about the remuneration of individual directors is provided in the Annual Report on Remuneration in Section B7.2.2.

	2021	2021	2020	2020
	£m	£m	£m	£m
Salaries and fees	**1.9**		1.9	
Cash amount of bonus	**0.7**		-	
Social security costs	**0.3**		0.5	
Short-term employee benefits		**2.9**		2.4
Post-employment benefits		**0.2**		0.3
IFRS 2 cost in respect of directors	**1.5**		0.7	
National Insurance thereon	**0.3**		(0.1)	
Share based payment		**1.8**		0.6
		4.9		3.3

Post-employment benefits shown above are shown as 'pension allowance' in Section B7.2.2. Costs in respect of share awards shown in the Annual Report on Remuneration are determined on a different basis to the IFRS 2 charge shown above.

Directors' bonuses in the year ended 30 September 2020 were entirely deferred in shares, in response to the Covid pandemic. Normal payment arrangements have resumed in the current year. The negative charge in respect of National Insurance accrued on share-based payments in 2020 is principally a result of reduced vesting estimates.

Social security costs paid in respect of directors are required to be included in this note by IAS 24, but do not fall within the scope of the disclosures in the Annual Report on Remuneration.

51. 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 49.

Further details of share based payment arrangements are given in the Annual Report on Remuneration in Section B7.2.2.

A summary of the number of share awards outstanding under each scheme at 30 September 2021 and at 30 September 2020 is set out below.

	2021	2020
	Number	Number
(a) Sharesave Plan	**3,561,675**	4,134,577
(b) Performance Share Plan	**5,375,494**	4,842,196
(c) Company Share Option Plan	**241,574**	444,771
(d) Deferred Bonus Plan	**1,387,137**	819,265
(e) Restricted Stock Units	**273,193**	265,672
	10,839,073	10,506,481

(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 2021 and the year ended 30 September 2020 is shown below.

	2021	**2021**	2020	2020
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
		p		p
Options outstanding				
At 1 October 2020	**4,134,577**	**295.40**	2,558,569	338.06
Granted in the year	**432,095**	**424.00**	2,748,494	278.56
Exercised or surrendered in the year	**(717,213)**	**306.32**	(940,709)	348.35
Lapsed during the year	**(287,784)**	**319.15**	(231,777)	351.68
At 30 September 2021	**3,561,675**	**306.89**	4,134,577	295.40
Options exercisable	**105,945**	**303.07**	345,756	341.85

The weighted average remaining contractual life of options outstanding at 30 September 2021 was 32.4 months (2020: 36.8 months). The weighted average market price at exercise for share options exercised in the year was 526.83p (2020: 441.06p).

Options are outstanding under the Sharesave plans to purchase ordinary shares as follows:

Grant date	**Period exercisable**	**Exercise price**	**Number 2021**	Number 2020
11/06/2015	01/08/2020 to 01/02/2021	345.68p	**-**	8,242
20/06/2016	01/08/2021 to 01/02/2022	249.44p	**68,546**	432,210
28/07/2017	01/09/2020 to 01/03/2021	341.76p	**2,633**	337,514
28/07/2017	01/09/2022 to 01/03/2023	341.76p	**20,971**	22,726
31/07/2018	01/09/2021 to 01/03/2022	408.80p	**34,766**	169,359
31/07/2018	01/09/2023 to 01/03/2024	408.80p	**21,124**	21,124
30/07/2019	01/09/2022 to 01/03/2023	360.16p	**379,915**	411,334
30/07/2019	01/09/2024 to 01/03/2025	360.16p	**5,409**	6,574
27/07/2020	01/09/2023 to 01/03/2024	278.56p	**2,078,709**	2,187,502
27/07/2020	01/09/2025 to 01/03/2026	278.56p	**518,610**	537,992
28/07/2021	01/09/2024 to 01/03/2025	424.00p	**350,345**	-
28/07/2021	01/09/2026 to 01/03/2027	424.00p	**80,647**	-
			3,561,675	4,134,577

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 holder's decease). Awards lapse on cessation of employment, other than in 'good leaver' circumstances.

The fair value of options granted is determined using a trinomial model. Details of the awards made in the year ended 30 September 2021 and the year ended 30 September 2020, are shown below.

Grant date	**28/07/21**	**28/08/21**	27/07/20	27/07/20
Number of awards granted	**351,448**	**80,647**	2,210,502	537,992
Market price at date of grant	**554.5p**	**554.5p**	343.2p	343.2p
Contractual life (years)	**3.5**	**5.5**	3.5	5.5
Fair value per share at date of grant (£)	**1.41**	**1.17**	0.62	0.55
Inputs to valuation model				
Expected volatility	**38.77%**	**33.10%**	34.24%	32.98%
Expected life at grant date (years)	**3.42**	**5.43**	3.45	5.45
Risk-free interest rate	**0.19%**	**0.31%**	(0.13)%	(0.11)%
Expected annual dividend yield	**3.90%**	**3.90%**	4.34%	4.34%
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')

PSP awards are made annually to executive directors and other senior employees as part of their variable remuneration. The grantees, and the values of their grants, are approved by the Remuneration Committee.

Awards under this plan comprise a right to acquire ordinary shares in the Company for nil or nominal payment and normally vest in the third financial year after the date of grant, to the extent that the applicable performance criteria have been satisfied, if the holder is still employed by the Group.

Awards vest on the date on which the Remuneration Committee determines the extent to which the performance conditions have been satisfied. For employees, other than the executive directors, awards may be exercised from the vesting date to the day before the tenth anniversary of the grant date. Executive directors' awards made in 2020 and subsequently are exercisable from the time of the Group's fifth results announcement after the date of the grant to the day before the tenth anniversary of the grant date. Where performance conditions are not met in full, awards lapse at this point. Awards will also lapse on cessation of employment, other than in 'good leaver' circumstances. Malus and clawback provisions apply to awards granted under the PSP as detailed in the Directors' Remuneration Policy.

The conditional entitlements outstanding under this scheme at 30 September 2021 and 30 September 2020 were:

Grant date	Period exercisable	Number 2021	Number 2020
17/12/2010	17/12/2013 to 16/12/2020†	**-**	9,925
21/12/2011	21/12/2014 to 20/12/2021†	**5,093**	5,093
28/02/2013	28/02/2016 to 27/02/2023†	**4,578**	5,443
10/12/2013	10/12/2016 to 09/12/2023†	**2,132**	6,210
18/12/2014	18/12/2017 to 17/12/2024†	**5,366**	6,277
22/12/2015	22/12/2018 to 21/12/2025†	**14,927**	16,887
01/12/2016	01/12/2019 to 30/11/2026†	**341,168**	462,076
08/12/2017	03/12/2020* to 07/12/2027β	**347,715**	1,155,740
14/12/2018	14/12/2021* to 13/12/2028ψ	**1,477,203**	1,479,563
06/07/2020	07/12/2022* to 05/07/2030Φ	**1,153,178**	1,185,790
06/07/2020	07/12/2024* to 05/07/2030Φ	**509,192**	509,192
11/12/2020	07/12/2023* to 10/12/2030δ	**1,129,235**	-
11/12/2020	07/12/2025* to 10/12/2030δ	**385,707**	-
		5,375,494	4,842,196

* Estimated date

† These awards, which were conditional on the achievement of performance-based criteria, vested before the start of the financial year. Any reduction in entitlements resulting from the application of those criteria is reflected in the numbers above.

β These awards are (or were) subject to performance criteria, assessed over a period of three financial years, starting with the year of grant.

- 50% to a Total Shareholder Return ('TSR') test based on a ranking of the Company's TSR against those of a comparator group of UK listed financial services companies, determined at the date of grant. This tranche vests in full for upper quartile performance, 25% vests for median performance and vesting between those points is determined on a straight line basis
- 25% to an EPS test. This tranche vests in full if EPS increases by at least 7% more than the retail price index ('RPI') over the test period, 25% vests if this increase is at least 3% more than the RPI and vesting between those points is determined on a straight line basis
- 25% to a risk test. The risk test is based on an internal scorecard of the Group's performance against its principal risk metrics

An 'underpin' condition also operates, such that the Remuneration Committee has to be satisfied with the Group's underlying financial performance over the performance period.

At the point of exercise, the gross number of awards vesting will be reduced so that the gain to the recipient from the PSP and the CSOP described below, evaluated at that point, is equal to the gain from the gross PSP vesting.

ψ These awards are subject to performance criteria and underpin, similar to those described at β above, except that:

- Under the EPS condition full vesting occurs if basic EPS for the third year of the test period is at least 68p, 25% vesting if EPS in this year is 60p and vesting between those points on a straight line basis

An individual performance condition relating to the grantee's performance in the final financial year of the vesting period also applies.

ϕ These awards are subject to performance criteria, similar to those described at ψ above, except that:

- The TSR condition related to 25% of the grant, not 50%
- Under the EPS condition full vesting occurs if basic EPS for the third year of the test period is at least 67p, 25% vesting if EPS in this year is 60p and vesting between those points on a straight line basis
- The risk condition comprises two components. 50% of the risk element is based on an assessment by the CRO of the six key measures of the Group's risk appetite: regulatory breaches; customer service performance; conduct; operational risk incidents; capital and liquidity; and credit losses. The remaining 50% is based on a strategic risk assessment reflecting the management of risk as it impacts on the delivery of the Group's medium term strategy
- 12.5% of the grant is determined based on a customer service test. The customer service test is based on the performance of the Group against its most significant customer service metrics including insight feedback on key product lines and complaint levels. 50% of this tranche will vest for on-target performance
- 12.5% of the grant is determined based on a people test. The people test is based on the performance of the Group against its most significant employment metrics including employee engagement, voluntary attrition and gender diversity levels. 50% of this tranche will vest for on-target performance
- Due to the volatility of the share price at the time of grant, the Remuneration Committee may adjust the vesting levels at the vesting date if it believes that the use of this share price has created a potential windfall gain
- No CSOP grants were made in conjunction with this award, therefore no adjustment on vesting will take place

δ These awards are subject to performance criteria, similar to those described at ϕ above, except that:

- Under the EPS condition full vesting occurs if EPS for the third year of the test period is at least 66p, 25% vesting if EPS in this year is 58p and vesting between those points on a straight line basis
- The ability of the Remuneration Committee to adjust specifically for windfall gains was not a condition of this grant

For each of the customer and people tests set out above, the Remuneration Committee will determine the extent to which this condition has been met, between 0% and 100%, and vesting for the relevant tranche will occur at that level, subject to a 25% threshold, below which no awards in the tranche will vest.

On exercise, holders of awards granted in February 2013 and thereafter receive a payment equivalent to the dividends accruing on the vested shares during the vesting period.

The fair value of awards granted under the PSP is determined using a Monte Carlo simulation model, to take account of the effect of the market based condition. Details of the awards over £1 ordinary shares made in the year ended 30 September 2021 and the year ended 30 September 2020 are shown below.

Grant date	**11/12/20**	06/07/20
Number of awards granted	**1,539,645**	1,694,982
Market price at date of grant	**446.8p**	360.60p
Contractual life (years)	**3.0**	2.4
Fair value per share at date of grant	**407.50p**	301.32p
Inputs to valuation model		
Expected volatility	**37.85%**	33.93%
Expected life (years)	**3.0**	2.4
Risk-free interest rate	**(0.12)%**	(0.06)%

For all the above grants no departures are expected. The expected volatility is based on the annualised standard deviation of daily changes in price over the three years preceding the grant date.

The effect of the CSOPs is not allowed for in the IFRS 2 market values of the 2016, 2017 and 2018 grants.

(c) Company Share Option Plan ('CSOP')

The PSP includes a tax advantaged element under which CSOP options can be granted. The CSOPs may be exercised alongside their accompanying PSPs based upon the exercise price that was set at the grant date. Each employee may be granted up to a maximum total value of £30,000 of tax benefitted options. No new CSOP awards were made in the years ended 30 September 2021 or 30 September 2020.

A reconciliation of movements in the number and weighted average exercise price of CSOP options over £1 ordinary shares during the year ended 30 September 2021 and the year ended 30 September 2020 is shown below.

	2021	**2021**	2020	2020
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
		p		p
Options outstanding				
At 1 October 2020	**444,771**	**419.97**	730,816	398.19
Exercised or surrendered in the year	**(87,377)**	**397.33**	(218,008)	361.88
Lapsed during the year	**(115,820)**	**471.06**	(68,037)	372.15
At 30 September 2021	**241,574**	**403.66**	444,771	419.97
Options exercisable	**62,049**	**425.70**	93,974	361.88

The weighted average remaining contractual life of options outstanding at 30 September 2021 was 81.5 months (2020: 89.5 months). The weighted average market prices at exercise for share options exercised in the year was 466.70p.

The conditional entitlements outstanding under this scheme at 30 September 2021 and 30 September 2020 were:

Grant date	**Period exercisable**	**Exercise price**	**Number**	Number
			2021	2020
01/12/2016	01/12/2019 to 30/11/2026†	361.88p	**27,875**	93,974
08/12/2017	08/12/2020 to 07/12/2027β	477.76p	**34,174**	169,502
14/12/2018	14/12/2021 to 13/12/2028β	396.04p	**179,525**	181,295
			241,574	444,771

†These awards, which were conditional on the achievement of performance-based criteria, vested before the start of the financial year. Any reduction in entitlements resulting from the application of those criteria is reflected in the numbers above.

β66.7% of these awards are (or were) subject to a TSR test and 33.3% are subject to an EPS test. These tests operate in the same manner and with the same conditions as those for the PSP grant of the same date.

To the extent that the CSOP awards vest, the vesting of the PSP award granted at the same time will be abated on exercise so that the overall gain to the grantee is the same as would be received on the related PSP award had the CSOP not been in place.

No separate fair value has been attributed to the CSOP options for IFRS 2 purposes as the IFRS 2 market values for the CSOP and PSP combined will equate to that calculated for the PSP without allowing for the CSOP. The benefit from the CSOP is in relation to the employees' tax position, which does not affect the IFRS 2 charge.

(d) Deferred Bonus awards

These plans are generally used for the deferral in shares of annual bonus awards made to executive directors and certain other senior managers ('executive awards'). Additionally in 2020 a one-off award was made on an all-employee basis.

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 2021 and 30 September 2020 were:

Grant date	Period exercisable	Number 2021	Number 2020
10/12/2013	10/12/2016 to 09/12/2023	**55,302**	55,302
18/12/2014	18/12/2017 to 17/12/2024	**52,888**	52,888
22/12/2015	22/12/2018 to 21/12/2025	**60,042**	60,042
01/12/2016	01/12/2019 to 30/11/2026	**71,235**	105,318
08/12/2017	08/12/2020 to 07/12/2027	**67,572**	102,516
14/12/2018	14/12/2021 to 13/12/2028	**334,498**	334,498
12/12/2019	12/12/2022 to 11/12/2029	**108,701**	108,701
11/12/2020	11/12/2023 to 10/12/2030	**382,334**	-
11/12/2020*	11/12/2023 to 01/06/2024	**254,565**	-
		1,387,137	819,265

*All-employee award.

The Deferred Bonus shares granted under the executive awards can be exercised from the third anniversary of the award date until the day before the tenth anniversary of the date of grant.

The all-employee awards will vest on the third anniversary of the grant date and the shares will be automatically transferred to the participants as soon as reasonably practicable thereafter. The period exercisable shown above therefore illustrates the latest date by which it is anticipated that these transfers will have been made.

In the event of death or redundancy the all-employee awards may vest early. Awards lapse on the cessation of employment, other than in 'good leaver' circumstances. Except in these regards the all-employee awards operate in the same way as the executive awards.

The Deferred Bonus shares granted in December 2016 and thereafter accrue dividends only over the vesting period, unlike earlier grants which accrued dividends until the point of exercise. The fair value of Deferred Bonus awards issued in the year was determined using a Black-Scholes Merton model.

Details of the awards made in the year ended 30 September 2021 and the year ended 30 September 2020 are shown below.

Grant date	**11/12/20** **All employee**	**11/12/20** **Executive**	12/12/19 Executive
Number of awards granted	**275,029**	**382,334**	108,701
Market price at date of grant	**446.80p**	**446.80p**	489.20p
Fair value per share at date of grant	**353.62p**	**446.80p**	489.20p

No departures are expected for grantees under this plan, except for grants under the all-employee grant in 2020, where a departure rate of 7.5% per annum is expected.

(e) Restricted Stock Units ('RSUs')

Since 2016, the Company has permitted certain employees to elect to receive RSU awards instead of PSP awards. For RSU awards to vest, the grantee's personal performance must be satisfactory during the financial year preceding the vesting date. In addition, a risk based performance condition, assessed against the Group's risk management metrics and, for the July 2020 grant only, against its strategic management of risk for the medium term, considered over the vesting period, must also be met. The level to which this condition is met will be determined by the Remuneration Committee and vesting levels scaled back as appropriate.

The conditional entitlements outstanding under this scheme at 30 September 2021 and 30 September 2020 were:

Grant date	Period exercisable	Number 2021	Number 2020
08/12/2017	03/12/2020 to 07/12/2027	-	22,672
14/12/2018	14/12/2021* to 13/12/2028	**52,040**	52,040
06/07/2020	07/12/2022* to 05/07/2030	**190,960**	190,960
11/12/2020	11/12/2023* to 10/12/2030	**30,193**	-
		273,193	265,672

* Estimated date.

The Accounts

The fair value of RSU awards issued in the year was determined using a Black-Scholes Merton model. Details of the awards made in the year ended 30 September 2021 and the year ended 30 September 2020 are shown below.

Grant date	**11/12/20**	06/07/20
Number of awards granted	**30,193**	190,690
Market price at date of grant	**446.80p**	360.60p
Contractual life (years)	**3.0**	2.4
Fair value per share at date of grant	**446.80p**	360.60p

For all these grants no departures are expected.

52. Retirement benefit obligations

(a) Defined benefit plan – description

The Group operates a funded defined benefit pension scheme in the UK, the Paragon Pension Plan (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.

Scheme benefit changes

During the year, following consultation with the active members of the Plan, changes were made affecting the accrual of benefits by members after 1 July 2021. The principal changes were:

- The earliest age that members can access benefits building up after 1 July 2021 without any reduction for early payment is 65, rather than 60
- The rate of salary increase counting towards benefits and contributions in the Plan is capped at 2.5% per annum
- Members were allowed to elect to either contribute 8% of capped salary to accrue benefits at the rate of 1/70 of capped final salary per year or continue to contribute 5% of capped salary to accrue benefits at the rate of 1/75 of capped final salary per year

The changes do not affect benefits already accrued to that date.

Employee contributions and benefits

The scheme was closed to new entrants in February 2002. Employees who are members of the plan are entitled to receive a pension of 1/60 of their final basic annual salary per year of service up to 30 June 2021. After that date further accrual is at a rate of 1/70 or 1/75 of capped final salary depending on the level of contributions. After 1 July 2021 employee contributions were either 5% or 8% of capped salary. Before that date all active members contributed at a rate of 5% of salary.

Dependants of Plan members are eligible for a dependant's pension and the payment of a lump sum in the event of death in service.

Actuarial risks

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 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 the expected rate of inflation. Should the salaries of Plan members increase at a higher rate, then the deficit will be higher. For service from 1 July 2021, a 2.5% cap on individual pensionable salary applies, mitigating this risk

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 changes referred to above will also reduce this cost going forward.

Actuarial valuation and recovery plan

The most recent full actuarial valuation of the Plan's liabilities, obtained by the Trustee, was carried out at 31 March 2019, by Aon Hewitt, the Plan's independent actuary. This showed that the value of the Plan's liabilities on a buy-out basis in accordance with section 224 of the Pensions Act 2004, the level of assets which would be required to buy insurance policies for benefits earned to the valuation date, was £203.6m, with a shortfall against the assets of £85.0m (2016: £118.4m). The deficit on the Technical Basis, the basis agreed by the Trustee as being appropriate to meet member benefits, assuming the plan continues as a going concern, was £18.2m (2016: £18.0m). This valuation forms the basis of the IAS 19 valuation.

