PARAGON BANKING GROUP PLC

Half Year Financial Report

For the six months ended 31 March 2020

SUPPORTING OUR PEOPLE, CUSTOMERS AND SUPPLIERS

Paragon Banking Group PLC ('Paragon' or the 'Group'), the specialist banking group, today announces its half year results for the six months ended 31 March 2020.

Nigel Terrington, Chief Executive of Paragon said:

"Our priorities during the outbreak of Covid-19 have been to support our customers and suppliers, protect our people, safeguard our capital base and preserve the long-term value of our business. We reacted quickly and with agility, achieving full operational stability and making all products and services available. The Group is also providing funding to our SME customers through the UK Government's CBILS and BBLS schemes.

Whilst it is difficult to predict the full impact of the pandemic, we have made provisions for £27.7 million in additional charges, based on careful economic modelling and customer analysis.

The Group made strong progress up to the commencement of the UK lockdown, with lending volumes and yields broadly in line with expectations. We have a high-quality loan book, 98% of which is secured, and strong capital and liquidity, and our business stands ready to meet the changing needs of our customers throughout this challenging period and into the next business cycle."

Highlights

All results shown below include the full impact of Covid-19. Given the pervasive nature of the crisis it is considered neither practicable nor useful to attempt to present a Covid-19-free position.

- Underlying profit £57.2 million (2019 H1: £79.8 million)†
- Statutory profit before tax £57.1 million (2019 H1: £72.0 million)
- £27.7 million of Covid-19 related charges (£3.7 million income, £24.0 million impairments)
- Expected credit loss provision £30.0 million (2019 H1: £4.9 million)
- Specialist buy-to-let advances £694.6 million (2019 H1: £693.1 million)
- Commercial lending advances £481.3 million (2019 H1: 455.3 million)
- No interim dividend declared. Dividend for full year to be considered at year end
- Capital remains strong; CET 1 ratio at 14.4% (30 September 2019: 13.7%)
- Full operational functionality preserved throughout Covid-19
- Over 90% of employees working from home
- Authorisation received under CBILS and BBLS schemes after period end
- Initial IRB module submitted

† Underlying results are defined in Appendix A

Outlook

Reduced demand across the UK economy will lead to decreased lending volumes which in turn will impact on the Group's future income. At this stage, it is difficult to predict when lending markets will return to normality. Paragon's prudent credit approach, strong balance sheet and management experience have placed the Group in a strong position to meet challenges arising from Covid-19 and to grow lending volumes in its chosen markets when customer confidence returns.

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The Group will be holding a call for sell-side analysts on 10 June 2020 at 9:30 am, a recording of which will be available on the Group's website at www.paragonbankinggroup.co.uk/investors from 2:30 pm that day. The presentation material will be available on the website from 7:00 am on the same day.

CAUTIONARY STATEMENT

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

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

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

Nothing in this half-yearly report should be construed as a profit forecast.

INTERIM MANAGEMENT REPORT

1. STRATEGIC OVERVIEW

Since the formation of the Group's banking subsidiary in 2014 and internal restructuring in 2017, Paragon's strategy has been focused on its development into a leading specialist bank. This builds on the Group's across-the-cycle delivery of superior credit performance within diversified business divisions that benefit from a broadly based, reliable, scalable and cost-efficient range of funding options, and is delivered on resilient and increasingly technology-focused operating platforms. Paragon's risk averse approach to business development, liquidity and capital management, combined with flexible and capable staff and management, have placed the Group in a strong position both to manage the current highly uncertain situation, and to address the post Covid-19 operating environment.

1. Overview

Prior to the rapid escalation of Covid-19 and the associated UK lockdown, the Group's progress had been strong during the first half of its 2020 financial year. In March, however, the operational focus rapidly shifted from the successful execution of its growth and diversification strategy to the implementation of a response to the developing Covid-19 situation. This focus was driven by a strategy of supporting customers and suppliers, protecting our people, safeguarding our capital base and preserving the long-term value of our business.

