Paragon Banking Group PLC

Pillar III Disclosures - 30 September 2019

Contents

1. Introduction

This section sets out

- An introduction to the Group
- An overview of the disclosure framework under which this document is prepared
- A summary of the Group's Pillar III disclosure policies
- A summary of the scope and basis of preparation for this document
- A summary of changes made since the Group's last Pillar III disclosures
- A summary of the approval process for the document

Paragon Banking Group PLC ('the Company') is a UK specialist banking group, sourcing funds in the retail deposit market and lending to consumers and smaller corporates. It is subject to banking regulation and therefore is required, by European Regulation, to publicly report on risk and governance matters for each financial year. This expands on the disclosures already required to be given in an entity's annual report and accounts.

This document, referred to as a Pillar III report, is intended to satisfy those requirements. An overview of the disclosures given by theme is shown on page 5.

THE GROUP

The Company controls a group of companies (together 'the Group') including a regulated bank, Paragon Bank PLC ('the Bank'). The Group analyses its operations, both for internal management reporting and external financial reporting, on the basis of the markets from which its assets are generated. The segments used are described below:

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

Each division is responsible for the generation of new business with servicing and the majority of other support functions managed on a group-wide basis.

On 18 February 2014 the Bank was authorised by the Prudential Regulation Authority ('PRA') and is regulated by the PRA and the Financial Conduct Authority ('FCA'). The PRA sets requirements for the Bank relating to capital and liquidity adequacy.

DISCLOSURE FRAMEWORK

The Group is regulated for prudential capital purposes under the Basel III regime which is implemented in the European Union ('EU') through the Capital Requirements Directive IV ('CRD IV'). The CRD IV text was formally published in the Official Journal of the EU in June 2013 and became effective from 1 January 2014. It is made up of the Capital Requirements Regulation ('CRR') (EU Regulation 575/2013), which is directly applicable to firms across the EU, together with the Capital Requirements Directive ('CRD'), which must be implemented through national law.

The PRA, as prudential regulator of the Company, is the body responsible for implementing CRD IV in the UK. The Company has been operating under the Basel III regime since the authorisation of the Bank.

The Group has adopted the Standardised Approach ('SA') for credit risk and the Basic Indicator Approach ('BIA') for operational risk.

CRD IV consists of three elements, or `Pillars', which represent the key principles of the Basel III regime:

Pillar I	This covers the minimum capital requirements of Basel III. The calculation is based on a risk based approach. It focuses on credit, operational and market risk in determining the Group's Minimum Capital Requirement ('MCR').
Pillar II	This requires that the Group conducts an Internal Capital Adequacy Assessment Process ('ICAAP') which is subject to review by the PRA under the Supervisory Review and Evaluation Process ('SREP'). In the ICAAP the Company's Board undertakes an assessment of the key risks facing the Company's business against which capital has not been provided under Pillar I to determine whether additional regulatory capital should be held, based on the identified risks and the risk management processes in place. A firm's Individual Capital Requirement ('ICR') is set by the PRA based on the ICAAP.
Pillar III	Pillar III complements Pillars I and II and aims to encourage market discipline by setting out disclosure requirements which should allow market participants to assess key pieces of information on a firm's capital, risk exposures, risk management processes and remuneration. These requirements are set out in Part 8 of the CRR ('Part 8') as supplemented by secondary EU legislation and guidance issued by appropriate bodies.

PILLAR III DISCLOSURE POLICY

The Company's Pillar III disclosures cover the Group as a whole, comprising the Company and its subsidiary undertakings. They are therefore prepared on the same basis as the Group's consolidated accounts. These bodies are regulated on a consolidated basis and this disclosure treats them as such. References to the Group in this document therefore include Paragon Bank PLC.

The Company's Disclosure Policy for its Pillar III disclosures is based on its Board of Directors' interpretation of the requirements of Part 8, having taken appropriate expert advice. The directors have regard to the guidelines on materiality issued, pursuant to Article 432(1) of the CRR, by the European Banking Authority ('EBA') in December 2014 (EBA/GL/2014/14). Disclosures which are required by the CRR, but which are considered to be immaterial in the context of the Group's operations and business model are not included. These include disclosures in respect of wrong way risk.

The Pillar III disclosures are updated on an annual basis using the Group's year end date of 30 September, following publication of the Annual Report and Accounts. The annual reporting process will include consideration of regulatory changes and developing best practice, to ensure that disclosures remain appropriate. More frequent disclosures will be made if there is a material change in the nature of the Group's risk profile during any particular year.

Pillar III disclosures are prepared with input from the Finance, Risk, Treasury and Human Resources functions and from regulatory specialists. They are reviewed at senior and executive management level and approved by the Board of Directors in the same way as the Group's Annual Report and Accounts for the year.

Pillar III regulatory capital disclosures each year are published on the investor relations section of the Group's corporate website www.paragonbankinggroup.co.uk, alongside the Annual Report and Accounts for the year. Both documents are published on the website at approximately the same time, in accordance with the requirement in Article 433 of Part 8 to publish the Pillar III disclosures in conjunction with the date of publication of the financial statements.

The Company's Pillar III disclosure policy is considered annually to ensure that it remains appropriate in the light of new regulations and emerging best practice.

The Company's Pillar III regulatory capital disclosure policies were approved by the Board of Directors in February 2015 and have been confirmed annually, most recently in December 2019 on the approval of this document.

SCOPE AND BASIS OF DISCLOSURE

This Pillar III disclosure has been drawn up in conjunction with the Annual Report and Accounts of the Group for the year ended 30 September 2019 ('the Group Accounts'). In accordance with Article 434 of the CRR, where a disclosure required by Part 8 is made in the Group Accounts it need not be repeated in this document.

The figures in this Pillar III disclosure are consistent with the Group Accounts, but do not form part of the Group Accounts. The disclosures presented have been reviewed internally but have not been externally audited.

The Group consolidation for regulatory purposes is the same as that used for statutory purposes and hence all subsidiary undertakings within the Group have been consolidated in the Pillar III disclosures. The names of all of these entities, and the basis on which they are considered to be subsidiaries of the Group are set out in note 68 to the Group Accounts.

The Pillar III disclosures have been prepared for the Group as a whole, in accordance with the rules laid out in Articles 431 to 451 of Part 8 and having regard to materiality as described above.

The disclosures provide information on the capital adequacy and risk management processes of the Group. These disclosures have been compiled on the most appropriate basis for this purpose and, as such, may not agree directly to similar disclosures presented in the Group Accounts.

The Bank's requirement to maintain regulatory capital and liquid resources above a level determined by the PRA could restrict its ability to make dividend payments or make loan repayments to other Group entities. There are no other current or foreseen material practical or legal impediments to the prompt transfer of capital resources or repayments of liabilities between the Company and its subsidiary undertakings.

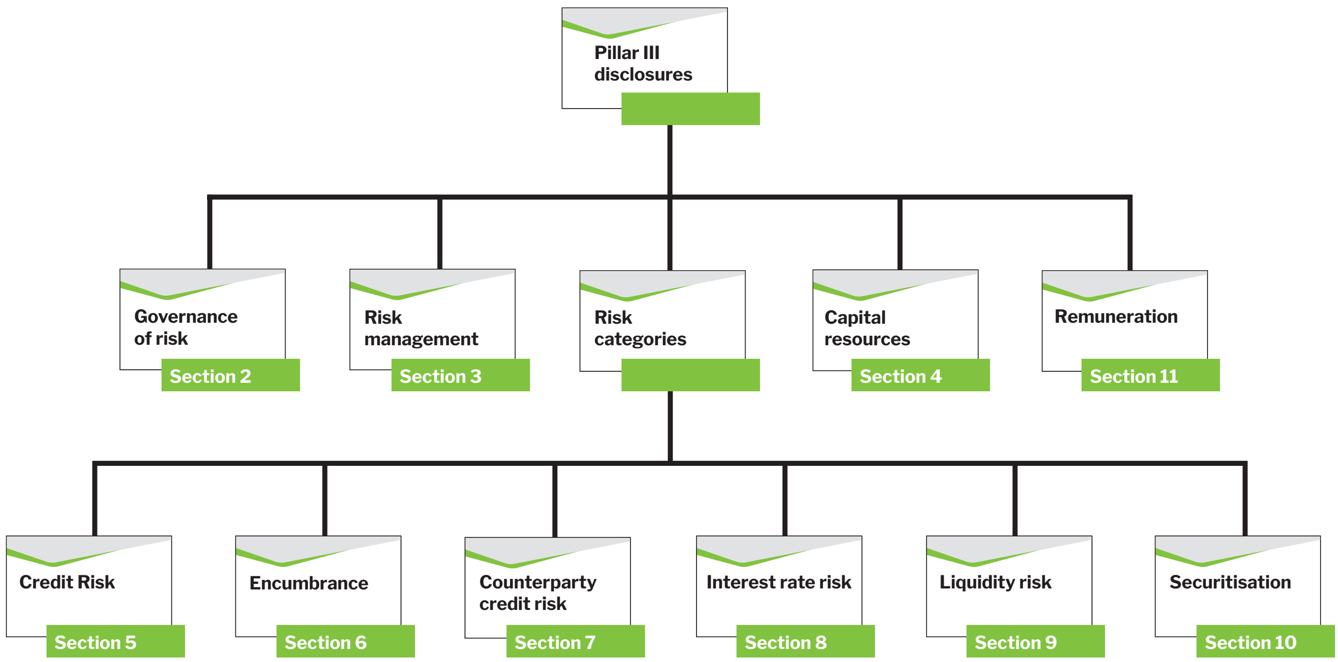
The Bank is required to prepare Remuneration Code Pillar III disclosures. These disclosures are included within this document, in section 11, as the relevant members of staff work for both the Group and the Bank.

The Pillar III disclosures are published annually. The EBA guidelines on frequency of disclosures contained in EBA/GL/2014/14 contain a number of size-based indicators which are relevant in considering whether more frequent reporting is necessary. The Group is substantially below these thresholds. Notwithstanding this, the need for more frequent disclosures is considered by the Board. At this stage, more frequent disclosure is not deemed necessary.

OVERVIEW OF DISCLOSURES

Part 8 sets out a series of disclosures which firms are required to make. For the purpose of this document these disclosures have been grouped thematically, as illustrated below.

Pillar III document overview



Where the CRR and its supporting technical standards require the publication of detailed templates as part of the document, these have generally been included in appendices and the useful information summarised in the main document.

DEVELOPMENT IN DISCLOSURES

The new accounting standard IFRS 9 – 'Financial Instruments', is applicable to the Group for the first time for the financial year ended 30 September 2019 and this transition impacts on the Group's capital position. For regulatory capital purposes the CRR allows the impact of the transition to be phased in over a five year period. The Group has taken this transitional relief, such that the initial impact on capital ratios is negligible. The transitional impact arising is described in section 4 and the EBA prescribed disclosure template is presented as Appendix C.

This Pillar III report presents similar disclosures to those published in respect of 2018, except that new credit risk disclosures reflect changes made in the Group's accounting and reporting as a result of the introduction of IFRS 9 in the period, and, as described above, information on the impacts of the Group's transition to IFRS 9 has been included.

Further background information has been provided to users in a number of areas.

In drawing up these disclosures the Group has considered new regulations and market practice and analysed Pillar III reports made by comparable UK lenders including those in the larger challenger banks and building societies to ensure that the level of detail given is broadly comparable.

The Group will continue to review market practice for Pillar III disclosures. It is considering the revised Pillar III disclosure requirements which were published by the BCBS in January 2015 and revised and enhanced in March 2017. The date from which these rules will apply to the Group and similar sized entities has yet to be set by the PRA.

Other technical pronouncements under development relate to liquidity and interest rate risk, and the Group will monitor developments in these areas as they emerge.

APPROVAL

The Board of Directors considered this document in the light of, amongst other things:

- The Board's consideration of the Group Accounts
- The ICAAP and the directors' input into this process
- The ILAAP and the directors' input into this process
- The Board's overall understanding of the Group's risk profile and operations

The Group Accounts include audited and unaudited disclosures addressing the Group's risk exposure, mitigation and appetites. In approving the Group Accounts the directors had to consider the appropriateness of those disclosures and the overall adequacy of the Group's risk management framework.

The Group went through the annual ICAAP process during the year. The ICAAP was prepared under the direction of the CFO and the executive management of the Group, with appropriate input and challenge from other areas of the business. The ICAAP was reviewed and challenged by the Group's executive and was formally approved by the Board in June 2019. Throughout the ICAAP's preparation, the Board was kept up-to-date with its progress and key findings, and the directors have received regulatory training sessions to ensure that they are able to provide the appropriate level of challenge.

The Group will review the ICAAP on at least an annual basis. The update process will occur more frequently if there is a significant change in the Group's business model (potentially following a major acquisition) or in the economic environment within which the Group operates.

The Group's regulator carried out a Supervisory Review and Evaluation Process ('SREP') based on the ICAAP submitted in 2017, the conclusion of which was that the actual level of the Group's capital was in excess of the minimum requirements. Future ICAAPs will be subject to SREP reviews periodically, particularly in the event of significant changes in the business.

This document was considered by the executive directors and by the Board and the Audit Committee and non-executive directors prior to publication, having regard to their understanding of the business and appropriate external advice.

In particular, they considered whether:

- As a whole, taken with the Group Accounts, the document properly represented the Group's position for the purposes of Part 8 of the CRR
- The use of materiality for disclosure purposes was appropriate
- The Group's formal Pillar III disclosure policy remained appropriate
- Annual publication of the disclosures remained appropriate

The directors were able to satisfy themselves on these matters and the Pillar III disclosures were therefore approved for publication by the Board of Directors of Paragon Banking Group PLC in January 2020.

2. Governance

This section sets out

- The Group's approach to corporate governance
- Details of the governance framework operated by the Company

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

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

As part of its governance arrangements, the Group has a defined risk management framework. This is designed to support the achievement of the Group's strategic objectives by ensuring that it is not exposed to material unexpected losses. In this way, the Group is able to protect the interests of both its customers and shareholders and maintain an effective balance between risk and reward. Further details of the risk management framework are provided below.

THE BOARD

The Board of Directors comprises a majority of independent non-executive directors, with a Chair who was independent on appointment. Consequently, the balance between independent and non-independent directors has been appropriate.

There is a strong non-executive representation on the Board, including the Senior Independent Director, providing effective balance and challenge. The non-executive directors meet with the Chair, from time to time, without the presence of the executive directors. All non-executive directors are appointed for fixed terms.

Throughout the year ended 30 September 2019 the Board included:

- Fiona Clutterbuck as Chair of the Board
- Nigel Terrington, Chief Executive Officer ('CEO'), Richard Woodman, Chief Financial Officer ('CFO') and John Heron, Director – Mortgages, as executive directors
- Peter Hartill, the Senior Independent Director, Hugo Tudor, Barbara Ridpath, Finlay Williamson and Graeme Yorston as independent non-executive directors

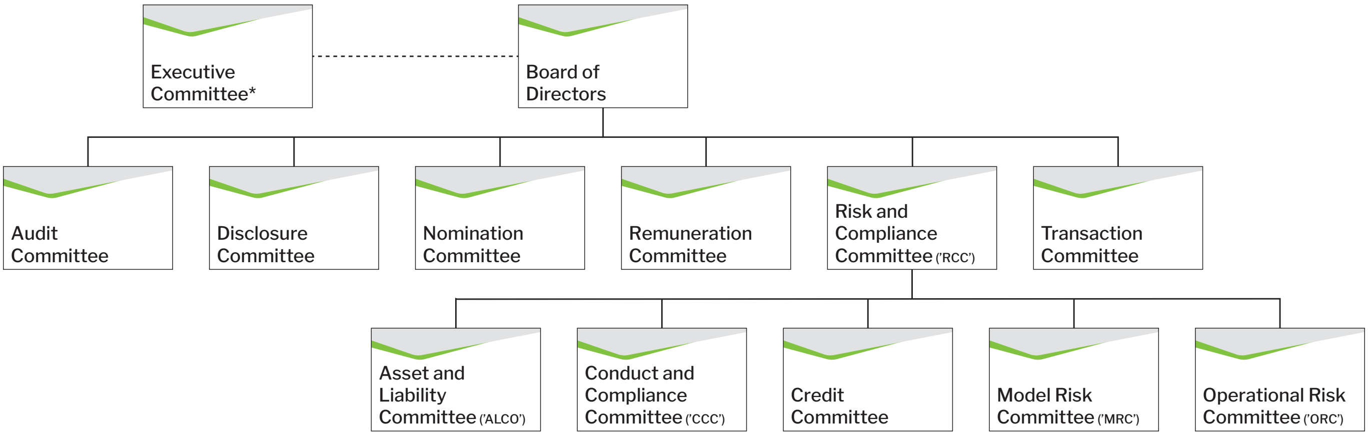
In addition Patrick Newberry served as an independent non-executive director until his resignation on 31 December 2018 and Alan Fletcher was a non-independent non-executive director until that date. All the directors bring a broad and valuable range of experience to the Company and further details, together with other biographical details, are set out in Section B2 of the Group Accounts. The Chair's other business commitments are also set out in that section.

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

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

An overview of the Board and Committee structure is set out below.

Board committee structure



*Not a board committee

BOARD COMMITTEES

The Board operates through a number of committees covering certain specific matters, illustrated in the chart shown above. Summary information on these committees, including their membership, is set out below.

Committee	Audit	Remuneration	Risk and Compliance	Nomination
Chair	P J N Hartill	H R Tudor	F F Williamson	F J Clutterbuck
Minimum number of meetings	4	3	4	2

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

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

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

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

EXECUTIVE COMMITTEES

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

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

Each of the executive committees operates within terms of reference formally approved by the Risk and Compliance Committee. The primary functions of each of these committees are described below.

Asset and Liability Committee ('ALCO')

ALCO comprises heads of relevant functions and is chaired by the CFO.

The principal purpose of ALCO is to monitor and review the financial risk management of the Group's balance sheet. As such, it is responsible for overseeing all aspects of market risk, liquidity risk and capital management as well as the treasury control framework. ALCO operates within clearly delegated authorities, monitoring exposures and providing recommendations on actions required. It also monitors performance against appetite on an on-going basis and makes recommendations for revisions to risk appetites to the Risk and Compliance Committee.

Conduct and Compliance Committee ('CCC')

The CCC comprises heads of relevant functions and is chaired by the Deputy CRO.

The CCC is responsible for overseeing the Group's conduct risk and compliance arrangements. The Committee considers conduct risk information such as details of conduct breaches; systems and procedures for delivering fair outcomes to customers; the product governance framework; monitoring reports; and employee incentive schemes. It also considers product reviews from a customer perspective. With respect to compliance, the CCC is responsible for overseeing the maintenance of effective systems and controls to meet conduct-related regulatory obligations. It is also responsible for reviewing the quality, adequacy, resources, scope and nature of the work of the Compliance function, including the annual Compliance Plan.

Credit Committee ('CC')

The Credit Committee comprises senior managers from the risk, finance and collections functions and is chaired by the CRO.

The Credit Committee approves credit risk policies in respect of customer exposures and defines risk grading and underwriting criteria for the Group. It also provides guidance and makes recommendations in order to implement the Group's strategic plans for credit. The Committee oversees the management of the credit portfolios, the post origination risk management processes and the management of past due or impaired credit accounts. It also monitors performance against appetite on an on-going basis and makes recommendations for revisions to the credit risk appetites to the Risk and Compliance Committee. The Committee also operates the Group's most senior lending mandate.

Model Risk Committee ('MRC')

The MRC comprises senior managers from risk, finance and the main business areas and is chaired by the CRO.

The role of the MRC is to review and make recommendations on all material aspects of the rating and estimation processes in relation to key credit and finance models. The MRC also acts as the 'Designated Committee' for IRB purposes, approving all material aspects of IRB rating systems.

Operational Risk Committee ('ORC')

The ORC comprises heads of relevant functions and is chaired by the CRO.

The ORC is responsible for overseeing the Group's operational risk and business risk management arrangements, including those systems and controls intended to counter the risk that the Group might be used to further financial crime. The Committee remit includes risks arising from personnel, technology, and environmental matters within the business. The Committee considers key operational risk information such as key risk indicators, themes within risk registers, emerging risks, loss events, control failures, and operational resilience measures.

It also monitors performance against appetite on an on-going basis and makes recommendations for revisions to the Risk and Compliance Committee.

MATTERS RESERVED FOR THE BOARD

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

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

CODE COMPLIANCE

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

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

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

BOARD AND COMMITTEE ATTENDANCE

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

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

Directors have attended a number of ad hoc meetings during the year in addition to the regular board meetings and have contributed to discussions outside of the regular meeting calendar.

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

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

OUTSIDE DIRECTORSHIPS

The number of other directorships of Board members, outside the Group, disclosed in accordance with Article 235(2) of Part 8 are set out below. For the purposes of this disclosure directorships of related entities (e.g. two subsidiaries of the same group) are counted as a single appointment.

Director	Position	Number of external appointments
F J Clutterbuck	Chair of the Board	2
N S Terrington	Chief Executive Officer	-
R J Woodman	Chief Financial Officer	-
J A Heron	Managing Director, Mortgages	-
P J N Hartill	Non-executive director	1
H R Tudor	Non-executive director	2
B A Ridpath	Non-executive director	-
F F Williamson	Non-executive director	-
G H Yorston	Non-executive director	-

Directorships in organisations which do not pursue predominantly commercial objectives are not required to be included.

FURTHER INFORMATION

The Corporate Governance Section (Section B) of the Group Accounts includes a detailed review of the system of governance in the Group and the activities of the Board and its committees in the year. In particular, in the report of the Nomination Committee, it addresses:

- The process for selecting members of the Board
- Succession planning in respect of the Board and senior management
- The Company's policy on diversity with regard to the selection of members of the Board

Further documentation relating to the governance framework available on the Group's website includes information on:

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

3. Risk Management

This section sets out

- An overview of the Group's risk management system
- The principal risks to which the Group is exposed and the main steps taken to mitigate against them
- A summary of the Group's risk appetite with regard to those risks
- Details of the Board's assessment of the Group's risk management processes

INTRODUCTION

The Group regards the effective identification, monitoring and control of risk as an integral part of its management processes.

There are a number of potential risks and uncertainties which could have a material impact on the Group's performance and could cause actual results to differ materially from previous or expected results. To identify and control these risks the Group utilises a risk management framework which analyses its risks under the categories of Business Risk, Credit Risk, Liquidity and Capital Risk, Market Risk, Operational Risk, Conduct Risk and Pension Obligation Risk. The Group maintains a defined risk appetite for each of these risk categories, further information on which is provided below.