Following the agreement of the 2019 actuarial valuation, the Trustee put in place a revised recovery plan. On current forecasts the Trustee's recovery plan would to meet the statutory funding objective by 31 July 2025. The revised recovery plan continues to include a Pension Funding Partnership ('PFP') arrangement effectively granting the Plan a first charge over the Group's head office building as security for payments under the plan (note 22). No amount is included in the Plan assets in respect of the building, which remains within the Group's Property, Plant and Equipment balance (note 22) but this arrangement provides the Plan with additional security in a stress event.

(b) Defined benefit plan – financial impact

For accounting purposes, the valuation at 31 March 2019 was updated to 30 September 2021 in accordance with the requirements of IAS 19 (revised) by Mercer, the Group's independent consulting actuary.

As the changes in the Plan described above did not affect benefits built up before 1 July 2021, the impact on the IAS 19 basis was immaterial and no remeasurement of assets and liabilities at 30 June 2021 has taken place. The service cost for the period between 1 July 2021 and 30 September 2021, and the associated interest cost and expected return, have been adjusted to reflect the value of benefits accruing from 1 July 2021.

The major categories of assets in the Plan at 30 September 2021, 30 September 2020 and 30 September 2019 and their fair values were:

	2021	2020	2019
	£m	£m	£m
Cash and cash equivalents	**17.1**	28.6	7.1
Equity instruments	**73.4**	60.7	60.7
Debt instruments	**54.8**	34.9	34.2
Real estate funds	-	10.3	10.8
Total fair value of Plan assets	**145.3**	134.5	112.8
Present value of Plan liabilities	**(155.6)**	(154.9)	(147.3)
(Deficit) in the Plan	**(10.3)**	(20.4)	(34.5)

At 30 September 2021 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.

Towards the end of the year the Plan disposed of its holdings in real estate funds, following a review of its investment strategy. These are currently in the process of reinvestment in other asset classes, with part of the proceeds held in cash at the year end.

During October 2018, the High Court made a ruling in the Lloyds Banking Group Pension Scheme GMP (Guaranteed Minimum Pension) equalisation case, which effectively directs defined benefit pension schemes to change their rules to equalise the benefits of male and female members for the effects of GMPs for employees who were, at one time, contracted out of state schemes. The Court did not specify a single method which schemes should employ and hence the impact of this on the Plan will not be certain until the Trustee has determined which method should be adopted and detailed calculations have been performed to evaluate the impact, as the impact on members will vary from person to person.

The estimated effect of this ruling was accounted for in the accounts of the Group for the year ended 30 September 2019 as a 'past service cost'. However, this estimate is based on one permissible method, method C2, and therefore the actual amount may vary due to the method which the Trustee chooses to apply, which is yet to be finalised, idiosyncratic impacts on individual members and the development of a wider legal and accounting consensus on the proper interpretation of the courts' requirements as further cases are determined.

A further judgement relating to GMP equalisation within historic transfer values was handed down in November 2020. The impact has been allowed for in employment cost for the year ended 30 September 2021, but is not significant.

The movement in the fair value of the Plan assets during the year was as follows:

	2021	2020
	£m	£m
At 1 October 2020	**134.5**	112.8
Interest on Plan assets	**2.4**	2.3
Cash flows		
Contributions by the Group	**4.8**	24.5
Contributions by Plan members	**0.2**	0.2
Benefits paid	**(6.8)**	(2.9)
Administration expenses paid	**(0.8)**	(0.6)
Remeasurement gain		
Return on Plan assets (excluding amounts included in interest)	**11.0**	(1.8)
At 30 September 2021	**145.3**	134.5

Contributions by the Group in the year ended 30 September 2020 included a one-off £20.0m payment made as part of the new recovery plan agreed between the Group and the Trustee in that year.

The actual return on Plan assets in the year ended 30 September 2021 was £13.4m (2020: £0.5m).

The movement in the present value of the Plan liabilities during the year was as follows:

	2021	2020
	£m	£m
At 1 October 2020	**154.9**	147.3
Current service cost	**1.8**	2.0
Past service cost	-	-
Funding cost	**2.7**	2.7
Cash flows		
Contributions by Plan members	**0.2**	0.2
Benefits paid	**(6.8)**	(2.9)
Remeasurement loss / (gain)		
Arising from demographic assumptions	**1.1**	1.2
Arising from financial assumptions	**1.7**	6.0
Arising from experience adjustments	-	(1.6)
At 30 September 2021	**155.6**	154.9

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.

Following the changes in the plan described above, liabilities for benefits accruing for service up to 1 July 2021 are calculated separately from those accruing in respect of service after that date.

The major weighted average assumptions used by the actuary were (in nominal terms):

	2021	2020	2019
In determining net pension cost for the year			
Discount rate	**1.75%**	1.85%	2.95%
Rate of compensation increase			
Pre July 2021-accrual	**2.95%**	3.20%	3.60%
Post 1 July 2021 accrual	**2.50%**	n/a	n/a
Rate of price inflation	**2.95%**	2.70%	3.10%
Rate of increase of pensions	**2.85%**	2.65%	2.95%
In determining benefit obligations			
Discount rate	**2.00%**	1.75%	1.85%
Rate of compensation increase:			
Pre 1 July 2021 accrual	**3.40%**	2.95%	3.20%
Post 1 July 2021 accrual	**2.50%**	2.50%	n/a
Rate of price inflation	**3.40%**	2.95%	2.70%
Rate of increase of pensions	**3.15%**	2.85%	2.65%
Further life expectancy at age 60			
Male member aged 60	**28**	28	28
Female member aged 60	**29**	29	29
Male member aged 40	**29**	30	30
Female member aged 40	**31**	31	31

In determining benefit obligations, mortality is projected using the S3PA Chartered Management Institute ('CMI') Projection Model with a 1.5% long-term improvement rate. At 30 September 2021 the 2020 (All) Year of Birth version of the model was used (2020: 2019 (All) Year of Birth, 2019: 2018 Light Year of Birth)

The amounts charged in the consolidated income statement in respect of the Plan are:

	Note	**2021**	2020
		£m	£m
Current service cost		**1.8**	2.0
Past service cost		-	-
Total service cost	*49*	**1.8**	2.0
Administration expenses		**0.8**	0.6
Included within operating expenses		**2.6**	2.6
Funding cost of Plan liabilities		**2.7**	2.7
Interest on Plan assets		**(2.4)**	(2.3)
Net interest expense	*5*	**0.3**	0.4
Components of defined benefit costs recognised in profit or loss		**2.9**	3.0

The amounts recognised in the consolidated statement of comprehensive income in respect of the Plan are:

	2021	2020
	£m	£m
Return on Plan assets (excluding amounts included in interest)	**11.0**	(1.8)
Actuarial gains/(losses)		
Arising from demographic assumptions	**(1.1)**	(1.2)
Arising from financial assumptions	**(1.7)**	(6.0)
Arising from experience adjustments	-	1.6
Total actuarial gain / (loss)	**8.2**	(7.4)
Tax thereon	**(0.9)**	2.1
Net actuarial gain / (loss)	**7.3**	(5.3)

Of the remeasurement movements reflected above:

- The return on plan assets to 30 September 2021 represents better than expected investment performance, including an element of post-Covid recovery in investment markets generally, as well as a reversal of the lower than expected returns in the year ended 30 September 2020.
- The change in demographic assumptions in the year ended 30 September 2021 predominantly reflects the adoption of new commutation factors by the Trustee from January 2021, which increased liabilities in respect of non-retired members. For the year ended 30 September 2020, the change in demographic assumption related to updated mortality assumptions, using the most recent version of the tables adopted by the Trustee in the triennial valuation, which predict marginally higher life expectancy among members than the previous versions
- The change in financial assumptions in the year ended 30 September 2021 reflects principally the impact of market implied inflation expectations increasing the value of Plan liabilities, although this was partially offset by higher discount rates, which are derived from market bond yields. Much of the change in the year ended 30 September 2020 resulted from the impact of falling bond yields on the discount rate used in the valuation
- The experience adjustments in 2020 arose on the adoption of the 2019 Plan valuation as the basis of the IAS 19 valuation in that year. This exercise only takes place triennially

(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 2021, 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%	(2.2)%
Rate of inflation*	0.1%	2.0%
Rate of salary growth	0.1%	0.4%
Rates of mortality	1 year of life expectancy	3.0%

* maintaining a 0.0% assumption for real salary growth

The sensitivity analysis presented above may not be representative of an actual future change in the defined benefit obligation as it is unlikely that changes in assumptions would occur in isolation, as some of the assumptions will be correlated. There has been no change in the method of preparing the analysis from that adopted in previous years. The impacts of equivalent decreases in assumptions are broadly equal and opposite to the effects of the increases shown above.

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.

Following a review of the Plan's investment strategy, the current target asset allocations for the year ending 30 September 2022 are 60% growth assets (primarily equities), and 40% matching assets (primarily bonds).

Following the finalisation of the March 2019 valuation, the agreed rate of employer contributions in respect of future service increased to 43.8% from 32.0% with effect from 1 July 2020. Additional contributions of £2.5m per annum for deficit reduction, including amounts payable under the PFP, and £0.4m per annum in respect of costs, each payable monthly, were also agreed. An additional contribution of £20.0m was made by the Group in June 2020. With effect from 1 July 2021, when the changes in the Plan benefits described above were implemented, the level of employer contributions for future service reduced to 25.0% of capped salary.

The present best estimate of the contributions to be made to the Plan by the Group in the year ending 30 September 2022 is £4.1m.

The average durations of the benefit obligations in the Plan at the year end are shown in the table below.

	2021	2020
	Years	Years
Category of member		
Active members	**24**	24
Deferred pensioners	**23**	23
Current pensioners	**15**	15
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. During the year ended 30 September 2020 the Group increased its contribution to the scheme for those employees making the maximum 6% contribution to 10% of salary from 6%, generating an increase in the amounts being saved by employees.

The Group also sponsors a number of other defined contribution pension plans relating to acquired entities and makes contributions to these schemes in respect of employees.

The assets of these schemes are not Group assets and are held separately from those of the Group, under the control of independent trustees. Contributions made by the Group to these schemes in the year ended 30 September 2021, which represent the total cost charged against income, were £3.7m (2020: £3.1m) (note 49).

D2.3 Notes to the Accounts – Capital and financial risk

For the year ended 30 September 2021

The notes below describe the processes and measurements which the Group and the Company use to manage their capital position and their exposure to financial risks including credit, liquidity, interest rate and foreign exchange risk. It should be noted that certain capital measures, which are presented to illustrate the Group's position, are not subject to audit. Where this is the case, the relevant disclosures are marked as such.

53. Capital management

The Group's objectives in managing capital are:

- To ensure that the Group has sufficient capital to meet its operational requirements and strategic objectives
- To safeguard the Group's ability to continue as a going concern, so that it can continue to provide returns to shareholders and benefits for other stakeholders
- To provide an adequate return to shareholders by pricing products and services commensurately with the level of risk
- To ensure that sufficient regulatory capital is available to meet any externally imposed requirements

The Group's response to the Covid situation has been planned and executed with the protection of its capital base and its long-term viability as key strategic priorities.

The Group sets its target amount of capital in proportion to risk, availability, regulatory requirements and cost. The Group manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets, having particular regard to the relative costs and availability of debt and equity finance at any given time. In order to maintain or adjust the capital structure the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares, issue or redeem other capital instruments, such as retail or corporate bonds, or sell assets to reduce debt.

The Group is subject to regulatory capital rules imposed by the PRA on a consolidated basis as a group containing an authorised bank. This is discussed further below.

(a) Regulatory capital

The Group is subject to supervision by the PRA on a consolidated basis, as a group containing an authorised bank. As part of this supervision the regulator will issue an individual capital requirement setting an amount of regulatory capital, which the Group is required to hold in order to safeguard depositors from loss in the event of severe losses being incurred by the Group. This comprises variable elements based on its total risk exposure and also fixed elements. This requirement is set in accordance with the international Basel III rules, issued by the Basel Committee on Banking Supervision ('BCBS') and currently implemented in UK law by EU Regulation 575/2013, referred to as the CRR. Following the UK's exit from the EU in December 2020 the PRA launched a consultation in February 2021 which would result in the Basel III rules being applied in the UK through the PRA Rulebook.

The Group's regulatory capital is monitored by the Board, its Risk and Compliance Committee and the Asset and Liability Committee, which ensure that appropriate action is taken to ensure compliance with the regulator's requirements. The future regulatory capital requirement is also considered as part of the Group's forecasting and strategic planning process.

The Group has elected to take advantage of the IFRS 9 transitional arrangements set out in Article 473a of the CRR, which allow the capital impact of expected credit losses to be phased in over a five-year period. The phase-in factors applying to transition adjustments will allow for a 95% add back to CET1 capital and Risk Weighted Assets ('RWA') in the financial year ended 30 September 2019, reducing to 85%, 70%, 50% and 25% for the financial years ending in 2020 to 2023, with full recognition of the impact on CET1 capital in the 2024 financial year.

As part of the regulatory response to Covid, Article 473a was revised to extend the transitional arrangements for Stage 1 and Stage 2 impairment provisions created in the financial year ended 30 September 2020 and the financial year ended 30 September 2021, while maintaining the transitional arrangements for impairment provisions created before the current period. In order to increase institutions lending capacity in the short term, the EU has determined that these additional provisions should be phased into capital over the financial years ending 30 September 2022 to 30 September 2024, rather than recognising the reduction in capital immediately.

These responses also allow, under paragraph 7a of the Article, the impact of transitional adjustments to be weighted at 100% in calculating RWA. The Group has taken advantage of this derogation and hence the IFRS 9 adjustment to RWA is equal to the adjustment to capital at 30 September 2021 and 30 September 2020.

Where these reliefs are taken, firms are also required to disclose their capital positions calculated as if the reliefs were not available (the 'fully loaded' basis).

The tables below demonstrate that at 30 September 2021 the Group's regulatory capital of £1,205.8m (2020: £1,141.2m) exceeded the amounts required by the regulator, including £604.2m (2020: £749.6m) in respect of its Total Capital Requirement ('TCR'), which is comprised of fixed and variable elements (amounts not subject to audit).

The total regulatory capital at 30 September 2021 on the fully loaded basis of £1,176.1m (2020: £1,098.9m) was in excess of the TCR of £601.8m (2020: £745.3m) on the same basis (amounts not subject to audit).

During the year the Group's TCR reduced from 10.8% of Total Risk Exposure ('TRE') at 30 September 2020 to 8.8% of TRE at 30 September 2021, principally as a result of the regulator's most recent review of the Group's risk profile and exposures.

The CRR also requires firms to hold additional capital buffers, including a Capital Conservation Buffer ('CCoB') of 2.5% of risk weighted assets (at 30 September 2021) (2020: 2.5%) and a Counter-Cyclical Buffer ('CCyB'), currently 0.0% of risk weighted assets (2020: 0.0%). The long term rate of the UK CCyB in a standard risk environment is expected to be 2.0%. Firm specific buffers may also be required.

The Group's regulatory capital differs from its equity as certain adjustments are required by the regulator. A reconciliation of the Group's equity to its regulatory capital determined in accordance with CRD IV at 30 September 2021 is set out below.

	Note	Regulatory basis		Fully loaded basis	
		2021	2020	**2021**	2020
		£m	£m	**£m**	£m
Total equity		**1,241.9**	1,156.0	**1,241.9**	1,156.0
Deductions					
Proposed final dividend	*40*	**(46.6)**	(36.4)	**(46.6)**	(36.4)
IFRS 9 transitional relief	*	**29.7**	42.3	-	-
Intangible assets	*23*	**(170.5)**	(170.1)	**(170.5)**	(170.1)
Software relief	†	**1.4**	-	**1.4**	-
Prudent valuation adjustments	§	**(0.1)**	(0.6)	**(0.1)**	(0.6)
Common Equity Tier 1 ('CET1') capital		**1,055.8**	991.2	**1,026.1**	948.9
Other tier 1 capital		-	-	-	-
Total Tier 1 capital		**1,055.8**	991.2	**1,026.1**	948.9
Corporate bond	*30*	**150.0**	150.0	**150.0**	150.0
Eligibility cap	Φ	-	-	-	-
Total Tier 2 capital		**150.0**	150.0	**150.0**	150.0
Total regulatory capital ('TRC')		**1,205.8**	1,141.2	**1,176.1**	1,098.9

*Firms are permitted to phase in the impact of IFRS 9 transition over a five-year period.

§ For capital purposes, assets and liabilities held at fair value, such as the Group's derivatives, are required to be valued on a more conservative basis than the market value basis set out in IFRS 13. This difference is represented by the prudent valuation adjustment above, calculated using the 'Simplified Approach' set out in the CRR.

† Under a relief enacted by the EU in December 2020 an amount in respect of software assets in intangibles is added back to capital. This is calculated in accordance with Article 36 (1) (b) of the CRR. In July 2021 the PRA reaffirmed its view that software assets would not absorb losses effectively in a stress. It therefore commenced a consultation on a proposal to remove this relief with effect from 1 January 2022.

Φ CRD IV restricts the amount of tier 2 capital which is eligible for regulatory purposes to 25% of TCR.

The total risk exposure amount calculated under the CRD IV framework against which this capital is held, and the proportion of these assets it represents, are calculated as shown below.

	Regulatory basis		Fully loaded basis	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Credit risk				
Balance sheet assets	**6,073.5**	6,171.7	**6,073.5**	6,171.7
Off balance sheet	**143.9**	104.1	**143.9**	104.1
IFRS 9 transitional relief	**29.7**	42.3	-	-
Total credit risk	**6,247.1**	6,318.1	**6,217.4**	6,275.8
Operational risk	**576.0**	544.3	**576.0**	544.3
Market risk	-	-	-	-
Other	**13.7**	85.7	**13.7**	85.7
Total risk exposure amount ('TRE')	**6,836.9**	6,948.1	**6,807.2**	6,905.8
Solvency ratios	**%**	%	**%**	%
CET1	**15.4**	14.3	**15.1**	13.7
TRC	**17.6**	16.4	**17.3**	15.9

This table is not subject to audit

The CRD IV risk weightings for credit risk exposures are currently calculated using the Standardised Approach ('SA'). 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, with retail deposits of over £50.0 billion. In addition, in October 2021 the PRA stated its expectation that all other UK firms should manage their leverage risk so that this ratio does not ordinarily fall below 3.25%.

	Note	**2021**	2020
		£m	£m
Total balance sheet assets		**15,137.0**	15,505.5
Less: Derivative assets	*19*	**(44.2)**	(463.3)
Central bank deposits	*14*	**(1,142.0)**	(1,637.1)
CRDs	*20*	**(23.7)**	(15.1)
Accrued interest on sovereign exposures		-	-
On-balance sheet items		**13,927.1**	13,390.0
Less: Intangible assets	*23*	**(170.5)**	(170.1)
Add back: Software relief		**1.4**	-
Total on balance sheet exposures		**13,758.0**	13,219.9
Derivative assets	*19*	**44.2**	463.3
Potential future exposure on derivatives		**36.3**	92.3
Total derivative exposures		**80.5**	555.6
Post offer pipeline at gross notional amount		**1,380.3**	949.1
Adjustment to convert to credit equivalent amounts		**(1,128.3)**	(773.8)
Off balance sheet items		**252.0**	175.3
Tier 1 capital		**1,055.8**	991.2
Total leverage exposure before IFRS 9 relief		**14,090.5**	13,950.8
IFRS 9 relief		**29.7**	42.3
Total leverage exposure		**14,120.2**	13,993.1
UK leverage ratio		**7.5%**	7.1%

This table is not subject to audit

The fully loaded leverage ratio is calculated as follows

	2021	2020
	£m	£m
Fully loaded Tier 1 capital	**1,026.1**	948.9
Total leverage exposure before IFRS 9 relief	**14,090.5**	13,950.8
Fully loaded UK leverage exposure	**7.3%**	6.8%

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.