2. Financial performance

The Group's financial performance in the half year has been dominated by the impact of Covid-19, which began to significantly impact the UK economy in March 2020. All financial statistics and KPIs include the full impacts of adjustments made in response to Covid-19, which increased impairment charges by £24.0 million to £30.0 million (increasing cost of risk by 39 basis points) and reduced income recognised on purchased loan portfolios by £3.7 million. After these charges the Group's underlying profit before tax reduced from £79.8 million in the first half of 2019 to £57.2 million for the current period (Appendix A).

INTERIM MANAGEMENT REPORT

1. STRATEGIC OVERVIEW

Significant financial key performance indicators ('KPIs') for the period are set out below:

KPI	2020 H1	2019 H1	Change	%
Underlying profit (£m)	57.2	79.8	(22.6)	(28.3)%
Pre-tax profit (£m)	57.1	72.0	(14.9)	(20.7)%
Total operating income (£m)	149.7	148.0	1.7	1.1%
Net Interest Margin (NIM) (bp)	229	224	5	
NIM excluding Idem Capital (bp)	214	189	25	
Operating costs (£m)	62.5	63.3	(0.8)	(1.3)%
Cost:income ratio (%)	41.8%	42.8%	(1.0)%	
Cost of risk (bp)	49	8	41	
Underlying RoTE (%)	9.7%	14.4%	(4.7)%	
Underlying basic earnings per share	17.6	25.0	(7.4)	(29.6)%
Basic earnings per share (p)	17.6	22.5	(4.9)	(21.8)%

3. New business activity

New lending for the half year across all business lines was generally in line with expectations, despite economic and political uncertainty depressing volumes in the early months but with markets improving through the early part of 2020. The impact of Covid-19 caused a tailing-off of completions in the second half of March as demand fell and practical difficulties in completing transactions became more severe. Completions in the period are set out below.

Business area	2020 H1 £m	2019 H1 £m	Change	%
Specialist buy-to-let	694.6	693.1	1.5	0.2%
Other mortgages	98.2	140.8	(42.6)	(30.3)%
Total mortgage lending	**792.8**	**833.9**	**(41.1)**	**(4.9)%**
Commercial lending	481.3	455.3	26.0	5.7%
Total new lending	**1,274.1**	**1,289.2**	**(15.1)**	**(1.2)%**

Advances in the Mortgages division reflect the tighter focus on the Group's specialist buy-to-let proposition over recent periods, increasing market share with professional landlords and reducing exposure to the lower-priced amateur landlord sector. Commercial Lending advances were driven by the increasing maturity of the Group's development finance operation and continued progress in the SME lending and structured lending businesses.

INTERIM MANAGEMENT REPORT

1. STRATEGIC OVERVIEW

The mortgage portfolio was also supported by reduced annual redemption rates, falling from 8.7% to 7.8% as the impact of retention activity with customers and longer fixed rate periods kept mortgages in the portfolio for longer, resulting in a 3.2% increase in the net mortgage book between September 2019 and March 2020.

Prospects for future lending are hard to predict with any certainty against an economic landscape dominated by Covid-19. Although lockdown easing has commenced, customer loan demand will initially be weak, reflecting the levels of constraints still imposed on businesses and consumers. However, the Group has:

- maintained all products and services throughout the crisis
- strong capital and liquidity to support balance sheet growth
- resumed appropriately socially-distanced on-site valuations from late May
- received authorisation to offer loans under the CBILS and BBLS schemes

When the economy emerges from the current crisis, the need for specialist lenders such as the Group, will be greater than ever. The ability to deliver bespoke products and services to people and businesses, utilising operational agility and excellence in approaches to technology, will be crucial in meeting customers' complex and changing needs.

4. Covid-19 portfolio impacts

The rapid escalation of the impact of Covid-19 on the UK economy, consumers and businesses has resulted in changes to customer demand and behaviours. The outlook for the UK economy has also experienced a seismic shift since mid-March, which has resulted in the Group reassessing the macro-economic forecasts that generally drive its impairment modelling, while carefully considering emerging customer behaviour, such as the take-up of Covid-19 payment reliefs, to determine whether any such evidence suggests a requirement for additional provision.

This exercise is far more subjective than a normal period end provisioning exercise, with much independent economic forecasting and commentary overtaken by events and little time since the onset of the crisis for reliable indicators of behaviour to emerge. However, the Group considers that the additional analysis provides as reliable a basis for the determination of expected losses as is possible in the circumstances.