The Group's risk management framework operates within a 'Three Lines of Defence' model:

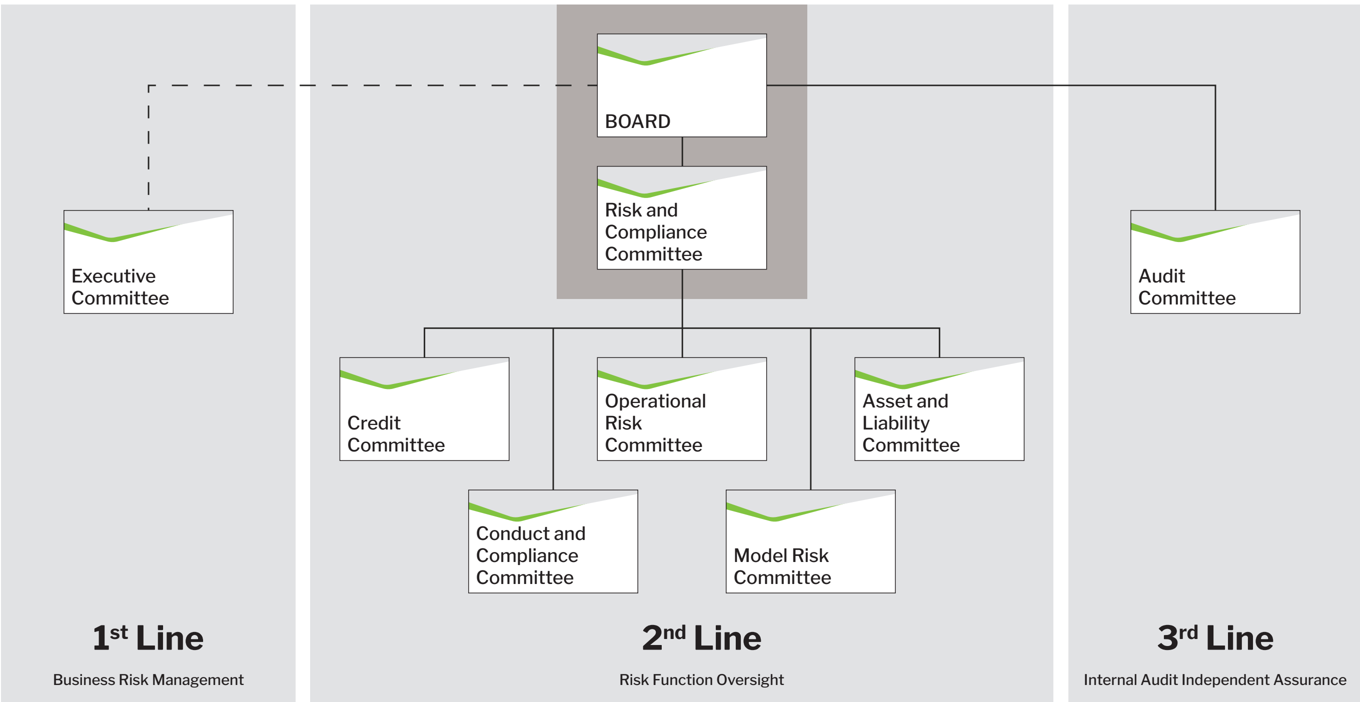
- The first line of defence, comprising executive directors, together with managers and employees in operational and support areas, holds primary responsibility for designing, operating and monitoring risk management and control processes
- The second line of defence, which is provided by Risk and Compliance division, headed by the Chief Risk Officer ('CRO'), which is responsible for providing risk oversight and guidance to the first line in addition to providing independent challenge and review. The function is overseen by the Risk and Compliance Committee and its supporting executive committees

  The Risk and Compliance division includes dedicated functions responsible for the oversight of Credit Risk, Property Risk, Compliance and Conduct Risk, Operational Risk, IT and Cyber Security, Financial Crime, Liquidity and Market Risk
- The third line of defence is provided by the Internal Audit function, which is responsible for reviewing the effectiveness of the first and second lines of defence. This function is overseen by the Audit Committee

Additional external levels of control complement the three internal layers. These are represented by the Group's external auditors and oversight is provided by the various regulatory bodies to whom the Group is accountable.

The way in which the Three Lines of Defence model aligns with the wider governance framework and the way in which information on risk matters ultimately flows to the Board is illustrated below:

Risk Management Model



The Group's risk management framework is intended to provide a structured and disciplined approach to the management of risk within agreed apetites thereby supporting the achievement of the Group's strategic objectives. The key objectives of the risk management framework are to:

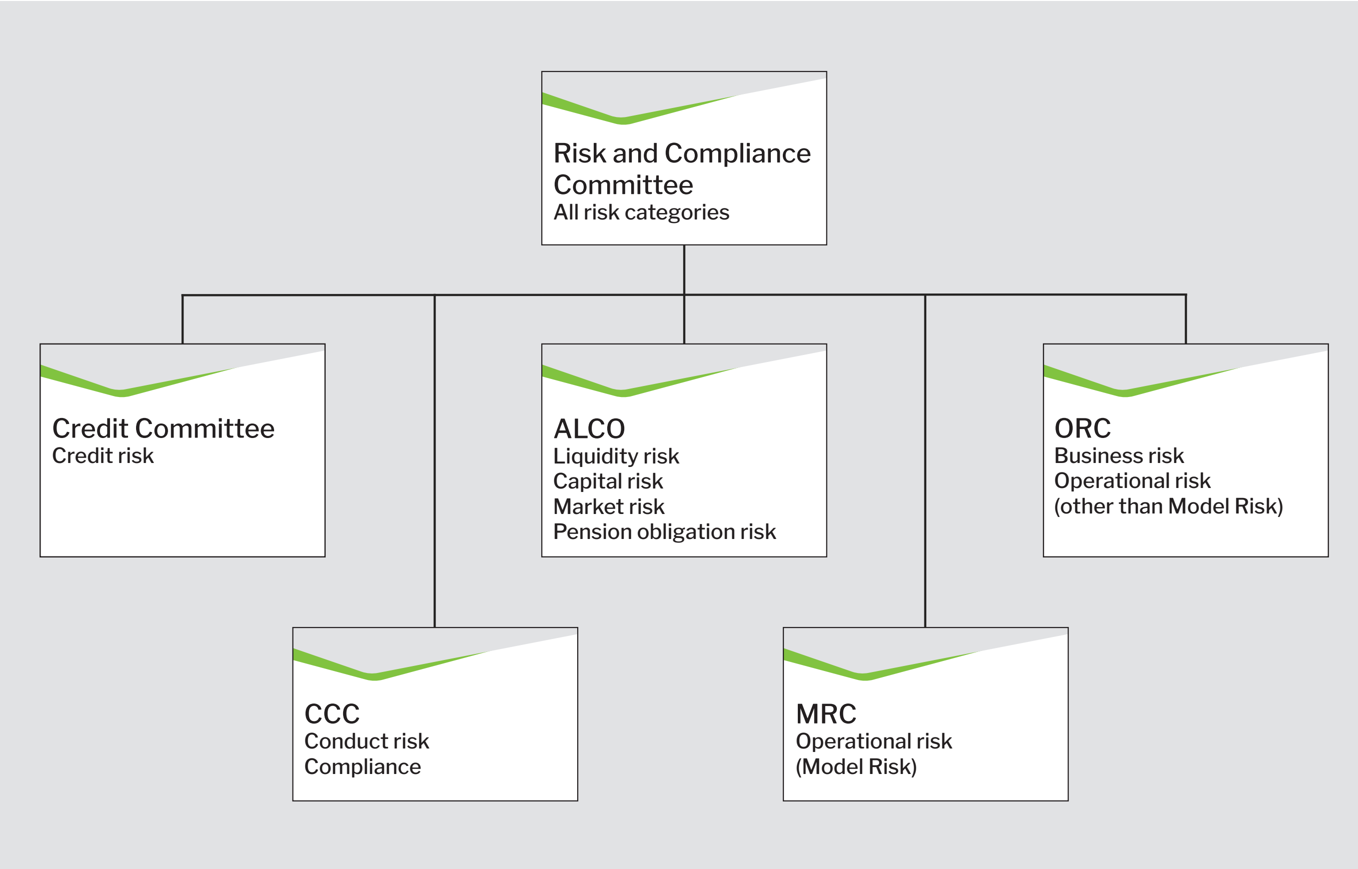
- Promote an appropriate risk culture across the Group ensuring risk is considered as part of key strategic and business decision making
- Establish standards for the consistent identification, measurement, monitoring, management and reporting of risk exposure and loss experience
- Outline the approach that will be taken in respect of setting and defining risk appetite and risk tolerances
- Promote risk management and the proactive reduction of the frequency and severity of risk events, driving control improvements where necessary
- Facilitate adherence to regulatory requirements, including threshold conditions, capital standards and to support the regulatory requirements associated with the ICAAP and ILAAP and RP
- Provide senior management and relevant committees with risk reporting that will be relevant and appropriate, enabling timely action to be taken in response to the information included within these reports

The Group Accounts includes a Risk Management Report, in Section B7. This report sets out:

- The activities of the Risk and Compliance Committee in the year
- A more detailed description of the risk management framework and the structure, organisation and activities of the Group's risk function
- A summary of the Group's risks, together with the mitigants in place to control these risks and the movement in these risks in the year

The maintenance of a standard, common risk language across the Group is a key enabler for risk identification and effective risk management. It provides a consistent basis for risk assessment and the development of policy, risk appetite and appropriate risk management structures. It also facilitates risk aggregation, risk reporting and segregation of accountabilities. The common risk categorisations used, and the committees responsible for them, from a second line governance perspective, are set out in the diagram below:

Risk Governance Responsibilities



PRINCIPAL RISKS

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

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

A more detailed discussion of those risks and uncertainties, how the Group seeks to mitigate those risks and the change in the perceived level of each risk in the last financial year ended 30 September 2019 is set out below.

This analysis represents the Group's gross risk position as presented to, and discussed by, the Risk and Compliance Committee as part of their ongoing monitoring of the Group's risk profile.

This summary should not be regarded as a complete statement of all potential risks and uncertainties faced by the Group but rather those which the Group believes have the potential to have a significant impact on its financial performance and future prospects.

The changes in the perceived level of each risk in the last financial year is indicated using the symbols shown below:

↑	↓	← →
Risk Increasing	Risk Decreasing	Risk Stable

BUSINESS RISK

Economic risk

Description	Mitigation
The potential for a deterioration in the UK's economic conditions is harder to forecast given the current uncertainties as to the terms on which the UK will leave the EU. Given that its income is wholly derived from activities within the UK, the Group could be materially affected by a severe downturn in the UK economy, which could reduce demand for the Group's loan products, increase the number of customers that default on their loans and cause security asset values to fall.	The Group closely monitors economic developments in the UK and overseas, with support from leading independent macro-economic and other advisors. This information supports the senior management's review of objectives each year and helps inform business plans for each of the Group's principal trading operations. As a lender and acquirer of credit portfolios, exposure to any material deterioration in economic conditions is inevitable. The Board's defined strategy is to limit this risk by operating as a specialist lender in carefully chosen markets where its employees have significant levels of experience and expertise. Robust underwriting and monitoring processes are employed throughout the Group which reflect prudent credit policies designed to be maintained through economic cycles. To support the validation of asset values for its core buy-to-let lending products, the Group maintains an in-house team of Chartered Surveyors with market leading experience and understanding of the sector. The Group also uses stress testing to assess its expected performance under a range of operating conditions. This provides the Board with an informed understanding and appreciation of the Group's capacity to withstand shocks of varying severities. In addition to considering the credit implications of such economic stress, the Board also considers the operational and liquidity implications of such scenarios, which would include the potential to increase liquidity coverage ratios, access contingent liquidity and further strengthen key risk and servicing functions as and when required.

Change	Whilst UK economic performance has again been broadly stable in the last financial year, the near-term outlook has continued to remain uncertain given a lack of clarity as to the basis of the UK's withdrawal from and future relationship with the EU. This continuing uncertainty has led to the overall risk assessment being considered to have increased further in the last year.	↑

BUSINESS RISK

Concentration risk

Description	Mitigation
Lending to customers investing in the UK private rented sector forms a substantial part of the Group's advances and assets. It is therefore exposed to any systemic deterioration in performance of the sector, which will be influenced by underlying factors such as house prices, supply of rental property, and demographic changes. The buy-to-let sector has been subject to a high level of fiscal and regulatory intervention in recent years, where such changes make buy-to-let less attractive to potential customers or affect the viability of existing customers' businesses, the Group is exposed to adverse consequences. Concentration risks may also arise within other business lines, affecting their performance.	The Group has a very deep understanding of the private rented sector built up over many years of successful operations in the buy-to-let market. This includes a long history of performance data through the economic cycle together with regular independently conducted research commissioned over many years. The Group seeks to use this expertise constructively by playing an active role in shaping the development of policy for the private rented sector both directly and through membership of the relevant groups within UK Finance, the Intermediary Mortgage Lenders Association and the National Landlords Association. Given its specialist knowledge of the sector and its historically prudent approach to underwriting, the Group has been well placed to respond promptly and effectively to regulatory changes relating to buy-to-let lending. As a result, it has been able to provide appropriate products to the full spectrum of buy-to-let borrowers. A suite of concentration risk metrics is monitored by the Group's Credit Risk function and reported monthly through the Credit Committee on to the Risk and Compliance Committee. Potential areas of concentration relating not just to loan products but also covering borrower, asset, or large exposure risk for example, are therefore managed within defined limits. 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. This has been illustrated in recent years by the evolution of its asset finance business and the growth, organically and by acquisition, of its property development finance operation.

Change	The Group continues to have significant exposure to buy-to-let lending but, due to its specialist knowledge of the sector, it has been able to respond promptly and positively to regulatory changes in recent years. This has served to refocus the market in some areas more towards larger portfolio landlords with more complex needs. Given its expertise and extensive experience, the Group already has the ability to service this area of the market effectively. The Group's diversification strategy has also positioned it to reduce its reliance on this product line. In the longer term, changes to the UK taxation regime for private landlords and greater regulatory intervention in the sector may reduce demand and availability of buy-to-let lending products. However, the Group continues to be confident in its ability to operate successfully in this evolving environment. It has therefore assessed the overall risk resulting from its reliance on the buy-to-let exposure in the last twelve months as stable.	

Transition risk

Description	Mitigation
The Group has made a number of acquisitions in previous periods. While there have been no acquisitions in the current accounting period, any failure to manage effectively the transition and implementation risks resulting from previous material corporate acquisitions may impact adversely on the Group's financial performance and its reputation.	The Board's M&A strategy is that the Group will only consider acquisitions in areas of business that it understands and which are complementary to its existing activities. Extensive pre-acquisition due diligence is always undertaken with support from respected, high quality advisors. Formal governance arrangements are applied to any proposed acquisition and to subsequent integration projects, with regular progress reporting to the executive team and the Board. Where necessary, enhancements have been made to the risk and control frameworks of acquired businesses to ensure these are aligned to those within the wider group. Similarly, where necessary, experienced additional resource has been recruited to ensure that operational and risk management capabilities are suitably robust.

Change	Ongoing integration activity has been successful and with no new acquisitions undertaken, transition risk has reduced.	

CREDIT RISK

Customer risk

Description	Mitigation
Failure to screen potential borrowers, underwrite new business, and manage repayments effectively could expose the Group to the risk of unexpected material losses. Recoverable amounts on loans may also be affected by adverse movements in security values such as house and commercial asset prices.	The Group has comprehensive policies in place that set out detailed criteria which must be met before loans are approved. 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 Credit Risk function provides regular reports to the Credit Committee and Risk and Compliance Committee on the performance of each of the Group's lending portfolios. These reports also include updated borrower and asset evaluations to ensure that risk profiles are continuously tracked. Originated loan assets are subject to individual underwriting approval with robust control and support provided in most areas by well-established decision tools. Complementing these controls is an established quality assurance framework ensuring that underwriting standards are maintained. Credit policies incorporate limits for concentration risks arising from factors such as large exposures to counterparties, geographical areas or types of lending. Exceptions to these policies require approval by the Credit Risk function, operating under a mandate from the Credit Committee. In terms of supporting collateral, the majority of the Group's loans by value continue to be secured against residential property in England and Wales at conservative loan-to-value levels. Collections and arrears management processes are in place which are consistent with the Group's principle of treating customers in financial difficulty fairly and supportively. These processes benefit from specialist staff. The Group maintains a robust stress testing framework to assess its expected performance under a range of operating conditions, including falls in asset values and increases in interest rates. This framework provides the Board with an informed understanding and appreciation of the Group's capacity to withstand shocks of varying severities.

Change	The Group's arrears rate and cost of risk have remained very low, reflecting the maintenance of robust, proven credit disciplines, generally stable economic conditions and the credit quality of its borrowers. The potential for any credit deterioration due to changing economic conditions, particularly given current uncertainties regarding the UK's future relationship with the EU, is being monitored closely across all Group portfolios. No material change has been seen in actual performance, nor underlying customer profile during the last year.	

Counterparty risk

Description	Mitigation
The Group is exposed to the failure of counterparties with which it places deposits, or which provide hedging agreements to mitigate interest rate and foreign exchange risk.	The Group has a strictly controlled number of approved treasury counterparties. To be approved, counterparties must meet specific credit rating criteria. Exposure to approved counterparties is monitored intra-day by senior management within the Group's Treasury function with all trading performed within approved limits. The credit quality of all treasury counterparties and the Group's exposure to them is reported monthly to ALCO. Treasury counterparties are typically highly rated banks and, for all cash deposits and derivative positions held within the Group's securitisation structures, they must comply with criteria set out in the financing arrangements, which are monitored externally. Where a counterparty to the Group's cross-currency basis swaps, which form its principal derivative exposures, fails to meet the required credit criteria they are obliged under the terms of the instruments to set aside a cash collateral deposit. Interest rate and foreign exchange derivatives are held solely for hedging purposes.

Change	The credit quality of the treasury counterparties with whom the Group transacts has been maintained during the year and this risk is therefore considered to have remained stable.	

CONDUCT RISK

Customer fair outcomes

Description

The Group provides a broad range of financial services products across a number of brands to consumers and small business customers.

As a result, the Group is exposed to potential conduct risk should it fail to deliver fair outcomes for its customers.

This could arise, for example, if certain products fail to meet the needs of customers or customer complaints are handled ineffectively.

Systemic poor customer treatment may lead to regulatory censure, reputational damage and resulting reductions in the Group's profitability.

Mitigation

The Group has a formal Conduct Risk Management framework, which includes a number of 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 as part of a framework within which business areas are required to develop systems and processes to identify, measure, manage, monitor and report risks in accordance with stated risk appetites.

Underpinning this policy are additional policies and standards that include but are not limited to:

- Complaint handling
- Responsible lending
- Sales and distribution practices
- Forbearance
- Vulnerable customer treatment

The management of conduct risk within the Group is tailored to the specific product and customer type concerned. Business areas dealing with consumers have dedicated quality and control teams which validate process adherence and the delivery of fair treatment for customers. In certain areas, this will include a dedicated customer support team to manage customers deemed to be vulnerable.

Additional controls and strategies can also include the following:

- Recording inbound and outbound calls and reviewing a sample of calls and correspondence each month
- Reviewing forbearance agreements in order to ensure these are not extended to the detriment of the customer's circumstances
- Utilising system controls to restrict those employees that can action the accounts of customers identified as vulnerable
- Monitoring the volume of customers disclosing sensitive information and the nature of their vulnerability
- Monitoring accounts where customers have been requested to provide evidence to support their health issues to ensure such requests are appropriate
- Actively encouraging customers in financial difficulty to obtain appropriate free independent advice from reputable, approved organisations.

All employees are required to undertake conduct risk related training and, where appropriate, staff receive additional focused training on a variety of customer centric topics which is subject to performance testing.

The Group utilises a centralised complaint handling function for consumer and home finance loans to ensure complaints relating to these key areas are dealt with in a consistent and efficient manner.

The CCC has a remit which extends to overseeing the fair treatment of customers. This Committee receives reports each month from business areas relating to customer treatment and complaint handling.

The Compliance function has a formal monitoring plan which is focused on conduct risk and the fair treatment of customers, particularly those that are defined as vulnerable, or in financial difficulty. The plan is reviewed and approved on at least an annual basis by the RCC.

Management actions to address any adverse compliance monitoring or Internal Audit reports are overseen at the CCC, ORC and RCC.

The Group's approach to employee remuneration means that very few staff are included in financial incentive schemes. However, notwithstanding this, the Group recognises the potential for incentivisation to promote, unintentionally, inappropriate behaviours and therefore it maintains a robust policy and formal procedures relating to the design, approval and monitoring of any remuneration schemes. All schemes are required to be approved by the CCC before implementation and then reviewed by the CCC at least annually.

Change

The Group operates in areas which are highly regulated and where continuing changes to the regulatory conduct landscape heighten the potential risk of financial losses or censure. In response to this, the Group has continued to develop and embed its conduct risk management framework during the year.

<table>
<tr><th colspan="3">OPERATIONAL RISK</th></tr>
<tr><th colspan="3">People risk</th></tr>
<tr><th>Description</th><th colspan="2">Mitigation</th></tr>
<tr><td>The Group is exposed to the risk that it is unable to recruit and retain skilled senior management and key personnel at all levels.

Failure to maintain the necessary skill base within its workforce could have a material impact on the Group's ability to deliver its business plan and strategic objectives.

This is a particular risk in respect of key specialist and executive positions, where the institutional knowledge of the incumbents would be very difficult to replicate in the short term.</td><td colspan="2">The Group manages and controls its key person dependency risk through effective succession planning, recruitment, development and retention strategies.
These include:
Undertaking formal succession planning reviews covering all key roles
Monitoring external remuneration and reward structures to ensure it remains competitive and is able to recruit and retain key personnel
Offering a range of employee benefits in addition to base salaries including a defined contribution pension scheme, Sharesave Plan and an annual profit related performance scheme for most employees
Maintaining an effective performance appraisal system to identify and provide appropriate training and development opportunities for employees
Providing regular internal training for all employees and financial support to employees undertaking relevant external professional qualifications
Creating a Senior Leadership Development Programme and Manager and Team Leader Academies to develop pools of strong, capable individuals with the potential to fill future managerial and specialist roles within the business
The Group has been accredited under the 'Investors in People' scheme since 1997 and has held Champion status in the scheme since May 2014. This accreditation is awarded to a very small proportion of organisations who are seen as pioneers in people management practices and role models in strategic leadership.</td></tr>
<tr><td>Change</td><td>A strong employment market and particularly buoyant demand for skilled financial services staff has again been a feature of the last financial year. This has led to continued strong competition to recruit and retain employees. Despite the increasingly competitive external environment, the Group remains confident in its ability to manage this risk as evidenced by the results of its latest employee survey which indicated an 85% engagement level amongst its staff. This is well above the average for the financial services sector.

The development of formal succession planning for senior roles has also helped to mitigate the Group's key person exposure in respect of certain executive personnel.</td><td></td></tr>
</table>

OPERATIONAL RISK

Systems risk

Description

The Group is exposed to the risk that its IT infrastructure and systems are unable to support its operational needs.

This includes the risk that the Group's processes fail to offer adequate protection against the threat of cyber-crime.

Failure in Group IT systems, either in terms of capacity or security, however caused, could result in detriment to customers, regulatory censure and reputational damage, while failure to match market levels of functionality could have an adverse impact on business volumes. All of these factors could materially impact income and profitability.

This risk also includes the potential that the Group's key outsourcing arrangements with third parties could expose it to material loss or reputational damage.

Mitigation

The Group has a formally agreed IT strategy which ensures that priority is given to those areas which are most critical to the delivery of the Group's strategy and business plan. These include the provision of management information to enable business heads to exercise effective control of key operational risks. The Group also employs a robust vendor management process to select and monitor third party IT suppliers.

Over the last twelve months the Group has continued to invest in new technology and services to maintain and increase its defence in depth strategy to protect its operational capability. The implementation of a new Security Operations Centre service has added third party expertise to support the existing Group's specialist resource.