(b) Return on tangible equity ('RoTE')

RoTE is a measure of an entity's profitability used by investors. RoTE is defined by the Group by comparing the profit after tax for the year, adjusted for amortisation charged on intangible assets, to the average of the opening and closing equity positions, excluding intangible assets and goodwill.

It effectively reflects a return on equity as if all intangible assets are eliminated immediately against reserves. As this is similar to the approach used for the capital of financial institutions it is widely used in the sector.

The Group's consolidated RoTE for the year ended 30 September 2021 is derived as follows:

	Note	**2021**	2021
		£m	£m
Profit for the year after tax		**164.5**	91.3
Amortisation of intangible assets	*23*	**2.0**	2.0
Adjusted profit		**166.5**	93.3
Divided by			
Opening equity		**1,156.0**	1,108.4
Opening intangible assets	*23*	**(170.1)**	(171.1)
Opening tangible equity		**985.9**	937.3
Closing equity		**1,241.9**	1,156.0
Closing intangible assets	*23*	**(170.5)**	(170.1)
Closing tangible equity		**1,071.4**	985.9
Average tangible equity		**1,028.7**	961.6
Return on Tangible Equity		**16.2%**	9.7%

This table is not subject to audit

(c) Dividend and distribution 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 38) and, other than the regulatory requirement to retain an appropriate level of capital in Paragon Bank PLC, there are no restrictions preventing profits elsewhere in the Group from being distributed to the parent.

Since the year ended 30 September 2018, the Company has adopted a policy of paying out approximately 40% of its basic earnings per share as dividend (a dividend cover ratio of around 2.5 times), in the absence of any idiosyncratic factors which might make such a dividend inappropriate. This policy is reviewed by the Board at least annually. The Company considers it has access to sufficient cash resources to pay dividends at this level and that its distributable reserves are abundant for this purpose.

To provide greater transparency, the Board also adopted a policy of paying an interim dividend in each year equivalent to half of the preceding final dividend in the absence of any factors which might make such a distribution inappropriate. After consideration of the Group's capital position an interim dividend for the year of 7.2p per share was declared, in line with this policy (2020: nil).

The Group's dividend and distribution decisions in the 2020 financial year were dominated by the potential impact of the Covid pandemic. The strategic decision to build capital in response to the inherent risks posed by the virus meant that no interim dividend was declared for the year. However, at the 2020 year end a dividend was declared in line with the Group's stated policy.

The appropriate level of final dividend for the current year was considered by the Board in light of economic and regulatory developments in the year, and the various potential paths for the UK economy as the pandemic recedes. In particular the levels of provision in the Group's loan portfolios and the potential for further provision under stress were considered by the Board, along with the capital impacts of stress testing carried out as part of the ICAAP and forecasting processes, discounting the effects of the current temporary reduction in regulatory buffers. On the basis of the analysis the Board concluded that a dividend payment for the year of around 40% of earnings, in line with policy, could be made.

The Board will therefore propose a final dividend for the year of 18.9p per share (2020: 14.4p per share) for approval of the 2022 AGM, making a total dividend for the year of 26.1p per share (2020: 14.4p per share).

In addition, at the time of approving the half year report in June 2021, the Board authorised a buy-back of up to £40.0m of shares in the market, initially to be held in treasury. This programme commenced that month, and by the year end funds of £37.7m (including costs) had been disbursed. This programme will be completed following the publication of the results for the year.

At the time of approving the final dividend for the year the Board also authorised a further buy-back programme of £50.0m. This programme will commence after the completion of the June 2021 programme and the shares purchased will initially be held in Treasury.

The dividend cover for the year, which is subject to approval at the forthcoming AGM, is set out below.

	Note	**2021**	2020
Earnings per share (p)	*13*	**65.2**	36.0
Proposed dividend per share in respect of the year (p)	*40*	**26.1**	14.4
Dividend cover (times)		**2.50**	2.50

For the purposes of dividend policy, the Group defines dividend cover based on basic earnings per share, adjusted where considered appropriate, and dividend per share. This is the most common measure used by financial analysts.

The most recent policy review, in November 2021, also confirmed the existing dividend policy would continue to apply for future periods, subject to the impact of any future events, and the Board will consider the appropriateness and scale of any interim dividend in the context of the Group's results and the operating and economic environment at the time.

54. 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 55 to 58 respectively.

The Board has a Risk and Compliance Committee, consisting of the Chair of the Board and the non-executive directors which is responsible for providing oversight and challenge to the Group's risk management arrangements. Executive responsibility for the oversight and operation of the Group's risk management framework is delegated to the Executive Risk Committee ('ERC'). ERC discharges its duties through a number of sub-committees and escalates issues of concern to the Risk and Compliance Committee where appropriate.

The Credit Committee and the Asset and Liability Committee ('ALCO') are sub-committees of the ERC which monitor performance against the risk appetites set by the Board and make recommendations for changes in risk appetite where appropriate. They also review and, where authorised to do so, agree or amend policies for managing each of these risks, which are summarised in the relevant note. The Corporate Governance Statement in Section B3 (which is not subject to audit) provides further detail on the operations of these committees.

The financial risk management policies have remained unchanged throughout the year and since the year end. The position discussed in notes 55 to 58 is materially similar to that existing throughout the year.

55. Credit risk

The assets of the Group and the Company which are subject to credit risk are set out below:

	Note	The Group		The Company	
		2021	2020	**2021**	2020
		£m	£m	**£m**	£m
Financial assets at amortised cost					
Loans to customers	*15*	**13,402.7**	12,631.4	-	-
Trade receivables	*20*	**1.3**	3.2	-	-
Amounts owed by Group companies	*20*	-	-	**73.0**	84.0
Cash	*14*	**1,360.1**	1,925.0	**19.6**	12.6
CSA assets	*20*	**36.6**	103.5	-	-
CRDs	*20*	**23.7**	15.1	-	-
Accrued interest income	*20*	-	0.1	**0.1**	0.6
		14,824.4	14,678.3	**92.7**	97.2
Financial assets at fair value					
Derivative financial assets	*19*	**44.2**	463.3	-	-
Maximum exposure to credit risk		**14,868.6**	15,141.6	**92.7**	97.2

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 56, limit the amount of principal repayments on the Group's securitised and warehouse borrowings in cases of capital losses on assets, considerably reducing the effective shareholder value at risk.

All financial assets at amortised cost are subject to the requirements of IFRS 9 relating to impairment.

Further information on the Group's exposure to credit risk by asset type, including the credit quality of assets and any potential concentrations of credit risk, is set out below for:

- Loans to customers
- Cash balances (including CSA assets, CRDs and accrued interest)
- Trade receivables
- Derivative financial assets

Loans to customers

The Group's credit risk is primarily attributable to its loans to customers and its business objectives rely on maintaining a high-quality customer base and place strong emphasis on good credit management, both at the time of acquiring or underwriting a new loan, where strict lending criteria are applied, and throughout the loan's life.

Primary responsibility for the management of credit risk relating to lending activities across the Group lies with the Credit Committee. The Credit Committee is made up of senior employees, drawn from financial and risk functions independent of the underwriting process. It is chaired by the Credit Risk Director. Its key responsibilities include setting and reviewing credit policy, controlling applicant quality, tracking account performance against targets, agreeing product criteria and lending guidelines and monitoring performance and trends.

The Group's underwriting philosophy is based on a combination of sophisticated individual credit assessment and the automated efficiencies of statistically-based decision making models. Information on each applicant is combined with data taken from credit reference agencies and other external sources 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. Similarly, where assets form part of the security to support the loan, robust asset valuation processes ensure appropriate risk mitigation is in place. Even so, in assessing credit risk an applicant's ability and propensity to repay the loan remain the principal factors in the decision to lend, even where the Group would have security on the proposed loan.

In considering whether to acquire pools of loan assets, the Group will undertake a due diligence exercise on the underlying loan accounts. Such assets are generally not fully performing and are offered at a discount to their current balance. The Group's procedures may include inspection of original loan documents, verification of security and the examination of the credit status of borrowers. Current and historic cash flow data will also be examined. The objective of the exercise is to establish, to a level of confidence similar to that provided by the underwriting process, that the assets will generate sufficient cash flows to recover the Group's investment and generate an appropriate return without exposing the Group to material operational or conduct risks.

This section sets out information relevant to assessing the credit risk inherent in the Group's loans to customers balances. It is set out in the following subsections:

- Types of lending and related security
- Overall credit grading
- Credit characteristics of particular portfolios
- Arrears performance
- Acquired assets

Types of lending

The Group's balance sheet loan assets at 30 September 2020 are analysed as follows:

	2021	**2021**	2020	2020
	£m	**%**	£m	%
Buy-to-let mortgages	**11,424.3**	**85.2%**	10,583.8	83.8%
Owner-occupied mortgages	**36.3**	**0.3%**	53.1	0.4%
Total first charge residential mortgages	**11,460.6**	**85.5%**	10,636.9	84.2%
Second charge mortgage loans	**281.7**	**2.1%**	354.5	2.8%
Loans secured on residential property	**11,742.3**	**87.6%**	10,991.4	87.0%
Development finance	**608.2**	**4.5%**	609.0	4.8%
Loans secured on property	**12,350.5**	**92.1%**	11,600.4	91.8%
Asset finance loans	**440.5**	**3.3%**	452.0	3.6%
Motor finance loans	**229.2**	**1.7%**	272.4	2.2%
Aircraft mortgages	**28.2**	**0.2%**	26.0	0.2%
Structured lending	**118.9**	**0.9%**	94.9	0.7%
Invoice finance	**20.9**	**0.2%**	13.5	0.1%
Total secured loans	**13,188.2**	**98.4%**	12,459.2	98.6%
Professions finance	**33.1**	**0.3%**	22.3	0.2%
RLS, CBILS and BBLS	**83.8**	**0.6%**	25.2	0.2%
Other unsecured commercial loans	**10.3**	**0.1%**	15.0	0.1%
Unsecured consumer loans	**87.3**	**0.6%**	109.7	0.9%
Total loans to customers	**13,402.7**	**100.0%**	12,631.4	100.0%

First and second charge mortgages are secured by charges over residential properties in England and Wales, or similar Scottish or Northern Irish securities.

Development finance loans are secured by a first charge (or similar Scottish security) over the development property and various charges over the build.

Asset finance loans and motor finance loans are effectively secured by the financed asset, while aircraft mortgages are secured by a charge on the aircraft funded.

Structured lending and invoice finance balances are effectively secured over the assets of the customer, with security enhanced by maintaining balances at a level less than the total amount of the security (the advance percentage).

Professions finance balances are generally short term unsecured loans made to firms of lawyers and accountants for working capital purposes.

Loans made under the Recovery Loan Scheme ('RLS'), the Coronavirus Business Interruption Loan Scheme ('CBILS') and the Bounce Back Loan Scheme ('BBLS') have the benefit of a guarantee underwritten by the UK Government.

Other unsecured consumer loans include unsecured loans either advanced by group companies or acquired from their originators at a discount.

There are no significant concentrations of credit risk to individual counterparties due to the large number of customers included in the portfolios. All lending is to customers within the UK. The total gross carrying value of the Group's loans to customers due from customers with total portfolio exposures over £10.0m is analysed below by product type.

	2021	2020
	£m	£m
Buy-to-let mortgages	**163.3**	154.3
Development finance	**217.9**	240.0
Structured lending	**108.7**	72.7
Asset finance	**10.4**	-
	500.3	467.0

The threshold of £10.0m is used internally for monitoring large exposures.

Credit grading

An analysis of the Group's loans to customers by absolute level of credit risk at 30 September 2021 is set out below. The analysed amount represents gross carrying amount.

	Stage 1	Stage 2	Stage 3	POCI	Total
	£m	£m	£m	£m	£m
30 September 2021					
Very low risk	**9,834.5**	**563.8**	**1.3**	**41.9**	**10,441.5**
Low risk	**1,716.9**	**532.2**	**78.5**	**16.3**	**2,343.9**
Moderate risk	**149.2**	**130.2**	**3.8**	**22.4**	**305.6**
High risk	**42.0**	**23.7**	**11.6**	**21.7**	**99.0**
Very high risk	**42.0**	**27.5**	**62.0**	**17.4**	**148.9**
Not graded	**115.8**	**1.7**	**7.1**	**4.6**	**129.2**
Total gross carrying amount	**11,900.4**	**1,279.1**	**164.3**	**124.3**	**13,468.1**
Impairment	**(15.0)**	**(11.3)**	**(38.9)**	**(0.2)**	**(65.4)**
Total loans to customers	**11,885.4**	**1,267.8**	**125.4**	**124.1**	**13,402.7**
30 September 2020					
Very low risk	8,771.2	453.3	20.8	45.9	9,291.2
Low risk	1,229.2	120.9	10.7	21.7	1,382.5
Moderate risk	742.2	184.7	12.1	32.8	971.8
High risk	285.2	143.9	50.7	32.0	511.8
Very high risk	48.3	67.9	49.9	22.9	189.0
Not graded	253.6	74.7	31.9	6.7	366.9
Total gross carrying amount	11,329.7	1,045.4	176.1	162.0	12,713.2
Impairment	(22.2)	(15.8)	(43.4)	(0.4)	(81.8)
Total loans to customers	11,307.5	1,029.6	132.7	161.6	12,631.4

Gradings above are based on credit scorecards or internally assigned risk ratings as appropriate for the individual asset class. These measures are calibrated across product types and used internally to monitor the Group's overall credit risk profile against its risk appetite.

These gradings represent current credit quality on an absolute basis and this may result in assets in higher IFRS 9 stages with low risk grades, especially where a case qualifies through breaching, for example, an arrears threshold but is making regular payments. This will apply especially to Stage 3 cases reported in note 18, other than those shown as 'realisations'.

Examples of lower risk cases in higher IFRS 9 stages include fully up-to-date receiver of rent cases; accounts where the customer is in arrears on their account with the Group but up to date on accounts with other lenders, creating a overall positive credit rating; and accounts where the default on the Group's loan has yet to impact on the external credit score.

A small proportion of the loan book (2021: 1.0%, 2020: 2.9%) is classed as 'not graded' above. This rating relates to loans that have been fully underwritten at origination but where the customer falls outside the automated assessment techniques used post-completion.

Credit characteristics by portfolio

Loans secured on residential property

First mortgage loans have a contractual term of up to thirty years and second charge mortgage loans up to twenty five years. In all cases the customer is entitled to settle the loan at any point and in most cases early settlement does take place. All customers on these accounts are required to make monthly payments.

An analysis of the indexed Loan-to-Value ('LTV') ratio for those loan accounts secured on residential property by value at 30 September 2021 is set out below. LTVs for second charge mortgages are calculated allowing for the interest of the first charge holder, based on the most recent first charge amount held by the Group, while for acquired accounts the effect of any discount on purchase is allowed for.

	First charge mortgages		Second charge mortgages	
	2021	2020	**2021**	2020
	%	%	**%**	%
Loan to value ratio				
Less than 70%	**83.8**	59.9	**88.4**	74.5
70% to 80%	**14.3**	35.9	**8.5**	16.7
80% to 90%	**0.5**	2.3	**1.5**	5.2
90% to 100%	**0.3**	0.4	**0.6**	1.2
Over 100%	**1.1**	1.5	**1.0**	2.4
	100.0	100.0	**100.0**	100.0
Average LTV ratio	**61.1**	65.7	**56.1**	62.2
Of which:				
Buy-to-let	**61.2**	65.8		
Owner-occupied	**42.0**	49.2		

The regionally indexed LTVs shown above are affected by changes in house prices, with the Nationwide house price index, for the UK as a whole, registering an annual increase of 10.0% in the year ended 30 September 2021 (2020: 5.0%).

The geographical distribution of the Group's residential mortgage assets by gross carrying value is set out below.

	First charge		Second charge	
	2021	2020	**2021**	2020
	%	%	**%**	%
East Anglia	**3.3**	3.2	**3.3**	3.3
East Midlands	**5.5**	5.4	**6.3**	6.1
Greater London	**18.5**	18.7	**7.8**	8.2
North	**3.1**	3.2	**4.0**	3.9
North West	**10.3**	10.4	**7.4**	7.4
South East	**31.8**	31.6	**39.3**	39.5
South West	**8.7**	8.7	**8.3**	8.0
West Midlands	**5.5**	5.4	**7.1**	7.3
Yorkshire and Humberside	**8.1**	8.4	**6.0**	5.9
Total England	**94.8**	95.0	**89.5**	89.6
Northern Ireland	**0.1**	0.1	**1.8**	1.7
Scotland	**2.0**	1.7	**5.2**	5.2
Wales	**3.1**	3.2	**3.5**	3.5
	100.0	100.0	**100.0**	100.0

Development finance

Development finance loans have an average term of 21 months (2020: 21 months). Settlement of principal and accrued interest takes place once the development is sold or refinanced following its completion and the customer is not normally required to make payments during the term of the loan. The loans are secured by a legal charge over the site and / or property together with other charges and warranties related to the build.

As customers are not required to make payments during the life of the loan, arrears and past due measures cannot be used to monitor credit risk. Instead, cases are monitored on an individual basis against the costs and progress in the agreed development programme 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.

	2021	**2021**	2020	2020
	By value	**By number**	By value	By number
	%	**%**	%	%
LTGDV				
50% or less	**2.9**	**5.3**	7.6	4.8
50% to 60%	**27.3**	**20.6**	22.4	13.2
60% to 65%	**44.3**	**49.4**	34.0	41.0
65% to 70%	**22.8**	**21.9**	31.3	36.1
70% to 75%	**1.4**	**1.6**	2.8	4.0
Over 75%	**1.3**	**1.2**	1.9	0.9
	100.0	**100.0**	100.0	100.0

The average LTGDV cover at the year end was 61.7% (2020: 63.1%).

LTGDV is calculated by comparing the current expected end of term exposure with the latest estimate of the value of the completed development based on surveyors' reports. The focus on residential property development within the portfolio means that asset values will generally move in line with the UK residential property market.

At 30 September 2021, the development finance portfolio comprised 247 accounts (2020: 229) with a total carrying value of £608.2m (2020: £609.0m). Of these accounts only 10 were included in Stage 2 at 30 September 2021 (2020: seven), with no accounts classified as Stage 3 (2020: one). In addition, one acquired account had been classified as POCI (2020: one). An allowance for this loss was made in the IFRS 3 fair value calculation.

The geographical distribution of the Group's development finance loans by gross carrying value is set out below.

	2021	2020
	%	%
East Anglia	**3.6**	5.1
East Midlands	**6.3**	5.5
Greater London	**6.1**	8.2
North	**2.4**	1.8
North West	**1.1**	0.4
South East	**57.5**	58.8
South West	**13.5**	14.0
West Midlands	**4.8**	4.0
Yorkshire and Humberside	**3.5**	1.1
Total England	**98.8**	98.9
Northern Ireland	-	-
Scotland	**1.2**	1.1
Wales	-	-
	100.0	100.0

Asset finance and motor finance

Asset and motor finance lending includes finance lease and hire purchase arrangements, which are accounted for as finance leases under IFRS 16. The average contractual life of the asset finance loans was 51 months (2020: 52 months) while that of the motor finance loans was 64 months (2020: 60 months), but it is likely that a significant proportion of customers will choose to settle their obligations early.

Asset finance customers are generally small or medium sized businesses. The nature of the assets underlying the Group's asset finance lending by gross carrying value is set out below.

	2021	2020
	%	%
Commercial vehicles	**33.4**	32.0
Construction plant	**34.2**	33.7
Technology	**7.0**	6.9
Manufacturing	**6.2**	6.7
Print and paper	**2.3**	3.7
Refuse disposal vehicles	**4.3**	4.8
Other vehicles	**4.3**	3.6
Agriculture	**3.1**	2.9
Other	**5.2**	5.7
	100.0	100.0

Motor finance loans are secured over cars, motorhomes and light commercial vehicles and represent exposure to consumers and small businesses.

