paragon

Paragon Banking Group PLC

GENDER PAY GAP REPORT 2018

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As sponsor of Paragon's Women in Finance programme, I am pleased to introduce the Group's second gender pay gap report, in a year which has seen the continued progress of diversity initiatives, as well as the appointment of Fiona Clutterbuck as the Group's first female Chairman.

Diversity continues to be a significant area of focus in the corporate world with the latest edition of the UK Corporate Governance Code, published in 2018, significantly enhancing expectations in this field. This builds on the ongoing gender pay reporting rules, the Hampton-Alexander Review on gender balance in FTSE leadership, and, specific to the financial services sector, the Women in Finance Charter.

Paragon Banking Group includes respect and fairness amongst its core values and considers that diversity amongst its directors, management and workforce is fundamental to these concepts as well as being good for business and ensuring good outcomes for customers. Gender diversity is an important element of our people strategy and specific initiatives have been developed to drive female involvement at the higher levels of Paragon as part of our participation in Women in Finance.

During the year these programmes have developed further and while the gender pay measures we are reporting for 2018 are broadly similar to those for 2017, it will take time for the measures adopted to affect the reported metrics, and the Group is well placed looking forward. I am particularly pleased that our Hampton-Alexander measure of gender diversity in senior roles had reached 35% by 31 December 2018, ahead of both our target and that set by the Hampton-Alexander Review, and that 39% of invitees at our recent leadership conference were women.

Our progress to date has been pleasing, especially in the context of the financial services field in which we operate. However, we recognise that there is still a long journey ahead, both for Paragon, and also for the industry. We are confident that the measures we have put in place will help provide our people with the opportunities they deserve and the Group with the workforce it needs to achieve its strategic goals.

RICHARD J WOODMAN
Chief Financial Officer
March 2019

Introduction

Paragon Banking Group PLC and its subsidiary companies (together 'the Group') employs over 1,350 people, all based in the UK, with the largest number based at its head office in Solihull.

The welfare, development and engagement of the Group's employees are fundamental to developing a strong culture, with employee capability and motivation acknowledged as being central to the delivery of the Group's strategy. Engagement levels are monitored through employee surveys. The most recent survey, carried out in November 2017, returned a response rate of 85% (previous survey: 91%) and an overall engagement score of 85% (previous survey: 86%) which compares favourably to the average of 82% in the financial services sector.

The Nomination Committee of the Board is responsible for oversight of all the Group's internal and external initiatives in the field of workforce and management diversity. The Committee, which is led by the Chairman, Fiona Clutterbuck, includes three independent non-executive directors and has two male and two female members. It reviews performance on diversity and provides challenge to executive management.

During last year the Committee adopted new terms of reference which specifically include its role in respect of diversity and gender pay, including reporting. The 2018 Code includes more specific guidance on Nomination Committee responsibilities in these areas, and the Committee will review guidance and emerging practice in order to identify any further changes which might be appropriate.

The Group is a signatory to the Women in Finance ('WiF') Charter, sponsored by HM Treasury, an initiative to address the underrepresentation of women in high level management positions in the financial services industry. The Group's first five-year targets were published in January 2017 and annual updates are given each September, in line with other charter signatories.

While the Group is confident that there is no systematic gender bias in its recruitment or remuneration practices, it is conscious of the underrepresentation of women in senior and executive positions in the financial services sector and it anticipates that one of the effects of its Women in Finance programme will be to erode the gender pay gap by increasing female representation at senior levels.

Remuneration packages across the business are compliant with the UK's national minimum wage rates. In addition, the Group is an accredited employer with the Living Wage Foundation and first met this standard in June 2016. The independent Living Wage Foundation sets an hourly rate calculated according to the cost of living in the UK which is updated annually. The Living Wage for employees outside London is £9.00 per hour from November 2018 (2017: £8.75), this is equivalent to £17,550 per annum based on a 37.5 hour working week (2017: £17,062). This is a higher rate than the government's National Living Wage. The Group supports the Living Wage Foundation's principle of a living wage being good for business, good for the individual and good for society and this is an important part of the Group's values and people strategy.

All employees' salaries are reviewed annually on an individual basis. This review considers their performance in the role, any changes in their responsibilities and benchmark salary information for the role provided by an external bureau. Where appropriate, the level of annual bonus will also be considered as part of this process. All salary and bonus recommendations are reviewed centrally by the Human Resources function to ensure that an appropriate process, in line with Group policies, has been carried out and that the recommendations have been properly justified. There are no collective pay arrangements.