A formal Cyber Incident Response Plan is in place to ensure the Group is well placed to deal with any issues or events. This is regularly reviewed and approved by the RCC. A programme of awareness and education is in place to reinforce the need for vigilance by all employees.

There is ongoing focus on the information security management system to ensure that controls, testing and user awareness are maintained and improved. The Group continues to be certified to ISO 27001 (Information Security Management).

Change programmes are closely managed with robust control and testing processes to ensure that system developments meet operational requirements and are effectively implemented.

To ensure it can deal effectively with unexpected operational disruptions, the Group has a well-established Business Continuity Plan ('BCP'), which is updated and tested regularly. The Group is currently certified to ISO 22301 (Business Continuity).

The Group has skilled resource in the Risk and Internal Audit areas to ensure its second and third line review processes have the capability to properly address these issues.

Before the Group outsources any key activities to a third party, it undertakes robust due diligence on them and ongoing performance and customer outcome monitoring thereafter. The Group only outsources activities under formal contractual arrangements which clearly set out the rights and obligations of both parties.

Change

The Group has continued to invest significantly in order to further enhance its operational resilience. However, the Group recognises that while it continues to develop, and maintain a secure IT infrastructure, the increased sophistication of cyber-crime attacks continues to be a significant risk for the business in common with the rest of the financial services sector.

Regulatory risk

Description

The Group is exposed to the risk that its financial performance and reputation could suffer significantly if it fails to identify, interpret and comply with relevant regulatory and legal obligations.

The customers and market sectors to which the Group supplies products, and the capital markets from which it obtains some of its funding, have been subject to increasing legislative and regulatory intervention over recent years.

The overwhelming majority of the Group's own business activities are now subject to direct and increasing levels of regulation.

Mitigation

The Group has Risk and Compliance and Legal teams who review key regulatory and legal developments to assess the impact on the Group's operations. These teams then work with business areas to provide advice on the implementation of appropriate measures to meet identified requirements. Expert external advice is also sought where necessary. Major regulatory or legal change initiatives are subject to formal change governance with progress reporting to the RCC.

All employees are required to undertake regulatory training and testing to ensure appropriate levels of competence are maintained. Those in relevant specialist roles are also required to adhere to formal regulatory training and competence regimes.

The Compliance function has developed a formal monitoring plan which is reviewed by the CCC and the RCC to ensure that regulatory requirements have been satisfactorily embedded, and any lessons learned are applied across all relevant areas of the Group.

Similarly, the Financial Crime function provides independent oversight of business areas' adherence to anti-money laundering and financial crime requirements.

During 2018-19 key regulatory initiatives have included the focus on operational resilience and the impact of climate change. Work has commenced in both these areas and will develop during 2019-20 as further clarity is received around regulatory expectations.

The formal project put in place to address developments required ahead of the General Data Protection Regulation is drawing to a conclusion and a full transition to business as usual will occur by the end of the 2019 calendar year. The project has successfully addressed the key requirements of the regulation.

Change

Whilst the Group considers that it continues to have robust arrangements in place, the increasing scope and complexity of regulatory regimes heightens the potential risk arising from any failure to comply with current regulations or to respond effectively to new and emerging ones.

LIQUIDITY AND CAPITAL RISK

Funding risk

Description	Mitigation
The Group is exposed to the risk that increases in the cost or reductions in the availability of funding could adversely impact its business model and strategic objectives. The Group relies on its access to various sources of funding to finance the origination of new business, portfolio acquisitions and working capital. If access to funding became restricted, either through market movements or regulatory intervention, this might result in the scaling back or cessation of some business lines. 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. In addition, there is a risk that the Group has insufficient funds to meet its obligations as they fall due.	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. The Group remains well funded with sufficient liquidity to meet all its financial obligations as they fall due. 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, through Paragon Bank, is authorised to accept retail deposits. As such, it is subject to regulation by the PRA, which aims to ensure that sufficient liquid assets are held, at all times, to mitigate the liquidity risk inherent in deposit taking. A significant proportion of Paragon Bank deposits (97.9%) are protected under the Financial Services Compensation Scheme ('FSCS') which provides protection to customers and mitigates the risk of material retail outflows in stress scenarios. The Group has an experienced structured finance function who maintain relationships with major participants in the capital markets and who have been instrumental in many securitisation and debt issues. This gives it access to capital markets when required. 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 completion in July 2019 of Paragon Mortgages (No. 26) plc, which was the Group's first SONIA-linked securitisation, supplemented retail deposit flows during the course of the year. The Group also has a committed secured warehouse facility which has been used to more efficiently manage liquidity. Going forward, the Group intends to use securitisation selectively to mitigate its exposure to liquidity risk, ensuring, as far as possible, that the maturities of assets and liabilities are matched. The Company has a BBB investment grade credit rating from Fitch to support maintenance of its access to funding markets.

Change	The Group remains well funded with sufficient liquidity to meet all its financial obligations as they fall due. It is well placed to access funding from a wide range of sources to meet its future funding requirements. During the year, the Group demonstrated its ability to access the securitisation market for additional funding on an ongoing basis, and its Fitch rating was confirmed. Although there has been strong competition for retail deposits, the overall risk is considered to have remained stable.	

Capital risk

Description	Mitigation
The changes made in the Basel III capital regime by the BCBS regarding minimum capital requirements from 2021 could impact on the Group. The BCBS changes include increases in risk weights for residential real estate exposures where repayment is materially dependant on cash flows generated by the property, which may include certain categories of buy-to-let lending. The Group's capital requirements would, therefore, be increased to some extent.	In order to further enhance its existing robust credit management capabilities and to mitigate the risks of the proposed BCBS changes, the Group took a strategic decision in 2016 to seek the necessary regulatory approval to implement an IRB ('Internal Ratings Based') approach for credit risk. In support of this, the Group appointed an experienced director of IRB to lead this initiative. A formal IRB project has since been initiated with support from respected external specialist advisors to enable the Group to commence its application process with the relevant regulatory authorities during the first half of the new financial year. The Group's IRB plan is well progressed, however a consultation paper produced in September 2019 highlighted a need for aspirant firms to comply with certain future regulations and requirements where the authorisation process extends beyond 2020. Whilst only a consultation at this stage, the Board has decided to ensure its IRB models are fully compliant with this requirement before making its first submissions to the PRA. The timing of the application will reflect the requirements of the Policy Statement that will result from the consultation process.

Change	During the year, the UK and European authorities developed their approach to the implementation of the Basel III changes. The impacts of their decisions were considered, and the proposed changes have been incorporated within the Group's IRB project. These developments did not change the Group's assessment of the likely impact of these changes. Further information on the Group's management of capital risk is given in note 55 to the Group Accounts.	

MARKET RISK

Interest rate risk

Description	Mitigation
The Group is exposed to the risk that changes in interest rates may adversely affect its net income and profitability. In particular, the Group's profitability is determined by the difference between the interest rates at which it lends and those at which it borrows. Changes in market interest rates could therefore materially impact the Group's profits as a result of significant mismatches between its assets and liabilities.	This risk is managed through Board approved risk appetite limits with comprehensive treasury polices in place to ensure that the risk posed by changes and mismatches in interest rates are effectively managed. The Board's risk management framework for Interest Rate Risk in the Banking Book ('IRRBB') has evolved in line with updates in regulatory guidance on methods expected to be used by banks for controlling such risks. Day-to-day management of interest rate risk within Board approved limits is the responsibility of Treasury with control and oversight provided by ALCO which reports to the RCC. ALCO also monitors the interest rate risk exposure within the Group's securitisations on a monthly basis. This ensures compliance with the requirements of the trustees in respect of the Group's securitisations and the terms of other borrowings, as well as adherence to internal policies. The Group seeks to match the maturity profile of assets and liabilities and uses appropriate financial instruments, such as interest rate swaps or cap agreements to hedge the exposure arising from repricing gaps.

Change	The Group's interest risk exposure profile, relative to its balance sheet has remained broadly similar and therefore associated risk levels remain generally stable compared to previous periods. The approach to managing the risks has, however, been enhanced to reflect the European Banking Authority's guidelines. Further information regarding the Group's management of interest rate risk is given in note 59 to the Group Accounts.	

PENSION OBLIGATION RISK

Pension obligation risk

Description	Mitigation
The Group operates a defined benefit pension scheme and defined contribution pension schemes in the UK. There is a risk that the Group's commitments under its defined benefit scheme expose it to the risk that the assets of the scheme may be insufficient to meet its liabilities, either due to adverse investment performance or inaccurate assumptions, including future inflation levels, members' salaries or mortality rates.	The Group's defined benefit scheme ('the Plan') was closed to new members with effect from February 2002. Since that time, new employees have been invited to join the Group's defined contribution pension scheme which carries no investment or mortality risk for the Group. To mitigate the risks inherent in its exposure to the Plan, the Group conducts regular asset-liability reviews in conjunction with the Trustee. These reviews are used to assist the Trustee and the Group to determine the optimal long-term asset allocation with regard to the structure of liabilities within the Plan. The results of the reviews also assist the Trustee in managing the volatility in the underlying investment performance and the risk of a significant increase in the scheme deficit by providing information used in investment strategy decisions. The Plan is subject to triennial formal valuation by the Plan actuary. The valuation process as at 31 March 2019 is currently in progress, and will include the agreement of a recovery plan between the Trustee and the Group which will aim to clear the deficit in the Plan. This will be agreed during the year ending 30 September 2020.

Change	Despite short-term fluctuations caused by market instability in interest rates and asset prices, the Group considers the underlying long-term funding position for the Plan to be robust and sustainable. Further details of the Group's exposure to the Plan are given in note 41 to the Group Accounts.	

RISK APPETITE STATEMENTS

Introduction

The Group is committed to maintaining an effective Risk Management Framework that is responsive to both internal and external events and stresses. As part of this framework, the Board has set statements of risk appetite, consistent with its desire to be a prudent, risk focussed, specialist lender which places the delivery of fair outcomes for its customers at the heart of its activities. These statements are reviewed and updated at least annually.

Risk appetite is defined as the amount and type of risk which the Group is prepared to seek, accept or tolerate in pursuit of its long-term business objectives. By setting defined risk appetites, the Board communicates the level of acceptable risk and mandates that the risk is proactively managed within those parameters.

Risk appetite principles

In determining its approach to the setting of risk appetite, the Board has agreed a number of core principles.

In summary these are that risk appetite must:

- Be defined and owned by the Board with periodic reviews to ensure the risk appetites remain up to date, relevant and appropriate
- Include quantitative and qualitative measures which are at a sufficiently granular level to be meaningful to the Board and to the business, but not be too numerous or broad to obscure key elements that may require attention
- Be robust and subjected to stress testing and scenario analysis, considering recent economic, political and regulatory developments
- Be reviewed at the ALCO, ORC, CCC and Credit Committee against performance measures with any immediate findings escalated to the Board

Qualitative risk appetite measures

In defining its risk appetite, the Board has established a number of core high level qualitative requirements that are intended to describe the overall risk landscape within which it wishes the Group to operate. These include:

- The Group's strategic objective is to be a prudent, risk focussed, specialist lender operating predominantly in the UK with a closely controlled, cost efficient operating model which places the delivery of fair customer outcomes at its core
- The Board expects executive management to develop and maintain a culture in relation to the management of risk that is consistent with its stated risk appetite
- The Board regards the Group's strong specialist underwriting capabilities as a competitive advantage but it has no appetite for the origination of unaffordable loans to borrowers
- The Board expects the overwhelming majority of originated loans to be secured on assets located within the UK
- The Board requires all treasury investment counterparties to be reputable, high quality institutions as defined by the minimum external rating criteria documented within the Group's treasury policies
- The Board requires the Group to maintain access to a range of alternative funding markets in order to ensure the sustainability of its business model
- The Board has no appetite for any risk arising from a material failure to deliver fair outcomes for customers. The fair treatment of customers is viewed as central to the achievement of the Group's strategic business objectives
- The Board has no appetite for material breaches to information security
- The Board has no appetite for material breaches to regulatory compliance or for accepting business than contravenes regulation or legislation
- The Board has limited appetite for any uncovered exposure to interest rate or foreign currency movement which could materially impact earnings
- The Board wishes to maintain capital, in terms of both quantity and quality, at a level sufficient to cover all known current and anticipated future risks and to cover a range of severe but plausible stressed scenarios
- The Board wishes to utilise capital to generate a strong, stable return for shareholders. As a banking group, its ongoing viability is dependent upon the level of confidence in its future held by its customers, shareholders, regulators and employees
- The Board therefore has no appetite for exposing itself to levels of risk that could lead to losses which would erode the Group's existing capital base

Quantitative risk appetite measures

In setting its key quantitative risk appetite statements, the Board has sought to ensure that:

- The Group's strategic objectives are aligned to its risk appetite
- Quantitative measures are consistent with the Group's overarching qualitative risk appetite statements
- The principal risks to which the Group is exposed are appropriately covered by risk appetite measures

The Board's key quantitative risk appetite statements have been structured in line with the Group's standard risk categorisation. In each case, the key quantitative risk appetite statements indicate the following:

- The respective risk category within which the measure sits
- The specific limits, triggers and targets
- An identified executive management owner for each measure

The key measures used to define the Group's most material quantitative risk appetite statements are set out below:

<table>
<tr><th colspan="8">CAPITAL RISK</th></tr>
<tr><td>Key capital ratios</td><td colspan="7">CET1 / Total Capital ratios
The key capital ratios above form the basis of all strategic decisions. The risks identified below are considered in conjunction with the capital ratios in order to determine other business decisions</td></tr>
<tr><th colspan="8">OTHER RISKS</th></tr>
<tr><th></th><th>Credit</th><th>Business</th><th>Pension</th><th>Market</th><th>Liquidity</th><th>Operational</th><th>Conduct</th></tr>
<tr><td rowspan="9">Key quantitative measures</td><td>Buy-to-let credit profile</td><td>RoTE target</td><td>Pension Plan Exposure</td><td>Interest rate risk management</td><td>LCR</td><td>Material operational risk events</td><td>Complaint levels</td></tr>
<tr><td>Buy-to-let affordability</td><td></td><td></td><td></td><td>NSFR</td><td>Issue management</td><td>Complaint resolution</td></tr>
<tr><td>Buy-to-let Credit LTV</td><td></td><td></td><td></td><td>Encumbrance</td><td>IT resilience</td><td>Quality assurance testing</td></tr>
<tr><td>Idem portfolio performance</td><td></td><td></td><td></td><td>Wholesale deposit ratio</td><td>Cyber security</td><td></td></tr>
<tr><td>Asset finance arrears / losses</td><td></td><td></td><td></td><td>Parent company liquidity</td><td>Resource capacity</td><td></td></tr>
<tr><td>Asset Finance-counterparty quality</td><td></td><td></td><td></td><td>OLAR</td><td></td><td></td></tr>
<tr><td>Development Finance Credit Collateral quality</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Development Finance defaults</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Development Finance – loan quality</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td rowspan="4">Key qualitative measures</td><td>Prudent lending standards</td><td>Specialist markets</td><td>Support for plan while protecting capital</td><td>Limited exposure to interest rate movements</td><td>Availability of funding</td><td>Controlled costs</td><td>Fair outcomes</td></tr>
<tr><td>Strong specialist underwriting</td><td>Income diversification</td><td></td><td>Very limited exposure to foreign exchange risk</td><td></td><td>Risk culture</td><td>No compliance breaches</td></tr>
<tr><td>UK focus</td><td>Acquisition integration</td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>High quality institutional obligors</td><td>New business development</td><td></td><td></td><td></td><td></td><td></td></tr>
</table>

BOARD ASSESSMENT OF RISK MANAGEMENT ARRANGEMENTS

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

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

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

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

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

At the year end the directors reviewed their on-going risk management activities and the most recent risk information available, including the risk register and risk metrics, 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 earlier in this section.

4. Capital resources

This section sets out

- An overview of the Group's capital position
- A description of the nature and composition of the Group's regulatory capital
- Analysis of the adequacy of capital compared to regulatory requirements
- The calculation of the Group's leverage ratio
- The regulatory capital buffers applying to the Group

The Group is subject to supervision by the PRA on a consolidated basis, as a group containing an authorised bank. As part of this supervision the regulator will issue an individual capital requirement setting an amount of regulatory capital, which the Group is required to hold relative to its total risk exposure in order to safeguard depositors from loss in the event of severe losses being incurred by the Group. This is defined by the international Basel III rules, set by the Basel Committee on Banking Supervision ('BCBS') and currently implemented in UK law by EU Regulation 575/2013, referred to as the Capital Requirements Regulation ('CRR'). Separate requirements apply to the Group, on a consolidated basis, and to the Bank.

The Group's regulatory capital is monitored by the Board, its Risk and Compliance Committee and the Asset and Liability Committee, who ensure that appropriate action is taken to ensure compliance with the regulator's requirements. The future regulatory capital requirement is also considered as part of the Group's forecasting and strategic planning process.

Both the Group's and the Bank's capital risk appetites are linked to their wider risk appetite statements and ultimately their strategy.

The Group's overriding objective in managing its capital is to generate a strong return for shareholders while operating within the risk appetite set by the Board which requires it to:

- Maintain capital quantity and quality to cover current and future risks within the Group
- Maintain sufficient capital to be able to survive a range of severe but plausible stressed scenarios
- Utilise capital in order to generate a strong return for shareholders

The Group's approach to defining capital risk appetite takes into account its prudent approach to operations and strong control environment. The risk appetite is described in both quantitative and qualitative terms:

- Quantitatively, by describing the overall risk limits numerically. These limits cover the quantity and quality of capital to be held
- Qualitatively, by outlining core principles in managing or mitigating risk and ensuring that the Group and the Bank have the necessary capabilities to prudently manage capital risks, and provide management with sufficient information to effectively oversee operations and risk levels

It should be noted that the regulatory capital disclosures in this section relate only to the consolidated position for the Group. Individual entities or groups of 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.

IFRS 9 TRANSITION

The introduction of IFRS 9 on 1 October 2018 impacted the Group's regulatory capital position. The principal impacts were:

- The reduction in reserves caused by increased provisions, net of associated future tax relief, reduces shareholders equity and hence regulatory capital
- The reduction in loans to customers generates a consequential reduction in risk weighted assets ('RWA'), the amount of which will vary by asset type
- Collectively assessed emergence provisions under IAS 39 qualified as tier 2 capital, with £4.9m being included in capital at 30 September 2018 in respect of such provisions. No such provisions are made under IFRS 9, therefore total capital is reduced

The Group has elected to take advantage of the transitional arrangements set out in Article 473a of the CRR, which allow the capital impact of expected credit losses to be phased in over a five-year-period. The phase-in factors will allow for a 95% add back to CET1 capital and risk weighted assets in the financial year ended 30 September 2019, reducing to 85%, 70%, 50% and 25% for the financial years ending in 2020 to 2023, with full recognition of the impact on CET1 capital in the 2024 financial year. Where such relief is taken, firms are also required to disclose their capital positions calculated as if the relief were not available (the 'fully loaded' basis).

The capital position at 1 October 2018, immediately after transition, is set out in the notes to the Group accounts, marked '2018 IFRS 9'.

CAPITAL RESOURCES

The Group's tier 1 capital arises from the equity represented by its ordinary shares, which are listed on the London Stock Exchange. These shares all rank pari passu and carry no special features.

The tier 2 capital instruments are fixed term corporate bonds, listed on the London Stock Exchange. They were issued in 2016 and mature in 2026. Further details of these bonds are given in note 35 to the Group Accounts.

The detailed information on these instruments required by Article 437 of Part 8 as applied by EU Commission Implementing Regulation 1423/2013, is set out in Appendix A.

The tables below demonstrate that at 30 September 2019 the Group's regulatory capital of £1,072.0m (2018: £1,044.8m) was comfortably in excess of the amounts required by the regulator, including £742.9m in respect of Pillar 1 and Pillar 2a capital, which is comprised of fixed and variable elements. The CRR also requires firms to hold additional capital buffers, the CRD IV buffers, described further below. Throughout the period from authorisation to that date, the Group's regulatory capital also complied with these requirements.

The total regulatory capital at 30 September 2019 on the fully loaded basis (excluding the impact of IFRS 9 relief) of £1,050.8m was in excess of the Pillar 1 and 2a requirement of £741.8m on the same basis.

The Group's regulatory capital differs from its equity as certain adjustments are required by the regulator. A reconciliation of the Group's equity to its regulatory capital determined in accordance with CRD IV at 30 September 2019 is set out below.

		30 September 2019	1 October 2018	30 September 2018
		IFRS 9	IFRS 9	IAS 39
		£m	£m	£m
Total equity		**1,108.4**	1,073.5	1,095.9
Deductions				
Proposed final dividend		**(35.8)**	(35.8)	(35.8)
IFRS 9 transitional relief	*	**21.2**	21.2	-
Intangible assets		**(171.1)**	(169.3)	(169.3)
Prudent valuation adjustments	◊	**(0.7)**	(0.9)	(0.9)
Common Equity Tier 1 ('CET1') capital		**922.0**	888.7	889.9
Other Tier 1 capital		**-**	-	-
Total Tier 1 capital		**922.0**	888.7	889.9
Corporate bond		**150.0**	150.0	150.0
Less: amortisation adjustment	†	**-**	-	-
		150.0	150.0	150.0
Collectively assessed credit impairment allowances	‡	**-**	-	4.9
Total Tier 2 capital		**150.0**	150.0	154.9
Total regulatory capital		**1,072.0**	1,038.7	1,044.8

* Firms are permitted to phase in the impact of IFRS 9 transition over a five-year period.

◊ For capital purposes, assets and liabilities held at fair value, such as the Group's derivatives, are required to be valued on a more conservative basis than the market value basis set out in IFRS 13. This difference is represented by the prudent valuation adjustment above, calculated using the 'Simplified Approach' set out in the CRR.

This was first included in the Group's regulatory capital position in the year and has been included in comparative amounts for consistency.

† When tier 2 capital instruments have less than five years to maturity the amount eligible as regulatory capital reduces by 20% per annum. No such adjustment is required in respect of the Corporate Bond issued in the year ended 30 September 2016, which matures in 2026.

‡ Under IFRS 9 there are no collectively assessed credit impairment allowances which are eligible as tier 2 capital.

On a fully loaded basis the capital position was.