Structured lending

The Group's structured lending division provides revolving loan facilities to support non-bank lending businesses. Loans are made to a Special Purpose Vehicle ('SPV') company controlled by the customer and effectively secured on the loans made by the SPV. Exposure is limited to a percentage of the underlying assets, providing a buffer against credit loss.

Summary details of the structured lending portfolio are set out below.

	2021	2020
Number of active facilities	**8**	8
Total facilities (£m)	**185.5**	139.0
Carrying value (£m)	**118.9**	94.9

The maximum advance under these facilities was 80% of the underlying assets.

These accounts do not have a requirement to make regular payments, operating on a revolving basis. The performance of each loan is monitored monthly on a case by case basis by the Group's Credit Risk function, assessing compliance with covenants relating to both the customer and the performance and composition of the asset pool. These assessments, which are reported to Credit Committee, are used to inform the assessment of expected credit loss under IFRS 9.

At 30 September 2021, one of these facilities was identified as Stage 2 (2020: four) with the remainder in Stage 1.

RLS, CBILS and BBLS

Loans under these schemes have the benefit of guarantees underwritten by the UK Government, which launched them as a response to the impact of Covid on UK SMEs.

CBILS and BBLS were launched in 2020 and remained open for new applications until March 2021. RLS was launched in April 2021 as a successor scheme and is expected to be available until June 2022.

The Group offered term loans and asset finance loans under the CBIL scheme. Interest and fees are paid by the UK Government for the first twelve months and the government guarantee covers up to 80% of the lender's principal loss after the application of any proceeds from the asset financed (if applicable).

Loans under the BBL scheme are six year term loans at a standard 2.5% per annum interest rate. The UK Government pays the interest on the loan for the first twelve months and provides lenders with a guarantee covering the whole outstanding balance.

The Group offers term loans and asset finance loans under the RLS. Interest and fees are payable by the customer from inception. The Government guarantee covers up to 80% of the lender's principal loss, after the application of any proceeds from the asset financed (if applicable), although the Government has announced its intent to reduce this cover to 70% for applications received after 1 January 2022.

The Group's outstanding RLS, CBILS and BBLS loans at 30 September 2021 were:

	2021	2020
	£m	£m
RLS		
Term loans	**0.1**	-
Asset finance	**20.7**	-
Total RLS	**20.8**	-
CBILS		
Term loans	**28.1**	20.6
Asset finance	**29.9**	1.0
Total CBILS	**58.0**	21.6
BBLS	**5.0**	3.6
	83.8	25.2

At 30 September 2021, only £0.2m of this balance was considered to be non-performing (2020: £nil).

Unsecured consumer loans

Almost all the Group's unsecured consumer loan assets are part of purchased debt portfolios where the consideration paid will have been based on the credit quality and performance of the loans at the point of the transaction. Collections on purchased accounts remain in excess of those implicit in the purchase prices.

Arrears performance

The number of accounts in arrears by asset class, based on the most commonly quoted definition of arrears for the type of asset, at 30 September 2021 and 30 September 2020, compared to the industry averages at those dates published by UK Finance ('UKF') and the FLA, was:

	2021	2020
	%	%
First mortgages		
Accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	**0.21**	0.15
Buy-to-let accounts excluding receiver of rent cases	**0.14**	0.10
Owner-occupied accounts	**4.48**	3.72
UKF data for mortgage accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	**0.45**	0.52
Buy-to-let accounts excluding receiver of rent cases	**0.43**	0.50
Owner-occupied accounts	**0.85**	0.90
All mortgages	**0.78**	0.82
Second charge mortgage loans		
Accounts more than 2 months in arrears		
All accounts	**19.08**	14.77
Post-2010 originations	**1.18**	0.62
Legacy cases (Pre-2010 originations)	**23.12**	21.17
Purchased assets	**24.76**	17.85
FLA data for secured loans	**8.60**	8.40
Motor finance loans		
Accounts more than 2 months in arrears		
All accounts	**4.15**	4.58
Originated cases	**2.30**	1.76
Purchased assets	**14.07**	13.10
Asset finance loans		
Accounts more than 2 months in arrears	**0.27**	1.75
FLA data for business lease / hire purchase loans	**0.60**	1.70

No published industry data for asset classes comparable to the Group's other books has been identified. Where revised data at 30 September 2020 has been published by the FLA or UKF, the comparative industry figures above have been amended.

Arrears information is not given for development finance, structured lending or invoice finance activities as the structure of the products means that such a measure is not appropriate.

It should be noted that, where customers were allowed to defer payments as part of Covid reliefs, these deferrals were not classified as arrears, in accordance with regulatory guidance.

Few of these arrangements remained in place at 30 September 2021, meaning that some of the increases shown above will relate to the suppression of arrears at the previous year end.

The Group calculates its headline arrears measure for buy-to-let mortgages, shown above, based on the numbers of accounts three months or more in arrears, including purchased Idem Capital assets, but excluding those cases in possession and receiver of rent cases designated for sale. This is consistent with the methodology used by UKF in compiling its statistics for the buy-to-let mortgage market as a whole.

The number of accounts in arrears will naturally be higher for legacy books, such as the Group's legacy second charge mortgages and residential first mortgages than for comparable active ones, as performing accounts pay off their balances, leaving arrears accounts representing a greater proportion of the total.

The figures shown above for secured loans incorporate purchased portfolios which generally include a high proportion of cases in arrears at the time of purchase and where this level of performance is allowed for in the discount to current balance represented by the purchase price. However, this will lead to higher than average reported arrears.

Acquired assets

Almost all the Group's unsecured consumer loan assets are part of purchased debt portfolios where the consideration paid was based on the credit quality and performance of the loans at the point of the transaction. No additional loans to customers treated as POCI were acquired in the year ended 30 September 2021.

Collections on purchased accounts have been comfortably in excess of those implicit in the purchase prices.

In the debt purchase industry, Estimated Remaining Collections ('ERC') is commonly used as a measure of the value of a portfolio. This is defined as the sum of the undiscounted cash flows expected to be received over a specified future period. In the Group's view, this measure may be suitable for heavily discounted, unsecured, distressed portfolios (which will be treated as POCI under IFRS 9), but is less applicable for the types of portfolio in which the Group has invested, where cash flows are higher on acquisition, loans may be secured on property and customers may not be in default. In such cases, the IFRS 9 amortised cost balance, at which these assets are carried in the Group balance sheet, provides a better indication of value.

However, to aid comparability, the 84 and 120 month ERCs value for the Group's purchased consumer loan assets, are set out below. These are derived using the same models and assumptions used in the EIR calculations. ERCs are set out both for all purchased consumer portfolios and for those classified as POCI under IFRS 9.

	2021	2020	2019
	£m	£m	£m
All purchased consumer assets			
Carrying value	**185.2**	235.3	291.1
84 month ERC	**221.2**	277.8	342.3
120 month ERC	**245.2**	313.7	387.5
POCI assets only			
Carrying value	**113.2**	139.8	168.3
84 month ERC	**143.9**	176.9	214.1
120 month ERC	**163.4**	203.7	246.0

Amounts shown above are disclosed as loans to customers (note 15). They include first mortgages, second charge mortgage loans and unsecured consumer loans.

Cash balances

The credit risk inherent in the cash positions of the Group and the Company is controlled by ALCO, which determines which institutions deposits may be placed with. The Group has formal risk policies, approved by the Risk and Compliance Committee. These include limitations on large exposures to mitigate any concentration risk in respect of its investments.

For cash deposits within the Group's securitisation structures, the scheme documents will set out criteria for allowable investments, including rating thresholds, which are monitored by the external trustees of each transaction.

The Group's cash balances are held in sterling at the Bank of England and at highly rated banks in current and call accounts. Cash is also invested in UK government securities and as short fixed term money market deposits from time to time.

The carrying value of the Group's and the Company's cash balances analysed by their long-term credit rating as determined by Fitch is set out below.

	2021	2020
	£m	£m
The Group		
Cash with central banks rated:		
AA-	**1,142.0**	1,637.1
	1,142.0	1,637.1
Cash with retail banks rated:		
AA-	**50.5**	112.0
A+	**167.6**	175.9
	218.1	287.9
Total exposure	**1,360.1**	1,925.0

	2021	2020
	£m	£m
The Company		
Cash with retail banks rated:		
A+	**19.6**	12.6

CRDs are exposures to the Bank of England and thus share the central bank rating noted above while CSA assets, placed with retail banks, have similar ratings to those shown above for retail bank deposits.

Credit risk on all these balances, and any interest accrued thereon, is considered to be minimal. These balances are considered as Stage 1 for IFRS 9 impairment purposes with a PD such that any provision required would be immaterial.

Trade debtors

The Group's trade debtors balance represents principally amounts outstanding on unpaid operating lease obligations in the asset finance business, where similar acceptance criteria to those used for finance lease cases apply.

Financial assets at fair value

The Group's financial assets held at fair value comprise solely derivative financial instruments used for hedging purposes (note 19).

In order to control credit risk relating to counterparties to the Group's derivative financial instruments, ALCO determines which counterparties the Group will deal with, establishes limits for each counterparty and monitors compliance with those limits. Such counterparties are typically highly rated banks and, for all derivative positions held within the Group's securitisation structures, must comply with criteria set out in the financing arrangements, which are monitored externally.

The Group uses the ISDA Master Agreement for documenting certain derivative activity. For certain counterparties a CSA has been executed in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between counterparties to mitigate the market contingent counterparty risk inherent in the outstanding positions. Collateral pledged to such counterparties by the Group is shown in note 20, while collateral pledged to the Group is shown in note 32.

Since June 2019, the Group has been centrally clearing certain eligible derivatives with a Central Clearing Counterparty ('CCP') which removes credit risk between bilateral counterparties and ensures timely settlement and / or porting of derivative contracts in the event of the failure of a counterparty.

The Group's cross-currency basis swaps, the last of which terminated in the year, had arrangements requiring any counterparty failing to meet required credit criteria, to provide a cash collateral deposit. These cash collateral deposits were held in escrow and not recognised as assets of the Group so did not form part of the Group's cash position.

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.

	2021	2020
	£m	£m
Carrying value of derivative financial assets		
Counterparties rated		
AA	**0.1**	-
AA-	**0.4**	97.8
A+	**43.1**	364.2
A	**0.6**	1.3
Gross exposure (note 19)	**44.2**	463.3
Collateral amounts posted		
Cross-currency basis swap arrangements	-	-
CSA collateral amounts (note 33)	-	-
Total collateral	-	-
Net exposure	**44.2**	463.3

The reduction in exposure shown above relates principally to the termination of cross-currency basis swaps on the repayment of the related securitisation borrowings.

56. 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.

As an authorised deposit taker, the liquidity position of Paragon Bank PLC, the Group's banking subsidiary, is also managed on a stand-alone basis.

Set out below is a summary of the contractual cash flows expected to arise from the Group's financial and leasing liabilities, based on the earliest date at which repayment can be demanded.

	Amounts payable				
	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	Total
	£m	£m	£m	£m	£m
30 September 2021					
Retail deposits	**7,306.3**	**1,626.9**	**540.1**	**12.3**	**9,485.6**
Borrowings	**220.3**	**25.0**	**2,913.7**	**185.6**	**3,344.6**
Total non-derivative liabilities	**7,526.6**	**1,651.9**	**3,453.8**	**197.9**	**12,830.2**
Derivative liabilities	**1.8**	**11.7**	**28.9**	**0.4**	**42.8**
	7,528.4	**1,663.6**	**3,482.7**	**198.3**	**12,873.0**
30 September 2020					
Retail deposits	5,740.0	1,608.2	704.5	-	8,052.7
Borrowings	792.9	398.1	1,079.0	161.5	2,431.5
Total non-derivative liabilities	6,532.9	2,006.3	1,783.5	161.5	10,484.2
Derivative liabilities	5.1	5.2	1.8	-	12.1
	6,538.0	2,011.5	1,785.3	161.5	10,496.3

Non-recourse balances are payable only to the extent that funds are available, as described further below, and do not expose the Group to any material liquidity risk. They are therefore not included in the table above.

As the amounts set out above include all expected future cash flows, including principal and interest, they will not agree to amortised cost or fair value amounts reported in the balance sheet.

Further information on the liquidity exposure arising from the Group's retail deposits, securitisation and other borrowings is set out below.

The liquidity exposures of the Company arise only from its borrowings, and are set out below.

The overall responsibility for the management of liquidity risk rests with ALCO which makes recommendations for the Group's liquidity policy for board approval. ALCO monitors liquidity risk metrics within limits set by the Board or regulators and uses detailed cash flow projections to ensure that an adequate level of liquidity is available at all times.

The Group's and the Bank's liquidity position is managed on a day to day basis by the treasury function, under the supervision of ALCO.

Retail deposits

The Group's retail funding strategy is focussed on building a stable mix of deposit products. A high proportion of balances, 97.0% (2020: 97.3%), are protected by the 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:

	2021	2020
	£m	£m
Payable on demand	**3,308.7**	2,363.8
Payable in less than three months	**808.1**	598.3
Payable in less than one year but more than three months	**3,189.5**	2,777.9
Payable in less than one year or on demand	**7,306.3**	5,740.0
Payable in one to two years	**1,626.9**	1,608.2
Payable in two to five years	**540.1**	704.5
Payable after more than five years	**12.3**	-
	9,485.6	8,052.7

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 2021 the liquidity buffer comprised the following on and off balance sheet assets. All these assets are held within the Bank and are readily realisable.

	2021	2020
	£m	£m
Balances with central banks	**942.7**	1,386.9
Total on balance sheet liquidity	**942.7**	1,386.9
Long / short repo transaction	**150.0**	150.0
	1,092.7	1,536.9

Balances with central banks above exclude group cash balances placed on deposit at the Bank of England through Paragon Bank.

Paragon Bank manages its Liquidity Coverage Ratio ('LCR'), the level of its High Quality Liquid Assets ('HQLA') relative to its short-term forecast net cash outflows. A minimum level of LCR, the Liquidity Coverage Requirement, is set through regulation for all regulated financial institutions. As at 30 September 2021, 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 2021 and 30 September 2020 based on their carrying values. These are analysed between non-recourse (securitisation) and other funding, with the liquidity position arising principally from the other funding.

The Group

	Financial liabilities falling due:				
	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**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**
30 September 2021					
Secured bank borrowings	**201.0**	-	-	**529.0**	**730.0**
Asset backed loan notes	-	-	-	**516.0**	**516.0**
Total non-recourse funding	**201.0**	-	-	**1,045.0**	**1,246.0**
Bank overdrafts	**0.3**	-	-	-	**0.3**
Retail bonds	**125.0**	-	**112.1**	-	**237.1**
Corporate bond	-	-	-	**149.0**	**149.0**
Central bank facilities	**69.0**	-	**2,750.0**	-	**2,819.0**
Lease liabilities	**1.5**	**1.9**	**3.8**	**2.3**	**9.5**
	396.8	**1.9**	**2,865.9**	**1,196.3**	**4,460.9**
30 September 2020					
Secured bank borrowings	-	-	-	657.8	657.8
Asset backed loan notes	-	-	-	3,270.5	3,270.5
Total non-recourse funding	-	-	-	3,928.3	3,928.3
Bank overdrafts	0.4	-	-	-	0.4
Retail bonds	60.0	124.8	112.0	-	296.8
Corporate bond	-	-	-	149.8	149.8
Central bank facilities	700.0	244.4	910.0	-	1,854.4
Lease liabilities	1.5	1.1	2.4	0.6	5.6
	761.9	370.3	1,024.4	4,078.7	6,235.3

The Company

	Financial liabilities falling due:				
	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**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**
30 September 2021					
Retail bonds	**125.0**	-	**112.1**	-	**237.1**
Corporate bond	-	-	-	**149.0**	**149.0**
Lease liabilities	**1.3**	**1.3**	**4.1**	**9.6**	**16.3**
	126.3	**1.3**	**116.2**	**158.6**	**402.4**
30 September 2020					
Retail bonds	60.0	124.8	112.0	-	296.8
Corporate Bond	-	-	-	149.8	149.8
Lease liabilities	1.2	1.3	4.0	11.0	17.5
	61.2	126.1	116.0	160.8	464.1

IFRS 7 requires the disclosure of future contractual cash flows (including interest) on these borrowings, and these are described and set out on the following pages.

Non-recourse funding

The Group has historically used securitisation as a principal source of funding, but currently only accesses this market on a strategic basis. In a securitisation an SPV company within the Group will issue asset backed loan notes ('Notes') secured on a pool of mortgage or other loan assets beneficially owned by the SPV in a public offer. The Notes have a maturity date later than the final repayment date for any asset in the pool, typically over thirty years from the issue date. The noteholders are entitled to receive repayment of the Note principal from principal funds generated by the loan assets from time to time, but their right to the repayment of principal is limited to the cash available in the SPV. Similarly, payment of accrued interest to the noteholders is limited to cash generated within the SPV. There is no requirement for any Group company other than the issuing SPV to make principal or interest payments in respect of the Notes. This matching of the maturities of the assets and the related funding substantially reduces the Group's exposure to liquidity risk. Details of Notes in issue are given in note 27 and the assets backing the Notes are shown in note 16.

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 existed which caused additional cash to be retained in the SPV rather than being transferred to the Group. While the Group could, if it chose, contribute additional cash to cover these requirements, it was under no obligation to do so. No such events occurred in the year ended 30 September 2021 or the year ended 30 September 2020 and no such SPVs remained live at 30 September 2021. The cash balances of the SPV companies are included within the restricted cash balances disclosed in note 14 as 'securitisation cash'.

Newly originated mortgage loans may be initially funded by a revolving loan facility or 'warehouse' from the point of their origination until their inclusion in a securitisation transaction or other refinancing. A warehouse may also be used to hold acquired loans or to refinance group loans on a short-term basis. A warehouse company functions in a similar way to an SPV, except that funds are drawn down as advances are made or loans are sold in, repaid when loans are securitised or refinanced by an internal asset sale and may subsequently be redrawn up to the end of a commitment period. The Group's Paragon Second Funding facility was initiated as a warehouse, but is no longer available for new drawings.

Repayment of the principal amount of the facilities is not required unless amounts are realised from the secured assets either through repayment, securitisation or asset sales, even after the end of the commitment period. There is no further recourse to other assets of the Group in respect of either interest or principal on the borrowings.

As with the SPVs, the Group provides subordinated funding to active warehouse companies and restricted cash balances are held within them. Contributions to the subordinated funding are made each time a drawing on the facility concerned is made. These amounts provide credit enhancement to the warehouse and cover certain fees. This funding is repaid when assets are securitised or refinanced by an internal asset sale. Credit enhancement in the active warehouse at 30 September 2021 was £27.4m (2020: £nil) and undrawn facilities of £199.0m were available at the year-end (2020: £400.0m).

Further details of the warehouse facilities are given in note 28 and details of the loan assets within the warehouses are given in note 16.

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 2045 and the latest in 2050.

The equivalent sterling principal amount outstanding at 30 September 2021 under the SPV and warehouse arrangements, allowing for the effect of the cross-currency basis swaps, described under currency risk (note 58), which are net settled with the loan payments, was £1,248.1m (2020: £3,489.1m). The total sterling amount payable under these arrangements, were these principal amounts to remain outstanding until the final repayment date, would be £1,886.9m (2020: £4,423.0m). 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. The oldest outstanding bond was redeemed in the year in accordance with its terms of issue, reducing the outstanding principal to £237.5m. This programme offers the Group opportunities to raise further working capital if needed.

The Group issued £150.0m of tier 2 debt in September 2016 with an optional call date in September 2021 and a final maturity of September 2026. This was called during the year and a replacement green bond was issued in March 2021. This bond is optionally callable between 25 June 2026 and 25 September 2026 and has a final maturity date of 25 September 2031.