Gender pay gap reporting

All UK companies with more than 250 employees are required to report on their gender pay gap, in accordance with the 'Equality Act 2010 (Gender Pay Gap) Regulations 2017' ('the Regulations').

The Group has one subsidiary with more than 250 employees, Paragon Finance PLC ('Paragon Finance') and gender pay data for this company has been reported in accordance with the Regulations and is set out below marked 'Paragon Finance'. However, in keeping with the overall intent of gender pay reporting, and to provide better information for users, the Group has decided to also disclose its consolidated figures, shown below as 'Group'.

The Regulations require entities to publish information on:

- Mean and median gender pay gaps
- The split of each pay quartile by gender
- The proportion of male and female employees receiving bonuses
- Mean and median gender bonus gaps

In the period since the last gender pay gap reporting date, a group reorganisation has resulted in a significant transfer of employees from Paragon Bank PLC to Paragon Finance. As a result, the current year figures for Paragon Finance are not directly comparable to those for the previous period. This does not impact Group disclosures.

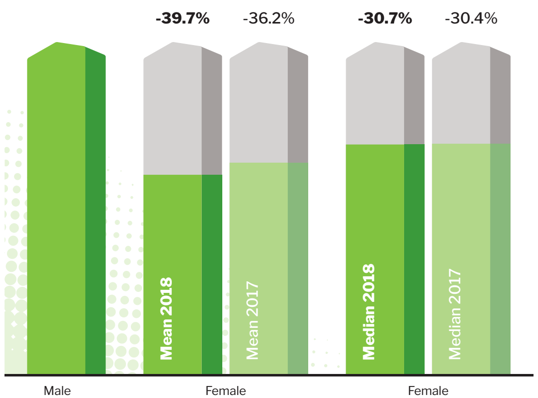
Gender pay gap

The gender pay gap is defined as the difference between the mean or median hourly rate of pay that male and female employees receive. A gender pay gap may exist as a result of the nature of the positions within an organisation held by male and female employees and does not necessarily indicate that men and women in similar positions are paid different amounts, which would contravene equal pay legislation.

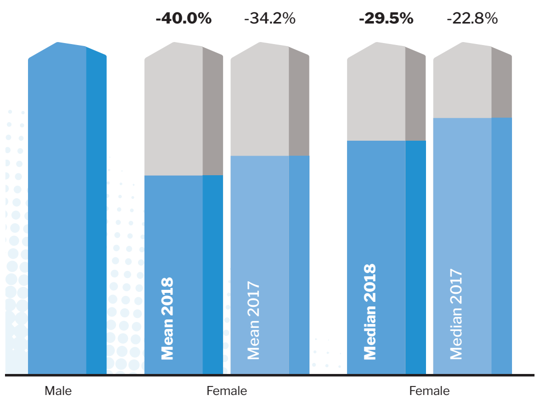
The mean pay gap is the difference between average hourly earnings of men and women. The median pay gap is the difference between the midpoints in the ranges of hourly earnings of men and women. It takes all salaries in the sample, orders them from lowest to highest and selects the middle value.

These figures are provided in the charts below based on hourly rates of pay as at 5 April 2018, the 'Snapshot Date' specified in the Regulations. At that date, Paragon Finance employed 91.8% of the Group's qualifying employees (2017: 74.4%). The remainder of the Group's employees worked for Paragon Asset Finance Limited and its subsidiaries.

Group



Paragon Finance



The reported results for the Group have worsened slightly between 5 April 2017 and 5 April 2018. While this is to be regretted, the Group has analysed salary distribution of the additional employees joining the payroll between those dates to identify any factors driving that movement. While both mean and median gaps in the new employees are lower than in the overall workforce, at 33.3% and 24.2%, over 30% of the new people were part of the upper quartile of salaries at 5 April 2018 and 75% of these people were male.

This is a result of the pattern of roles that were added to the payroll in the period. Particularly:

- The Iceberg professions finance business was acquired in December 2017. This had a number of highly paid male employees on its acquisition by the Group
- The Group's structured finance operation was established in the period and its development finance proposition was expanded. These both required the recruitment of experienced customer relationship focussed personnel with existing market knowledge, in fields where female participation in the labour force is not high

These additional, highly paid male employees have made positive movement in the gender pay gap difficult. It should also be noted that the measures to enhance female representation in the recruitment process discussed in last year's gender pay report were only introduced during the reporting period and therefore would not have had their full impact on the results.