	30 September 2019	1 October 2018	30 September 2018
	IFRS 9	IFRS 9	IAS 39
	£m	£m	£m
CET1 Capital	**922.0**	888.7	889.9
Add back: IFRS 9 relief	**(21.2)**	(21.2)	-
Fully loaded CET1 Capital	**900.8**	867.5	889.9
Total Regulatory Capital	**1,072.0**	1,038.7	1,044.8
Add back: IFRS 9 relief	**(21.2)**	(21.2)	-
Fully loaded Total Regulatory Capital	**1,050.8**	1,017.5	1,044.8

The movements in the Group's capital resources in the year can be analysed as follows:

		2019			2018	
		IFRS 9			IAS 39	
	CET 1	**Tier 2**	**Total**	CET 1	Tier 2	Total
	£m	**£m**	**£m**	£m	£m	£m
Capital at 1 October 2018						
As originally reported	**890.8**	**154.9**	**1,045.7**	876.1	154.4	1,030.5
New accounting standards*	**(22.4)**	**(4.9)**	**(27.3)**	-	-	-
IFRS 9 transitional relief	**21.2**	**-**	**21.2**	-	-	-
Prudent valuation adjustments	**(0.9)**	**-**	**(0.9)**	-	-	-
As restated	**888.7**	**150.0**	**1,038.7**	876.1	154.4	1,030.5
Trading transactions						
Profit after tax	**127.4**	**-**	**127.4**	145.8	-	145.8
Other comprehensive income†	**(14.4)**	**-**	**(14.4)**	8.0	-	8.0
Charge for share based payment	**5.9**	**-**	**5.9**	6.1	-	6.1
Tax on share based payment	**0.4**	**-**	**0.4**	1.1	-	1.1
Movement in collectively assessed impairment allowances	**-**	**-**	**-**	-	0.5	0.5
Intangible assets arising on acquisition	**(2.2)**	**-**	**(2.2)**	(65.5)	-	(65.5)
Purchase of intangible assets	**(2.0)**	**-**	**(2.0)**	(1.5)	-	(1.5)
Amortisation of intangible assets	**2.4**	**-**	**2.4**	2.1	-	2.1
Capital transactions						
Proposed dividend at year end	**(35.8)**	**-**	**(35.8)**	(35.8)	-	(35.8)
Interim dividend paid in year	**(18.2)**	**-**	**(18.2)**	(14.2)	-	(14.2)
Share buy-backs	**(26.7)**	**-**	**(26.7)**	(25.2)	-	(25.2)
Shares issued	**4.1**	**-**	**4.1**	0.4	-	0.4
Shares purchased by ESOP	**(7.6)**	**-**	**(7.6)**	(6.2)	-	(6.2)
Share awards exercised	**(0.2)**	**-**	**(0.2)**	(0.4)	-	(0.4)
Movement in prudent valuation adjustment	**0.2**	**-**	**0.2**	-	-	-
Capital at 30 September 2019	**922.0**	**150.0**	**1,072.0**	890.8	154.9	1,045.7

* Impact of the introduction of IFRS 9 and IFRS 15, net of tax. A full discussion of this restatement is given in note 62 to the Group Accounts.

† The amount shown above for other comprehensive income principally represents actuarial (losses) / gains on the Group's defined benefit pension plan.

TOTAL RISK EXPOSURE

The total risk exposure 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. The minimum capital requirement in respect of each class, based on 8% of risk exposure, is also set out below.

	Risk exposure			Capital requirement		
	2019	2018	2018	**2019**	2018	2018
	IFRS 9	IFRS 9	IAS 39	**IFRS 9**	IFRS 9	IAS 39
	£m	£m	£m	**£m**	£m	£m
Credit risk						
Balance sheet assets	**5,997.2**	5,756.3	5,767.3	**479.8**	460.5	461.4
Off balance sheet	**85.5**	87.8	87.8	**6.8**	7.0	7.0
IFRS 9 transitional relief	**10.5**	10.5	-	**0.9**	0.9	-
Total credit risk	**6,093.2**	5,854.6	5,855.1	**487.5**	468.4	468.4
Operational risk	**516.6**	485.1	485.1	**41.3**	38.8	38.8
Market risk	**-**	-	-	**-**	-	-
Other	**114.0**	105.1	105.1	**9.1**	8.4	8.4
Total risk exposure	**6,723.8**	6,444.8	6,445.3	**537.9**	515.6	515.6

Solvency ratios	**%**	%	%
CET1	**13.7**	13.8	13.8
Total regulatory capital	**15.9**	16.2	16.2

Source: Group Accounts

The total risk exposure, minimum capital requirements and solvency ratios calculated on a fully loaded basis are set out below

	Risk exposure			Capital requirement		
	2019	2018	2018	**2019**	2018	2018
	IFRS 9	IFRS 9	IAS 39	**IFRS 9**	IFRS 9	IAS 39
	£m	£m	£m	**£m**	£m	£m
Total risk exposure	**6,723.8**	6,444.8	6,445.3	**537.9**	515.6	515.6
IFRS 9 transitional relief	**(10.5)**	(10.5)	-	**(0.9)**	(0.9)	-
Fully loaded total risk exposure	**6,713.3**	6,434.3	6,445.3	**537.0**	514.7	515.6

Fully loaded solvency ratios	**%**	%	%
CET1	**13.4**	13.5	13.8
Total regulatory capital	**15.7**	15.8	16.2

The Group calculates CRD IV risk weightings for credit risk exposures using the Standardised Approach, while the Basic Indicator Approach for operational risk is used.

The table below shows the causes of movements in risk weighted assets ('RWA'), before IFRS 9 relief, in the year at the Group level, analysed by those movements caused by changes in the average risk weightings applied to portfolios ('Portfolio Quality') and changes in the unweighted value of the portfolios ('Portfolio Size').

	2018 RWA	Change of basis*	Portfolio Quality	Portfolio Size	**2019 RWA**
	£m	£m	£m	£m	**£m**
First mortgages	3,713.2	37.9	0.3	(80.7)	**3,670.7**
Second charge mortgages	223.9	0.9	(12.7)	(23.2)	**188.9**
Development finance	529.2	(0.7)	-	262.6	**791.1**
Exposures secured on real estate	4,466.3	38.1	(12.4)	158.7	**4,650.7**
Retail exposures	436.2	(1.2)	(27.1)	76.3	**484.2**
Asset finance exposures	358.9	(1.5)	-	40.6	**398.0**
Exposure on loans to customers	5,261.4	35.4	(39.5)	275.6	**5,532.9**
Institutions	518.7	-	-	(114.4)	**404.3**
Other assets	75.0	-	-	70.5	**145.5**
	5,855.1	35.4	(39.5)	231.7	**6,082.7**

* Change of basis represents the effect on RWA of the transition to IFRS 9 and the change in the regulatory definition of default for SA purposes which increased risk weightings for some assets, particularly buy-to-let mortgages in receiver of rent.

Credit RWAs before IFRS 9 relief have increased by approximately 3.8% since 30 September 2018. The principal cause of this increase has been asset growth from increased levels of advances across the Group's business lines. However, the impact on RWA from asset growth was offset by the impact of IFRS 9 and the other changes described above, and mitigated by an improvement in book quality due to increased house prices, impacting exposure on mortgage assets, and better performance.

Changes in operational risk requirements reflect income growth within the regulatory prescribed income streams, as the Group calculates risk exposure from operating risk using the Basic Indicator Approach.

LEVERAGE RATIOS

Risk of excessive leverage is the risk that arises through maintaining an inappropriate leverage ratio or mismatches between assets and obligations. This risk is not considered significant for the reasons considered below.

The current structure of the balance sheet returns a high leverage ratio. The Group's leverage ratio has remained well in excess of the minimum 3% set out in the CRR since the Bank's authorisation. This positive position will be maintained during the period covered by the business planning process, which will take account of stress testing impacts on the ratio.

The Group monitors its leverage exposure on the basis set out by the PRA ('UK basis'). Firms are required to report in their Pillar III disclosures on the basis prescribed by the EBA, which differs in the treatment of central bank balances. Accordingly, both measures are presented in this document.

The table below shows the calculation of the leverage ratios at the year end, based on the consolidated balance sheet assets, adjusted for amounts already provided in the Group Accounts and the post-offer pipelines of loan assets at 30 September 2019.

	UK Basis			EBA Basis		
	2019	2018	2018	**2019**	2018	2018
	IFRS 9	IFRS 9	IAS 39	**IFRS 9**	IFRS 9	IAS 39
	£m	£m	£m	**£m**	£m	£m
Total balance sheet assets	**14,395.5**	14,487.9	14,515.1	**14,395.5**	14,487.9	14,515.1
Add: Credit fair value adjustments on loans to customers	**-**	24.1	24.1	**-**	24.1	24.1
Add: Debit fair value adjustments on retail deposits	**-**	4.2	4.2	**-**	4.2	4.2
Adjusted balance sheet assets	**14,395.5**	14,516.2	14,543.4	**14,395.5**	14,516.2	14,543.4
Less: Derivative assets	**(592.4)**	(855.7)	(855.7)	**(592.4)**	(855.7)	(855.7)
Less: Central bank deposits	**(816.4)**	(895.9)	(895.9)	**-**	-	-
Less: CRDs	**(11.4)**	(6.2)	(6.2)	**-**	-	-
Less: Accrued interest on sovereign exposures	**(0.2)**	(0.4)	(0.4)	**-**	-	-
On balance sheet items	**12,975.1**	12,758.0	12,785.2	**13,803.1**	13,660.5	13,687.7
Less: Intangible assets	**(171.1)**	(169.3)	(169.3)	**(171.1)**	(169.3)	(169.3)
Total on balance sheet exposures	**12,804.0**	12,588.7	12,615.9	**13,632.0**	13,491.2	13,518.4
Derivative assets	**592.4**	855.7	855.7	**592.4**	855.7	855.7
Potential future exposure on derivatives	**120.0**	172.1	172.1	**120.0**	172.1	172.1
Total derivative exposures	**712.4**	1,027.8	1,027.8	**712.4**	1,027.8	1,027.8
Post-offer pipeline at gross notional amount	**903.4**	817.7	817.7	**903.4**	817.7	817.7
Adjustment to convert to credit equivalent amounts	**(739.2)**	(569.2)	(569.2)	**(739.2)**	(569.2)	(569.2)
Off balance sheet items	**164.2**	248.5	248.5	**164.2**	248.5	248.5
Total leverage exposure before IFRS 9 relief	**13,680.6**	13,865.0	13,892.2	**14,508.6**	14,767.5	14,794.7
IFRS 9 relief	**25.8**	25.8	-	**25.8**	25.8	-
Total leverage exposure	**13,706.4**	13,890.8	13,892.2	**14,534.4**	14,793.3	14,794.7
Tier 1 capital	**922.0**	888.7	889.9	**922.0**	888.7	889.9
Total leverage exposure	**13,706.4**	13,890.8	13,892.2	**14,534.4**	14,793.3	14,794.7
Leverage ratio	**6.7%**	6.4%	6.4%	**6.3%**	6.0%	6.0%

Source: Group Accounts (excluding EBA basis)

The increase in leverage ratio is driven by the reduction in credit equivalent amounts of the pipeline and in derivative assets.

The disclosure of the EBA leverage ratio calculation in accordance with the template published in EU Commission Implementing Regulation 2016/200 is shown in Appendix B.

On a fully loaded basis, the leverage ratios were as set out below.

	UK Basis			EBA Basis		
	2019	2018	2018	**2019**	2018	2018
	IFRS 9	IFRS 9	IAS 39	**IFRS 9**	IFRS 9	IAS 39
	£m	£m	£m	**£m**	£m	£m
Fully loaded Tier 1 capital	**900.8**	867.5	889.9	**900.8**	867.5	889.9
Total leverage exposure before IFRS 9 relief	**13,680.6**	13,865.0	13,892.2	**14,508.6**	14,767.5	14,794.7
Fully loaded leverage ratio	**6.6%**	6.3%	6.4%	**6.2%**	5.9%	6.0%

CAPITAL BUFFERS

CRD IV establishes a number of capital buffers to be met with CET1 capital, in addition to the Group's funds requirement set through Pillar 1 and Pillar 2 (together referred to as the 'CRD IV Buffers'). The buffers which apply to the Group at 30 September 2019 and which are expected to apply in the near term are:

- A Capital Conservation Buffer ('CCoB') which has been 2.50% since 1 January 2019. This is currently expected to be the long-term level for this buffer
- A Counter Cyclical Buffer ('CCyB'), set separately for each jurisdiction in which a firm operates
- The PRA buffer, set for firms on an individual basis. It should be noted that the PRA buffer is set as a percentage of TRE, rather than an absolute amount, so will vary with the balance sheet

Additional buffers provided for by CRD IV do not apply to the Group.

While an institution's CCyB will be a weighted average of those set by the regulators in the jurisdictions in which it operates, forming an 'Institution Specific CCyB Rate', as all of the Group's risk exposure is within the UK, its rate will be equal to that set for the UK.

The CCyB rate for the UK is controlled by the Financial Policy Committee of the Bank of England ('FPC'), and is currently 1.00% of TRE. The FPC will reconsider the level of the UK CCyB at each quarterly meeting, but has indicated that the 1.0% rate is expected to be the long-term level of the buffer in normal circumstances.

Therefore the Group's Institution Specific CCyB Requirement as at 30 September 2019 was £67.2m (2018: £32.2m). The Group's approach to reporting CCyB is discussed in Appendix D.

The PRA have indicated that their intention is that their buffer will be used to address governance and risk management issues which have not been adequately addressed by firms. The level of any PRA buffer may not be disclosed.

The PRA buffer may be amended by the PRA as part of the SREP process, while the FPC may vary the CCyB from time to time. For forecasting purposes the Group has assumed a CCyB of 1.0%.

CRD IV also sets minimum requirements for the quality of capital held, i.e. its distribution between Tier 1, Additional Tier 1 and Tier 2 instruments. At 30 September 2019 the Group's regulatory capital was mostly CET1 equity.

The Group has reviewed the requirements set out within the CRR, including the impact of the changes in buffers. The capital position of the Group over the planning horizon demonstrates a significant surplus that can accommodate the requirements of the capital conservation and countercyclical capital buffers.

The Group has concluded that it will maintain a capital surplus over and above the CRR capital requirements, including relevant buffers, through the planning horizon.

5. Credit risk

This section sets out

- An overview of the Group's overall exposure to credit risk
- How the Group's risk exposure for credit risk (its risk weighted assets) is derived
- The most significant metrics used by the Group to assess credit risk in its principal asset classes

The Group's business objectives rely on maintaining a high-quality customer base and place strong emphasis on good credit management, both at the time of acquiring or underwriting a new loan, where strict lending criteria are applied, and throughout the loan's life.

Primary responsibility for credit risk management across the Group lies with the Credit Committee. The Credit Committee is made up of senior employees, drawn from financial and risk functions independent of the underwriting process. It is chaired by the CRO. Its key responsibilities include setting and reviewing credit policy, controlling applicant quality, tracking account performance against targets, agreeing product criteria and lending guidelines and monitoring performance and trends.

The assets of the Group which are subject to credit risk are set out below:

	2019	2018	2018
	IFRS 9	IFRS 9	IAS 39
	£m	£m	£m
Loans to customers	**12,186.1**	12,100.6	12,127.8
Trade receivables	**3.6**	2.2	2.2
Cash	**1,225.4**	1,310.6	1,310.6
Credit Support Annex ('CSA') assets	**72.2**	3.8	3.8
CRDs	**11.4**	6.2	6.2
Accrued interest income	**0.4**	0.6	0.6
Derivative financial assets	**592.4**	855.7	855.7
Maximum exposure to credit risk	**14,091.5**	14,279.7	14,306.9

Source: Group Accounts

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 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.

The credit profile of the loans to customers and trade debtor balances are discussed in more detail later in this section. The credit characteristics of the cash, derivatives and related balances are discussed in Section 7.

The Group's risk weighted assets, used in determining its Pillar 1 capital requirement, can be analysed by category as shown below.

		Exposure	Average risk weighting	Risk weighted exposure	Minimum capital required
		£m	%	£m	£m
30 September 2019 (IFRS 9)					
Government and central banks	(a)	**828.0**	**0.0%**	**-**	**-**
Credit institutions	(f)	**1,073.5**	**37.7%**	**404.3**	**32.3**
Total liquidity exposures		**1,901.5**	**21.3%**	**404.3**	**32.3**
Local authorities	(b)	**23.5**	**20.0%**	**4.7**	**0.4**
Corporate and similar exposures	(g)	**252.2**	**96.4%**	**243.2**	**19.5**
Retail and SME lending	(h)	**865.9**	**71.9%**	**622.9**	**49.8**
Residential lending	(i)	**10,395.3**	**35.3%**	**3,666.3**	**293.3**
Non-performing	(j)	**139.0**	**105.6%**	**146.8**	**11.7**
Specialist lending	(k)	**506.5**	**150.0%**	**759.8**	**60.8**
Commercial property	(l)	**3.7**	**100.0%**	**3.7**	**0.3**
Loans and advances to customers		**12,186.1**	**44.7%**	**5,447.4**	**435.8**
Fixed and other assets	(q)	**136.8**	**106.4%**	**145.5**	**11.7**
Total on balance sheet exposures		**14,224.4**	**42.2%**	**5,997.2**	**479.8**
Off balance sheet exposures - pipeline		**903.4**	**9.5%**	**85.5**	**6.8**
Total credit risk exposure		**15,127.8**	**40.2%**	**6,082.7**	**486.6**
30 September 2018 (IAS 39)					
Government and central banks	(a)	902.5	0.0%	-	-
Credit institutions	(f)	1,270.4	40.8%	518.7	41.5
Total liquidity exposures		2,172.9	23.9%	518.7	41.5
Local authorities	(b)	13.5	20.0%	2.7	0.2
Corporate and similar exposures	(g)	188.3	100.0%	188.3	15.1
Retail and SME lending	(h)	797.9	71.9%	573.7	45.9
Residential lending	(i)	10,743.4	35.8%	3,843.2	307.5
Non-performing	(j)	36.8	103.5%	38.1	3.0
Specialist lending	(k)	352.8	150.0%	529.2	42.3
Loans and advances to customers		12,132.7	42.7%	5,175.2	414.0
Fixed and other assets	(q)	73.4	100.0%	73.4	5.9
Total on balance sheet exposures		14,379.0	40.1%	5,767.3	461.4
Off balance sheet exposures - pipeline		817.7	10.7%	87.8	7.0
Total credit risk exposure		15,196.7	38.5%	5,855.1	468.4

‘Specialist lending’ includes assets of the Group’s development finance business.

‘Other assets’ includes residual values of assets leased under finance leases, included in finance lease assets in the balance sheet. Risk weighted exposures on derivatives include allowances for potential future exposure.

The exposures shown above are assigned to the exposure classes set out in Article 112 of the CRR as shown below:

a) Exposures to central governments or central banks

b) Exposure to regional governments and local authorities

f) Exposure to institutions

g) Exposure to corporates

h) Retail exposures

i) Exposures secured by mortgages on immovable property

j) Exposures in default

k) Exposures associated with particularly high risk

l) Exposure to commercial property

q) Other items

There are no equity exposures.

These calculations use the SA for credit risk for all asset classes. A risk weighting of 8% is applied to risk weighted asset values calculated in accordance with Article 92 of the CRR to determine the minimum Pillar I requirement for credit risk.

The risk weightings used in the SA for exposures to central governments, central banks and local authorities within the EU are set in the CRR.

For institutional exposures, where the SA requires the use of external ratings to determine appropriate risk weightings, the Group uses ratings published by Fitch, Standard and Poor’s and Moody’s assigning the exposure to the credit quality step indicated by the majority. This is the only use of External Credit Assessment Institutions (‘ECAI’) in the Group’s application of the SA.

Further information on the credit risk relating to the Group’s sovereign and institutional exposures is given in Section 7.

A reconciliation of the on-balance sheet exposure shown above to the audited amounts in the Group Accounts is shown below.

	2019	2018
	IFRS 9	IAS 39
	£m	£m
Total balance sheet assets	**14,395.5**	14,515.1
Less amounts deducted in regulatory capital		
Intangible assets	**(171.1)**	(169.3)
Add back		
Non-specific provisions qualifying as tier 2 capital	**-**	4.9
Fair value hedging portfolio adjustments	**-**	28.3
Total balance sheet exposure	**14,224.4**	14,379.0

Source: Group Accounts

No adjustment is required for fair value hedge adjustments in 2019 as these adjustments each have the ‘correct’ sign. i.e. the adjustment against loans to customers is a debit and that against retail deposits is a credit.

The Group has a very low operational risk appetite, highlighted by its lack of historic operational risk losses. In order to assess whether a Pillar 2a add-on is required for operational risk, the Group has reviewed historic operational losses, as well as performing scenario analysis on the Group’s major operational risks.

Individual balance sheet classes of credit risk bearing instruments are discussed further below.

LOANS TO CUSTOMERS

The Group's credit risk is primarily attributable to its loans to customers. There are no significant concentrations of credit risk to individual counterparties due to the large number of customers included in the portfolios. Note 57 to the Group Accounts includes information on exposures greater then £10.0m.

All of the Group's loan assets are situated in the UK and therefore each portfolio is considered to comprise a single geographical exposure. The Group's retail lending portfolios, including buy-to-let lending, each comprise a single counterparty type. Hence no analysis of these portfolios, or elements within them, is provided.

Specific credit risk adjustments represent loan-by-loan impairments determined using an expected credit loss basis in accordance with IFRS 9. All loans are considered for provision, and an impairment amount calculated based on each account's probability of default. The expected credit loss represents the probability weighted exposure at default reduced by the value of any security.

No collectively assessed impairment provisions are made under IFRS 9. Impairment provisions at 30 September 2018 shown above include collectively assessed provisions of £4.9m. Of these provisions, £2.7m related to buy-to-let mortgages, £nil to second charge mortgage loans, £0.4m to car loans and £1.8m to asset finance loans.

For capital adequacy purposes, collectively assessed credit impairment allowances under IAS 39 were considered to be Tier 2 capital. This amount was capped at 1.25% of risk weighted assets.

An analysis of the movements in impairment provisions is given in note 23 to the Group Accounts.

The Group's loan assets at 30 September 2019 are analysed as follows:

	Gross loan assets	Expected loss	Net loan assets	
	£m	£m	£m	%
30 September 2019 (IFRS 9)				
Buy-to-let mortgages	**10,128.4**	**(26.5)**	**10,101.9**	**82.9**
Owner-occupied mortgages	**70.7**	**(0.1)**	**70.6**	**0.6**
Total first residential mortgages	**10,199.1**	**(26.6)**	**10,172.5**	**83.5**
Second charge mortgage loans	**392.0**	**(2.8)**	**389.2**	**3.2**
Loans secured on residential property	**10,591.1**	**(29.4)**	**10,561.7**	**86.7**
Development finance	**508.1**	**(1.6)**	**506.5**	**4.1**
Loans secured on property	**11,099.2**	**(31.0)**	**11,068.2**	**90.8**
Asset finance loans	**475.9**	**(3.0)**	**472.9**	**3.9**
Motor finance loans	**322.5**	**(3.6)**	**318.9**	**2.6**
Aircraft mortgages	**19.4**	**(0.1)**	**19.3**	**0.2**
Invoice finance	**19.5**	**(1.0)**	**18.5**	**0.1**
Structured lending	**88.1**	**-**	**88.1**	**0.7**
Professions finance	**47.3**	**(1.1)**	**46.2**	**0.4**
Other commercial loans	**19.6**	**(0.3)**	**19.3**	**0.2**
Unsecured consumer loans	**136.5**	**(1.8)**	**134.7**	**1.1**
Total loans to customers	**12,228.0**	**(41.9)**	**12,186.1**	**100.0**

	Gross loan assets	Impairment provisions	Net loan assets	
	£m	£m	£m	%
30 September 2018 (IAS 39)				
Buy-to-let mortgages	10,344.1	(82.5)	10,261.6	84.6
Owner-occupied mortgages	79.1	(8.5)	70.6	0.6
Total first residential mortgages	10,423.2	(91.0)	10,332.2	85.2
Second charge mortgage loans	417.4	(1.5)	415.9	3.5
Loans secured on residential property	10,840.6	(92.5)	10,748.1	88.7
Development finance	359.0	(6.2)	352.8	2.9
Loans secured on property	11,199.6	(98.7)	11,100.9	91.6
Asset finance loans	393.0	(2.0)	391.0	3.2
Motor finance loans	332.1	(2.7)	329.4	2.7
Aircraft mortgages	12.4	-	12.4	0.1
Invoice finance	22.1	(0.3)	21.8	0.2
Professions finance	42.7	(0.1)	42.6	0.4
Structured lending	38.7	-	38.7	0.3
Other commercial loans	17.3	-	17.3	0.1
Unsecured consumer loans	182.3	(8.6)	173.7	1.4
Total loans to customers	**12,240.2**	**(112.4)**	**12,127.8**	**100.0**

Source: Group Accounts

Other consumer loans include unsecured loans either advanced by Group companies or acquired from their originators at a discount. Professions finance loans are generally short term unsecured loans made to lawyers and accountants for working capital purposes.