The Group's ability to issue debt is supported by its credit rating issued by Fitch which was confirmed at BBB- in March 2021 with the published outlook for the rating revised to stable (from negative), in common with the ratings of other UK banks.

Of the Group's corporate and retail bond issuance, £125.0m falls due for payment in the next twelve months.

Central bank facilities

The Group has accessed term facilities under the central bank schemes described in note 31. 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 2021 the amount of drawings available in respect of prepositioned assets was £1,424.2m (2020: £684.0m).

Additional liquidity

The Group holds certain of its own listed, externally rated, asset backed securities which may be used as security to access credit facilities, including those offered by the Bank of England. The principal value of these notes is analysed by credit grade and utilisation status below.

		2021			2020	
	Utilised	**Available**	**Total**	Utilised	Available	Total
	£m	**£m**	**£m**	£m	£m	£m
Rating						
AAA	**1,276.1**	**287.0**	**1,563.1**	367.8	643.6	1,011.4
AA+ / AA / AA-	**5.3**	**100.9**	**106.2**	3.4	64.2	67.6
A+ / A / A-	**4.6**	**59.9**	**64.5**	3.6	51.8	55.4
BBB+ / BBB / BBB-	**4.3**	**81.4**	**85.7**	3.4	64.2	67.6
	1,290.3	**529.2**	**1,819.5**	378.2	823.8	1,202.0

As these notes are held internally, they are not included in balance sheet liabilities. Mortgage assets backing these securities remain on the Group's balance sheet and are included in amounts pledged as collateral in note 16.

Utilised notes includes those which the Group is obliged to hold under regulations governing securitisation issuance.

The available AAA notes would give access to £149.3m (2020: £502.5m) if used to secure drawings on Bank of England facilities. This is expected to increase to £297.1m when approval of the Group's LIBOR transition arrangements is received.

During the year ended 30 September 2020, the Group entered into a back-to-back long / short sale and repurchase ('repo') transaction with a UK bank which continued throughout the current year. This provides £150.0m of liquidity (2020: £150.0m), utilising £26.8m of the loan notes shown above, but does not appear on the Group's balance sheet.

The Group has also entered into short-term repo transactions from time to time during the year and maintains the capability to access the repo market for liquidity purposes.

Contractual cash flows

The total undiscounted amounts, inclusive of estimated interest, which would be payable in respect of the non-securitisation borrowings of the Group and the Company, should those balances remain outstanding until the contracted repayment date, or the earliest date on which repayment can be required, are set out below.

	Contingent consideration	Corporate bonds	Retail bonds	Central bank facilities	Lease liabilities	Total
	£m	£m	£m	£m	£m	£m
a) The Group						
30 September 2021						
Payable in:						
Less than one year	**4.6**	**6.6**	**135.6**	**71.8**	**1.7**	**220.3**
One to two years	**3.0**	**6.6**	**6.8**	**6.7**	**1.9**	**25.0**
Two to five years	-	**19.7**	**119.2**	**2,770.9**	**3.9**	**2,913.7**
Over five years	-	**182.7**	-	-	**2.9**	**185.6**
	7.6	**215.6**	**261.6**	**2,849.4**	**10.4**	**3,344.6**
30 September 2020						
Payable in:						
Less than one year	3.2	10.9	75.3	701.9	1.6	792.9
One to two years	5.0	10.9	135.6	245.4	1.2	398.1
Two to five years	5.8	32.6	126.0	912.0	2.6	1,079.0
Over five years	-	160.9	-	-	0.6	161.5
	14.0	215.3	336.9	1,859.3	6.0	2,431.5

	Corporate bonds	Retail bonds	Lease liabilities	Total
	£m	£m	£m	£m
b) The Company				
30 September 2021				
Payable in:				
Less than one year	**6.6**	**135.6**	**1.7**	**143.9**
One to two years	**6.6**	**6.8**	**1.7**	**15.1**
Two to five years	**19.7**	**119.2**	**5.0**	**143.9**
Over five years	**182.7**	-	**10.3**	**193.0**
	215.6	**261.6**	**18.7**	**495.9**
30 September 2020				
Payable in:				
Less than one year	10.9	75.3	1.7	87.9
One to two years	10.9	135.6	1.7	148.2
Two to five years	32.6	126.0	5.0	163.6
Over five years	160.9	-	12.0	172.9
	215.3	336.9	20.4	572.6

Amounts payable in respect of the 'other accruals' and 'trade creditors' shown in note 32 fall due within one year. The cash flows described above will include those for interest on borrowings accrued at 30 September 2021 disclosed in note 32.

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:

	2021	2020
	Total cash outflow / (inflow)	Total cash outflow / (inflow)
	£m	£m
On derivative liabilities		
Payable in less than one year	**1.8**	5.1
Payable in one to two years	**11.7**	5.2
Payable in two to five years	**28.9**	1.8
Payable in over five years	**0.4**	-
	42.8	12.1
On derivative assets		
Payable in less than one year	**(25.1)**	(38.1)
Payable in one to two years	**(13.6)**	(43.4)
Payable in two to five years	**(3.8)**	(45.7)
Payable in over five years	-	(0.1)
	(42.5)	(127.3)
	0.3	(115.2)

The reduction in the level of expected flows is a result of the termination of cross-currency basis swaps in the year.

57. Interest rate risk

Interest rate risk is the current or prospective risk to capital or earnings arising from adverse movements in interest rates. The Group's exposure to this risk is a natural consequence of its lending, deposit taking and other borrowing activities, as some of its financial assets and liabilities bear interest at rates which float with various market rates while others are fixed, either for a term or for their whole lives. Such risk is referred to as Interest Rate Risk in the Banking Book ('IRRBB'). The Group does not seek to generate income from taking interest rate risk and aims to minimise exposures that occur as a natural consequence of carrying out its normal business activities.

The principal market-set interest rate used by the Group has historically been LIBOR, which has been used to set rates for certain loan assets and borrowings. However, the Group has continued to move towards the use of alternative reference rates, principally SONIA, during the year. All new wholesale debt and interest rate swaps recognised since that point have referenced SONIA, while existing LIBOR linked instruments have either been transitioned or are in the process of transitioning in response to the expected withdrawal of LIBOR from late 2021. This process is expected to be completed in the first half of new financial year, before the LIBOR withdrawal date.

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

- Duration or re-pricing risk. The risk created when interest rates on assets, liabilities and off-balance sheet items reprice at different times causing them to move by different amounts
- Basis risk. The risk arising where assets and liabilities re-price with reference to different reference interest rates, for example rates set by the Group and market rates, such as Bank of England base rate, SONIA and LIBOR. Relative changes in the difference between the reference rates over time may impact earnings
- Optionality or prepayment risk. The risk that settlement of asset and liability balances at different times from those forecast due to economic conditions or customer behaviour may create a mismatch in future periods

Due to the maturity transformation inherent in the Group's business model it is also exposed to the risk that the relationship between the rates affecting the shorter term funding balance and the rates affecting the longer term lending balance will have altered when the funding has to be refinanced.

The Group measures these risks through a combination of economic value and earnings-based measures considering prepayment risk:

- Economic Value ('EV') – a range of parallel and non-parallel interest rate stresses are applied to assess the change in market value from assets, liabilities and off balance sheet items re-pricing at different times
- Net Interest Income ('NII') – impact on earnings from a range of interest rate stresses

The Group's use of financial derivatives for hedging interest rate risk is discussed further in note 19.

IBOR transition

In July 2017 the FCA announced that by the end of 2021 it would no longer compel banks to make submissions to the LIBOR setting process. As a result of this, LIBOR will be discontinued in the early part of the financial year ending 30 September 2022. The UK Working Group on Sterling Risk-Free Interest Rates has recommended SONIA as its replacement and this recommendation has been adopted by the Group where appropriate.

LIBOR was historically used in setting interest rates on significant amounts of the Group's loan assets and borrowings and an internal working group was established to identify the impact on the business and ensure an orderly transition from LIBOR to other reference rates across all classes of financial instrument. This process is well progressed and the Group is on course to complete its transition ahead of the required date.

The current balances of the Group's loans to customers where the interest rate or the reversionary interest rate is set by reference to IBOR rates are set out below.

	2021	2020
	£m	£m
First mortgages	-	3,750.0
Development finance facilities	**63.3**	234.6
Second charge mortgages	**45.0**	61.4
Structured lending	**43.4**	94.9
Aviation mortgages	**12.1**	24.1
	163.8	4,165.0

All these loans reference sterling LIBOR, except certain aviation mortgages denominated in US dollars which reference US dollar LIBOR.

All of the Group's LIBOR-linked first mortgage loans were transitioned to a SONIA-linked basis in line with appropriate regulatory expectations during the year.

The Group's development finance operation ceased to lend on a LIBOR linked basis from 1 April 2020. A programme to transition the remaining LIBOR linked facilities to the Group's Commercial Variable Rate ('CVR') commenced in the year. Of the balance shown above, £21.0m transitioned with effect from 1 October 2021 and the remaining balances are expected to be repaid before 31 December 2021.

The second charge mortgages shown above were moved to LIBOR as a temporary measure following the withdrawal of the Finance House Base Rate in 2020. These will be transitioned to a basis linked to Bank Base Rate ('BBR') by 31 December 2021.

Structured finance facilities agreed since 22 February 2021 have interest rates linked to Daily Compounded SONIA. The majority of extant LIBOR loans were transitioned to the SONIA basis during the year with the remainder expected to transition before the end of December 2021.

No new aviation mortgages referencing sterling LIBOR have been written since 1 October 2020. During the year all extant LIBOR linked loans were transitioned to BBR linked arrangements.

Aviation mortgages referencing US Dollar LIBOR remained in place at year end. US Dollar LIBOR will continue to be published until June 2023.

Borrowings where interest rates are based on LIBOR and other IBOR rates are shown in notes 27 and 28. All such arrangements have either expired, transitioned to SONIA in the year, or an agreement to transition to SONIA on an appropriate timescale is in place.

Derivative financial assets and liabilities where cash flows are based on IBOR rates are shown in note 19. All remaining LIBOR linked derivatives will transition to SONIA in line with ISDA protocols at the LIBOR withdrawal date.

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 2021, 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 2021 by £25.6m (2020: reduced by £0.9m) and increase profit before tax by £16.7m (2020: increase by £19.8m).

This calculation allows only for the direct effects of any change in UK interest rates. In practice, such a change might have wider economic consequences which would themselves potentially affect the Group's business and results.

In previous years certain of the Group's borrowings have had interest rates dependent on US dollar and Euro LIBOR rates, with the effect of related cross-currency basis swaps being such that the Group's results had no material exposure to movements in these rates. None of these borrowings remained in place at 30 September 2021 and therefore independent 1.0% increases in US dollar or Euro interest rates would have no impact on the Group's equity (2020: increase by £0.3m and £0.9m respectively).

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. The Company's investments in loans to subsidiary companies include a Tier-2 Bond issued by Paragon Bank PLC, with terms matching the Tier-2 Bond issued by the Company. Its intercompany balance with Paragon Bank also includes £199.3m which is placed on deposit with the Bank of England. Interest is received on this balance at the same rate as that paid by the Bank of England. Other assets and liabilities with group entities bore interest at rates based on LIBOR up to 30 September 2021, after which they were transitioned to a SONIA basis. All other balances in the Company balance sheet are non-interest bearing.

58. Currency risk

The Group has little appetite for material amounts of exposure to foreign currency movements and applies a hedging strategy for any material open positions through the use of spot or forward contracts or derivatives.

All the Group's significant assets and liabilities at 30 September 2021 are denominated in sterling. In previous years certain of the asset backed loan notes were denominated in US dollars or euros, as described in note 27. Although IFRS 9 required that they were accounted for as currency liabilities and valued at their spot rates, a condition of the issue of these notes was that bespoke interest rate and currency swaps ('cross-currency basis swaps') were put in place for the duration of the borrowing, having the effect of converting the liability to a LIBOR-linked floating rate sterling borrowing eliminating currency risk for these exposures. The amount of this effective borrowing, the amount of the currency borrowing translated at the exchange rate on inception, is referred to as the 'equivalent sterling principal'. The final examples of such notes were repaid in the year.

The equivalent sterling principal amounts of notes in issue under the arrangements described above, and their carrying values at 30 September 2021 and 30 September 2020 are set out below:

	2021	**2021**	2020	2020
	Equivalent sterling principal	**Carrying value**	Equivalent sterling principal	Carrying value
	£m	**£m**	£m	£m
US dollar notes	-	-	397.0	609.6
Euro notes	-	-	687.5	917.8
	-	-	1,084.5	1,527.4

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 19.

None of the assets or liabilities of the Company are denominated in foreign currencies.

D2.4 Notes to the Accounts – Basis of preparation

For the year ended 30 September 2021

The notes set out below describe the accounting basis on which the Group and the Company prepare their accounts, the particular accounting policies adopted by the Group and the principal judgements and estimates which were required in the preparation of the financial statements.

They also include other information describing how the accounts have been prepared required by legislation and accounting standards.

59. Basis of preparation

The Group is required to prepare its financial statements for the year ended 30 September 2021 in accordance with IFRS in conformity with the requirements of the Companies Act 2006. They must also be prepared in accordance with IFRS adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union ('EU'). In the financial years reported on this will also mean that, in the Group's circumstances, the financial statements also accord with IFRS as approved by the International Accounting Standards Board.

The "requirements of the Companies Act 2006" here means accounts being prepared in accordance with "IAS" as defined in section 474(1) of that Act, as it applied immediately before IP Completion Day (the end of the UK's transition period following its departure from the EU) ('IPCD'), including where the Company also makes use of standards which have been adopted for use within the United Kingdom in accordance with regulation 1(5) of the IAS and European Public Limited Liability Company (Amendment etc.) (EU Exit) Regulations 2019, subsequent to the IPCD.

Under the Listing Rules of the FCA, despite the UK's exit from the EU on 31 January 2020, the EU endorsed IFRS regime remains applicable to the Group until its first financial year commencing after the IPCD on 31 December 2020.

Therefore, while EU endorsed IFRS applies to these financial statements, those for the year ending 30 September 2022 will instead be prepared under 'UK-adopted IAS.

The changes in the way that the basis of preparation is described, which result from the UK's exit from the EU, including the move to UK-adopted IAS from the Group's financial year commencing 1 October 2021, do not represent a change in the basis of accounting which would necessitate a prior year restatement.

The particular accounting policies adopted have been set out in note 61 and the critical accounting judgements and estimates which have been required in preparing these financial statements are described in notes 62 and 63 respectively.

The Group has historically chosen to present an additional comparative balance sheet.

Adoption of new and revised reporting standards

In the preparation of these financial statements, the following accounting standard is being applied for the first time.

- 2020 amendments to IAS 39 – 'Interest Rate Benchmark Reform' and consequential amendments to IFRS 7

Comparability of information

IFRS 16 did not require that the balance sheet information at 30 September 2019 was restated on the adoption of the Standard. The information presented for that period in these financial statements is derived in accordance with IAS 17 – 'Leases' ('IAS 17'), and therefore may not be directly comparable with the balance sheet at 30 September 2021 and 30 September 2020 which are prepared under IFRS 16.

Standards not yet adopted

There are no standards and interpretations in issue but not effective which address matters relevant to the Group's accounting and reporting.

60. Changes in accounting standards

IAS 39 amendments 'Interest Rate Benchmark Reform'

In August 2020 the IASB issued a further amendment to IAS 39 'Interest Rate Benchmark Reform – Phase 2'. This amendment sets out accounting requirements for the treatment of IBOR-linked financial assets and liabilities under the amortised cost method and IBOR related hedge accounting when a firm replaces the IBOR linkage in the underlying instruments with a replacement benchmark. It is therefore potentially applicable to the Group's LIBOR-linked loan assets and those FRN liabilities where interest is charged on the basis of LIBOR or other IBOR rates. It also affects the Group's LIBOR (and other IBOR) referenced derivative assets and liabilities and the hedging relationships which they form part of.

The intention of the standard is that, where the transition is effectively a like for like replacement, no windfall gain or loss should occur on transition, and hedging relationships should be able to continue.

This amendment is effective from the Group's financial year ending 30 September 2022 but has been endorsed by both the EU and the UK and has been early adopted by the Group as permitted. The Group has utilised, and will continue to utilise, the provisions of the amendment as it transitions its IBOR-linked assets and liabilities. The impact of the amendment will depend upon the IBOR related assets, liabilities and hedging relationships at the point at which transition occurs.

61. Accounting policies

The particular policies applied by the Group in preparing these financial statements in accordance with the EU endorsed IFRS regime are described below.

As comparative financial information relating to the year ended 30 September 2019 and earlier periods has not been restated for IFRS 16, as permitted by that standard, the accounting policies applied differ to those used in the accounts for the year ended 30 September 2021. Where this is significant both policies are shown.

(a) Accounting convention

The financial statements have been prepared under the historical cost convention, except as required in the valuation of certain financial instruments which are carried at fair value.

(b) Basis of consolidation

The consolidated financial statements deal with the accounts of the Company and its subsidiaries made up to 30 September 2021. Subsidiaries comprise all those entities over which the Group has control, as defined by IFRS 10 – 'Consolidated Financial Statements'.

In addition to legal subsidiaries, where the Company owns shares in the entity, directly or indirectly, in accordance with IFRS 10, companies owned by charitable trusts into which loans originated by group companies were sold as part of its warehouse and securitisation funding arrangements, where the Group enjoys the benefits of ownership and which, therefore, it is considered to control, are treated as subsidiaries.

Similarly, trusts set up to hold shares in conjunction with the Group's employee share ownership arrangements are also treated as subsidiaries.

A full list of the Group's subsidiaries is set out in note 66, together with further information on the basis on which they are considered to be controlled by the Company. The results of businesses acquired are dealt with in the consolidated accounts from the date of acquisition.

(c) Going concern

The consolidated financial statements have been prepared on the going concern basis.

The directors have adopted this basis following a going concern assessment for the Group and the Company covering a period of at least twelve months following the date of approval of these financial statements. Details of this assessment are set out in note 64.

(d) Acquisitions and goodwill

Goodwill arising from the purchase of subsidiary undertakings, representing the excess of the fair value of the purchase consideration over the fair values of acquired assets, including intangible assets, is held on the balance sheet and reviewed annually to determine whether any impairment has occurred.

As permitted by IFRS 1, the Group has elected not to apply IFRS 3 – 'Business Combinations' to combinations taking place before its transition date to IFRS (1 October 2004). Therefore any goodwill which was written off to reserves under UK GAAP will not be charged or credited to the profit and loss account on any future disposal of the business to which it relates.

Contingent consideration arising on acquisitions is first recognised in the accounts at its fair value at the acquisition date and subsequently revalued at each accounting date until it falls due for payment or the final amount is otherwise determined.

(e) Cash and cash equivalents

Balances shown as cash and cash equivalents in the balance sheet comprise demand deposits and short-term deposits with banks with initial maturities of not more than 90 days.

(f) Leases

For leases where the Group is the lessee a right of use asset is recognised in property, plant and equipment on the inception of the lease based on the discounted value of the minimum lease payments at inception. A lease liability of the same amount is recognised at inception, with the unwinding of the discount included in the interest payable.

Leases where the Group is lessor are accounted for as operating or finance leases in accordance with IFRS 16 – 'Leases'. A finance lease is one which transfers substantially all of the risks and rewards of the ownership of the asset concerned. Any other lease is an operating lease.

Finance lease receivables are accounted for as loans to customers, with impairment provisions determined in accordance with IFRS 9.

Rental income and costs on operating leases are charged or credited to the profit and loss account on a straight-line basis over the lease term. The associated assets are included within property, plant and equipment.

(g) Loans to customers

Loans to customers includes assets accounted for as financial assets and finance leases. The Group assesses the classification and measurement of a financial asset based on the contractual cash flow characteristics of the asset and its business model for managing the asset. The Group has concluded that its business model for its customer loan assets is of the type defined as 'Held to collect' by IFRS 9 and the contractual terms of the asset should give rise to cash flows that are solely payments of principal and interest ('SPPI'). Such loans are therefore accounted for on the amortised cost basis.