In order to mitigate the short-term impact of Covid-19 on its customers the Group has introduced payment relief schemes across its portfolios. In the first and second mortgage books payment holidays have been offered, in line with UK Government and FCA guidance. In Commercial Lending operations a variety of different reliefs have been used to ensure each customer receives an appropriate outcome. At 31 May 2020 17.8% of accounts in the Mortgages division, 22.1% of Commercial Lending accounts and 2.9% of Idem Capital accounts, all by number, had been granted some form of relief.

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1. STRATEGIC OVERVIEW

The greatest use of reliefs has been within the SME lending business. However, only 16% of reliefs in this area are full payment holidays, with the remainder typically in the form of interest only payment periods. Around 90% of SME lending cases with reliefs are asset leasing cases, where the Group has security on the underlying asset.

The key macro-economic drivers forming inputs into the Group's calculation of expected credit losses ('ECLs'), are UK output (GDP), unemployment rates and house price levels. Four separate Covid-19 scenarios, reflecting the variety of currently held opinions have been modelled in detail for use in the Group's ECL modelling. The annual averages of the key assumptions in the base and most severe scenarios for each of the next two years are shown below and benchmarked against the scenario used in the Bank of England desk-top stress test (published on 7 May 2020).

	Base scenario		Severe scenario		Bank of England	
	Year 1	Year 2	Year 1	Year 2	Year 1	Year 2
GDP / output	(6.7)%	9.0%	(11.9)%	10.1%	(14.0)%	15.0%
Unemployment	6.8%	5.5%	8.5%	8.1%	8.0%	7.0%
House prices	(1.7)%	(0.5)%	(9.8)%	(13.8)%		

The Bank of England scenario has a start-to-trough variance on house prices of 16.0% across the forecast period.

For the estimation of ECLs the Group has weighted its base case (scenario 1) at 40%, a less severe case, scenario 2, at 10%, and more severe variants, scenario 3 and scenario 4 (illustrated above) at 35% and 15% respectively.

The impact of Covid-19 on the Group's ECL results from the effects of these macro-economic scenarios, together with careful consideration of the potential effect of the pandemic across all the Group's portfolios. This analysis uses expert credit judgement informed by account information including analysis of reliefs taken, customer insight data and direct customer engagement. Together, these factors have increased the impairment provision by £24.0 million beyond the base case charge for the period of £6.0 million. This charge is allocated as follows:

Segment	Base case £m	Covid impact £m	Total provision £m	2019 H1 £m	2019 Full year £m
Mortgages	2.7	11.1	13.8	0.7	1.0
Commercial Lending	3.9	11.6	15.5	3.7	7.2
Idem Capital	(0.6)	1.3	0.7	0.5	(0.2)
Total	**6.0**	**24.0**	**30.0**	**4.9**	**8.0**

Whilst the forward-looking nature of IFRS 9 would require provisions to be established for all losses arising out of the current Covid-19 crisis, the level of uncertainty around those impacts means that additional provision, or releases of provision, might be required in future periods.

5. Funding and capital

The Group's Paragon Bank savings operation has continued its strategy of increasing the scale of its addressable market while broadening its product range and distribution channels. Notable developments have included an increasing presence on savings marketplaces operated by digital banks and on wealth management platforms. Deposits at the end of March 2020 were £6.9 billion (30 September 2019: £6.4 billion) and have continued to grow since the period end, reaching £7.5 billion by 31 May 2020.

A retained securitisation was completed after the period end, providing collateral benefits and the Group anticipates accessing the Bank of England Term Funding Scheme for SMEs ('TFSME') during the next twelve months following accreditation in May 2020.

Given uncertainties arising from Covid-19, the Group took the decision not to declare an interim dividend. The appropriate level of dividend for the financial year as a whole will be considered before the results for the year are published.

Capital ratios at Group level have all been enhanced from the year end position. The CET 1 ratio stood at 14.4% (14.0% fully loaded) against the 30 September level of 13.7% (13.4% fully loaded) while the Total Capital Ratio was 16.7% (16.2% fully loaded) compared to 15.9% (15.7% fully loaded) at the start of the period. This gives the Group over £200 million of headroom against the regulatory minimum.