Development finance loans are secured by the development property and various charges over the build.

Structured lending and invoice finance balances are effectively secured over the assets of the customer, with security enhanced by maintaining balances at a level less than the total amount of the security (the advance percentage).

The Group does not utilise any form of credit risk mitigation in respect of loan assets beyond the security provided by its customers under their loan agreements.

More details on the credit profile of the following asset classes are given below:

- Loans secured on residential property
- Development finance loans
- Asset and motor finance loans
- Secured lending accounts

Additional details on all asset classes are given in note 57 to the Group Accounts.

Average exposure against the Group's loan assets is presented below.

For the quarter ended	**30 September 2019**	30 June 2019	31 March 2019	31 December 2018
	(IFRS 9)	(IFRS 9)	(IFRS 9)	(IFRS 9)
	£m	£m	£m	£m
Buy-to-let mortgages	**10,036.5**	10,259.5	10,481.0	10,320.7
Owner-occupied mortgages	**70.2**	73.3	81.6	83.7
Total first residential mortgages	**10,106.7**	10,332.8	10,562.6	10,404.4
Second charge mortgage loans	**392.2**	400.0	405.9	410.6
Loans secured on residential property	**10,498.9**	10,732.8	10,968.5	10,815.0
Development finance	**484.7**	444.5	404.6	368.1
Loans secured on property	**10,983.6**	11,177.3	11,373.1	11,183.1
Motor finance loans	**318.0**	316.5	321.2	327.8
Other consumer loans	**143.8**	155.8	162.1	169.7
Asset finance loans including factoring and discounting balances	**564.7**	546.2	521.3	493.3
Structured lending	**80.1**	64.1	49.0	40.3
Average exposure	**12,090.2**	12,259.9	12,426.7	12,214.2

For the quarter ended	30 September 2018	30 June 2018	31 March 2018	31 December 2017
	(IAS 39)	(IAS 39)	(IAS 39)	(IAS 39)
	£m	£m	£m	£m
Buy-to-let mortgages	10,179.0	10,022.2	9,936.8	9,873.2
Owner-occupied mortgages	68.3	53.8	36.5	23.1
Total first residential mortgages	10,247.3	10,076.0	9,973.3	9,896.3
Second charge mortgage loans	453.7	471.2	472.4	482.1
Loans secured on residential property	10,701.0	10,547.2	10,445.7	10,378.4
Development finance	343.6	68.6	51.3	43.7
Loans secured on property	11,044.6	10,615.8	10,497.0	10,422.1
Motor finance loans	246.2	213.2	186.4	171.5
Other consumer loans	174.5	182.5	197.0	210.3
Asset finance loans including factoring and discounting balances	545.9	455.5	444.5	433.3
Structured lending	26.7	15.0	-	-
Average exposure	12,037.9	11,482.0	11,324.9	11,237.2

All of the loans shown allow the customer to repay the balance early and this facility is often used, especially for mortgage loans. It is therefore considered that an analysis of these balances by contractual maturity would not provide useful information. An analysis of the contractual due dates for motor finance and asset finance loans is given in note 22 to the Group Accounts.

The Group's underwriting philosophy is based on a combination of sophisticated individual credit assessment and the automated efficiencies of a scored decision making process. Information on each applicant is combined with data taken from a credit reference bureau to provide a complete credit picture of the applicant and the borrowing requested. Key information is validated through a combination of documentation and statistical data which collectively provide evidence of the applicant's ability and willingness to pay the amount contracted under the loan agreement. In assessing credit risk, even where the Group would have security on a proposed loan, an applicant's ability and propensity to repay the loan remain the principal factors in the decision to lend.

In considering whether to acquire pools of loan assets, the Group will undertake a due diligence exercise on the underlying loan accounts. Such assets are generally not fully performing and are offered at a discount to their current balance. The Group's procedures may include inspection of original loan documents, verification of security and the examination of the credit status of borrowers. Current and historic cash flow data will also be examined. The objective of the exercise is to establish, to a level of confidence similar to that provided by the underwriting process, that the assets will generate sufficient cash flows to recover the Group's investment and generate an appropriate return without exposing the Group to material operational or conduct risks.

Credit characteristics by portfolio

Loans secured on residential property

First mortgages and second charge mortgage loans are secured by charges over residential properties in England and Wales, or similar Scottish or Northern Irish securities.

An analysis of the indexed loan to value ratio ('LTV') for those loan accounts secured on residential property by value at 30 September 2019 is set out below. LTVs for second charge mortgages are calculated allowing for the interest of the first charge holder, based on the most recent first charge amount held by the Group, while for acquired accounts the effect of any discount on purchase is allowed for.

	2019	**2019**	2018	2018
	First Mortgages	**Second charge mortgages**	First Mortgages	Second charge mortgages
	%	**%**	%	%
Loan to value ratio				
Less than 70%	**54.3**	**66.5**	60.6	66.1
70% to 80%	**36.2**	**18.5**	29.7	17.4
80% to 90%	**7.2**	**8.9**	7.1	9.3
90% to 100%	**0.6**	**2.7**	0.8	3.5
Over 100%	**1.7**	**3.4**	1.8	3.7
	100.0	**100.0**	100.0	100.0
Average loan to value ratio	**67.3**	**65.7**	66.0	65.9
Of which:				
Buy-to-let	**67.4**		66.1	
Owner-occupied	**53.2**		51.3	

Source: Group Accounts

The regionally indexed LTVs shown above are affected by changes in house prices, with the Nationwide house price index, for the UK as a whole, registering an annual increase of 0.2% in the year ended 30 September 2019 (2018: 2.0%). The increase in average prices, however, is part of a more volatile picture, which has been particularly marked at the local and regional level. The Group maintains a specialist team of in-house surveyors to maximise its understanding of particular markets, both from a valuation and lettings standpoint.

The Group conducts valuations of properties given as security at the inception of loans and updates the valuations from time to time as part of its arrears management process, typically conducting drive-by or full valuations as accounts move through arrears stages. LTV amounts shown above are based on the most recent valuation of each property on the Group's records.

In determining appropriate allowances for impairment, the most recent valuation of the security will be used, with a discount reflecting the potential impact of a forced sale.

An analysis of those loan accounts secured on residential property, classified by property location, by value at 30 September 2019 is set out below. For acquired accounts the effect of any discount on purchase is allowed for.

	First Charge		Second Charge	
	2019	2018	**2019**	2018
	%	%	**%**	%
Region				
East Anglia	**3.2**	3.0	**3.3**	3.5
East Midlands	**5.3**	5.2	**6.3**	6.5
Greater London	**18.9**	18.6	**7.8**	7.1
North	**3.3**	3.5	**4.2**	4.7
North West	**10.1**	10.2	**8.0**	8.5
South East	**31.9**	31.3	**37.7**	35.2
South West	**8.9**	9.2	**7.9**	8.0
West Midlands	**5.1**	4.8	**7.6**	8.0
Yorkshire and Humberside	**8.6**	9.4	**6.2**	6.7
Total England	**95.3**	95.2	**89.0**	88.2
Northern Ireland	**0.1**	0.1	**1.9**	2.1
Scotland	**1.4**	1.4	**5.6**	5.9
Wales	**3.2**	3.3	**3.5**	3.8
Total United Kingdom	**100.0**	100.0	**100.0**	100.0

Source: Group Accounts

The majority of the Group's lending, excluding asset finance, development finance and structured lending, is to consumers.

Development Finance

Development finance loans have an average term of 20 months (2018: 21 months). Settlement of principal and accrued interest takes place once the development is sold or refinanced following its completion and the customer is not normally required to make payments during the term of the loan. The loans are secured by a legal charge over the site and / or property together with other charges and warranties related to the build.

As customers are not required to make payments during the life of the loan, arrears and past due measures cannot be used to monitor credit risk. Instead, cases are monitored on an individual basis by management and Credit Risk. The average loan to gross development value ('LTGDV') ratio for the portfolio at year end, a measure of security cover, is analysed below.

	2019	**2019**	2018	2018
	By value	**By number**	By value	By number
	%	**%**	%	%
LTGDV				
50% or less	**8.5**	**3.4**	3.4	4.4
50% to 60%	**18.2**	**15.5**	18.9	22.8
60% to 65%	**31.6**	**39.1**	63.3	59.6
65% to 70%	**32.3**	**32.4**	7.1	9.6
70% to 75%	**6.8**	**8.2**	0.7	0.7
Over 75%	**2.6**	**1.4**	6.6	2.9
	100.0	**100.0**	100.0	100.0

Source: Group Accounts

The average LTGDV cover at the year end was 64.8% (2018: 63.2%).

The increase in LTGDV percentages over the year reflects the changing mix in the portfolio between those accounts originated using the initial cautious underwriting approach of the Group's in-house operation and those originated though the acquired operation. Following acquisition, risk appetites were adjusted to reflect the increased experience and maturity of the combined operation.

At 30 September 2019 the development finance portfolio comprised 207 accounts (2018: 136) with a total carrying value of £506.5m (2018: £352.8m). Of these accounts only six were included in stage 2 at 30 September 2019 (2018 IFRS 9: none). In addition, three accounts acquired in the Titlestone purchase had been classified as purchased or originated credit impaired ('POCI') (2018: four). An allowance for these losses was made in the IFRS 3 fair value calculation.

Asset and Motor Finance

Asset finance loans and motor finance loans are effectively secured by the financed asset.

Asset finance customers are generally small or medium sized businesses. The nature of the assets underlying the Group's asset finance lending by gross carrying value is set out below.

	2019	2018
	%	%
Commercial vehicles	**30.3**	22.6
Construction plant	**34.8**	38.9
Technology	**7.8**	6.6
Manufacturing	**6.1**	5.2
Print and paper	**4.8**	7.1
Refuse disposal vehicles	**5.2**	6.7
Other vehicles	**3.0**	4.2
Agriculture	**2.7**	1.2
Other	**5.3**	7.5
	100.0	100.0

Source: Group Accounts

Motor finance loans are secured over cars, motorhomes and light commercial vehicles and represent exposure to consumers and small businesses.

The broad industrial sectors to which the Group's SME finance business has credit exposure are set out below. All of the activities take place in the UK. All amounts disclosed are pre risk weighting. The balances are shown above as asset finance loans, factoring and discounting balances, professions finance and other commercial loans.

	2019	2018
	%	%
Transport, distribution and construction		
Construction and plant hire	**31.4**	34.7
Distribution	**7.1**	3.8
Waste	**2.9**	2.4
Travel	**5.7**	4.7
Other transport	**5.6**	7.4
	52.7	53.0
Services		
Business services	**16.5**	17.0
Broadcast and audio	**4.7**	4.8
Local authority	**3.5**	2.6
Veterinary services	**1.4**	2.1
Property	**0.3**	0.2
Other services	**6.2**	6.6
	32.6	33.3
Manufacturing		
Print	**2.6**	4.2
Engineering	**2.1**	2.1
Packaging	**0.4**	0.2
Other manufacturing	**6.8**	5.2
	11.9	11.7
Energy and raw materials		
Forestry and agriculture	**2.8**	2.0
Total	**100.0**	100.0

Structured Lending

The Group's structured lending division provides revolving loan facilities to support non-bank lending businesses. Loans are made to a Special Purpose Vehicle ('SPV') company controlled by the customer and effectively secured on the loans made by the SPV. Exposure is limited to a percentage of the underlying assets, providing a buffer against credit loss.

Summary details of the structured lending portfolio are set out below:

	2019	2018
Number of transactions	**8**	3
Total facilities (£m)	**135.0**	52.5
Carrying value (£m)	**88.1**	38.7

Source: Group Accounts

The maximum advance under these facilities was 80% of the underlying assets.

These accounts do not have a requirement to make regular payments, operating on revolving basis. The performance of each loan is monitored monthly on a case by case basis by the Group's Credit Risk function, assessing compliance with covenants relating to both the customer and the performance and composition of the asset pool. These assessments, which are reported to Credit Committee, are used to inform the assessment of expected credit loss under IFRS 9.

At 30 September 2019 there were no significant concerns regarding the credit performance of these facilities.

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 as are used for finance lease cases apply.

Arrears

The Group conducts detailed analysis of customer servicing risk indicators across its portfolios, analysing some 510 million pieces of customer data each month to identify potential future arrears cases. The Group's customer servicing teams then work with the identified customers to prevent the accounts falling into arrears where possible.

The number of accounts in arrears by asset class, based on the most commonly quoted definition of arrears for the type of asset, at 30 September 2019 and 30 September 2018, compared to the industry averages at those dates published by UK Finance ('UKF') and the Finance and Leasing Association ('FLA'), was:

	2019	2018
	%	%
First mortgages		
Accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	**0.18**	0.11
Buy-to-let accounts excluding receiver of rent cases	**0.07**	0.03
Owner-occupied accounts	**2.44**	3.15
UKF data for mortgage accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	**0.42**	0.42
Buy-to-let accounts excluding receiver of rent cases	**0.37**	0.38
Owner-occupied accounts	**0.81**	0.88
All mortgages	**0.73**	0.79
Second charge mortgage loans		
Accounts more than 2 months in arrears		
All accounts	**14.08**	13.64
Post-2010 originations	**0.38**	0.21
Legacy cases (Pre-2010 originations)	**19.85**	17.91
Purchased assets	**16.05**	14.81
FLA data for secured loans	**8.70**	9.40
Car loans		
Accounts more than 2 months in arrears	**5.25**	3.91
FLA data for point of sale hire purchase	**2.70**	2.50
Asset finance loans		
Accounts more than 2 months in arrears	**0.43**	0.78
FLA data for business lease / hire purchase loans	**1.10**	0.70

Source: Group Accounts

No published industry data for asset classes comparable to the Group's other books has been identified. Where revised data at 30 September 2018 has been published by the FLA or UKF, the comparative industry figures above have been amended.

Arrears information is not given for development finance, structured lending or factoring activities as the structure of the products means that such a measure is not relevant.

The Group calculates its headline arrears measure for buy-to-let mortgages, shown above, based on the numbers of accounts three months or more in arrears, including purchased Idem Capital assets, but excluding those cases in possession and receiver of rent cases designated for sale. This is consistent with the methodology used by UKF in compiling its statistics for the buy-to-let mortgage market as a whole.

The number of accounts in arrears will naturally be higher for legacy books, such as the Group's legacy second charge mortgages and residential first mortgages than for comparable active ones, as performing accounts pay off their balances, leaving arrears accounts representing a greater proportion of the total.

The figures shown above for secured loans incorporate purchased portfolios which generally include a high proportion of cases in arrears at the time of purchase and where this level of performance is allowed for in the discount to current balance represented by the purchase price. However, this will lead to higher than average reported arrears.

Acquired assets

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, but is less applicable for the types of portfolio in which the Group has invested, where cash flows are higher on acquisition, loans may be secured on property and customers may not be in default. In such cases, the IFRS 9 amortised cost balance, at which these assets are carried in the Group balance sheet, provides a better indication of value.

However, to aid comparability, the 84 and 120 month ERC values for the Group's purchased consumer loan assets, are set out below. These are derived using the same models and assumptions used in the Effective Interest Rate ('EIR') calculations, but the differing bases of calculation lead to different outcomes.

	Carrying value	**84 month ERC**	**120 month ERC**
	£m	**£m**	**£m**
30 September 2019	**291.1**	**342.3**	**387.5**
30 September 2018	364.2	434.9	489.6

Source: Group Accounts

Impairment provisions

From the financial year ended 30 September 2019 the Group implemented the impairment requirements of IFRS 9 - 'Financial Instruments'. This significantly affected the Group's reporting of its credit position, with provisions made on an expected, rather than incurred loss basis, resulting in the earlier recognition of losses.

IFRS 9 requires that impairment is evaluated on an expected credit loss ('ECL') basis. ECLs are based on an assessment of the probability of default ('PD') and loss given default ('LGD'), discounted to give a net present value. The estimation of ECL should be unbiased and probability weighted, considering all reasonable and supportable information, including forward-looking economic assumptions and a range of possible outcomes. Provision may be based on either twelve month or lifetime ECL, dependant on whether an account has experienced a significant increase in credit risk ('SICR').

Calculation of expected credit loss ('ECL')

For the majority of the Group's loan assets, the ECL is generated using statistical models applied to account data to generate PD and LGD components.

PD on both a twelve month and lifetime basis is estimated based on statistical models for the Group's most significant asset classes. The PD calculation is a function of current asset performance, customer information and future economic assumptions. The structure of the models was derived through analysis of correlation in historic data, which identified which current and historical customer attributes and external economic variables were predictive of future loss. PD measures are calculated for the full contractual lives of loans with the models deriving probabilities that, at a given future date, a loan will be in default, performing or closed. The Group utilised all reasonably available information in its possession for this exercise.

LGD for each account is derived by calculating a value for exposure at the point of default (which will include consideration of future interest, account charges and receipts) and reducing this for security values, net of likely costs of recovery. These calculations allow for the Group's potential case management activities. This evaluation includes the potential impact of economic conditions at the time of any future default or enforcement. The derivation of the significant assumptions used in these calculations is discussed below.

In certain asset classes a fully modelled approach is not possible. This is generally where there are few assets in the class, where there is insufficient historical data on which to base an analysis or where certain measures, such as days past due are not useful (e.g. where the loan agreement does not require regular payments of pre-determined amounts). In these cases, which represent a small proportion of the total portfolio, alternative approaches are adopted. These rely on internal credit monitoring practices and professional credit judgement.

Notwithstanding the mechanical procedures discussed above, the Group will always consider whether the process generates sufficient provision for particular loans, especially large exposures, and will provide additional amounts as appropriate.

Significant Increase in Credit Risk ('SICR')

Under IFRS 9, SICR is not defined solely by account performance, but on the basis of the customer's overall credit position, and this evaluation should include consideration of external data. The Group's aim is to define SICR to correspond, as closely as possible, to that population of accounts which are subject to enhanced administrative and monitoring procedures operationally. The Group assesses SICR in its modelled portfolios primarily on the basis of the relative difference in an account's lifetime PD between origination and the reporting date. The levels of difference required to qualify as an SICR may differ between portfolios and will depend, to some extent, on the level of risk originally perceived and are monitored on an ongoing basis to ensure that this calibrates with actual experience.

It should be noted that the use of the current PD, which includes external factors such as credit bureau data, means that all relevant information in the Group's hands concerning the customers present credit position is included in the evaluation, as well as the impact of future economic expectations.

For non-modelled portfolios, the SICR assessment is based on the credit monitoring position of the account in question and for all portfolios a number of qualitative indicators which provide evidence of SICR have been considered.

In all cases accounts which are more than one month in arrears, where this is a meaningful measure, are considered to have an SICR. However, in certain loan portfolios, regular monthly payments of pre-set amounts are not required and hence this criterion cannot be used.

The Group uses arrears multiples as a proxy for days past due, as this measure is commonly used in its arrears reporting. A loan will generally be one month in arrears from the point it is one day past due until it is thirty days past due.

Definitions of default

As the IFRS 9 definition of ECL is based on PD, default must be defined for this purpose. The Group's definitions of default for its various portfolios are aligned to its internal operational procedures and the regulatory definitions of default used internally. In particular the Group's receiver of rent cases are defined as defaulted for modelling purposes as the behaviour of the case after that point is significantly influenced by internal management decisions.

IFRS 9 provides a rebuttable presumption that an account is in default when it is ninety days overdue and this was used as the basis of the Group's definition. A combination of qualitative and quantitative measures were used in developing the definitions. These include account management activities and internal statuses.

Credit Impaired loans

IFRS 9 defines a credit impaired account as one where the account has suffered one or more event which has had a detrimental effect on future cash flows. It is thus a backward-looking definition, rather than one based on future expectations.

Credit impaired assets are identified either through quantitative measures or by operational status. Designations of accounts for regulatory capital purposes are also taken into account. Assets may also be assigned to Stage 3 if they are identified as credit impaired as a result of management review processes.

All loans which are in the process of enforcement, from the point where this becomes the administration strategy, are classified as credit impaired.

During the year the Group revised certain of its default definitions for regulatory purposes. Where appropriate, IFRS 9 definitions have been amended to harmonise with the new definition and hence the staging at 1 October 2018 set out below differs from that presented in the Group's transition report.

As a result of this harmonisation all default cases are considered to be credit impaired, including all receiver of rent cases and all cases with at least one payment more than ninety days overdue, even where such cases are being managed in the expectation of realising all of the carrying balance. In order to provide better information for users, additional analysis of credit impaired accounts has been presented below distinguishing between receiver of rent accounts, accounts subject to realisation / enforcement procedures and long term managed accounts, all of which are treated as credit impaired.

IFRS 9 Staging

IFRS 9 calculations and related disclosures require loan assets to be divided into three stages, with accounts which were credit impaired on initial recognition representing a fourth class.

The three classes comprise: those where there has been no SICR since advance or acquisition (Stage 1); those where there has been a SICR (Stage 2); and loans which are impaired (Stage 3).

- On initial recognition, and for assets where there has not been an SICR, provisions will be made in respect of losses resulting from the level of credit default events expected in the twelve months following the balance sheet date
- Where a loan has experienced an SICR, whether or not the loan is considered to be credit impaired, provisions will be made based on the ECLs over the full life of the loan
- For credit impaired assets, provisions will also be made on the basis of ECLs.

For assets which were 'Purchased or Originated as Credit Impaired' ('POCI') accounts (i.e. considered as credit impaired at the point of first recognition), such as certain of the Group's acquired assets in Idem Capital, the carrying valuation is based on expected cash flows discounted by the EIR determined at the point of acquisition.