Loans advanced are valued at inception at the initial advance amount, which is the fair value at that time, inclusive of procuration fees paid to brokers or other business providers and less initial fees paid by the customer. Loans acquired from third parties are initially valued at the purchase consideration paid or payable. Thereafter, all loans to customers are valued at this initial amount less the cumulative amortisation calculated using the EIR method. The loan balances are then reduced where necessary by an impairment provision.

The EIR method spreads the expected net income arising from a loan over its expected life. The EIR is that rate of interest which, at inception, exactly discounts the future cash payments and receipts arising from the loan to the initial carrying amount.

Where financial assets are credit-impaired at initial recognition the EIR is calculated on the basis of expected future cash receipts allowing for the effect of credit risk. In other cases, the expected contractual cash flows are used.

(h) Finance lease receivables

Finance lease receivables are included within 'Loans to Customers' at the total amount receivable less interest not yet accrued, unamortised commissions and provision for impairment.

Income from finance lease contracts is governed by IFRS 16 – 'Leases' and accounted for on the actuarial basis.

(i) Impairment of loans to customers

The carrying values of all loans to customers, whether accounted for under IFRS 9 or IFRS 16, are reduced by an impairment provision based on their ECL, determined in accordance with IFRS 9. These estimates are reviewed throughout the year and at each balance sheet date.

With the exception of POCI financial assets (which are discussed separately below), all assets are assessed to determine whether there has been a significant increase in credit risk ('SICR') since the point of first recognition (origination or acquisition). Assets are also reviewed to identify any which are 'Credit Impaired'. SICR and credit impairment are identified on the basis of pre-determined metrics including qualitative and quantitative factors relevant to each portfolio, with a management review to ensure appropriate allocation.

Assets which have not experienced an SICR are referred to as 'Stage 1' accounts, assets which have experienced an SICR but are not credit impaired are referred to as 'Stage 2' accounts, while credit impaired assets are referred to as 'Stage 3' accounts.

An impairment allowance is provided on an account by account basis:

- For Stage 1, at an amount equal to 12-month ECL, the total ECL that results from those default events that are possible within 12 months of the reporting date, weighted by the probability of those events occurring
- For Stage 2 and 3 accounts, at an amount equal to lifetime ECL, the total ECL that results from any future default events, weighted by the probability of those events occurring

In establishing an ECL allowance, the Group assesses its PD, LGD and exposure at default for each reporting period, discounted to give a net present value. The estimates used in these assessments must be unbiased and take into account reasonable and supportable information including forward-looking economic inputs.

While the Group uses statistical models as the basis for its calculation of ECLs where appropriate, expert judgement will always be used to assess the adequacy of any calculated amount and additional provision made if required.

Within its buy-to-let portfolio the Group utilises a receiver of rent process, whereby the receiver stands between the landlord and tenant and will determine an appropriate strategy for dealing with any delinquency. This strategy may involve the immediate sale of any underlying security or the short or long term letting of the property to cover arrears and principal shortfalls. Such cases are automatically considered to have an SICR, but where a letting strategy is adopted by the receiver and a tenant is in place, arrears may be reduced or cleared. Properties in receivership are eventually either returned to their landlord owners or sold.

For loan portfolios acquired at a discount, the discounts take account of future expected impairments and such assets are treated as POCI. For these assets, the Group recognises all changes in future cash flows arising from changes in credit quality since initial recognition as a loss allowance with any changes recognised in profit or loss.

For financial accounting purposes, provisions for impairments of loans to customers are held in an impairment allowance account from the point at which they are first recognised. These balances are released to offset against the gross value of the loan when it is written off for accounting purposes. This occurs when standard enforcement processes have been completed, subject to any amount retained in respect of expected salvage receipts. Any further gains from post-write off salvage activity are reported as impairment gains.

(j) Amounts owed by or to group companies

In the accounts of the Company, balances owed by or to other group companies are carried at the current amount outstanding less any provision. Where balances owing between group companies fall within the definition of either financial assets or financial liabilities given in IAS 32 – ‘Financial Instruments: Presentation’ they are classified as assets or liabilities at amortised cost, as defined by IFRS 9.

(k) Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation.

Assets held for letting under operating leases are depreciated in equal annual instalments to their estimated residual value over the life of the related lease. Vehicles held for short term hire are depreciated in equal annual instalments to their estimated residual value over their expected useful life. This depreciation is deducted in arriving at net lease income and is shown in note 6.

The assets’ residual values and useful lives are reviewed by management and adjusted, if appropriate, at each balance sheet date.

Depreciation on operating assets is provided on cost in equal annual instalments over the lives of the assets. Land is not depreciated. The rates of depreciation are as follows:

Freehold premises	Short leasehold premises	Computer hardware	Furniture, fixtures and office equipment	Company motor vehicles
2% per annum	over the term of the lease	25% per annum	15% per annum	25% per annum

Depreciation on right of use assets recognised in accordance with IFRS 16 is provided on a straight line basis over the term of the lease.

(l) Intangible assets

Intangible assets comprise purchased computer software and other intangible assets acquired in business combinations.

Purchased computer software is capitalised where it has a sufficiently enduring nature and is stated at cost less accumulated amortisation. Amortisation is provided in equal instalments at a rate of 25% per annum.

Other intangible assets acquired in business combinations include brands and business networks and are capitalised in accordance with the requirements of IFRS 3 – ‘Business Combinations’. Such assets are stated at attributed cost less accumulated amortisation. Amortisation is provided in equal instalments at a rate determined at the point of acquisition.

(m) Investments in subsidiaries

The Company's investments in subsidiary undertakings are valued at cost less provision for impairment.

(n) Own shares

Shares in Paragon Banking Group PLC held in treasury or by the trustee of the Group's employee share ownership plan are shown on the balance sheet as a deduction in arriving at total equity. Own shares are stated at cost.

(o) Retail deposits

Retail deposits are carried in the balance sheet on the amortised cost basis. The initial fair value recognised represents the cash amount received from the customer.

Interest payable to the customer is expensed to the income statement as interest payable over the deposit term on an EIR basis.

(p) Borrowings

Borrowings are carried in the balance sheet on the amortised cost basis. The initial value recognised includes the principal amount received less any discount on issue or costs of issuance.

Interest and all other costs of the funding are expensed to the income statement as interest payable over the term of the borrowing on an EIR basis.

(q) Central bank facilities

Where central bank facilities are provided at a below market rate of interest, and therefore fall within the definition of government assistance as defined by IAS 20 – 'Accounting for Government Grants and Disclosure of Government Assistance', the liability is initially recognised at the value of its expected cash flows discounted at a market rate of interest for a comparable commercial borrowing. Interest is recognised on this liability on an EIR basis, using the imputed market rate to determine the EIR.

The remaining amount of the advance is recognised as deferred government assistance and released to the profit and loss account through interest payable over the periods during which the arrangement affects profit.

(r) Derivative financial instruments

All derivative financial instruments are carried in the balance sheet at fair value, as assets where the value is positive or as liabilities where the value is negative. Fair value is based on market prices, where a market exists. If there is no active market, fair value is calculated using present value models which incorporate assumptions based on market conditions and are consistent with accepted economic methodologies for pricing financial instruments. Changes in the fair value of derivatives are recognised in the income statement, except where such amounts are permitted to be taken to equity as part of the accounting for a cash flow hedge.

(s) Hedging

IFRS 9 paragraph 7.2.21 permits an entity to elect, as a matter of accounting policy, to continue to apply the hedge accounting requirements of IAS 39 in place of those set out in Chapter 6 of IFRS 9. The Group has made this election and the accounting policy below has been determined in accordance with IAS 39.

For all hedges, the Group documents the relationship between the hedging instruments and the hedged items at inception, as well as its risk management strategy and objectives for undertaking the transaction. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the hedging arrangements put in place are considered to be 'highly effective' as defined by IAS 39.

For a fair value hedge, as long as the hedging relationship is deemed 'highly effective' and meets the hedging requirements of IAS 39, any gain or loss on the hedging instrument recognised in income can be offset against the fair value loss or gain arising from the hedged item for the hedged risk. For macro hedges (hedges of interest rate risk for a portfolio of loan assets or retail deposit liabilities) this fair value adjustment is disclosed in the balance sheet alongside the hedged item, for other hedges the adjustment is made to the carrying value of the hedged asset or liability. Only the net ineffectiveness of the hedge is charged or credited to income. Where a fair value hedge relationship is terminated, or deemed ineffective, the fair value adjustment is amortised over the remaining term of the underlying item.

Where a derivative is used to hedge the variability of cash flows of an asset or liability, it may be designated as a cash flow hedge so long as this relationship meets the hedging requirements of IAS 39. For such an instrument the effective portion of the change in the fair value of the derivative is taken initially to equity, with the ineffective part taken to profit or loss. The amount taken to equity is released to the income statement at the same time as the hedged item affects the income statement. Where a cash flow hedge relationship is terminated, or deemed ineffective, the amount taken to equity will remain there until the hedged transaction occurs, or is no longer expected to take place.

(t) Taxation

The charge for taxation represents the expected UK corporation tax (including the Bank Corporation Tax Surcharge where applicable) and other income taxes arising from the Group's profit for the year. This consists of the current tax which will be shown in tax returns for the year and tax deferred because of temporary differences. This in general, represents the tax impact of items recorded in the current year but which will impact tax returns for periods other than the one in which they are included in the financial statements.

The Group will hold a provision for any uncertain tax positions at the balance sheet date based on a global assessment of the expected amount that will ultimately be payable.

Tax relating to items taken directly to equity is also taken directly to equity.

(u) Deferred taxation

Deferred taxation is provided in full on temporary differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Deferred tax assets are recognised to the extent that it is regarded as probable that they will be recovered. As required by IAS 12 – 'Income Taxes', deferred tax assets and liabilities are not discounted to take account of the expected timing of realisation.

(v) Retirement benefit obligations

The expected cost of providing pensions within the funded defined benefit scheme, determined on the basis of annual valuations by professionally qualified actuaries using the projected unit method, is charged to the income statement. Actuarial gains and losses are recognised in full in the period in which they occur and do not form part of the result for the period, being recognised in the Statement of Comprehensive Income.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation, as reduced by the fair value of scheme assets at the balance sheet date.

The expected financing cost of the deficit, as estimated at the beginning of the period is recognised in the result for the period within interest payable. Any variances against the estimated amount in the year form part of the actuarial gain or loss.

The charge to the income statement for providing pensions under defined contribution pension schemes is equal to the contributions payable to such schemes for the year.

(w) Revenue

The revenue of the Group comprises interest receivable and similar charges, operating lease income and other income. The accounting policy for the recognition of each element of revenue is described separately within these accounting policies.

(x) Other income

Other income, which is accounted for in accordance with IFRS 15, includes:

- Event-based administration fees charged to borrowers (other than the initial fees included in amortised cost), which are credited when the related service is performed
- Fees charged to third parties for account administration services, which are credited as those services are performed
- Commissions receivable on the sale of insurances, as agent of the third-party insurer, which are taken to profit at the point at which the Group becomes unconditionally entitled to the income
- Maintenance income charged as part of the Group's contract hire arrangements which is recognised as the services are provided. Costs of these services are deducted in other income
- Broker fees receivable on the arrangement of loans funded by third parties, on an agency basis, which are taken to profit at the point of completion of the related loan

(y) Share based payments

In accordance with IFRS 2 – 'Share-based Payments', the fair value at the date of grant of awards to be made in respect of options and shares granted under the terms of the Group's various share based employee incentive arrangements is charged to the profit and loss account over the period between the date of grant and the vesting date.

National Insurance on share based payments is accrued over the vesting period, based on the share price at the balance sheet date.

Where the allowable cost of share based awards for tax purposes is greater than the cost determined in accordance with IFRS 2, the tax effect of the excess is taken to reserves.

(z) Dividends

In accordance with IAS 10 – 'Events after the balance sheet date', dividends payable on ordinary shares are recognised in equity once they are appropriately authorised and are no longer at the discretion of the Company. Dividends declared after the balance sheet date, but before the authorisation of the financial statements remain within shareholders' funds.

However, such dividends are deducted from regulatory capital from the point at which they are announced, and capital disclosures are prepared on this basis.

(aa) Foreign currency

Foreign currency transactions, assets and liabilities are accounted for in accordance with IAS 21 – 'The Effects of Changes in Foreign Exchange Rates'. The functional currency of the Company and all of the other entities in the Group is the pound sterling. Transactions which are not denominated in sterling are translated into sterling at the spot rate of exchange on the date of transaction. Monetary assets and liabilities which are not denominated in sterling are translated at the closing rate on the balance sheet date.

Gains and losses on retranslation are included in interest payable or interest receivable depending on whether the underlying instrument is an asset or a liability, except where deferred in equity in accordance with the cash flow hedging provisions of IAS 39.

(bb) Segmental reporting

The accounting policies of the segments are the same as those described above for the Group as a whole. Interest payable by each segment includes directly attributable funding and the allocated cost of retail deposit funds utilised. Costs attributed to each segment represent the direct costs incurred by the segment operations.

62. Critical accounting judgements

The most significant judgements which the directors have made in the application of the accounting policies set out in note 61 relate to:

(a) Significant Increase in Credit Risk ('SICR')

Under IFRS 9, the directors are required to assess where a credit obligation has suffered a Significant Increase in Credit Risk ('SICR'). The directors' assessment is based primarily on changes in the calculated 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, for account types where days overdue is an appropriate measure.

If additional accounts were determined to have an SICR, these balances would attract additional impairment provision and the overall provision charge would be higher.

In determining whether an account has an SICR in the Covid environment the granting of Covid reliefs, including payment holidays and similar arrangements, may mean that an SICR may exist without this being reflected in either arrears performance or credit bureau data. The Group has accepted the advice of UK regulatory bodies that the grant of Covid-related relief does not, of itself, indicate an SICR, but has carefully considered internal credit and customer data to determine whether there might be any accounts with SICR not otherwise identified by the process.

Where accounts have received secondary periods of relief beyond the initial three month period, this has generally been considered to be strongly indicative of underlying problems and such accounts have been identified as having an SICR. Furthermore, adjustments to correct probabilities of default in models will also have a consequent result of identifying more SICRs.

More information on the definition of SICR adopted is given in note 18.

(b) Definition of default

In applying the impairment provisions of IFRS 9, the directors have used models to derive the probabilities of default. In order to derive and apply such models, it is required to define 'default' for this purpose. The Group's definition of default is aligned to its internal operational procedures. IFRS 9 provides a rebuttable presumption of default when an account is 90 days overdue and this was used as the starting point for this exercise. Other factors include account management activities such as appointment of a receiver or enforcement procedures.

A combination of qualitative and quantitative measures was considered in developing the definition of default.

If a different definition of default had been adopted the expected loss amounts derived might differ from those shown in the accounts.

More information on the Group's definition of default adopted is given in note 18.

(c) Classification of financial assets

The classification of financial assets under IFRS 9 is based on two factors:

- The company's 'business model' – how the it intends to generate cash and profit from the assets
- The nature of the contractual cash flows inherent in the assets

Financial assets are classified as held at amortised cost, at fair value through OCI, or at fair value through profit and loss.

For an asset to be held at amortised cost, the cash flows received from it must comprise solely payments of principal and interest ('SPPI'). In effect, this restricts this classification to 'normal' lending activities, excluding arrangements where the lender may have a contingent return or profit share from the activities funded. The Group has considered its products and concluded that, as standard lending products, they fall within the SPPI criteria.

This is because all the Group's lending arrangements involve the advancing of amounts to customers, either as loans or finance lease products and the receipt of repayments of principal and charges, where those charges are calculated based on the amount loaned. There are no 'success fee' or other compensation arrangements not linked to the loan principal.

The use of amortised cost accounting is also restricted to assets which a company holds within a business model whose object is to collect cash flows arising from them, rather than seek to profit by disposing of them (a 'Held to Collect' model). The Group's strategy is to hold loan assets until they are repaid or written off. Loan disposals are rare, and the Group does not manage its assets in order to generate profits on sale. On this basis, it has categorised its business model as Held to Collect.

Therefore, the Group has classified its customer loan assets as carried at amortised cost.

63. Critical accounting estimates

Certain balances reported in the financial statements are based wholly or in part on estimates or assumptions made by the directors. There is, therefore, a potential risk that they may be subject to change in future periods. The most significant of these are:

(a) Impairment losses on loans to customers

Impairment losses on loans are calculated based on statistical models, applied to the present status, performance and management strategy for the loans concerned which are used to determine each loan's PD and LGD.

Internal information used will include number of months arrears, qualitative information, such as possession by a first charge holder on a second charge mortgage or where a buy-to-let case is under the control of a receiver of rent, the receiver's present and likely future strategy for the property (such as keeping current tenants in place, refurbish and relet, immediate sale etc).

External information used includes customer specific data, such as credit bureau information as well as more general economic data.

Key internal assumptions in the models relate to estimates of future cash flows from customers' accounts, their timing and, for secured accounts, the expected proceeds from the realisation of the property or other charged assets. These cash flows will include payments received from the customer, and, for buy-to-let cases where a receiver of rent is appointed, rental receipts from tenants, after allowing for void periods and running costs. These key assumptions are based on observed data from historical patterns and are updated regularly based on new data as it becomes available.

In addition, the directors consider how appropriate past trends and patterns might be in the current economic situation and make any adjustments they believe are necessary to reflect current and expected conditions.

All of this information may be impacted by the ongoing effects of the Covid pandemic, its economic effect on customers and the forms of the reliefs given to ameliorate that impact. These may both change the underlying data and impact on the derivation of metrics normally used to monitor credit performance.

The accuracy of the impairment calculations would therefore be affected by unexpected changes to the economic situation, variances between the models used and the actual results, or assumptions which differ from the actual outcomes. In particular, if the impact of economic factors such as employment levels on customers is worse than is implicit in the model then the number of accounts requiring provision might be greater than suggested by the model, while falls in house prices, over and above any assumed by the model might increase the provision required in respect of accounts currently provided. Similarly, if the account management approach assumed in the modelling cannot be adopted the provision required may be different.

In order to provide forward looking economic inputs to the modelling of the ECL, the Group must derive a set of scenarios which are internally coherent. The Group addresses these requirements using four distinct economic scenarios chosen to represent the range of possible outcomes. These scenarios at 30 September 2021 have been derived in light of the current economic situation, modelling a variety of possible outcomes as described in note 18. It should be noted, however, that there remains a significant range of different opinions amongst economists about the longer-term prospects for the UK and, while these positions are converging, this is likely to remain the case for some time to come.

The variables are used for two purposes in the IFRS 9 calculations:

- They are applied as inputs in the models which generate PD values, where those found by statistical analysis to have the most predictive value are used
- They are used as part of the calculation where the variable has a direct impact on the expected loss calculation, such as the house price index

The economic variables will also inform assumptions about the Group's approach to account management given a particular scenario.

In addition to uncertainty created by the economic scenarios, the Group recognises that the present situation lies outside the range of situations considered when it originally derived its IFRS 9 approach to impairment. It therefore considered, for each class of asset, whether any adjustment to the normal approach was required to ensure sufficient provision was created and also reviewed other available data, both from account performance and customer feedback to form a view of the underlying reasons for observed customer behaviours and of their future intentions and prospects.

As a result of this exercise additional requirements for provision were identified, to compensate for potential model weakness and to allow for economic pressures in the wider economy which cannot be identified by a modelled approach. By their nature such adjustments are less systematic and therefore subject to a wider range of outturns. The nature and amounts of these PMA's are set out in note 18.

The position after considering all these matters is set out in note 18, together with further information on the Group's approach and sensitivity analysis. The economic scenarios described above and their impact on the overall provision are also set out in that note.