During the period the Group submitted its Module 1 IRB application for buy-to-let mortgage assets to the PRA for approval. This internal rating system is expected to deliver long-term risk management benefits to the Group.

Liquidity remained strong in the period and delivered a Liquidity Cover Ratio ('LCR') at 31 March 2020 of 219% (30 September 2019: 138%), with the Group increasing liquidity levels towards the end of the period as part of its response to Covid-19. The Group also expanded its contingent liquidity resources during the period.

6. Resilience and operations post Covid-19

The Group's operational response to Covid-19 was swift, deploying well-developed contingency plans reflecting its highly agile and flexible infrastructure, technology and people. By 31 March 2020 over 90% of the Group's people were working from home, supported by IT upgrades and expanded use of technology across the business.

The Group maintained full operational capacity from the onset of the crisis and the decision was taken not to place any employees on furlough schemes. At the same time the Group adopted a flexible approach to working patterns and introduced policies focussing on the morale and wellbeing of its employees in the current situation, providing extensive communication and enhanced management.

As a result of these changes the Group maintained strong levels of customer engagement whilst preserving the integrity of the control environment and continuing to develop the business. The skills and experience of our specialist customer-facing teams mean they are well placed to understand the impact of Covid-19 on customers and support them thorough the period.

The Group continued to apply the skills and experience of its in-house surveying team throughout the period, ensuring full consideration was given to the level of tenant demand and asset values. With lockdown easing, the surveyors are now fully engaged in supporting the needs of our specialist landlords and their complex requirements.

Following the period end these measures have now transitioned into a modified 'business-as-usual' approach from a crisis management basis. The Group is making plans for a phased return of employees to its offices but will proceed with these plans only when government advice suggests that would be appropriate.

7. Customer focus

One of the Group's principal objectives is to ensure that service levels are maintained and that its customers receive appropriate outcomes. In common with other lenders the Group adopted a policy of granting payment relief to customers, including payment holidays, with major developments in systems and procedures delivered using agile techniques and on an accelerated timescale.

Systems were adapted to record such reliefs and ensure that these reliefs did not impact on customers' credit agency records. Detailed engagement plans were put in place in customer servicing areas, while flexible pools of employees were established so that high volume areas could be addressed. As a result of these plans contact centre queues were kept to a minimum and complaint levels also remained low.

As a result of the operational, human resources and systems response to the crisis, new business flows continued throughout the early part of the crisis and to date. The Group has also instituted a programme of customer engagement surveys and data collection to support its response to Covid-19 on an ongoing basis and ensure that optimal approaches to customers' individual situations are identified. For SME lending customers this may include providing funding under the CBILS and BBLS schemes, where the Group has been accredited.

8. Outlook

Paragon's historic credit focus and operational resilience has put the Group in a strong position to meet the challenges from Covid-19, with functionality maintained across all customer-facing and support areas.

The Group's capital position was strengthened during the period and its liquidity access remains good. No interim dividend is proposed given the current economic environment and the Group's desire to retain resources to support its customers and continue to deliver growth, protecting its long-term financial position.

Reduced demand across the economy means lending volumes, and hence future income are hard to predict in the near term, with an inevitable knock-on to the longer-term size of the portfolio.

INTERIM MANAGEMENT REPORT

1. STRATEGIC OVERVIEW

The Group has taken early action to increase provision cover, but little evidence on long-term customer vulnerability and credit quality is yet available. These may not become clear for some time, given the unprecedented levels of government intervention and the arrangements for Covid-19 payment reliefs, which will support customers in the short term, but may serve to conceal indicators of distress.

The Group's lending is largely secured, principally on residential property and other real estate, with an average loan-to-value ratio of 67.6% in its first mortgage book and 87.4% of lending in the Commercial Lending division secured on tangible assets.