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 2019					
Gross loan book					
Mortgages	**9,847.7**	**378.2**	**129.3**	**15.7**	**10,370.9**
Commercial Lending	**1,376.7**	**64.6**	**8.2**	**13.3**	**1,462.8**
Idem Capital	**158.2**	**15.7**	**30.4**	**190.0**	**394.3**
Total	**11,382.6**	**458.5**	**167.9**	**219.0**	**12,228.0**
Impairment provision					
Mortgages	**(0.4)**	**(2.0)**	**(24.4)**	**-**	**(26.8)**
Commercial Lending	**(5.4)**	**(1.3)**	**(4.0)**	**-**	**(10.7)**
Idem Capital	**(0.2)**	**(0.4)**	**(3.8)**	**-**	**(4.4)**
Total	**(6.0)**	**(3.7)**	**(32.2)**	**-**	**(41.9)**
Net loan book					
Mortgages	**9,847.3**	**376.2**	**104.9**	**15.7**	**10,344.1**
Commercial Lending	**1,371.3**	**63.3**	**4.2**	**13.3**	**1,452.1**
Idem Capital	**158.0**	**15.3**	**26.6**	**190.0**	**389.9**
Total	**11,376.6**	**454.8**	**135.7**	**219.0**	**12,186.1**

	Stage 1	Stage 2*	Stage 3*	POCI	Total
	£m	£m	£m	£m	£m
1 October 2018					
Gross loan book					
Mortgages	9,961.6	369.9	142.4	11.7	10,485.6
Commercial Lending	1,106.4	8.2	5.8	17.5	1,137.9
Idem Capital	206.1	19.7	40.0	265.5	531.3
Total	11,274.1	397.8	188.2	294.7	12,154.8
Impairment provision					
Mortgages	(0.3)	(1.7)	(34.1)	-	(36.1)
Commercial Lending	(4.2)	(0.4)	(2.0)	-	(6.6)
Idem Capital	(0.4)	(0.5)	(10.6)	-	(11.5)
Total	(4.9)	(2.6)	(46.7)	-	(54.2)
Net loan book					
Mortgages	9,961.3	368.2	108.3	11.7	10,449.5
Commercial Lending	1,102.2	7.8	3.8	17.5	1,131.3
Idem Capital	205.7	19.2	29.4	265.5	519.8
Total	11,269.2	395.2	141.5	294.7	12,100.6

* Stage 2 and 3 balances are analysed in more detail below.

	Stage 1	Stage 2	Stage 3	POCI	Total
Coverage ratio					
30 September 2019					
Mortgages	**-**	**0.53%**	**18.87%**	**-**	**0.26%**
Commercial Lending	**0.39%**	**2.01%**	**48.78%**	**-**	**0.73%**
Idem Capital	**0.13%**	**2.55%**	**12.50%**	**-**	**1.12%**
Total	**0.05%**	**0.81%**	**19.18%**	**-**	**0.34%**
1 October 2018					
Mortgages	-	0.46%	23.95%	-	0.34%
Commercial Lending	0.38%	4.88%	34.48%	-	0.58%
Idem Capital	0.19%	2.54%	26.50%	-	2.16%
Total	0.04%	0.65%	24.81%	-	0.45%

In terms of the Group's credit management processes, Stage 1 cases will fall within the appropriate customer servicing functions and Stage 2 cases will be subject to account management arrangements. Stage 3 cases will include both those subject to recovery or similar processes and those which, though being managed on a long-term basis, are included with defaulted accounts for regulatory purposes. However, these broad categorisations may vary between different product types.

POCI balances included in the Commercial Lending segment arise principally from acquired businesses, where those assets were identified as credit impaired at the point of acquisition when the acquired portfolios as a whole were evaluated.

Idem Capital loans include acquired consumer and motor finance loans together with legacy (originated pre-2010) second charge mortgage and unsecured consumer loans. Legacy assets and acquired loans which were performing on acquisition are included in the staging analysis above. Acquired portfolios which were largely non-performing at acquisition, and which were purchased at a deep discount to face value are shown as POCI assets above. Although no provision is shown above for such assets, the effect of the discount on purchase is included in the gross value ensuring that the carrying value is substantially less than the current balances due from customers and the level of cover is considerable.

Analysis of Stage 2 loans

The table below analyses the accounts in Stage 2 between those not more than one month in arrears where an SICR has nonetheless been identified from other information and accounts more than one month in arrears, which are automatically deemed to have an SICR.

Coverage for Stage 2 cases remains broadly similar year-on-year in both the Mortgages and Idem Capital divisions. Within the Commercial Lending division, the '<1 month' total in 2019 includes increased balances from the maturing structured lending and development finance portfolios, where security levels are high and hence provision requirements are generally lower than for other businesses within the division. The '>1 month <=3 months' total in Commercial Lending includes very few cases and hence the coverage ratio may vary depending on the cases currently in progress.

	< 1 month arrears	> 1 <= 3 months arrears	Total
	£m	£m	£m
30 September 2019			
Gross loan book			
Mortgages	**336.3**	**41.9**	**378.2**
Commercial Lending	**57.2**	**7.4**	**64.6**
Idem Capital	**7.7**	**8.0**	**15.7**
Total	**401.2**	**57.3**	**458.5**
Impairment provision			
Mortgages	**(1.3)**	**(0.7)**	**(2.0)**
Commercial Lending	**(1.0)**	**(0.3)**	**(1.3)**
Idem Capital	**(0.2)**	**(0.2)**	**(0.4)**
Total	**(2.5)**	**(1.2)**	**(3.7)**
Net loan book			
Mortgages	**335.0**	**41.2**	**376.2**
Commercial Lending	**56.2**	**7.1**	**63.3**
Idem Capital	**7.5**	**7.8**	**15.3**
Total	**398.7**	**56.1**	**454.8**

	< 1 month arrears	> 1 <= 3 months arrears	Total
	£m	£m	£m
1 October 2018			
Gross loan book			
Mortgages	306.3	63.6	369.9
Commercial Lending	4.0	4.2	8.2
Idem Capital	8.8	10.9	19.7
Total	319.1	78.7	397.8
Impairment provision			
Mortgages	(0.8)	(0.9)	(1.7)
Commercial Lending	(0.1)	(0.3)	(0.4)
Idem Capital	(0.2)	(0.3)	(0.5)
Total	(1.1)	(1.5)	(2.6)
Net loan book			
Mortgages	305.5	62.7	368.2
Commercial Lending	3.9	3.9	7.8
Idem Capital	8.6	10.6	19.2
Total	318.0	77.2	395.2

	< 1 month arrears	> 1 <= 3 months arrears	Total
Coverage ratio			
30 September 2019			
Mortgages	**0.39%**	**1.67%**	**0.53%**
Commercial Lending	**1.75%**	**4.05%**	**2.01%**
Idem Capital	**2.60%**	**2.50%**	**2.55%**
Total	**0.62%**	**2.09%**	**0.81%**
1 October 2018			
Mortgages	0.26%	1.42%	0.46%
Commercial Lending	2.50%	7.14%	4.88%
Idem Capital	2.27%	2.75%	2.54%
Total	0.34%	1.91%	0.65%

Analysis of Stage 3 loans

The table below analyses the accounts in Stage 3 between accounts in the process of enforcement or where full recovery is considered unlikely ('Realisations' in the table), loans being managed on a long term basis where full recovery is possible but which are considered in default for regulatory purposes and buy-to-let mortgages where a receiver of rent ('RoR') has been appointed by the Group to manage the property on the customer's behalf. RoR accounts in Stage 3 may be fully up-to-date with full recovery possible. These accounts are included in Stage 3 as they are classified as defaulted for regulatory purposes.

Coverage for Stage 3 Mortgages has reduced over the year as a number of heavily provided legacy receiver of rent cases have been resolved. The coverage ratio for Commercial Lending is subject to large fluctuations, as the number and absolute value of Stage 3 cases are relatively low and hence the specific details of individual cases will influence the ratio. In Idem Capital, the principal impact on the values shown below was a major operational review of legacy balances during the year which resulted in a change in the collection strategy and a consequent writing off of a large proportion of the balances shown at 1 October 2018.

	> 3 month arrears £m	RoR managed £m	Realisations £m	Total £m
30 September 2019				
Gross loan book				
Mortgages	**8.3**	**106.3**	**14.7**	**129.3**
Commercial Lending	**1.7**	**-**	**6.5**	**8.2**
Idem Capital	**26.0**	**-**	**4.4**	**30.4**
Total	**36.0**	**106.3**	**25.6**	**167.9**
Impairment provision				
Mortgages	**(0.4)**	**(19.3)**	**(4.7)**	**(24.4)**
Commercial Lending	**(0.5)**	**-**	**(3.5)**	**(4.0)**
Idem Capital	**(1.9)**	**-**	**(1.9)**	**(3.8)**
Total	**(2.8)**	**(19.3)**	**(10.1)**	**(32.2)**
Net loan book				
Mortgages	**7.9**	**87.0**	**10.0**	**104.9**
Commercial Lending	**1.2**	**-**	**3.0**	**4.2**
Idem Capital	**24.1**	**-**	**2.5**	**26.6**
Total	**33.2**	**87.0**	**15.5**	**135.7**

	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m
1 October 2018				
Gross loan book				
Mortgages	5.0	116.3	21.1	142.4
Commercial Lending	1.1	-	4.7	5.8
Idem Capital	29.0	-	11.0	40.0
Total	35.1	116.3	36.8	188.2
Impairment provision				
Mortgages	-	(26.8)	(7.3)	(34.1)
Commercial Lending	(0.4)	-	(1.6)	(2.0)
Idem Capital	(1.7)	-	(8.9)	(10.6)
Total	(2.1)	(26.8)	(17.8)	(46.7)
Net loan book				
Mortgages	5.0	89.5	13.8	108.3
Commercial Lending	0.7	-	3.1	3.8
Idem Capital	27.3	-	2.1	29.4
Total	33.0	89.5	19.0	141.5

	> 3 month arrears	RoR managed	Realisations	Total
Coverage ratio				
30 September 2019				
Mortgages	**4.82%**	**18.16%**	**31.97%**	**18.87%**
Commercial Lending	**29.41%**	**-**	**53.85%**	**48.78%**
Idem Capital	**7.31%**	**-**	**43.18%**	**12.50%**
Total	**7.78%**	**18.16%**	**39.45%**	**19.18%**
1 October 2018				
Mortgages	-	23.04%	34.60%	23.95%
Commercial Lending	36.36%	-	34.04%	34.48%
Idem Capital	5.86%	-	80.91%	26.50%
Total	5.98%	23.04%	48.37%	24.81%

The 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.

Idem Capital balances with over three months arrears comprise principally second charge mortgage accounts originated over ten years ago which have been over three month 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.

FURTHER INFORMATION

Further information on the Group's IFRS 9 impairment calculations and the credit risk profile of its loan assets can be found in the Group Accounts in notes 20-23 and 57.

The Group's transition to IFRS 9 is discussed in note 62 to the Group Accounts.

6. Asset encumbrance

This section sets out

- An overview of the Group's overall exposure to asset encumbrance
- An analysis of encumbered assets as disclosed in the Group Accounts
- The asset encumbrance template disclosures required under CRD IV

Asset encumbrance is the process by which assets are pledged in order to secure, collateralise or credit-enhance a financial transaction from which they cannot be freely withdrawn. The Group maintains a level of encumbrance commensurate with the scale and scope of its business operation, within the context of a robust and diversified funding capability. The majority of encumbrance arises from its securitisation transactions and from activity in connection with Bank of England facilities intended to support lending. Assets are encumbered in accordance with the contractual requirements of these transactions.

Unencumbered assets include cash-in-hand, un-securitised loan assets, derivative assets, property, plant and other fixed assets, intangible assets including goodwill, and deferred tax assets.

Certain of the Group's buy-to-let mortgage assets have been utilised as whole mortgage pools for the purpose of the Funding for Lending Scheme ('FLS'). This has enabled off balance sheet liquidity to be provided, based on the value of the assets pledged, subject to a haircut. The amount of the liquidity presently drawn is £109.0m (2018: £108.7m).

During the year the Bank has also drawn down funding under the Term Funding Scheme ('TFS'), again utilising whole mortgage pools, to support new lending. This funding scheme is based on the value of the pledged assets, subject to a haircut. At 30 September 2019, £944.4m had been drawn under the TFS (2018: £944.4m).

Following the closure of the TFS to new drawings in February 2018, the Bank participated in the Bank of England Indexed Long-Term Repo scheme ('ILTR') again encumbering assets. Drawings under the ILTR at 30 September 2019 were £50.0m (2018: £80.0m). Further mortgage assets of the Bank have been pre-positioned with the Bank of England for use in the FLS, TFS and other funding schemes.

Responsibility for monitoring the Group's use of asset encumbrance in financial transactions lies with ALCO.

An analysis of the Group's loan assets between assets held within securitisation structures, those within warehouse structures awaiting securitisation, those utilised for the FLS and TFS or prepositioned with the Bank of England and other loan assets is shown below.

	First Mortgages	Consumer Finance	Other	Total
	£m	£m	£m	£m
30 September 2019 (IFRS 9)				
In respect of:				
Asset backed loan notes	**4,338.3**	-	-	**4,338.3**
Warehouse facilities	**948.1**	-	-	**948.1**
Central bank facilities	**1,734.4**	-	-	**1,734.4**
Total pledged as collateral	**7,020.8**	-	-	**7,020.8**
Prepositioned with Bank of England	**1,873.7**	-	-	**1,873.7**
Other assets not pledged as collateral	**1,278.0**	**842.8**	**1,170.8**	**3,291.6**
	10,172.5	**842.8**	**1,170.8**	**12,186.1**

	First Mortgages	Consumer Finance	Other	Total
	£m	£m	£m	£m
1 October 2018 (IFRS 9)				
In respect of:				
Asset backed loan notes	5,037.8	40.4	-	5,078.2
Warehouse facilities	1,023.8	-	-	1,023.8
Central bank facilities	1,670.1	-	-	1,670.1
Total pledged as collateral	7,731.7	40.4	-	7,772.1
Prepositioned with Bank of England	1,171.0	-	-	1,171.0
Other assets not pledged as collateral	1,405.6	877.0	874.9	3,157.5
	10,308.3	917.4	874.9	12,100.6
30 September 2018 (IAS 39)				
In respect of:				
Asset backed loan notes	5,052.2	40.8	-	5,093.0
Warehouse facilities	1,030.2	-	-	1,030.2
Central bank facilities	1,670.1	-	-	1,670.1
Total pledged as collateral	7,752.5	40.8	-	7,793.3
Prepositioned with Bank of England	1,171.1	-	-	1,171.1
Other assets not pledged as collateral	1,408.6	878.2	876.6	3,163.4
	10,332.2	919.0	876.6	12,127.8

Source: Group Accounts

At 30 September 2019, 46.4% (2018: 53.7%) of the carrying value of the Group's loans to customers was funded by securitisations and structures affecting the credit risk exposure of the Group in a similar way (see Section 10).

The Group manages its level of encumbrance in accordance with the approved limits within its liquidity and funding risk strategies, and endeavours to ensure that a ratio covering depositor liabilities with unencumbered assets is maintained during normal business conditions. It continues to work closely with the regulators to ensure that its encumbrance profile remains transparent, proportionate and relevant to the business model.

The disclosures below are drawn up in accordance with the templates included in Commission Delegated Regulation (EU) 2017/2295. This means they will differ to the asset encumbrance disclosures presented in the Group Accounts, due to scope and definition differences. Furthermore, the Regulation requires that the data is presented as an interpolated median calculation, based on the four quarter end positions, rather than at a point in time.

These interpolated medians are calculated on a line by line basis, so totals presented may not equal the sum of component amounts where the same two quarters are not used to calculate the median.

This regulation uses the definitions set out for regulatory reporting purposes, set out in Annex XVI to Commission Implementing Regulation (EU) 680/2014 as its basis, but makes some changes to analysis of items, as well as requiring the use of medians.

Assets Encumbered (Template A)

This sets out the assets of the Group, analysed between those pledged as security or otherwise encumbered and unencumbered assets, both at their carrying amounts and fair values (where reported), split by category of asset, and in some cases, further analysed. It should be noted that the template may not provide sub-categories for all balances within an individual category. A row reference has been provided to align the table below with Template A set out in Regulation 2017/2295.

Row Ref		Carrying amount of encumbered assets £m	Fair value of encumbered assets £m	Carrying amount of unencumbered assets £m	Fair value of unencumbered assets £m
	At 30 September 2019				
010	**Assets of the reporting institution**	**7,716.7**	**N/A**	**6,648.6**	**N/A**
040	Debt securities	**-**	**-**	**-**	**-**
070	*Of which: issued by general government*	**-**	**-**	**-**	**-**
120	Other assets	**7,716.7**	**N/A**	**6,631.7**	**N/A**
121	*Of which: Loans on demand*	**311.1**	**N/A**	**861.4**	**N/A**
	Of which: Loans and advances other than loans on demand	**6,767.9**	**N/A**	**5,492.0**	**N/A**
	Of which: mortgage loans	**6,767.9**	**N/A**	**3,846.9**	**N/A**
	Of which: non-loan assets	**662.7**	**N/A**	**331.2**	**N/A**
	At 30 September 2018				
010	**Assets of the reporting institution**	8,805.8	N/A	5,033.3	N/A
040	Debt securities	-	-	5.0	5.0
070	*Of which: issued by general government*	-	-	5.0	5.0
120	Other assets	8,805.8	N/A	5,208.4	N/A
121	*Of which: Loans on demand*	358.4	N/A	984.5	N/A
	Of which: Loans and advances other than loans on demand	7,637.7	N/A	3,794.2	N/A
	Of which: mortgage loans	7,428.7	N/A	2,974.3	N/A
	Of which: non-loan assets	822.3	N/A	162.2	N/A

In the template above, encumbered 'Loans on demand' includes the cash balances held within the Group's securitisation SPVs, while encumbered 'non-loan assets' includes derivatives and other assets held by those SPVs. Unencumbered 'non-loan assets' includes principally intangible assets, which may not be encumbered.

Where assets are included in securitisations where the Group has retained a proportion of the issued notes, the assets attributable to the retained amount are shown as unencumbered above.

The analysis at row 121 is provided in order to explain the use of encumbrance within the business, as required by Regulation 2017/2295.

Collateral received (Template B)

This template sets out items which might not be shown on a firms balance sheet, but which are nonetheless available for encumbrance. In the Group's case these will include retained notes in its securitisations, which are eliminated on consolidation, but may be used as collateral in future borrowing arrangements. The assets backing these notes will be included amongst the unencumbered assets in table A. Collateral which is not available for encumbrance is not required to be shown in the table.

		Fair value of encumbered collateral received or own debt securities issued	Fair value of collateral received or own debt securities issued available for encumbrance
Row Ref		**£m**	**£m**
	At 30 September 2019		
130	Collateral received by the organisation	-	-
240	Own debt securities issued other than own covered bonds or Asset Backed Securities (ABS)	-	-
241	*Own covered bonds and ABS issued and not yet pledged*	**N/A**	**317.2**
250	**Total assets, collateral received and own debt securities issued***	-	-
	At 30 September 2018		
130	Collateral received by the organisation	-	-
240	Own debt securities issued other than own covered bonds or Asset Backed Securities (ABS)	-	-
241	*Own covered bonds and ABS issued and not yet pledged*	N/A	194.9
250	**Total assets, collateral received and own debt securities issued***	-	-

* The total on line 250 excludes, by definition, own covered bonds and ABS issued but not yet pledged.

Encumbered Assets / Collateral Received and associated liabilities (Template C)

This table sets out those of the Group's liabilities and contingent liabilities in respect of which it has given security, or otherwise encumbered assets, set out in the left-hand column. In the right-hand column is set out the value of the Group's assets or collateral to which it is entitled, which are encumbered in respect of those liabilities.

Row Ref		Matching liabilities, contingent liabilities or securities lent £m	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m
	At 30 September 2019		
010	Carrying amount of selected financial liabilities	**6,644.2**	**7,534.4**
011	*Asset Backed Securities*	**4,781.2**	**5,023.4**
	Secured bank borrowings	**964.1**	**982.7**
	Central bank borrowings	**1,009.4**	**1,562.4**
	Other sources of encumbrance	**140.8**	**185.9**
	Total sources of encumbrance	**6,785.0**	**7,716.7**
	At 30 September 2018		
010	Carrying amount of selected financial liabilities	7,773.2	8,621.3
011	*Asset Backed Securities*	5,686.4	6,059.7
	Secured bank borrowings	984.6	1,094.3
	Central bank borrowings	974.4	1,489.3
	Other sources of encumbrance	138.5	184.0
170	**Total sources of encumbrance**	7,764.9	8,805.8

Regulation 2017/2295 requires only line 010 above, but provides that firms should additionally disclose sufficient information to explain their use of emcumbrance.

Narrative information (Template D)

The narrative information required by template D is set out within this section 6.

7. Counterparty credit risk

This section sets out

- An overview of the Group's policy on counterparty credit exposure
- The Group's institutional exposures and the ratings used for these balances

The Group's Treasury Policy statements include policies covering liquidity risk, interest risk, foreign exchange risk and counterparty risk, which are used to manage the credit risk that arises from exposures to treasury counterparties. The Counterparty Policy limits the Group's exposure to individual counterparties and compliance with the policy is reviewed monthly by ALCO. The Group requires all counterparties with which it contracts to meet specific credit rating criteria.

In order to control credit risk relating to counterparties to the Group's derivative financial instruments and cash deposits, ALCO determines which counterparties the Group will deal with, establishes limits for each counterparty and monitors compliance with those limits. Exposure is monitored daily by senior management within the Group's Treasury function and is reported monthly to ALCO. Counterparties are typically highly rated banks and, for all cash deposits and derivative positions held within the Group's securitisation structures, must comply with criteria set out in the financing arrangements, which are monitored externally.

Where a derivative counterparty to the Group's cross-currency basis swaps fails to meet the required criteria, they are obliged under the terms of the instruments to set aside a cash collateral deposit. The amounts of these cash collateral deposits, which are held in escrow and do not form part of the Group's cash position, are included in the amount shown below.

The Group uses the International Swaps and Derivatives Association ('ISDA') Master Agreement for documenting certain derivative activity. For certain counterparties a Credit Support Annex ('CSA') has been executed in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between counterparties to mitigate the market contingent counterparty risk inherent in the outstanding positions. Collateral pledged to the Group is shown below.

This use of collateral is the only credit mitigation technique used by the Group.

While the Group's counterparty credit risk policies cover all of its institutional exposures, the CRR defines counterparty credit risk for the Group as the credit risk relating to its derivative asset exposures only.

Summary of exposures

The Group's counterparty credit risk exposures can be summarised as shown below.

	Carrying value		Exposure value	
	2019	2018	**2019**	2018
	£m	£m	**£m**	£m
Institutional exposures				
Derivative financial assets	**592.4**	855.7	**286.4**	435.8
Bank deposits	**409.0**	414.7	**81.8**	82.9
CSA assets	**72.2**	-	**36.1**	-
Total institutional exposures	**1,073.6**	1,270.4	**404.3**	518.7
Sovereign exposures				
Central bank deposits	**816.4**	895.9	**-**	-
CRDs	**11.4**	6.2	**-**	-
Accrued interest on sovereign exposures	**0.2**	0.4	**-**	-
Total sovereign exposures	**828.0**	902.5	**-**	-
Total counterparty credit exposures	**1,901.6**	2,172.9	**404.3**	518.7

Derivative financial assets

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, and the Credit Quality Step ('CQS') to which these are mapped by the regulator, is set out below.