(b) Effective interest rates

In order to determine the EIR applicable to loans and borrowings an estimate must be made of the expected life of each asset or liability and hence the cash flows relating thereto, including those relating to early redemption charges. For purchased loan accounts this will involve estimating the likely future credit performance of the accounts at the time of acquisition. For each portfolio a model is in place to ensure that income is appropriately spread.

The underlying estimates are based on historical data and reviewed regularly. For purchased accounts historical data obtained from the vendor will be examined. The accuracy of the EIR applied would therefore be compromised by any differences between actual repayment profiles and those predicted, which in turn would depend directly or indirectly (in the case of borrowings) on customer behaviour.

To illustrate the potential variability of the estimate, the amortised cost values were recalculated by changing one factor in the EIR calculation and keeping all others at their current levels. This exercise indicated that:

- A reduction of the assumed average lives of loans secured on residential property by three months would reduce balance sheet assets by £12.0m (2020: £11.2m), while an increase of the assumed asset lives of such assets by three months would increase balance sheet assets by £12.1m (2020: £10.3m)
- An increase of 50% in the number of five year fixed rate buy-to-let loan assets assumed to redeem before the end of the fixed rate period, generating additional early redemption charges would increase balance sheet assets by £11.2m (2020: £7.3m)
- A reduction (or increase) in estimated cash flows from purchased loan assets of 5% would reduce (or increase) balance sheet assets by £7.1m (2020: £9.4m)

As any of these changes would, in reality, be accompanied by movements in other factors, actual outcomes may differ from these estimates.

(c) Impairment of goodwill

The carrying value of goodwill recognised on acquisitions is verified by use of an impairment test based on the projected cash flows for the CGU, based on management forecasts and other assumptions described in note 24, including a discount factor.

The accuracy of this impairment calculation would therefore be compromised by any differences between these forecasts and the levels of business activity that the CGU is able to achieve in practice. As the Group forecasts are based on the Group's central economic scenario, any variance from this will potentially impact on the valuation. 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 24.

(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 52. 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 52.

64. Going concern

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

Particular focus is given to the Group's financial forecasts to ensure the adequacy of resources available for the Group to meet its business objectives on both a short term and strategic basis. The guidance requires that this assessment covers a period of at least twelve months from the date of approval of these financial statements.

The Group makes extensive use of stress testing in compiling and reviewing its forecasts. This stress testing approach was reviewed in detail during the year as part of the annual ICAAP cycle, where testing considered the impact of a number of severe but plausible scenarios. During the planning process, sensitivity analysis was carried out on a number of key assumptions that underpin the forecast to evaluate the impact of the Group's principal risks.

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

- Increased business volumes an increase of 20% in buy-to-let application volumes. This examined the impact of volumes on profitability and illustrated the extent to which capital resources and liquidity would be stretched due to the higher cash and capital requirements
- Higher funding costs – 25bps higher cost on all new savings deposits throughout. This scenario illustrated the impact of a significant prolonged margin squeeze on profitability and whether this would cause significant impacts on any capital, liquidity or encumbrance ratios
- Lower development finance growth – 50% lower loan book growth across the plan horizon coupled with a 50bp margin reduction. This scenario replicated a significant increase in competition within the sector, illustrating the impact of a lower proportion of the high-yielding development finance product in the Group's long-term asset mix on contribution to costs and other key ratios for the Group
- Higher buy-to-let redemptions – double redemption rates on all cohorts for the first three months post-reversion. With a significant volume of five-year fixes coming to an end in 2022, this scenario highlighted the potential risk that is inherent in the accounting difference between current and amortised cost balances on such loans, and invited discussion as to what mitigating action could be taken to avoid such an impact
- High impairment a stress that modelled the IFRS 9 year end severe scenario across the plan horizon, simulating a significant short-term capital and profitability shock with prolonged house price deflation, but maintaining the same lending levels as the base case. This scenario is described in more detail in Note 18 and is derived from, but more severe than the stress testing scenario published by the Bank of England in January 2021. Although it is not deemed likely that such a scenario would materialise, since severe stresses almost always result in lower lending volumes, the output from this stress provides a benchmark for a plausible worst-case position that impacts all aspects of business performance and ratios, in particular, capital

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

As part of the ICAAP process the Group also assessed the potential operational risks it could face. This was done through the analysis of the impact and cost of a series of severe but plausible scenarios. This analysis did not highlight any factors which cast doubt on the Group's ability to continue as a going concern.

The Group begins the forecast period with a strong capital and liquidity position, enabling the management of any significant outflows of deposits and / or reduced inflows from customer receipts. Overall, the forecasts, even under reasonable further levels of stress show the Group retaining sufficient equity, capital, cash and liquidity throughout the forecast period to satisfy its regulatory and operational requirements.

The availability of funding and liquidity is a key consideration, including retail deposit, wholesale funding, central bank and other contingent liquidity options.

The Group's retail deposits of £9,300.4m (note 26), raised through Paragon Bank, are repayable within five years, with 77.6% of this balance (£7,212.9m) payable within twelve months of the balance sheet date. The liquidity exposure represented by these deposits is closely monitored; a process supervised by the Asset and Liability Committee. The Group is required to hold liquid assets in Paragon Bank to mitigate this liquidity risk. At 30 September 2021 Paragon Bank held £942.7m of balance sheet assets for liquidity purposes, in the form of central bank deposits (note 56). A further £150.0 million of liquidity was provided by an off balance sheet swap arrangement (note 56), bringing the total to £1,092.7m.

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, updated annually. The Bank maintains a liquidity framework that includes a short to medium term cash flow requirement analysis, a longer-term funding plan and access to the Bank of England's liquidity insurance facilities, where pre-positioned assets would support drawings of £1,424.2m. Holdings of the Group's own externally rated mortgage backed loan notes can also be used to access the Bank of England's liquidity facilities or other funding arrangements. At 30 September 2021 the Group had £529.2m of such notes available for use, of which £287.0m were rated AAA. The available AAA notes would give access to £149.3m if used to support drawings on Bank of England facilities.

The Group's securitisation funding structures, described in note 56, provide match funding for part of the asset base. Repayment of the securitisation borrowings is restricted to funds generated by the underlying assets and there is limited recourse to the Group's general funds. Recent and current loan originations are financed through retail deposits and may be refinanced through securitisation where this is appropriate and cost-effective. While the Group has not accessed the public securitisation market in the year, the market remains active with strong levels of demand and the Group maintains the infrastructure required to access it.

The earliest maturity of any of the Group's bond debt is the £125.0m retail bond, due January 2022. £69.0m of TFS debt was paid down after the year end and all other central bank debt was refinanced and is not payable until 2025.

The Group's access to debt is enhanced by its corporate BBB rating, affirmed by Fitch Ratings in March 2021, and its status as an issuer is evidenced by the BB+ rating of its £150.0m Tier-2 bond issued in the year. It has regularly accessed the capital markets for warehouse funding and corporate and retail bonds over recent years and continues to be able to access these markets.

The Group has access to the short-term repo market for liquidity purposes which it uses from time to time, including during the financial year ended 30 September 2021.

The Group's cash analysis, which includes the impact of all scheduled debt and deposit repayments, continues to show a strong position, even after allowing scope for significant discretionary payments and capital distributions.

As described in note 53 the Group's capital base is subject to consolidated supervision by the PRA. The most recent review of the Group's capital position and management systems resulted in a reduction of the minimum capital level. Its capital at 30 September 2021 was in excess of regulatory requirements and its forecasts indicate this will continue to be the case.

After performing this assessment, the directors concluded that there was no material uncertainty as to whether the Group and the Company would be able to maintain adequate capital and liquidity for at least twelve months following the date of approval of these financial statements and consequently that it was appropriate for them to continue to adopt the going concern basis in preparing the financial statements of the Group and the Company.

65. Financial assets and financial liabilities

The Group's financial assets and financial liabilities are valued on one of two bases, defined by IFRS 9:

- Financial assets and liabilities carried at fair value through profit and loss ('FVTPL')
- Financial assets and liabilities carried at amortised cost

IFRS 7 – 'Financial Instruments: Disclosures' requires that where assets are measured at fair value these measurements should be classified using the fair value hierarchy set out in IFRS 13 – 'Fair Value Measurement'. This hierarchy reflects the inputs used and defines three levels:

- Level 1 measurements are unadjusted market prices
- Level 2 measurements are derived from directly or indirectly observable data, such as market prices or rates
- Level 3 measurements rely on significant inputs which are not derived from observable data

As quoted prices are not available for level 2 and 3 measurements, the valuation is derived from cash flow models based, where possible, on independently sourced parameters. The accuracy of the calculation would therefore be affected by unexpected market movements or other variances in the operation of the models or the assumptions used.

The Group had no financial assets or liabilities in the year ended 30 September 2021 or the year ended 30 September 2020 carried at fair value and valued using level 3 measurements, other than contingent consideration amounts (note 33).

The Group has not reclassified any of its measurements during the year.

The methods by which fair value is established for each class of financial assets and liabilities are set out below.

(a) Assets and liabilities carried at fair value

The following table summarises the Group's financial assets and liabilities which are carried at fair value.

	Note	**2021**	2020
		£m	£m
Financial assets			
Derivative financial assets	*19*	**44.2**	463.3
		44.2	463.3
Financial liabilities			
Derivative financial liabilities	*19*	**43.9**	132.4
Contingent consideration	*33*	**7.5**	13.5
		51.4	145.9

All of these financial assets and financial liabilities are required to be carried at fair value by IFRS 9.

The Company has no financial assets or liabilities carried at fair value.

Derivative financial assets and liabilities

Derivative financial instruments are stated at their fair values in the accounts. The Group uses a number of techniques to determine the fair values of its derivative assets and liabilities, for which observable prices in active markets are not available. These are principally present value calculations based on estimated future cash flows arising from the instruments, discounted using a market interest rate, adjusted for risk as appropriate.

The principal inputs to these valuation models are LIBOR and SONIA benchmark interest rates for the currencies in which the instruments are denominated, being sterling, euro and dollars. The cross-currency basis swaps have a notional principal related to the outstanding currency borrowings and therefore the estimated rate of repayment of these notes also affects the valuation of the swaps. However, variability in this input does not have a significant impact on the valuation, compared to other inputs.

In order to determine the fair values, the management applies valuation adjustments to observed data where that data would not fully reflect the attributes of the instrument being valued, such as particular contractual features or the identity of the counterparty. The management reviews the models used on an ongoing basis to ensure that the valuations produced are reasonable and reflect all relevant factors. These valuations are based on market information and they are therefore classified as level 2 measurements. Details of these assets are given in note 19.

Contingent consideration

The value of the contingent consideration balances shown in note 33 are required to be stated at fair value in the accounts. These amounts are valued based on the expected outcomes of the performance tests set out in the respective sale and purchase agreements, discounted as appropriate. The most significant inputs to these valuations are the Group's forecasts on future activity relating to business generated by operational units acquired, business derived as a result of the vendor's contacts or other goodwill and any other new business flows which are or might be attributable to the acquisition agreement, which are drawn from the overall Group forecasting model. As such, these are classified as unobservable inputs and the valuations classified as level 3 measurements.

(b) Assets and liabilities carried at amortised cost

The fair values for financial assets and financial liabilities held at amortised cost, determined in accordance with the methodologies set out below are summarised below.

	Note	**2021**	**2021**	2020	2020
		Carrying amount	**Fair value**	Carrying amount	Fair value
		£m	**£m**	£m	£m
The Group					
Financial assets					
Cash	*14*	**1,360.1**	**1,360.1**	1,925.0	1,925.0
Loans to customers	*15*	**13,402.7**	**13,470.6**	12,631.4	12,856.1
Sundry financial assets	*20*	**65.7**	**65.7**	125.3	125.3
		14,828.5	**14,896.4**	14,681.7	14,906.4
Financial liabilities					
Short-term bank borrowings		**0.3**	**0.3**	0.4	0.4
Asset backed loan notes		**516.0**	**516.0**	3,270.5	3,270.5
Secured bank borrowings		**730.0**	**730.0**	657.8	657.8
Retail deposits	*26*	**9,300.4**	**9,308.5**	7,856.6	7,900.6
Corporate and retail bonds		**386.1**	**411.9**	446.6	455.7
Other financial liabilities	*32*	**66.2**	**66.2**	74.6	74.6
		10,999.0	**11,032.9**	12,306.5	12,359.6

	Note	**2021**	**2021**	2020	2020
		Carrying amount	**Fair value**	Carrying amount	Fair value
		£m	**£m**	£m	£m
The Company					
Financial assets					
Cash	*14*	**19.6**	**19.6**	12.6	12.6
Loans to group companies	*20*	**73.0**	**73.0**	84.0	84.0
Sundry financial assets	*20*	**0.1**	**0.1**	0.6	0.6
		92.7	**92.7**	97.2	97.2
Financial liabilities					
Corporate and retail bonds		**386.1**	**411.9**	446.6	455.7
Amounts owed to group companies	*32*	**22.6**	**22.6**	22.7	22.7
Other financial liabilities	*32*	**3.0**	**3.0**	2.9	2.9
		411.7	**437.5**	472.2	481.3

The fair values of retail deposits and corporate and retail bonds shown above will include amounts for the related accrued interest.

Cash, bank loans and securitisation borrowings

The fair values of cash and cash equivalents, bank loans and overdrafts and asset backed loan notes, which are carried at amortised cost are considered to be not materially different from their book values. In arriving at that conclusion market inputs have been considered but because all the assets mature within three months of the year end and the interest rates charged on financial liabilities reset to market rates on a quarterly basis, little difference arises. This also applies to the parent company's loans to its subsidiaries.

While the Group's asset backed loan notes are listed, the quoted prices for an individual note may not be indicative of the fair value of the issue as a whole, due to the specialised nature of the market in such instruments and the limited number of investors participating in it.

As these valuation exercises are not wholly market based, they are considered to be level 2 measurements.

Loans to customers

To assess the likely fair value of the Group's loan assets in the absence of a liquid market, the directors have considered the estimated cash flows expected to arise from the Group's investments in its loans to customers based on a mixture of market based inputs, such as rates and pricing and non-market based inputs such as redemption rates. Given the mixture of observable and non-observable inputs these are considered to be level 3 measurements.

Corporate debt

The Group's retail and corporate bonds are listed on the London Stock Exchange and there is presently a reasonably liquid market in the instruments. It is therefore appropriate to consider that the market price of these borrowings constitutes a fair value. As this valuation is based on a market price, it is considered to be a level 1 measurement.

Retail deposits

To assess the likely fair value of the Group's retail deposit liabilities, the directors have considered the estimated cash flows expected to arise based on a mixture of market based inputs, such as rates and pricing and non-market based inputs such as withdrawal rates. Given the mixture of observable and non-observable inputs, these are considered to be level 3 measurements.

Sundry assets and liabilities

Fair values of financial assets and liabilities disclosed as sundry assets and sundry liabilities are not considered to be materially different to their carrying values.

These assets and liabilities are of relatively low value and may be settled at their carrying value at the balance sheet date or shortly thereafter.

66. Details of subsidiary undertakings

Subsidiary undertakings of the Group at 30 September 2021, where the share capital is held within the Group are shown below. The holdings shown are those held within the Group. The shareholdings of the Company in the direct subsidiaries listed below are the same as those held by the Group, except that for the shareholdings marked * the Company holds only 74% of the share capital. In these cases, the remainder is held by other group companies.

The issued share capital of all subsidiaries consists of ordinary share capital, except those companies marked § which have additional preference share capital held within the Group.

Company	Holding	Principal activity
Direct subsidiaries of Paragon Banking Group PLC		
Paragon Bank PLC	100%	Deposit taking, residential mortgages and loan and vehicle finance
Paragon Car Finance Limited	100%	Vehicle finance
Idem Capital Holdings Limited	100%	Intermediate holding company
Moorgate Servicing Limited	100%	Intermediate holding company
The Business Mortgage Company Limited	100%	Mortgage broker
Paragon Mortgages (No. 11) PLC	100%*	Residential mortgages
Paragon Mortgages (No. 12) PLC	100%*	Residential mortgages
Paragon Mortgages (No. 13) PLC	100%*	Residential mortgages
Paragon Mortgages (No. 14) PLC	100%*	Residential mortgages
Paragon Mortgages (No. 15) PLC	100%*	Residential mortgages
Colonial Finance (UK) Limited	100%	Non-trading
Earlswood Finance Limited	100%	Non-trading
Herbert (1) PLC	100%	Non-trading
Herbert (2) PLC	100%	Non-trading
Herbert (4) PLC	100%	Non-trading
Herbert (5) PLC	100%	Non-trading
Herbert (6) PLC	100%	Non-trading
Herbert (7) PLC	100%	Non-trading
Herbert (8) PLC	100%	Non-trading
Herbert (9) PLC	100%	Non-trading
Herbert (10) PLC	100%	Non-trading
Paragon Car Finance (1) Limited	100%	Non-trading
Paragon Dealer Finance Limited	100%	Non-trading
Paragon Loan Finance (No. 3) Limited	100%	Non-trading
Paragon Mortgages (No. 5) PLC	100%	Non-trading
Paragon Pension Investments GP Limited	100%	Non-trading
Paragon Pension Plan Trustees Limited	100%	Non-trading
Paragon Personal Finance (1) Limited	100%	Non-trading
Paragon Third Funding Limited	100%	Non-trading
Paragon Vehicle Contracts Limited	100%	Non-trading
Plymouth Funding Limited	100%	Non-trading
Universal Credit Limited	100%	Non-trading
Yorkshire Freeholds Limited	100%	Non-trading
Yorkshire Leaseholds Limited	100%	Non-trading
Plymouth Funding 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
Mortgage Trust Services PLC	100%	Residential mortgages and asset administration
Paragon Second Funding Limited	100%	Residential mortgages and loan and vehicle finance
Paragon Asset Finance Limited	100%	Holding company and portfolio administration
Paragon Business Finance PLC	100%	Asset finance
Paragon Commercial Finance Limited	100%	Asset finance
Paragon Development Finance Limited	100%	Development Finance
Paragon Development Finance Services Limited	100%	Development Finance
Paragon Technology Finance Limited	100%	Asset finance
PBAF Acquisitions Limited	100%	Residential mortgages and loan finance
PBAF (No.1) Limited	100%	Holding Company
Premier Asset Finance Limited	100%	Asset finance broker
Specialist Fleet Services Limited	100%	Asset finance and contract hire
City Business Finance Limited	100%	Non-trading
Collett Transport Services Limited	100%	Non-trading
Fineline Holdings Limited	100%	Non-trading
Fineline Media Finance Limited	100%	Non-trading
Homer Management Limited	100%	Non-trading
Lease Portfolio Management Limited	100%	Non-trading
Paragon Options PLC	100%	Non-trading
State Securities Holdings Limited	100%	Non-trading
State Security Limited	100%	Non-trading

Other indirect subsidiary undertakings

Moorgate Loan Servicing Limited	100%	Asset administration
Idem Capital Securities Limited	100%	Asset investment
Paragon Personal Finance Limited	100%	Consumer loan finance
Redbrick Survey and Valuation Limited	100%	Surveyors and property consulting
Buy to Let Direct Limited	100%	Non-trading
Moorgate Asset Administration Limited	100%	Non-trading
TBMC Group Limited	100%	Non-trading
The Business Mortgage Company Services Limited	100%	Non-trading

The financial year end of all the Group's subsidiary companies is 30 September. They are all registered in England and Wales and operate in the UK except Paragon Pension Investments GP Limited, which is registered in Scotland and operates in the UK.

As part of the Group's financing arrangements certain mortgage and consumer loans originated by Paragon Mortgages (2010) Limited and Mortgage Trust Limited or acquired by Idem Capital Securities Limited have been sold to special purpose entity companies, which had raised non-recourse finance to fund these purchases. The shares of these companies are ultimately beneficially owned through independent trusts, but they are considered to be controlled by the Group, as defined by IFRS 10, due to the Group's exposures to the variable returns from the assets of each entity and its ability to direct their activities, within the constraints imposed by the lending documents. Hence, they are considered to be subsidiaries of the Group.