The Group reacted to the emerging crisis quickly and reconfigured its operations and processes to manage the situation, displaying high levels of operational resilience. It has now moved to a modified business-as-usual phase and has initiated workstreams considering the medium and long-term implications of Covid-19 for our strategy, markets, customers and operating model. While uncertainties remain, the importance of a prudent risk culture, strong balance sheet and management experience will be as important in the future as they have been in the past. We are living through a monumental and tragic part of history and inevitably much will change in society and in the needs of individuals and businesses in the UK. The Group is well placed to respond to these changes, playing our part in supporting customers, stakeholders and the wider UK economy in the times ahead.

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

2. Lending review	3. Funding review	4. Capital review	5. Financial review	6. Operational review
Lending, performance and markets	Retail deposits, wholesale and central bank funding	Capital and liquidity management	Results for the period, assets and liabilities	Governance, people, risk and regulation

INTERIM MANAGEMENT REPORT

2. LENDING REVIEW

The Group's operations are organised into three divisions, based on product types and origination and servicing capabilities. Customer loan balances at 31 March 2020 and advances in the period for each of those divisions are summarised below:

	Advances in the period			Loans to customers at the period end		
	Six months ended 31 March 2020 £m	Six months ended 31 March 2019 £m	Year ended 30 September 2019 £m	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m
Mortgages	792.8	833.9	1,568.6	10,676.1	10,783.9	10,344.1
Commercial Lending	481.3	455.3	968.0	1,494.3	1,283.9	1,452.1
Idem Capital	-	-	-	335.7	457.8	389.9
	1,274.1	1,289.2	2,536.6	12,506.1	12,525.6	12,186.1

The first half of the year has seen the overall loan balance increase by 2.6% over the six months, with advances broadly similar to the same period in 2019. However, the mix of lending continues to develop, with an increasing proportion of lending represented by the growing Commercial Lending segment.

2.1 MORTGAGES

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

Housing and mortgage market

During March 2020 the UK housing market began to be impacted by the Covid-19 crisis, with the increased levels of economic uncertainty impacting on house purchase decisions. Government responses on lockdown and social distancing also placed practical limitations on the operation of the housing market. RICS reported in its April 2020 Residential Market Survey that levels of activity in the housing market were the weakest since the inception of the survey in 1999.

The UK Government introduced mortgage relief schemes, covering both owner-occupied and buy-to-let mortgages of residential property, where customers could make no payments for a period, initially of three months, without this impacting on their credit records, which lenders in the sector then had to put in place. In turn, many of the Group's landlord customers have also been providing rent relief to their tenants, at least in the short term.

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2. LENDING REVIEW

For most of the earlier part of the six-month period the prospects for the UK housing market had appeared relatively positive, with economic uncertainty reduced by the UK general election in December 2019, bringing more clarity on the likely form of any Brexit agreement. This led to increasing transaction levels and upward pressure on house prices following a period of stagnation in the market. Market conditions for mortgage customers remained benign, with low interest rates, arrears and possession levels.

New mortgage approvals in the period, reported by the Bank of England, at £130.5 billion, increased by 6.1% from the £123.0 billion recorded in the same period in the preceding year, with the split of remortgage and house purchase accounts remaining broadly similar. This remains low by historic standards, even before Covid-19, which began to impact the housing market from March 2020. As a result of Covid-19 restrictions, property sales became difficult to conduct and volumes sharply reduced, leaving many lenders to focus on remortgage products.

House prices began to increase after the election, with the Nationwide Building Society reporting an average increase of 2.0% in the six-month period, following growth of only 0.2% in the year ended September 2019, with a pre-Covid-19 expectation of further increases to come. Post Covid-19 it is difficult to gauge the impact on prices, as the transaction volume is so low.

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

Specialist landlords form the largest part of the Group’s target market. These are landlords with four or more rental properties who generally run their portfolio as a business and have a high level of personal day-to-day involvement. The Group is amongst a small number of specialist lenders addressing this sector, which is underserved by many of the larger lenders.

Within the larger mortgage finance sector, buy-to-let lending remained strong in the early part of the period, with new advances of £21.3 billion in the six months reported by UK Finance (‘UKF’), compared to £20.4 billion in the same period in the previous year. Refinancing by landlords continued to represent the bulk of this activity, with 72% of new advances by value representing remortgages (2019 H1: 73.0%). The trend in favour of longer-term fixed interest rates has also continued, both in the Group’s lending and in the wider market and has also impacted on remortgage levels as product maturity terms increase.