		Carrying value		Exposure value	
		2019	2018	**2019**	2018
		£m	£m	**£m**	£m
Counterparties rated					
AA	(CQS 1)	**7.3**	7.9	**1.8**	2.0
AA-	(CQS 1)	**155.6**	169.7	**37.6**	41.0
A+	(CQS 2)	**388.8**	5.4	**228.4**	3.1
A	(CQS 2)	**5.5**	630.2	**6.4**	373.2
A-	(CQS 2)	**35.2**	-	**22.6**	-
BBB+	(CQS 3)	**-**	42.5	**-**	29.9
Gross exposure		**592.4**	855.7	**296.8**	449.2
Collateral amounts posted		**(64.1)**	(77.8)	**(10.4)**	(13.4)
Net exposure		**528.3**	777.9	**286.4**	435.8

Source: Group Accounts (excluding exposure values)

The carrying values shown above are calculated as the fair value of the assets at the balance sheet date in accordance with the provisions of IFRS 13 – 'Fair Value Measurement'. The exposure values are calculated according to the Standardised Approach for risk weighting and include allowances for potential future exposure ('PFE') on all derivatives whether they are currently assets or liabilities.

The increase in reported credit quality is due to upgrades in the year to the ratings of two of the Group's principal counterparties, Barclays and RBS.

The reduction in exposure value shown against the collateral amounts posted represents the impact on risk weighted assets of the use of the collateral for the purpose of credit risk mitigation.

Cash collateral deposits placed by derivative counterparties are held with UK banks or other entities which satisfy a minimum rating of at least F1 and a long-term default rating of A by Fitch, and similar ratings by other agencies. These deposits will therefore always qualify for CQS 1.

The only financial instruments to which the Group is a party which require the posting of collateral are certain interest rate swaps in Paragon Bank documented under the ISDA Master Agreement. For certain counterparties to such swaps a CSA has been executed, and the amount of collateral posted by the Group under such CSA agreements at 30 September 2019 was £72.2m (30 September 2018: £3.8m). This amount remains on the Group balance sheet.

Short term investments

The Group may hold short term investments within the Bank as part of the liquidity buffer it is required to hold by the PRA. These investments may only be placed in treasury bills and gilts issued by the UK government, or such similar instruments as are permitted by the regulator, and as such the credit risk was judged to be minimal.

No such securities were held at either 30 September 2019 or 30 September 2018, but the Group held this type of investment during the year.

Cash and cash equivalents

The Group's cash balances are held in sterling at the Bank of England and highly rated banks in current accounts and as short fixed term deposits and money market placements. The Group has a large exposures policy to mitigate any concentration risk in respect of its cash deposits.

The list of institutions where the Group's cash balances may be placed is agreed annually by ALCO, but kept under permanent review by the Treasury function. Counterparties for corporate deposits must be rated at least P-2 by Moody's and/or A-2 by Standard and Poors and/or F2 by Fitch Ratings. Counterparties for deposits in SPV companies must be rated at least P-1 by Moody's and/or A-1 by Standard and Poors and/or F1 by Fitch Ratings.

The SPV deposits, which comprise the greatest proportion of the Group's cash position, will therefore always qualify for CQS 1, with other deposits qualifying for at least CQS 2. Credit risk on these balances and the interest accrued thereon is considered to be minimal.

8. Interest rate risk

This section sets out
• An overview of the Group's exposure to interest rate risk
• The sources of that risk
• The Group's approach to controlling the risk
• An illustration of the Group's sensitivity to movements in interest rates

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.

IRRBB exposures

Risk exposure in the Group's operations might occur through:

- Gap or repricing 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 reprice with reference to different reference interest rates, for example rates set by the Group and market rates, such as Bank of England base rate, SONIA and LIBOR. Relative changes in the difference between the reference rates over time may impact earnings
- Option or prepayment risk. The risk that settlement of asset and liability balances at different times from those forecast due to economic conditions or customer behaviour may create a mismatch in future periods

Due to the maturity transformation inherent in the Group's business model it is also exposed to the risk that the relationship between the rates affecting the shorter-term funding balance and the rates affecting the longer-term lending balance will have altered when the funding has to be refinanced.

The principal market-set interest rate used by the Group is the London Interbank Offered Rate ('LIBOR') which is used to set rates for certain loan assets and borrowings. During the year, the Group issued its first debt with interest set by reference to the Sterling Overnight Index Average ('SONIA'), which is expected to be used more widely going forward.

Interest rate benchmarks such as LIBOR have been subject to increasing global regulatory scrutiny. In July 2017 the FCA announced that it was its intention that by the end of 2021 it would no longer compel banks to make submissions to the LIBOR setting process. As a result of this, LIBOR is expected to be discontinued and alternative reference rates are being developed. For LIBOR, the Bank of England's Working Group on Sterling Risk-Free Interest Rates recommended SONIA as that alternative. However, there remains significant uncertainty as to how the transition from LIBOR and other Interbank Offered Rates to alternative benchmarks will be managed across the banking industry.

LIBOR is used in setting interest rates on significant amounts of the Group's loan assets and borrowings and the Group has established an internal working group to identify the impact on the business and ensure an orderly transition from LIBOR to other reference rates.

Managing IRRBB

The Group has a dedicated Treasury function which is responsible for the day-to-day management of interest rate risk within Board approved limits. Measurement of IRRBB is reported to ALCO on a monthly basis who provide control and oversight, and report to the Risk and Compliance Committee.

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 for 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.

The Group measures IRRBB 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 has performed stress testing in order to assess whether a Pillar 2a add-on is required for interest rate risk and capital has been provided in accordance with the results.

Interest rate sensitivity

The sensitivity of the Group's earnings to movements in UK interest rates is illustrated below. This table shows the effect of a 1.0% movement in interest rates on the annual interest payable or receivable on those of the Group's assets and liabilities which bear interest at variable rates, based on the balances outstanding on such assets and liabilities at 30 September 2019 and 30 September 2018. For the purpose of this disclosure, movements in bank base rates and market interest rates are assumed to be broadly parallel and movements in market rates are assumed to be passed on immediately to borrowers and depositors where rates are in the Group's control. Any repricing is assumed to take place on the year end date.

	2019	2018
	£m	£m
Variable rate mortgage loans	**49.4**	61.8
Variable rate consumer loans	**3.3**	3.9
Portfolio hedging on fixed rate loans	**26.8**	34.4
Interest bearing cash balances	**22.2**	12.6
Sterling equivalent principal of FRN and warehouse borrowings	**(47.1)**	(56.7)
TFS funding at bank base rate	**(9.4)**	(9.4)
Variable rate retail deposits	**(22.3)**	(16.5)
Portfolio hedging on fixed rate retail deposits	**(22.2)**	(19.6)
	0.7	10.5

It should be noted that such a change in rates might have other impacts on the Group's performance and that the extent to which increases in rates can be passed on to certain customers may be limited by commercial and regulatory factors.

The sensitivity set out above is illustrative only, and much simplified from those used to manage IRRBB in practice.

9. Liquidity risk

This section sets out

- An overview of the Group's exposure to liquidity risk and liquidity position
- The Group's approach to managing this risk
- Key metrics relating to liquidity risk
- Sources of further available liquidity

Liquidity risk exposure represents the amount of potential stressed outflows in any future period less expected inflows. Liquidity is considered from both an internal and a regulatory perspective. The Group's most material source of liquidity risk arises from the Bank's obligations to retail depositors and that exposure, which is subject to PRA regulation, is considered here.

The Board has set a liquidity risk appetite which aims to ensure a sufficient level of liquidity is held to cover any unexpected outflows, such that the Group is always able to meet its short-term commitments as required. The risk appetite set takes into consideration appropriate liquidity risk stresses to ensure liquidity remains appropriate throughout a target survival period.

The Group's retail funding strategy is focused on building a stable mix of deposit products. A high proportion of balances, 97.8% (2018: 97.9%), are protected by the Financial Services Compensation Scheme ('FSCS') which mitigates against the possibility of a retail run.

The cash outflows, including principal and estimated interest contractually required by the Group's retail deposit balances, analysed by the earliest date at which repayment can be demanded are set out below:

	2019	2018
	£m	£m
Payable on demand	**1,783.9**	1,294.3
Payable in less than three months	**482.7**	281.9
Payable in less than one year but more than three months	**2,151.4**	2,098.6
Payable in less than one year or on demand	**4,418.0**	3,674.8
Payable in one to two years	**1,210.1**	1,068.8
Payable in two to five years	**982.4**	720.8
	6,610.5	5,464.4

Source: Group Accounts

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 ILAAP submitted by the Bank. The ILAAP determines the liquid resources that must be maintained in the Bank to meet its Overall Liquidity Adequacy Requirement ('OLAR') and to ensure that it can meet its liabilities as they fall due. It is based on an analysis of its business as usual forecast cash requirements but also considers their predicted behaviour in stressed conditions.

At 30 September 2019 the liquidity buffer comprised the following on and off balance sheet assets, all held within the Bank.

	2019	2018
	£m	£m
Balances with central banks	**646.4**	724.9
Short term investments	**-**	-
Total on balance sheet liquidity	**646.4**	724.9
FLS drawings	**109.0**	108.7
Total	**755.4**	833.6

Source: Group Accounts

Risk monitoring

To protect the Group and its customers against the effects of liquidity risk, the Group performs regular assessments of its liquidity position through meetings of the Liquidity Outlook Group ('LOG'), ALCO and the ILAAP.

LOG meetings occur weekly and comprise senior operational, treasury, finance and savings managers who meet to ensure a sufficient liquidity position is being held as well as to forecast any upcoming liquidity surplus or deficits to ensure appropriate action can be taken. The outcomes and key findings from LOG meetings are then escalated to ALCO meetings to ensure a clear and consistent communication line is maintained.

Through the LOG process, the Bank manages its Liquidity Coverage Ratio ('LCR'), the level of its High Quality Liquid Assets ('HQLA) relative to its short term forecast net cash outflows. A minimum level of LCR, the Liquidity Coverage Requirement, is set through regulation for all regulated financial institutions. 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.

Through the ILAAP the Group assesses the level of liquidity required to prudently cover a wide variety of systemic and idiosyncratic risks. This process identifies a liquidity buffer for the Group to hold in order to cover such circumstances.

Key Liquidity Indicators

Key liquidity indicators for regulatory purposes are monitored at the level of the firm, rather than the consolidated group. The only entity within the Group subject to such regulation is the Bank, and its liquidity measures are set out below.

Indicator	**2019**	2018	Regulatory minimum
LCR	**138%**	144%	100%
NSFR	**115%**	113%	100%†

† not yet a binding requirement

The LCR is designed to ensure financial institutions have the necessary HQLA on hand to cover net cash outflows during a 30-day period in a liquidity stress scenario. Various inflow and outflow rates are prescribed for assets and liabilities to reflect their assumed behaviour in stressed conditions.

The NSFR measures the amount of longer-term, stable sources of funding used by financial institutions in relation to the composition of their assets and off-balance sheet activities. Various weightings are prescribed for the components of stable funding and the assets being financed.

The above ratios are likely to normalise as the scale of the Bank's activities grow.

Appendix E sets out certain of the disclosures on liquidity mandated by the EBA Guidelines on LCR disclosure (EBA/GL/2017/01), appropriate to the Group's size.

Potential liquidity

At 30 September 2019 the Group had £5,165.3m of unencumbered loan assets at carrying value, which might be used to generate liquidity either as security for debt, or through sales (2018: £4,334.5m). Of these £1,873.7m had been pre-positioned with the Bank of England, giving rapid access to central bank funding (2018: £1,171.1m).

This provides the Group with the ability to raise funds at short notice, if required, and therefore aids the liquidity position.

Available cash at the year end, excluding balances included in the liquidity buffer and already charged balances, was £225.7m (2018: £238.0m).

Further information

More details on the Group's wider, longer-term liquidity exposure are given in note 58 to the Group Accounts.

10. Securitisation

This section sets out

- The Group's involvement in securitisation
- The location of the information required to be disclosed under Part 8

One of the Group's principal sources of funding is asset securitisation. The largest part of this funding relates to securitisations issued under the 'Paragon Mortgages' programme but other issues have been made from time to time to support other parts of the business. In each of these transactions a group company acts as issuer of the securitised debt and group companies act as administrator of the assets after the completion of the deal.

The strategy underlying the Group's securitisation activities is to gain access to attractive funding rates for its lending activities and to mitigate liquidity risk by match funding the underlying loan assets. The structures are not intended to achieve significant transfer of credit risk away from the Group. The risk relating to the underlying assets therefore remains with the Group and is included in the credit risk analyses in this document.

All of the Group's loan assets funded through securitisation are included in 'loans to customers' in the Group Accounts and risk weighted accordingly. The amount of the Group's loan assets funded through securitisation is shown in Section 6 – 'Asset encumbrance'.

There are no specific capital requirements for the Group's securitisation vehicle companies.

The Group has no exposures to purchased securitisation positions.

Derecognition of securitised assets

During the year ended 30 September 2019 the Group disposed of its remaining interest in a legacy securitisation transaction, Paragon Mortgages (No. 12) PLC ('PM12'). The Group's exposure was reduced to the point where the assets and liabilities of the deal were derecognised and no amount is included in risk weighted assets in respect of this transaction.

The Group continues to administer PM12, but receives only an arms length administration fee.

Further details of the transcation, including the assets and liabilities derecognised and the gain realised, are set out in note 7 to the Group Accounts.

Further information

A more detailed description of the Group's securitisation activities and how they affect the Group's risk profile and contribute to its risk management objectives is given in note 58 to the Group Accounts.

Further information on the Group's securitisations, including average funding rates, outstanding balances and redemption dates, on a transaction by transaction basis is provided in note 32 to the Group Accounts and detailed information on each of the Group's public securitisation transactions is published in the 'Bond Investor Reporting' section of the Group's corporate website at www.paragonbankinggroup.co.uk

11. Remuneration policies and practices

This section sets out

- The basis on which the Group is required to disclose information on remuneration under CRD IV
- Information on remuneration governance and practices
- Disclosures required on the remuneration of certain employees
- The location of further relevant disclosures on remuneration

The Bank is required to prepare Remuneration Code Pillar III disclosures in addition to the regulatory capital disclosures. As all of the information which must be included in the disclosures is also relevant to the Group as a whole, these disclosures have been included in this document instead of being presented separately.

PRA Supervisory Statement LSS8/13 'Remuneration Standards: the application of proportionality' (updated June 2015) categorises the Bank within proportionality level 3, as a bank with total assets of less than £15 billion, reducing the level of disclosures required by Part 8. This supervisory statement also sets out the PRA view that the requirement for remuneration disclosures applies only to CRR firms directly.

Following the Group's reorganisation on 20 September 2017, the directors of the Company have also constituted the Board of Directors of the Bank and the members of its Remuneration Committee have comprised the Remuneration Committee of the Bank.

Governance

The Board of Directors of the Bank has delegated the responsibility for oversight of its remuneration policy and the remuneration decision making process to its Remuneration Committee.

The Committee comprised the Chair of the Board and three independent non-executive directors at the year-end and was chaired by one of the independent non-executive directors. The terms of reference for the Remuneration Committee have been approved by the Bank's Board of Directors. The Remuneration Committee's mandate is to:

1. Determine remuneration policy in relation to fixed and variable pay for employees
2. Ensure that executive directors and senior employees of the Bank are fairly rewarded for their individual contributions to overall performance, having regard to the importance of retention, motivation, risk appetite and achievement of good customer outcomes
3. Apply the EBA Guideline 5.2 to determine which employees are Remuneration Code Staff ('Code Staff') for the purposes of the Remuneration Code. The Bank considers the following to be Code Staff:
    i. Paragon Bank executive directors
    ii. Paragon Bank independent non-executive directors
    iii. Employees performing selected roles which have significant influence on the firm's risk profile ('Material Risk Takers' or 'MRT') including selected control functions, as detailed under the Senior Managers and Certification Regime ('SMCR'); either requiring regulatory approval as holding a Senior Management Function ('SMF') role or included in the Certification Regime
4. Determine levels of fixed and variable pay for individual Code Staff and, as appropriate, for certain schemes, consider the application of malus and clawback
5. Ensure that its decisions are consistent with an assessment of the Bank's financial condition and future prospects and in the interests of its shareholders and other stakeholders
6. Monitor that the Bank is fully compliant with the requirements of the PRA/FCA's Remuneration Code

Advisors

During the year, the Remuneration Committee considered advice from:

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

  The total fees paid to Deloitte for advice to the Committee during the year amounted to £160,000 (including VAT). Deloitte provided other professional services to the Group during the year including share scheme advice, regulatory support, customer contact support and co-sourced internal audit services

- The CEO, the Chair of the Risk and Compliance Committee, the People Director and Chief Risk Officer in determining remuneration for the year for executive directors and senior management

Link between pay and performance

Fixed pay (salary and benefits) is primarily set considering market rates and benchmarks as appropriate. Variable pay is determined via a combination of long-term performance measures and individual performance ratings.

Long-term business performance measures

The long-term business performance measures are documented in long-term incentive schemes which are operated and provided by the Group, details of which are set out in the Group Accounts.

Individual performance ratings

Individual performance ratings are part of the annual review process and reflect individual contribution against personal objectives. Appropriate risk conduct is reflected in the annual performance objectives, and subsequent rating of the employee.

Aggregate quantitative information on remuneration

Year ended 30 September 2019			
	Senior Management*	**Other MRT****	**Totals**
Number of Code Staff	**15**	**36**	**51**
Remuneration	**£000**	**£000**	**£000**
Fixed remuneration	**2,874**	**4,966**	**7,840**
Variable remuneration – cash	**2,840**	**2,085**	**4,925**
Cash paid in year	**5,714**	**7,051**	**12,765**
Variable remuneration - deferred in shares†	**2,883**	**2,822**	**5,705**
Total deferred in current year	**2,883**	**2,822**	**5,705**
Total remuneration	**8,597**	**9,873**	**18,470**

Year ended 30 September 2018			
	Senior Management*	Other MRT**	Totals
Number of Code Staff	14	-	14
Remuneration	£000	£000	£000
Fixed remuneration	2,636	-	2,636
Variable remuneration – cash	2,492	-	2,492
Cash paid in year	5,218	-	5,218
Variable remuneration - deferred in shares†	3,281	-	3,281
Total deferred in current year	3,281	-	3,281
Total remuneration	8,409	-	8,409

Notes to the remuneration table

The number of Code Staff represents the number of persons who held a regulatory authorised role at any point in the year. Code staff include four independent non-executive directors, the independent Chairman and senior business, risk, compliance and control personnel. Code staff work across all business areas and therefore it is not appropriate to present a split of this information by business area.

During the year, the Bank completed an internal review of the application of the remuneration policy in accordance with the EBA's Guidelines 5.2 – 'Governance of the MRT Identification Process' and agreed to change the definition of Code Staff to align with the Bank's approach to the identification of roles to be included within SMCR.

* Senior management are defined as those staff who hold an approved SMF role under the SMCR.

** Other MRT are defined as other employees whose roles which fall within the Certification Regime under the SMCR.

† Share based remuneration is valued on the basis of the market value of shares granted at the date of grant.

Further information

Information on the remuneration of the directors and senior personnel of the Group is contained in the Directors' Remuneration Report presented as Section B6 of the Group Accounts. This report includes:

- Details of the operation of the Remuneration Committee, including its membership and the number of meetings held
- The design of variable remuneration, including share based awards, and the vesting and deferral criteria applied
- Details of the Group's external advisers on remuneration
- The Group's remuneration policy statement, which includes policies on levels and forms of remuneration, initial arrangements and severance provisions

12. Glossary

This section sets out

- A listing of defined terms used in the document.

ALCO	Asset and Liability Committee
AT1	Additional Tier 1
BCBS	Basel Committee on Banking Supervision
BCP	Business Continuity Plan
BIA	Basic Indicator Approach
CC	Credit Committee
CCC	Conduct and Compliance Committee
CCoB	Capital Conservation Buffer
CCyB	Counter Cyclical Buffer
CEO	Chief Executive Officer
CET1	Common Equity Tier 1
CFO	Chief Financial Officer
Code Staff	Remuneration Code Staff
CQS	Credit Quality Step
CRD	Capital Requirements Directive
CRD IV	Capital Requirements Directive IV
CRO	Chief Risk Officer
CRR	Capital Requirements Regulation
CSA	Credit Support Annex
C-SREP	Capital Supervisory Review and Evaluation Process
Deloitte	Deloitte LLP
EBA	European Banking Authority
ECAI	External Credit Assessment Institutions
EIR	Effective Interest Rate
ERC	Estimated Remaining Collections
ESOP	Employee Share Ownership Plan
EU	European Union
EV	Economic Value
FCA	Financial Conduct Authority
FLA	Finance and Leasing Association
FLS	Funding for Lending Scheme
FPC	Financial Policy Committee (of the Bank of England)
FRC	Financial Reporting Council
FRN	Floating Rate Note
FSCS	Financial Services Compensation Scheme
Group Accounts	Annual Report and Accounts of Paragon Banking Group PLC for the year ended 30 September 2019
G-SII	Global Systematically Important Institution
HQLA	High Quality Liquid Assets
IAS	International Accounting Standards
ICAAP	Internal Capital Adequacy Assessment Process
ICR	Individual Capital Requirement
IFRS	International Financial Reporting Standard(s)
ILAAP	Internal Liquidity Adequacy Assessment Process
ILG	Individual Liquidity Guidance
ILTR	Bank of England Indexed Long-Term Repo scheme
IRB	Internal Ratings Based
IRRBB	Interest Rate Risk in the Banking Book
ISDA	International Swaps and Derivatives Association
LCR	Liquidity Coverage Ratio
LIBOR	London Interbank Offered Rate
LOG	Liquidity Outlook Group
L-SREP	Liquidity Supervisory Review and Evaluation Process
LTGDV	Loan to Gross Development Value
LTV	Loan to value

MCR	Minimum Capital Requirement
MRC	Model Risk Committee
MRT	Material Risk Taker
NII	Net Interest Income
NSFR	Net Stable Funding Ratio
OLAR	Overall Liquidity Adequacy Requirement
ORC	Operational Risk Committee
O-SII	Other Systematically Important Institution
Part 8	Part 8 of the CRR
PFE	Potential Future Exposure
PM12	Paragon Mortgages (No. 12) PLC
POCI	Purchased or Originated Credit Impaired
Portfolio Quality	Average risk weightings applied to portfolios
Portfolio Size	Unweighted value of portfolios
PRA	Prudential Regulation Authority
RCC	Risk and Compliance Committee
Regulatory minimum / maximum	Where applicable, the minimum or maximum levels set by the PRA, FCA or other regulatory bodies
Risk appetite	The maximum level of risk the Group is prepared to take to meet its strategic objectives
Risk appetite limit	The level of risk which, if breached, would require immediate corrective action and escalation to the RCC or Board
Risk appetite target	The level at, or range within, which the Group would, in normal circumstances, wish to operate
Risk appetite trigger	The level at which escalation will occur to the next RCC because the risk profile is sufficiently close to the risk appetite limit to warrant corrective actions being considered
Risk capacity	The maximum level of risk at which the Group can operate whilst remaining within the constraints implied by capital and funding needs and the obligations to its stakeholders
Risk profile	The Group's entire risk landscape reflecting the nature and scale of its risk exposures aggregated within and across each relevant risk category
RoR	Receiver of Rent
RP	Recovery Plan
RWA	Risk Weighted Assets
SA	Standardised Approach
SMCR	Senior Managers and Certification Regime
SME	Small and/or Medium Sized Enterprise
SMF	Senior Management Functions
SONIA	Sterling Overnight Index Average
SPV	Special Purpose Vehicle
SREP	Supervisory Review and Evaluation Process
TFS	Term Funding Scheme
The Bank	Paragon Bank PLC
The 2016/2018 Code	The UK Corporate Governance Code (2016/2018 version)
The Company	Paragon Banking Group PLC
The Group	Paragon Banking Group PLC and all its subsidiary entities
The Plan	The defined benefit pension plan operated by the Group
TRE	Total Risk Exposure
UK	United Kingdom
UKF	UK Finance
Wrong Way Risk	Risk arising either due to a material positive correlation between collateral and counterparty or arising due to counterparty credit risk

Appendix A

Own funds disclosures

CAPITAL INSTRUMENTS' MAIN FEATURES

Presented in accordance with Annex II of Commission Implementing Regulation (EU) No 1423/2013.