The principal companies party to these arrangements at 30 September 2021 comprise:

Company	Principal activity
Paragon Seventh Funding Limited	Residential mortgages
Paragon Mortgages (No. 25) Holdings Limited	Holding company
Paragon Mortgages (No. 25) PLC	Residential mortgages
Paragon Mortgages (No. 26) Holdings Limited	Holding company
Paragon Mortgages (No. 26) PLC	Residential mortgages
Paragon Mortgages (No. 27) Holdings Limited	Holding company
Paragon Mortgages (No. 27) PLC	Residential mortgages
Paragon Mortgages (No. 28) Holdings Limited	Holding company
Paragon Mortgages (No. 28) PLC	Residential mortgages
Arianty Holdings Limited	Holding company
Arianty No. 1 PLC	Non-trading
Paragon Fifth Funding Limited	Non-trading
Paragon Sixth Funding Limited	Non-trading
Paragon Mortgages (No. 18) Holdings Limited	Non-trading
Paragon Mortgages (No. 18) PLC	Non-trading
Paragon Mortgages (No. 19) Holdings Limited	Non-trading
Paragon Mortgages (No. 19) PLC	Non-trading
Paragon Mortgages (No. 20) Holdings Limited	Non-trading
Paragon Mortgages (No. 20) PLC	Non-trading
Paragon Mortgages (No. 21) Holdings Limited	Non-trading
Paragon Mortgages (No. 21) PLC	Non-trading
Paragon Mortgages (No. 22) Holdings Limited	Non-trading
Paragon Mortgages (No. 22) PLC	Non-trading
Paragon Mortgages (No. 23) Holdings Limited	Non-trading
Paragon Mortgages (No. 23) PLC	Non-trading
Paragon Mortgages (No. 24) Holdings Limited	Non-trading
Paragon Mortgages (No. 24) PLC	Non-trading

All these companies are registered and operate in the UK.

Earlswood Finance (No. 3) Limited, a company limited by guarantee, is registered in England and Wales and operates in the UK. It is included in the consolidation as it is ultimately controlled by the parent company.

The 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 was Greenmeadow House, 2 Village Way, Greenmeadow Springs Business Park, Cardiff, CF15 7NE at 30 September 2021, and was changed on 1 November 2021 to Regus House, Malthouse Avenue, Cardiff Gate Business Park, Cardiff CF23 8RU
- The registered office of State Security Limited is Burlington House, Botleigh Grange Office Campus, Grange Drive, Hedge End, Southampton, SO30 2AF
- The registered office of the Scottish entities is Citypoint, 65 Haymarket Terrace, Edinburgh, EH12 5HD

All the entities listed above are included in the consolidated accounts of the Group.

The following legal subsidiaries of the Group are currently in liquidation. They do not form part of the consolidation as they are considered to be controlled by the liquidator.

Company	Holding	Principal activity
Direct subsidiaries of Paragon Banking Group PLC		
First Flexible (No.7) PLC	100%*	Non-trading
Paragon Fourth Funding Limited	100%	Non-trading
Paragon Loan Finance (No. 1) Limited	100%§	Non-trading
Paragon Loan Finance (No. 2) Limited	100%§	Non-trading
Paragon Mortgages (No. 9) PLC	100%*	Residential mortgages
Paragon Mortgages (No. 10) PLC	100%*	Residential mortgages
Paragon Secured Finance (No. 1) PLC	100%	Non-trading
Indirect subsidiaries		
First Flexible No.6 PLC	100%§	Residential Mortgages
Idem (No.3) Limited	100%	Asset investment

The shareholdings of the Company in each of the direct subsidiaries shown above is the same as that of the Group, except for companies marked * where the shareholding of the company is 74%. The issued share capital of each of the companies listed above consists of ordinary shares only, except for companies marked § which have additional preference share capital held within the Group.

First Flexible No.5 PLC a company previously controlled but not legally owned by the Group which had been party to the type of financing arrangements described above was also in liquidation at 30 September 2021.

LEARNING & DEVELOPMENT

In 2021, Paragon launched an exciting, new development programme, welcoming a range of people from across Group to the High Potential Programme.

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.

P304 E1. Appendices to the Annual Report

E1. Appendices to the Annual Report

For the year ended 30 September 2021

A. Underlying results

The Group reports underlying profit excluding fair value accounting adjustments arising from its hedging arrangements and certain one-off items of income and costs relating to asset sales and acquisitions.

The fair value adjustments arise principally as a result of market interest rate movements, outside the Group's control. They are profit neutral over time and are not included in operating profit for management reporting purposes. They are also disregarded by many external analysts.

The transactions relating to the asset disposals and acquisitions do not form part of the day-to-day activities of the Group and, therefore, their removal provides greater clarity on the Group's operational performance.

This definition of 'underlying' has been chosen following consideration of the needs of investors and analysts following the Group's shares, and because management feel it better represents the underlying economic performance of the Group's business.

	2021	2020
	£m	£m
Profit on ordinary activities before tax	**213.7**	118.4
Add back: Fair value adjustments	**(19.5)**	1.6
Underlying profit	**194.2**	120.0

Underlying basic earnings per share, calculated on the basis of underlying profit, charged at the overall effective tax rate, is derived as follows.

	2021	2020
	£m	£m
Underlying profit	**194.2**	120.0
Tax at effective rate (note 11)	**(44.7)**	(27.5)
Underlying earnings	**149.5**	92.5
Basic weighted average number of shares (note 13)	**252.3**	253.6
Underlying earnings per share	**59.3p**	**36.5p**

Underlying return on tangible equity is derived using underlying earnings calculated on the same basis.

	2021	2020
	£m	£m
Underlying earnings	**149.5**	92.5
Amortisation of intangible assets (note 8)	**2.0**	2.0
Adjusted underlying earnings	**151.5**	94.5
Average tangible equity (note 53(b))	**1,028.7**	961.6
Underlying RoTE	**14.7%**	9.8%

B. Income statement ratios

NIM and cost of risk (impairment charge as a percentage of average loan balance) for the Group are calculated as follows:

Year ended 30 September 2021

	Note	**Mortgage Lending**	**Commercial Lending**	**Idem Capital**	**Total**
		£m	**£m**	**£m**	**£m**
Opening loans to customers	*15*	**10,819.5**	**1,514.8**	**297.1**	**12,631.4**
Closing loans to customers	*15*	**11,608.7**	**1,568.8**	**225.2**	**13,402.7**
Average loans to customers		**11,214.1**	**1,541.8**	**261.1**	**13,017.0**
Net interest	*2*	**219.2**	**94.5**	**20.2**	**310.5**
NIM		**1.95%**	**6.13%**	**7.74%**	**2.39%**
Impairment provision (release) / charge	*18*	**(5.9)**	**2.9**	**(1.7)**	**(4.7)**
Cost of risk		**(0.05)%**	**0.19%**	**(0.65)%**	**(0.04)%**

Year ended 30 September 2020

	Note	Mortgage Lending	Commercial Lending	Idem Capital	Total
		£m	£m	£m	£m
Opening loans to customers	*15*	10,344.1	1,452.1	389.9	12,186.1
Closing loans to customers	*15*	10,819.5	1,514.8	297.1	12,631.4
Average loans to customers		10,581.8	1,483.4	343.5	12,408.7
Net interest	*2*	190.0	82.1	26.1	278.1
NIM		1.80%	5.53%	7.60%	2.24%
Impairment provision charge	*18*	25.8	21.7	0.8	48.3
Cost of risk		0.24%	1.46%	0.23%	0.39%

Not all interest is allocated to segments (note 2).

C. Cost:income ratio

Cost:income ratio is derived as follows:

	Note	2021	2020
		£m	£m
Cost – operating expenses	*8*	**135.4**	126.8
Total operating income		**324.9**	295.1
Cost / Income		**41.7%**	43.0%

D. Net asset value

	Note	2021	2020
Total equity (£m)		**1,241.9**	1,156.0
Outstanding issued shares (m)	*37*	**262.5**	261.8
Treasury shares (m)	*39*	**(12.1)**	(5.2)
Shares held by ESOP schemes (m)	*39*	**(3.7)**	(3.6)
		246.7	253.0
Net asset value per £1 ordinary share		**£5.03**	£4.57
Tangible equity (£m)	*53*	**1,071.4**	985.9
Tangible net asset value per £1 ordinary share		**£4.34**	£3.90

Each year, employees vote to support a focus charity. Alzheimer's Society was chosen as Charity of the Year for 2021, inspiring a wide range of fundraising activities across the Group

F. Useful information

Information which may be helpful to shareholders and other users of the Annual Report and Accounts

P310 **F1. Glossary**
A summary of abbreviations used in the Annual Report and Accounts

P312 **F2. Shareholder information**
Information about dividends, meetings and managing shareholdings

P314 **F3. Other public reporting**
Current and future public reporting information for the Group

P315 **F4. Contacts**
Names and addresses of the Group's advisers

F1. Glossary

The Act	The Companies Act 2006
AGM	Annual General Meeting
ALCO	Asset and Liability Committee
AQR	Audit Quality Review
The Articles	The Articles of Association of the Company
ASHE	Annual Survey of House and Earnings
AT1	Additional Tier 1
The Bank	Paragon Bank PLC
BBLS	Bounce Back Loan Scheme
BBR	Bank Base Rate
BCBS	Basel Committee on Banking Supervision
BEIS	Department for Business, Energy and Industrial Strategy
BEPS	Base Erosion and Profit Shifting
BGS	Balance Guarantee Swaps
CAGR	Compound Annual Growth Rate
CBI	Confederation of British Industry
CBILS	Coronavirus Business Interruption Loan Scheme
CCC	Customer and Conduct Committee
CCoB	Capital Conservation Buffer
CCP	Central Counterparty
CCyB	Counter-Cyclical Buffer
CEO	Chief Executive Officer
CET1	Core Equity Tier 1
CFO	Chief Financial Officer
CGU	Cash Generating Unit
CIPD	Chartered Institute of Personnel Development
CMI	Chartered Management Institute
CML	Council of Mortgage Lenders
The Code	UK Corporate Governance Code
CO_2e	CO_2 Equivalent
The Company	Paragon Banking Group PLC
COO	Chief Operating Officer
Compliance Plan	Compliance Monitoring Plan
CPI	Consumer Price Index
CRD IV	The current EU Capital Requirements Regulation and Directive Regime
CRD V	Capital Requirements Directive V
CRDs	Cash Ratio Deposits
CRO	Chief Risk Officer
CRR	Capital Requirements Regulation – EU Regulation 575/2013
CSA	Credit Support Annex
CSOP	Company Share Option Plan
CTRF	Contingent Term Repo Facility
DEFRA	Department for Environment, Food and Rural Affairs
Deloitte	Deloitte LLP
DISP	FCA's Dispute Resolution: Complaints Sourcebook
DSBP	Deferred Share Bonus Plan
DTR	Disclosure and Transparency Rule(s)
ECL	Expected Credit Loss
EDI	Equality, Diversity and Inclusion
EIR	Effective Interest Rate
EPC	Energy Performance Certificate
EPS	Earnings per Share
EQA	External Quality Assessment
ERC	Estimated Remaining Collections
ERMF	Enterprise Risk Management Framework
ESG	Environmental, Social and Governance
ESOP	Employee Share Ownership Plan
ESOS	Energy Savings and Opportunities Scheme
EU	European Union
EUR	Euro
EURIBOR	Euro Interbank Offered Rate
EV	Economic Value
ExCo	Executive Performance Committee
FCA	Financial Conduct Authority
FLA	Finance and Leasing Association
FLS	Funding for Lending Scheme
FOS	Financial Ombudsman Service
The Framework	The Group Corporate Governance Policy Framework
FRC	Financial Reporting Council
FRN	Floating Rate Note
FSCS	Financial Services Compensation Scheme
FVTPL	Fair Value Through Profit and Loss
GDP	Gross Domestic Product
GDV	Gross Development Value
GHG	Greenhouse Gases
GMP	Guaranteed Minimum Pension
The Group	The Company and all of its subsidiary undertakings
HMOs	Houses in Multiple Occupation
HMRC	Her Majesty's Revenue and Customs
HPI	House Price Index
HQLA	High Quality Liquid Assets
HR	Human Resources
IAS	International Accounting Standard(s)
IASB	International Accounting Standards Board
IBE	Institute of Business Ethics
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standard(s)
ILAAP	Internal Liquidity Adequacy Assessment Process
ILG	Individual Liquidity Guidance
ILTR	Indexed Long Term Repo Scheme
IMLA	Intermediary Mortgage Lenders Association
IRB	Internal Ratings Based
IRRBB	Interest Rate Risk in the Banking Book
ISDA	International Swaps and Derivatives Association

ISO14001:2015	International Organization for Standardization 14001:2015, 'Environmental Management Systems'
ISO45001:2018	International Organization for Standardization 45001:2018, 'Management Systems of Occupational Health and Safety'
KPMG	KPMG LLP, the Group's auditor
LCR	Liquidity Coverage Ratio
LGD	Loss Given Default
LIBOR	London Interbank Offered Rate
Line 3	The third line of defence
LTGDV	Loan to Gross Development Value
LTV	Loan to Value
M&A	Mergers and Acquisitions
MRC	Model Risk Committee
MRT	Material Risk Taker
MWh	Mega-Watt Hours
NI	National Insurance
NII	Net Interest Income
NIM	Net Interest Margin
Notes	Asset backed loan notes
NPS	Net Promoter Score
NSFR	Net Stable Funding Ratio
OBR	Office of Budget Responsibility
OCI	Other Comprehensive Income
OFGEM	Office of Gas and Electricity Markets
OHSMS	Occupational Health and Safety Management System
OLAR	Overall Liquidity Adequacy Requirement
ONS	Office for National Statistics
ORC	Operational Risk Committee
The Order	The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014
PAYE	Pay As You Earn
PD	Probability of Default
Performance Exco	Executive Performance Committee
PFP	Pension Funding Partnership
PIDA	Public Interest Disclosure Act 1998
PIE	Public Interest Entity
The Plan	The Paragon Pension Plan
PLC	Public Limited Company
PMA	Post-model Adjustments
POCI	Purchased or Originated Credit Impaired (assets)
PPC	Payment Protection Insurance
PRA	Prudential Regulation Authority (of the Bank of England)
PRP	Profit Related Pay
PRS	Private Rented Sector
PSP	Performance Share Plan
PwC	PricewaterhouseCoopers
RBA	Role Based Allowance
RICS	Royal Institution of Chartered Surveyors
RIDDOR	Reporting of Incidents, Disease and Dangerous Occurrences Regulation 2013
RLS	Recovery Loan Scheme
RMBS	Residential Mortgage Backed Securities
RoR	Receiver of Rent
RoTE	Return on Tangible Equity
ROU	Right of Use
RPI	Retail Price Index
RSU	Restricted Stock Unit
RWA	Risk Weighted Assets
SA	Standardised Approach
Schedule 7	Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008
SFS	Specialist Fleet Services Limited
SICR	Significant Increase in Credit Risk
Sharesave	All Employee Share Option scheme
SME	Small and / or Medium-sized Enterprise(s)
SMF	Senior Management Function
SMCR	Senior Managers and Certification Regime
SONIA	Sterling Overnight Interbank Average
SPPI	Solely Payments of Principal and Interest
SPV	Special Purpose Vehicle
TBMC	The Business Mortgage Company
TCFD	Taskforce on Climate-related Financial Disclosures
TCR	Total Capital Requirement
TFS	Term Funding Scheme
TFSME	Term Funding Scheme for SMEs
TRC	Total Regulatory Capital
TRE	Total Risk Exposure
TSR	Total Shareholder Return
UK	United Kingdom
UKF	UK Finance
UK GAAP	UK Generally Accepted Accounting Practice
USD	US Dollar
US Dollar LIBOR	The London Interbank Offered Rate on balances denominated in US dollars

F2. Shareholder information

Want more information or help?

The Company's share register is maintained by our Registrars, Computershare, who you should contact directly if you have questions about your shareholding or wish to update your address details.

Computershare Investor Services PLC
The Pavilions
Bridgwater Road
Bristol BS99 6ZZ

Telephone: 0370 707 1244*

and outside the UK +44 (0)370 707 1244

Online: www.investorcentre.co.uk

*Calls are charged at the standard geographic rate and will vary by provider. Calls outside the UK will be charged at the applicable international rate. Lines are open 8:30am to 5:30pm, Monday to Friday, excluding UK public holidays.

Electronic communications

You can view and manage your shareholding online by registering with Computershare's Investor Centre service. To register:

- Visit www.investorcentre.co.uk
- Go to 'Manage my shareholdings'
- Register using your Shareholder Reference Number and your postcode

We actively encourage our shareholders to receive communications via email and view documents electronically on our website, including our Annual Report and Accounts, as this has significant environmental and cost benefits. Should you wish to receive electronic documents please contact Computershare by telephone or online.

Website

You can find further useful information on our website, www.paragonbankinggroup.co.uk, including:

- Regular updates about our business
- Comprehensive share price information
- Financial results and reports
- Historic dividend dates and amounts

Financial calendar

January 2022
Trading update

June 2022
Half-year results

July 2022
Trading update

December 2022
Full-year results

Dividend calendar

27 January 2022
Ex-dividend date for 2021 final dividend

28 January 2022
Record date for 2021 final dividend

4 March 2022
Payment date for 2021 final dividend

7 July 2022
Ex-dividend date for 2022 interim dividend

8 July 2022
Record date for 2022 interim dividend

29 July 2022
Payment date for 2022 interim dividend

Annual General Meeting

2 March 2022

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 FCA before getting involved. You can check at **www.fca.org.uk/consumers/protect-yourself** and can report calls from unauthorised firms to the FCA by calling 0800 111 6768.

Duplicate documents and communications

If you receive more than one copy of shareholder documents, it is likely that you have multiple accounts on the share register, perhaps with a slightly different name or address. To combine your shareholdings, please contact Computershare and provide your Shareholder Reference Number.

F3. Other Public Reporting

In addition to its annual financial reporting the Group has published, or will publish, the following documents in respect of the year ended 30 September 2021, 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 2021, 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 fifth report against its Women in Finance charter commitments in September 2021.

All this reporting will be continued in the financial year ending 30 September 2022.

The Group will publish its Responsible Business Report: 2021, its first sustainability report, in December 2021. This will give additional information on ESG issues and illustrate the application of the Group's ESG strategy in practice. This is intended to be the first in an annual series of reports.

The Group also publishes on its website a statement setting out how it has applied the PRA / FCA dual regulated firms Remuneration Code, as required by the Rule 7.5 of the Remuneration part of the PRA Rulebook and FCA standard SYSC19D.3.13R.

F4. Contacts

Registered and head office	51 Homer Road Solihull West Midlands B91 3QJ Telephone: 0121 712 2323
Investor Relations	investor.relations@paragonbank.co.uk
Company Secretariat	company.secretary@paragonbank.co.uk
Internet	www.paragonbankinggroup.co.uk
Auditor	KPMG LLP One Snowhill Snow Hill Queensway Birmingham B4 6GH
Solicitors	Slaughter and May One Bunhill Row London EC1Y 8YY
Registrars	Computershare Investor Services PLC The Pavilions Bridgwater Road Bristol BS99 6ZZ Telephone: 0370 707 1244
Brokers	Jefferies International Limited 100 Bishopsgate London EC2N 4JL Peel Hunt LLP 100 Liverpool street London EC2M 2AT UBS Limited 5 Broadgate London EC2M 2QS
Remuneration consultants	PricewaterhouseCoopers LLP 1 Embankment Place London WC2N 6RH
Consulting actuaries	Mercer Limited Four Brindleyplace Birmingham B1 2JQ

PARAGON BANKING GROUP PLC
51 Homer Road, Solihull,
West Midlands B91 3QJ

Telephone: 0345 849 4000
www.paragonbankinggroup.co.uk
Registered No. 2336032

GRP0054-001 (12/2021)