Towards the end of the period market activity contracted sharply, with many lenders withdrawing products, at least in the short term. Practical issues also impacted the lending process for those firms remaining in the market, most notably around the property inspection and valuation process.

Whilst Covid-19 restrictions meant that on-site property valuations could not be conducted, the Group developed an enhanced desktop valuation process and introduced products with stricter than normal loan-to-value limits. These changes allowed lending to continue, particularly in the larger remortgage market, ahead of a phased reintroduction of physical valuations.

2. LENDING REVIEW

The lettings market remained stable through the early part of the period with RICS reporting continuing supply issues leading to an expectation of rent increases. The Covid-19 impact saw downward pressure on supply, demand and rents, but in its April survey RICS expected rents to stabilise within twelve months and forecast long-term rental growth of 2.5% per annum at the five-year horizon.

Lending activity

The Group's principal focus in the mortgage market continues to be on its specialist buy-to-let lending proposition, with other products carefully targeted to ensure that yields and risk profiles were appropriate. The new lending activity in the division during the six months is set out below:

	Six months ended 31 March 2020 £m	Six months ended 31 March 2019 £m	Year ended 30 September 2019 £m
Specialist buy-to-let	694.6	693.1	1,315.1
Simple buy-to-let	57.8	94.4	165.4
Owner-occupied	0.3	8.6	11.9
Second charge lending	40.1	37.8	72.0
	792.8	833.9	1,564.4
Acquired assets	-	-	4.2
	792.8	833.9	1,568.6

Total mortgage lending decreased by 4.9% in the six months compared to the same period in the previous year. This reflected both the result of reduced completions towards the end of the period as the property market began to be impacted by Covid-19, and a reduced focus on simple lending (funding amateur landlords) in favour of the more specialist segment of the market.

Buy-to-let

Specialist buy-to-let lending activity rose 0.2% when compared to the same period in 2019, whereas simple buy-to-let lending fell by 38.8%. The new business pipeline, the loans passing through the underwriting process, was £789.8 million at the period end (30 September 2019: £911.7 million, 31 March 2019: £711.1 million). In normal circumstances this pipeline would be expected to contribute significantly to lending in the second half of the financial year, but conversion may be lower and slower than in previous periods, with Covid-19 restrictions making the physical process of completion difficult for some customers.

The focus on specialist landlords is set to continue in the second half of the year, with 92.9% of pipeline cases being specialist (31 March 2019: 91.5%).

2. LENDING REVIEW

The Group sources the majority of its new buy-to-let lending through specialist intermediaries and it continues to invest to ensure the service offered to them is excellent. It was therefore gratifying that in feedback from intermediaries in the period, 91% were satisfied with the ease of obtaining a response from the Group (2019 H1: 93%), delivering a net promoter score at offer stage of +65 (2019 H1: +55). This demonstrates the widespread appreciation amongst the intermediary community of the Group's proposition and process.

Other lending

The division's other first and second charge mortgage lending has been carefully managed to ensure that only lending with appropriate risks and returns is undertaken.

Lending in the Group's second charge mortgage operation at £40.1 million was in line with plan, 6.1% up on the comparable period in 2019. Within the second charge mortgage market the Group targets only higher credit quality customers, rather than the lower-rated borrowers generally associated with this sector. This limits potential lending in this field but should provide more resilience in adverse economic conditions.

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

2. LENDING REVIEW

Performance

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

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m
Post-2010 assets			
Buy-to-let	5,926.5	4,998.5	5,427.7
Owner-occupied	58.8	67.0	68.3
Second charge	186.2	159.1	171.6
	6,171.5	5,224.6	5,667.6
Legacy assets			
Buy-to-let	4,502.6	5,549.5	4,674.2
Owner-occupied	2.0	9.8	2.3
	10,676.1	10,783.9	10,344.1

At 31 March 2020 loan balances in the Mortgages division were 1.0% lower than a year earlier. This decrease is a result of the derecognition of a £695.8 million portfolio of legacy assets in June 2019, with the reduction now made up with new lending balances. The buy-to-let portfolio had decreased year-on-year by 1.1 % to £10,429.1 million (31 March 2019: £10,548.0 million) for the same reason, with the value of the post-2010 originated assets growing by 18.6%, representing 56.8% of the total (31 March 2019: 47.3%).