As noted above, the significant movement in the results for Paragon Finance is due to the impact on the profile of Paragon Bank employees who were transferred to the company in the year, altering the mix of employees included.

The median and mean pay gaps are in line with the 32.5% median pay gap and 31.7% mean pay gap for full-time employees in the financial services sector reported by the Office of National Statistics ('ONS') in its Annual Survey of Hours and Earnings published in October 2018 (2017: 33.7% and 34.8% respectively). They are also broadly in line with those reported by the companies in the banking sector. A sample of 16 similarly sized smaller banks and larger building societies who published gender pay gap data for 2017 had median gaps, on average, of 35.0% and mean gaps, on average of 35.8%. However, there was a wide range of gaps reported, reflecting, in part, the differing business models adopted. Available 2018 data so far shows a broadly similar position.

The calculation mandated by the Regulations takes no account of hours worked by employees in calculating averages. This gives the hourly rate of a part-time employee the same weight as a full-time person, despite the full-time person contributing more of the Group's labour. As more part-time working is available at lower levels and as flexible working has historically been more attractive to female employees, this tends to amplify the gender pay gap. This effect is recognised by the ONS, which reports data for full-time and part-time employees separately. Calculating the Group's gender pay gap for full-time employees only, the difference reduces to 28.9% for the median (2017: 28.9%) and 36.7% for the mean (2017: 34.1%).

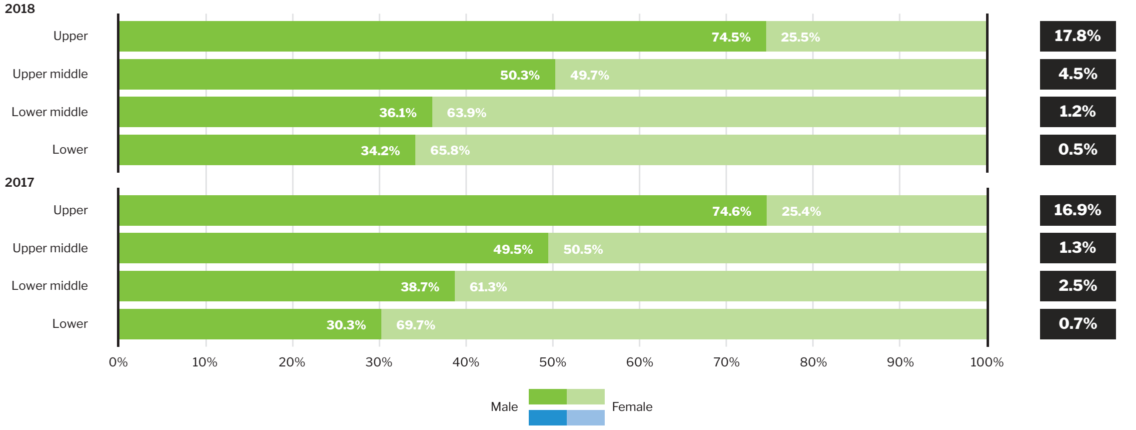
While there is a pay gap between female part-time and female full-time employees, with a median gap of 5.9% (2017: 6.1%) and a mean gap of 18.5% (2017: 13.9%), this represents a narrower gap than that between full-time and part-time employees in the broader economy. This suggests that enhancing opportunities for flexible working within the Group, which is an objective under the Women in Finance Charter, has not been detrimental to women's hourly earnings.

During the year the Group has undertaken various exercises to understand the reasons for its gender pay gap, both separately and as part of the pay review process. This suggests that the principal determining factor of the pay gap is the differing positions occupied by men and women in the Group, rather than a differential between women and men undertaking the same role. This is in line with analysis produced by ONS on the UK national pay gap, which suggested that differences in the positions held by men and women, and their likelihoods to work part-time, were significant factors.