		1	2
		EQUITY	2016 CORPORATE BOND
1	Issuer	Paragon Banking Group PLC	Paragon Banking Group PLC
2	Unique identifier (eg. CUSIP, ISIN or Bloomberg identifier for private placement)	ISIN GB00B2NGPM57	ISIN XS1482136154
3	Governing law(s) of the instrument	England and Wales	England and Wales
REGULATORY TREATMENT			
4	Transitional CRR rules	N/A	N/A
5	Post-transitional CRR rules	Common Equity Tier 1	Tier 2
6	Eligible at solo/(sub-) consolidated/ solo and (sub-) consolidated	Solo and (sub) consolidated	Solo and (sub) consolidated
7	Instrument type (types to be specified by each jurisdiction)	Ordinary Shares	Corporate Bond
8	Amount recognised in regulatory capital (currency in million, as most recent reporting date)	£329.9m	£150.0m
9	Nominal amount of instrument	£261.6m	£150.0m
9a	Issue price	Nominal value £1†	Par
9b	Redemption price	N/A	Par
10	Accounting classification	Shareholders' Equity	Liability-amortised cost
11	Original date of issuance	Original listing date 15 May 1989*	9 September 2016
12	Perpetual or dated	Perpetual	Dated
13	Original maturity date	No maturity	9 September 2026
14	Issuer call subject to prior supervisory approval	No	Yes
15	Optional call date, contingent call dates and redemption amount	N/A	Callable by issuer on 9 September 2021 Tax and Regulatory calls also
16	Subsequent call dates, if applicable	N/A	N/A
COUPONS / DIVIDENDS			
17	Fixed or floating dividend/coupon	Floating	Fixed‡
18	Coupon rate and related index	N/A	7.25%
19	Existence of a dividend stopper	N/A	No
20a	Fully discretionary, partially discretionary or mandatory (in terms of timing)	Fully discretionary	Mandatory
20b	Fully discretionary, partially discretionary or mandatory (in terms of amount)	Fully discretionary	Mandatory
21	Existence of step up or other incentive to redeem	No	No
22	Non-cumulative or cumulative	Non-cumulative	Cumulative

COUPONS / DIVIDENDS			
23	Convertible or non-convertible	Non-convertible	Non-convertible
24	If convertible, conversion trigger(s)	N/A	N/A
25	If convertible, fully or partially	N/A	N/A
26	If convertible, conversion rate	N/A	N/A
27	If convertible, mandatory or optional conversion	N/A	N/A
28	If convertible, specify instrument type convertible into	N/A	N/A
29	If convertible, specify issuer of instrument it converts into	N/A	N/A
30	Write-down features	N/A	No
31	If write-down, write-down trigger(s)	N/A	N/A
32	If write-down, full or partial	N/A	N/A
33	If write-down, permanent or temporary	N/A	N/A
34	If temporary write-down, description of write-up mechanism	N/A	N/A
35	Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	2	N/A
36	Non-compliant transitioned features	No	No
37	If yes, specify non-compliant features	N/A	N/A

† Shares have been issued at various different premiums from time to time.

* This is the date of the first listing of the Company's ordinary shares. There have been restructurings since that date and further shares have been issued from time to time.

‡ Subject to market based repricing five years after issue.

Full terms of business for the Group's Common Equity Tier 1 and Tier 2 instruments are provided on the Investor Relations section of its website https://www.paragonbankinggroup.co.uk/investors

OWN FUNDS DISCLOSURE

Presented in accordance with Annex IV from the Commission Implementing Regulation (EU) No 1423/2013.

		2019 £m	2018 £m	REGULATION (EU) NO 575/2013 ARTICLE REFERENCE
COMMON EQUITY TIER 1 (CET1) CAPITAL: INSTRUMENTS AND RESERVES				
1	Capital instruments and the related share premium accounts	329.9	347.4	26 (1), 27, 28, 29
	Of which: ordinary shares	329.9	347.4	EBA list 26 (3)
2	Retained earnings	835.9	890.7	26 (1) (c)
3	Accumulated other comprehensive income (and other reserves)	(57.4)	(142.2)	26 (1)
3a	Funds for general banking risk	-	-	26 (1) (f)
4	Amount of qualifying items referred to in Article 484 (3) and the related share premium accounts subject to phase out from CET1	-	-	486 (2)
5	Minority interests (amount allowed in consolidated CET1)	-	-	84
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	(35.8)	(35.8)	26 (2)
6	**Common Equity Tier 1 (CET1) capital before regulatory adjustments**	**1,072.6**	**1,060.1**	**Sum of rows 1 to 5a**

		2019 £m	2018 £m	REGULATION (EU) NO 575/2013 ARTICLE REFERENCE
COMMON EQUITY TIER 1 (CET1) CAPITAL: REGULATORY ADJUSTMENTS				
7	Additional value adjustments (negative amount)	(0.7)	(0.9)	34, 105
8	Intangible assets (net of related tax liability) (negative amount)	(171.1)	(169.3)	36 (1) (b), 37
9	Empty set in the EU			
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38 (3) are met) (negative amount)	-	-	36 (1) (c), 38
11	Fair value reserves related to gains or losses on cash flow hedges	-	-	33 (1) (a)
12	Negative amounts resulting from the calculation of expected loss amounts	-	-	36 (1) (d), 40, 159
12a	IFRS 9 transitional adjustment to CET1	21.2	-	
13	Any increase in equity that results from securitised assets (negative amount)	-	-	32 (1)
14	Gains or losses on liabilities valued at fair value resulting from changes in own credit standing	-	-	33 (1) (b)
15	Defined-benefit pension fund assets (negative amount)	-	-	33 (1) (e), 41
16	Direct and indirect holdings by an institution of own CET1 instruments (negative amount)	-	-	36 (1) (f), 42
17	Direct, indirect and synthetic holdings of the CET 1 instruments of financial sector entities, where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	-	-	36 (1) (g), 44
18	Direct, indirect and synthetic holdings by the institution of the CET 1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	-	36 (1) (h), 43, 45, 46, 49 (2) (3), 79
19	Direct, indirect and synthetic holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	-	36 (1) (i), 43, 45, 47, 48 (1) (b), 49 (1) to (3), 79
20	Empty set in the EU			
20a	Exposure amount of the following items which qualify for a RW of 1250% where the institution opts for the deduction alternative	-	-	36 (1) (k)
20b	Of which: qualifying holdings outside the financial sector (negative amount)	-	-	36 (1) (k) (i), 89 to 91
20c	Of which: securitisation positions (negative amount)	-	-	36 (1) (k) (ii), 243 (1) (b), 244 (1) (b), 258
20d	Of which: free deliveries (negative amount)	-	-	36 (1) (k) (iii), 379 (3)
21	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability where the condition in Article 38 (3) are met (negative amount)	-	-	36 (1) (c), 38, 48 (1) (a)
22	Amount exceeding the 15% threshold (negative amount)	-	-	48 (1)

		2019 £m	2018 £m	REGULATION (EU) NO 575/2013 ARTICLE REFERENCE
23	Of which: direct and indirect holding by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities	-	-	36 (1) (i), 48 (1) (b)
24	Empty set in the EU			
25	Of which: deferred tax assets arising from temporary differences	-	-	36 (1) (c), 38, 48 (1) (a)
25a	Losses for the current financial year (negative amount)	-	-	36 (1) (a)
25b	Foreseeable tax charges relating to CET1 items (negative amount)	-	-	36 (1) (i)
27	Qualifying AT1 deductions that exceed the AT1 Capital of the institution (negative amount)	-	-	36 (1) (j)
28	**Total regulatory adjustments to Common Equity Tier 1 (CET 1)**	**(150.6)**	**(170.2)**	**Sum of rows 7 to 20a, 21, 22 and 25a to 27**
29	**Common Equity Tier 1 (CET1)**	**922.0**	**889.9**	**Row 6 minus row 28**
ADDITIONAL TIER 1 (AT1) CAPITAL INSTRUMENTS				
30	Capital instruments and the related share premium accounts	-	-	51, 52
31	Of which: classified as equity under applicable accounting standards	-	-	-
32	Of which: classified as liabilities under applicable accounting standards	-	-	-
33	Amount of qualifying items referred to in Article 484 (4) and the related share premium accounts subject to phase out from AT1	-	-	486 (3)
34	Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in row 5) issued by subsidiaries and held by third parties	-	-	85, 86
35	Of which: instruments issued by subsidiaries subject to phase out	-	-	486 (3)
36	**Additional Tier 1 (AT1) capital before regulatory adjustments**	**-**	**-**	**Sum of rows 30, 33 and 34**
ADDITIONAL TIER 1 (AT1) CAPITAL: REGULATORY ADJUSTMENTS				
37	Direct and indirect holdings by an institution of own AT1 instruments (negative amount)	-	-	52 (1) (b), 56 (a), 57
38	Direct, indirect and synthetic holdings of the AT1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	-	-	56 (b), 58
39	Direct, indirect and synthetic holdings of the AT1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	-	56 (c), 59, 60, 79
40	Direct, indirect and synthetic holdings by the institution of the AT1 instruments of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions) (negative amount)	-	-	56 (d), 59, 79
41	Empty set in the EU			
42	Qualifying T2 deductions that exceed the T2 capital of the institution (negative amount)	-	-	56 (e)

		2019 £m	2018 £m	REGULATION (EU) NO 575/2013 ARTICLE REFERENCE
43	**Total regulatory adjustments to Additional Tier 1 (AT1) Capital**	-	-	**Sum of rows 37 to 42**
44	**Additional Tier 1 (AT1) capital**	**-**	**-**	**Row 36 minus row 43**
45	**Tier 1 capital (T1 = CET1 + AT1)**	**922.0**	**889.9**	**Sum of row 29 and row 44**
TIER 2 (T2) CAPITAL: INSTRUMENTS AND PROVISIONS				
46	Capital instruments and the related share premium accounts	150.0	150.0	62, 63
47	Amount of qualifying items referred to in article 484 (5) and the related share premium accounts subject to phase out from T2	-	-	486 (4)
48	Qualifying own funds instruments included in consolidated T2 capital (including minority interests and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties	-	-	87, 88
49	Of which: instruments issued by subsidiaries subject to phase out	-	-	486 (4)
50	Credit risk adjustments	-	4.9	62 (c) & (d)
51	**Tier 2 (T2) capital before regulatory adjustments**	**150.0**	**154.9**	
TIER 2 (T2) CAPITAL: REGULATORY ADJUSTMENTS				
52	Direct and indirect holdings by an institution of own T2 instruments and subordinated loans (negative amount)	-	-	63 (b) (i), 66 (a), 67
53	Holdings of the T2 instruments and subordinated loans of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	-	-	66 (b), 68
54	Direct and indirect holdings of the T2 instruments and subordinated loans of financial sector entities where the institution does not have a significant investment in these entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	-	66 (c), 69, 70, 79
55	Direct and indirect holdings by the institution of the T2 instruments and subordinated loans of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions) (negative amount)	-	-	66 (d), 69, 79
57	**Total regulatory adjustments to Tier 2 (T2) capital**	**-**	**-**	**Sum of rows 52 to 56**
58	**Tier 2 (T2) capital**	**150.0**	**154.9**	**Row 51 minus row 57**
59	**Total capital (TC = T1 + T2)**	**1,072.0**	**1,044.8**	**Sum of row 45 and row 58**
60	**Total risk weighted assets**	**6,723.8**	**6,445.3**	
CAPITAL RATIOS AND BUFFERS				
61	Common Equity Tier 1 (as a percentage of total risk exposure amount)	13.7%	13.8%	92 (2) (a)
62	Tier 1 (as a percentage of total risk exposure amount)	13.7%	13.8%	92 (2) (b)
63	Total capital (as a percentage of total risk exposure amount)	15.9%	16.2%	92 (2) (c)

		2019 £m	2018 £m	REGULATION (EU) NO 575/2013 ARTICLE REFERENCE
64	Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus systemically important institution buffer expressed as a percentage of risk exposure amount)	11.50%	11.00%	CRD 128, 129, 130, 131, 133
65	Of which: capital conservation buffer requirement	2.50%	2.50%	
66	Of which: countercyclical buffer requirement	1.00%	0.50%	
67	Of which: systemic risk buffer requirement	-	-	
67a	Of which: Global Systematically Important Institution (G-SII) or Other Systematically Important Institution (O-SII) buffer	-	-	
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	5.7%	5.8%	CRD 128
AMOUNTS BELOW THE THRESHOLDS FOR DEDUCTION (BEFORE RISK WEIGHTING)				
72	Direct and indirect holdings of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	-	-	36 (1) (h), 46, 45, 56 (c), 59, 60, 66 (c), 69, 70
73	Direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	-	-	36 (1) (i), 45, 48
74	Empty set in the EU			
75	Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in Article 38 (3) are met)	-	-	36 (1) (c), 38, 48
APPLICABLE CAPS ON THE INCLUSION OF PROVISIONS IN TIER 2 36 (1) (C), 38, 48				
76	Credit risk adjustments included in T2 in respect of exposures subject to standardised approach (prior to the application of the cap)	-	4.9	62
77	Cap on inclusion of credit risk adjustments in T2 under standardised approach	-	-	62
78	Credit risk adjustments included in T2 in respect of exposures subject to internal ratings-based approach (prior to the application of the cap)	-	-	62
79	Cap for inclusion of credit risk adjustments in T2 under internal ratings-based approach	-	-	62
CAPITAL INSTRUMENTS SUBJECT TO PHASE-OUT ARRANGEMENTS (ONLY APPLICABLE BETWEEN 1 JAN 2014 AND 1 JAN 2022)				
80	Current cap on CET1 instruments subject to phase out arrangements	-	-	484 (3), 486 (2) & (5)
81	Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)	-	-	484 (3), 486 (2) & (5)
82	Current cap on AT1 instruments subject to phase out arrangements	-	-	484 (4), 486 (3) & (5)
83	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	-	-	484 (4), 486 (3) & (5)
84	Current cap on T2 instruments subject to phase out arrangements	-	-	484 (5), 486 (4) & (5)
85	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)	-	-	484 (5), 486 (4) & (5)

Appendix B

Leverage ratio disclosures

Presented in accordance with Annex 1 of the Commission Implementing Regulation (EU) 2016/200.

CRR Leverage Ratio

Reference Date	30 September 2019
Entity name	Paragon Banking Group PLC
Level of application	Consolidated

Table LRSum: Summary reconciliation of assets and leverage ratio exposures

		APPLICABLE AMOUNT	
		2019 £m	2018 £m
1	Total assets as per published financial statements	14,395.5	14,515.1
2	Adjustment for entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation	-	-
3	(Adjustment for fiduciary assets recognised on the balance sheet pursuant to the applicable accounting framework but excluded from the leverage ratio total exposure measure in accordance with Article 429(13) of Regulation (EU) No 575/2013)	-	-
4	Adjustments for derivative financial instruments	120.0	172.1
5	Adjustment for securities financing transactions (SFTs)	-	-
6	Adjustment for off-balance sheet items (ie conversion to credit equivalent amounts of off-balance sheet exposures)	164.2	248.5
EU-6a	(Adjustment for intragroup exposures excluded from the leverage ratio total exposure measure in accordance with Article 429(7) of Regulation (EU) No 575/2013)	-	-
EU-6b	(Adjustment for exposures excluded from the leverage ratio total exposure measure in accordance with Article 429(14) of Regulation (EU) No 575/2013)	-	-
7	Other adjustments	(145.3)	(141.0)
8	**Leverage ratio total exposure measure**	**14,534.4**	**14,794.7**

Table LRCom: Leverage ratio common disclosure

		CRR LEVERAGE RATIO EXPOSURES	
		2019 £m	2018 £m
ON-BALANCE SHEET EXPOSURES (EXCLUDING DERIVATIVES AND SFTS)			
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	13,803.1	13,687.7
2	(Asset amounts deducted in determining Tier 1 capital)*	(145.3)	(169.3)
3	**Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets) (sum of lines 1 and 2)**	**13,657.8**	**13,518.4**
DERIVATIVE EXPOSURES			
4	Replacement cost associated with all derivatives transactions (ie net of eligible cash variation margin)	592.4	855.7
5	Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	120.0	172.1
EU-5a	Exposure determined under Original Exposure Method	-	-
6	Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the applicable accounting framework	-	-
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	-	-
8	(Exempted CCP leg of client-cleared trade exposures)	-	-
9	Adjusted effective notional amount of written credit derivatives	-	-
10	(Adjusted effective notional offsets and add-on deductions for written credit derivatives)	-	-
11	**Total derivatives exposures (sum of lines 4 to 10)**	**712.4**	**1,027.8**
SFT EXPOSURES			
12	Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	-	-
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	-	-
14	Counterparty credit risk exposure for SFT assets	-	-
EU-14a	Derogation for SFTs: Counterparty credit risk exposure in accordance with Articles 429b(4) and 222 of Regulation (EU) No 575/2013	-	-
15	Agent transaction exposures	-	-
EU-15a	(Exempted CCP leg of client-cleared SFT exposure)	-	-
16	**Total securities financing transaction exposures (sum of lines 12 to 15a)**	**-**	**-**
OTHER OFF-BALANCE SHEET EXPOSURES			
17	Off-balance sheet exposures at gross notional amount	903.4	817.7
18	(Adjustments for conversion to credit equivalent amounts)	(739.2)	(569.2)
19	**Other off-balance sheet exposures (sum of lines 17 and 18)**	**164.2**	**248.5**
EXEMPTED EXPOSURES IN ACCORDANCE WITH ARTICLE 429(7) AND (14) OF REGULATION (EU) NO 575/2013 (ON AND OFF BALANCE SHEET)			
EU-19a	(Intragroup exposures (solo basis) exempted in accordance with Article 429(7) of Regulation (EU) No 575/2013 (on and off balance sheet))	-	-
EU-19b	(Exposures exempted in accordance with Article 429 (14) of Regulation (EU) No 575/2013 (on and off balance sheet))	-	-

		CRR LEVERAGE RATIO EXPOSURES	
		2019 £m	2018 £m
CAPITAL AND TOTAL EXPOSURE MEASURE			
20	Tier 1 capital	922.0	889.9
21	**Leverage ratio total exposure measure (sum of lines 3, 11, 16, 19, EU-19a and EU-19b)**	**14,534.4**	**14,794.7**
LEVERAGE RATIO			
22	**Leverage ratio**	**6.3%**	**6.0%**
CHOICE ON TRANSITIONAL ARRANGEMENTS AND AMOUNT OF DERECOGNISED FIDUCIARY ITEMS			
EU-23	Choice on transitional arrangements for the definition of the capital measure	Fully phased in	Fully phased in
EU-24	Amount of derecognised fiduciary items in accordance with Article 429(11) of Regulation (EU) No 575/2013	-	-

* includes intangible assets and impact of IFRS 9 transitional relief

Table LRSpl: Split-up of on balance sheet exposures (excluding derivatives, SFT and exempted exposures)

		CRR LEVERAGE RATIO EXPOSURES	
		2019 £m	2018 £m
EU-1	Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	13,657.8	13,518.4
EU-2	Trading book exposures	-	-
EU-3	Banking book exposures, of which:	13,657.8	13,518.4
EU-4	Covered bonds	-	-
EU-5	Exposures treated as sovereigns	828.0	902.5
EU-6	Exposures to regional governments, MDB, international organisations and PSE not treated as sovereigns	23.5	13.5
EU-7	Institutions	481.1	414.7
EU-8	Secured by mortgages of immovable properties	10,399.0	10,743.4
EU-9	Retail exposures	865.9	797.9
EU-10	Corporate	252.2	188.3
EU-11	Exposures in default	139.0	36.8
EU-12	Other exposures (eg equity, securitisations, and other non-credit obligation assets)	669.1	421.3

Table LRQua: Free form text boxes for disclosure on quantitative items

1	Description of the processes used to manage the risk of excessive leverage	Risk of excessive leverage is the risk that arises through maintaining an inappropriate leverage ratio or mismatches between assets and obligations. This risk is not considered significant for the reasons considered below. The current structure of the balance sheet returns a high leverage ratio. The Group's leverage ratio has remained well in excess of the minimum 3% set out in the CRR since the Bank's authorisation. This positive position will be maintained during the period covered by the business planning process, which will take account of stress testing impacts on the ratio.
2	Description of the factors that had an impact on the leverage ratio during the period to which the disclosed leverage ratio refers	Included in Section 4

Appendix C

IFRS 9 Transitional Arrangements

Presented in accordance with Annex I of the EBA Guidelines on uniform disclosures under Article 473a of Regulation (EU) No 575/2013 as regards transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds (EBA/GL/2018/01) published on 16 January 2018.

QUANTITATIVE TEMPLATE

		APPLICABLE AMOUNT
		30 SEPTEMBER 2019 £m
AVAILABLE CAPITAL (AMOUNTS)		
1	Common Equity Tier 1 (CET1) capital	922.0
2	Common Equity Tier 1 (CET1) capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	900.8
3	Tier 1 capital	922.0
4	Tier 1 capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	900.8
5	Total capital	1,072.0
6	Total capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	1,050.8
RISK-WEIGHTED ASSETS (AMOUNTS)		
7	Total risk-weighted assets	6,723.8
8	Total risk-weighted assets as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	6,713.3
CAPITAL RATIOS		
9	Common Equity Tier 1 (as a percentage of risk exposure amount)	13.7%
10	Common Equity Tier 1 (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	13.4%
11	Tier 1 (as a percentage of risk exposure amount)	13.7%
12	Tier 1 (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	13.4%
13	Total capital (as a percentage of risk exposure amount)	15.9%
14	Total capital (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	15.7%
LEVERAGE RATIO		
15	Leverage ratio total exposure measure	13,706.4
16	Leverage ratio	6.7%
17	Leverage ratio as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	6.6%

Qualitative information

A description of the Group's application of transitional relief on the adoption of IFRS 9 is given in Section 4.

Appendix D

Countercyclical buffer disclosures

The Group has not presented the template analysing its firm specific countercyclical buffer, as required by Annex I of the Commission Delegated Regulation (EU) 2015/1555, as all of its credit exposures are within the UK and therefore only the CCyB set by the FPC applies to it.

Appendix E

LCR common disclosure template

Presented in accordance with Annex II of the EBA Guidelines on LCR Disclosure (EBA/GL/2017/01) published on 8 March 2017.

TEMPLATE EU LIQ1

		APPLICABLE AMOUNT	
		2019 £m	2018 £m
21	Liquidity buffer	921.1	965.9
22	Total net cash outflows	641.1	528.0
23	Liquidity Coverage Ratio	144%	186%

Amounts presented in the table are the averages of the twelve month end amounts in the reporting period.

PARAGON BANKING GROUP PLC
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