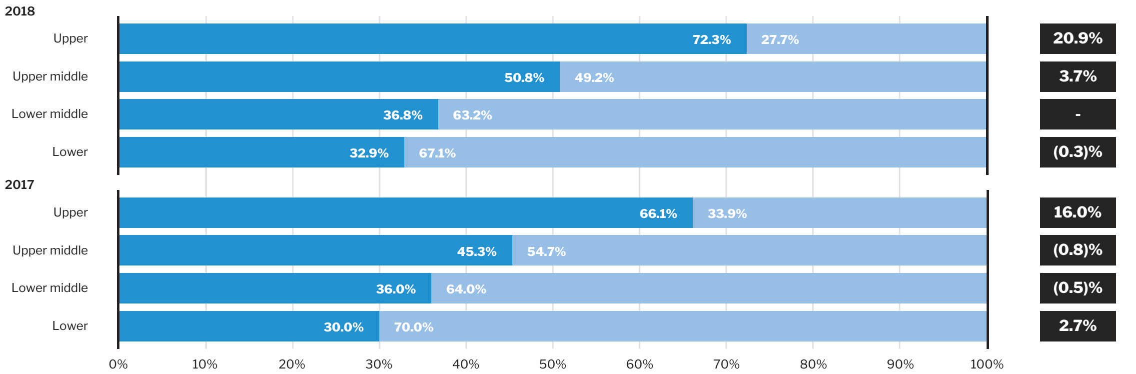
Quartiles

The Regulations require an analysis of the structure of the workforce by pay quartiles, to illustrate factors driving the pay gap. These charts show the gender split of employees grouped by hourly pay rates into four equally sized quartiles, including 322 employees each for the Group (2017: 317) and 296 employees each for Paragon Finance (2017: 236). The upper quartile includes the highest paid employees, the lower quartile the lowest.

Group **Median Gap**



Paragon Finance **Median Gap**



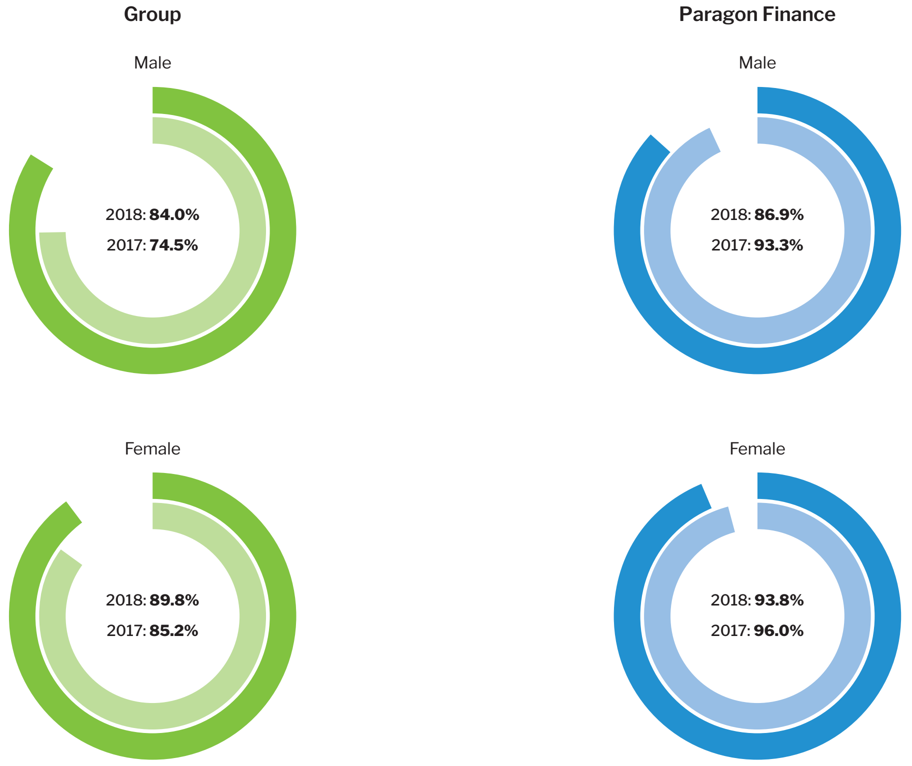
The charts show the higher proportions of male employees in the higher part of the pay range. The reasons for this distribution have been investigated and a significant impact is the inclusion in that quartile of a number of skilled and professionally qualified roles which demand salaries at this level, such as sales managers, IT professionals, surveyors and finance, treasury and analytical roles.

In all of these areas the number of male employees significantly outnumbers females, and, for certain roles, evidence suggests that the level of appropriately qualified females might make achieving parity challenging. As an example, the Royal Institution of Chartered Surveyors has reported a female membership below 20%, and the consensus of surveys carried out in the IT industry points to the number of female IT professionals being at a similar level. However, the Group's Women in Finance programme will particularly target high paying roles where women are underrepresented and where candidates are available or can be developed.

While the median pay position weakened in the upper quartiles, this is partially attributable to the introduction of new roles in Paragon's Commercial Finance division, discussed above.

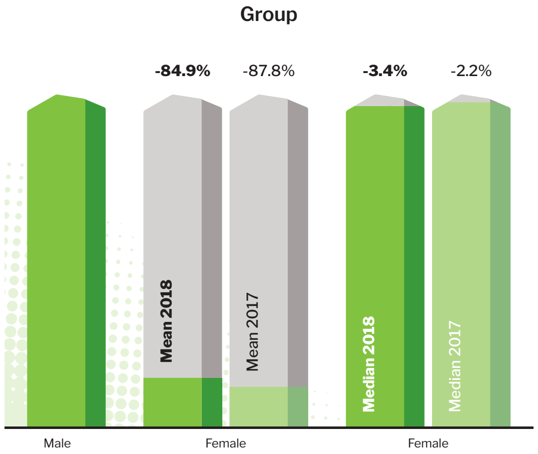
Bonuses

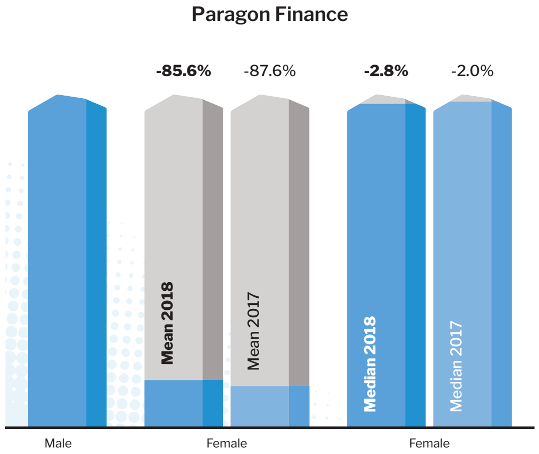
The charts below show the proportion of male and female employee numbers receiving a bonus in the year ended on the Snapshot Date. The statutory definition of bonus includes the annual profit related pay ('PRP') award which is payable annually to all employees of Paragon Finance (other than senior management) who were employed during the year concerned. These amounts are, therefore, paid to the vast majority of the Group's employees and movements in the percentage will relate largely to the proportion of the payroll at the Snapshot Date who had been employed during the financial year ended on the previous 30 September.



As well as the PRP award, bonus payments include annual discretionary bonuses and share based awards. Share based awards, which have vesting conditions based on the Group's performance, are included in the calculation when they are exercised by the recipient, rather than when they are awarded. They are valued, for the purpose of the Regulations, at their market value on exercise rather than at the date when they are awarded, which may be significantly different. The impact of these awards on the bonus gap, year-on-year, may be distorted by individuals' decisions to exercise, the amounts of awards vesting and the Group's share price.

The gender bonus gap, calculated on the basis set out in the legislation, is set out below.





It is a feature of the Group's remuneration policy that discretionary bonus payments and share awards are only available to more senior employees, and that the proportion of a person's maximum potential remuneration derived from variable elements rises sharply at the most senior levels. Only 316 employees (27.4% of those receiving bonus) received discretionary awards.

The impact of this on the median bonus is to generate a very small gap as the median male and female employees are both in the range where almost all of the bonus is derived from the PRP scheme, which is non-discretionary and paid at the same level to all qualifying employees. Analysis of median bonus between full-time and part-time employees indicates that the small gap shown is related almost entirely to hours worked, with the median bonus gap for full-time employees only reducing to 1.7% (2017: 0.8%).

The impact of this salary structure on the mean bonus is to generate a large gap so long as all, or a majority, of the most senior employees are men. The impact of a very small number of bonus payments to executive directors and other very senior employees and the exercise of share-based awards by these people mathematically outweighs the PRP based bonuses paid to the majority.

Details of the bonus arrangements of the three executive directors, who are all male, are given in the Directors' Remuneration Report in the Group's annual accounts. Maximum opportunity for these people is set at a cash bonus of 200% of salary together with PSP awards of up to 200% of base salary, a much greater proportion of variable pay than for other employees. The design of these remuneration packages is based on the expectation of investors and governance analysts. These awards represent the largest part of the bonuses in the calculations for both the Group and Paragon Finance.

Exclusion of the executive directors from the bonus gap calculation reduces the bonus gap for the Group from 85.6% to 68.6% on the statutory basis, illustrating the impact on the gap of the most senior post-holders.

Of the 313 other employees who received discretionary awards, only 157, all at senior levels, received bonuses in excess of £5,000 in the year (2017: 149), 14% of the total who received some bonus. Bonus for these employees will consist of their annual bonuses, awarded for the year ended 30 September 2017 and any share-based awards exercised in the year ended 5 April 2018, which will have been awarded at least three years earlier.

Amongst this group there are wide variances in the levels of bonus, arising from:

- Levels of seniority, as there are more males at the highest levels
- Differences in market expectations of levels of maximum bonus, compared to salary within different career paths, with roles directly responsible for profit generation commanding greater levels of bonus relative to salary than those in support functions
- Remuneration policy in certain business areas where low-level bonus payments have been made to staff on salary levels which would not attract a bonus in other parts of the business. This has brought additional. mainly female, employees into the group, reducing the mean female bonus
- Distribution of male and female employees between career paths where, in common with much of the financial sector, senior female employees are concentrated, predominantly, in support areas
- Levels of exercise of share based awards, which is entirely at the discretion of the employees concerned and which may not take place regularly, year on year. This impacts particularly for the highest paid employees who have the greatest number of awards
- Time lapsed between vesting and exercise on share based awards, which is at the discretion of the employee and can potentially bring up to an additional seven years of share price appreciation into the bonus gap calculation
- Share prices at the time of exercise of share based awards, especially for the highest paid. This is a particular issue for the Group, which has seen a significant increase in share price over recent years, causing the amounts reported to be much greater than the value of the awards at the time of grant

The interrelationship of these factors creates a complex pattern overall. Their combined effect produces a gender bonus gap, taking into account discretionary awards only, of 60.9% amongst those employees receiving discretionary bonuses (excluding executives).

The impact of share price appreciation can be clearly seen from the case of one male senior employee who had not exercised his vested awards over a number of years and exercised a number of years' entitlements in the period. Exclusion of this person from the calculations reduces the gap for discretionary bonuses to 47.0%.

All awards of bonus within this group are considered individually at executive director level. For the 2017 annual bonuses, the Remuneration Committee, as well as considering levels of executive bonuses and share awards, also approved the awards of the 47 other most senior employees, a deliberately more targeted approach than in previous years, where the population considered was determined merely on the basis of gradings.

During the year the Committee has reviewed its procedures in light of the evolving regulatory and governance environment, including HA and developments in the Corporate Governance Code to define a longer list of employees whose awards it will review, including all people within the FCA Senior Managers and Certification Regime.

The Group is confident that bonuses awarded are justifiable on a case-by-case basis, taking into account roles, responsibilities, performance and market remuneration practice for individual positions.

Women in Finance

The Women in Finance Charter requires businesses to set a target for female representation in senior management. The Group's performance against these targets is reviewed regularly by Senior Management and the Nomination Committee. The Group has also chosen to set further targets to support its programme.

In January 2017, the Group published its five-year targets for its Women in Finance programme. The Group's intention is to achieve these by January 2022. The most recent updates were published on the Group's website in September 2018 and the intention is to publish further updates each September in line with other Charter signatories.

The Group continues to make good progress with its headline measure, the percentage of women in senior positions (defined as being Executive Directors, Executive Committee members and their direct reports, in accordance with the recommendations in the HA Report) having reached 34.6% at 31 December 2018, compared to 29.2% a year earlier. This is based on an increase in the number of senior managers from 48 in December 2017 to 52 in December 2018. The Report published by the HA Review in November 2018 classified the Group's performance on this basis as likely to meet its 33% target, and the Group is currently exceeding this threshold.

The Group is pleased with the progress to date and will be working to ensure that all its benchmarks are met by the target date of January 2022.

Actions on diversity

The Group continues to analyse its gender pay data, overall, within business areas and by comparing similar positions across the business. Policies are in place to ensure equality of opportunity in recruitment, promotion and remuneration and the effectiveness of these is monitored on an ongoing basis.

The Group's HR and training policies and procedures include these steps to ensure equality of opportunity and to increase the pipeline of female candidates available to assume senior roles in the business, or elsewhere in the financial services sector:

- Recruitment and selection practices are regularly reviewed to identify potential sources of bias and procedures refined as appropriate
- Search firms are instructed to provide appropriate gender diversity amongst candidates
- Female career development and leadership training is provided
- A programme is in place to identify female leaders and potential leaders amongst the workforce, providing those individuals with more mentoring opportunities
- The Group participates in the Women Ahead cross-company mentoring programme
- Training on unconscious bias
- Regular diversity surveys amongst employees

Confirmation statement

I confirm the accuracy of the information presented above in respect of Paragon Finance PLC required by regulation 2 of the Regulations.

RICHARD J WOODMAN
Chief Financial Officer
March 2019

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