The annualised redemption rate on buy-to-let mortgage assets was 7.8% in the six months to 31 March 2020 (2019 H1: 8.7%, 2019: 8.6%). The reduction in redemption rates reflects continuing operational initiatives which led to larger numbers of the Group's customers opting to re-fix their loans during the period and a lower absolute level of maturing products resulting from the increased proportion of five-year fixed rate business written in recent years. There may also have been some impact from the reduction in residential property transactions seen as the Covid-19 situation began to impact.

Arrears on the buy-to-let book remained stable in the six months at 0.16% (30 September 2019: 0.18%, 31 March 2019: 0.12%). These arrears remain very low compared to performance in the national buy-to-let market, with UKF reporting arrears of 0.41% across the sector at 31 March 2020 (30 September 2019: 0.42%, 31 March 2019: 0.41%).

This exemplary performance reflects the Group's through-the-cycle experience in focussing underwriting on the credit quality and financial capability of its customers, underpinned by a detailed and thorough assessment of the value and suitability of the property as security. While the timing of the Covid-19 outbreak means that these figures have not been significantly impacted at the period end, the Group believes that the quality of the portfolio will provide long-term resilience in the face of the pandemic.

2. LENDING REVIEW

The Group is also confident that its robust approach to valuation and the loan-to-value coverage in its buy-to-let book, at 67.7% (31 March 2019: 67.8%) provide it with significant security in the face of the present economic stress. The levels of interest cover and stressed affordability in the portfolio suggest that its customers are also well placed to manage Covid-19 impacts on their businesses in the longer term.

By 31 May 2020, 21% of buy-to-let customers by value had requested, and been granted, a payment holiday in order to manage the short-term impact of the crisis, effective from March 2020. Subsequent customer contacts indicate that the majority of these customers sought relief principally because they were concerned about their tenants' capacity to meet rent payments in the short term, with the majority confident in the long-term stability of their businesses.

Second charge mortgage arrears increased marginally to 0.51% (31 March 2019: 0.41%, 30 September 2019: 0.38%), with performance remaining strong. The Group's lending in this field is targeted towards stronger credit propositions and therefore the differential between this performance and the market average published by the Finance and Leasing Association ('FLA') for all second charge mortgage loans is expected. As with first charges, this measure had not been significantly impacted by the Covid-19 situation at 31 March 2020.

The Group's receiver of rent process for buy-to-let assets helps to reduce the level of loss incurred by both it and, in turn, its landlord customers by giving direct access to the rental flows from the underlying properties. At the period end, 648 properties were managed by a receiver on the customer's behalf, a year-on-year reduction of 13.7% (31 March 2019: 751 properties). Almost all these cases currently relate to pre-2010 lending, with cases being resolved on a long-term basis to ensure the best outcome. There were relatively low numbers of cases entering receivership in the period.

Outlook

The Group's established market position in specialist buy-to-let, combined with its access to funding means that it is well placed to support its customer base through the Covid-19 crisis and build on its relationships into the future.

Products have been reviewed and a suite of offerings launched which can be processed through to completion, even in the current climate, while the business's resource levels have been maintained to support customer service. From late May physical inspections of properties were able to recommence, which further enhances the propositions capable of consideration.

The long-term economic impact of Covid-19 may be to increase reliance on the PRS. Households may be less likely to make a first move to owner-occupation, with larger numbers motivated to move away from property ownership. This would create demand in the PRS which the Group's landlord customers will be needed to support.

The Group's Mortgages operation has demonstrated, in its response to the Covid-19 crisis, its ability to understand and respond to the needs of its core specialist landlord customer base. Despite the crisis, the majority of specialist landlords expect to remain active in the sector and the Group will continue to develop and enhance its business to support them.

2. LENDING REVIEW

2.2 COMMERCIAL LENDING

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

The proposition is delivered through four key business lines;

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

In each of its markets the division's competitors are small banks and similar sized lenders. They are markets in which the largest lenders have little presence, creating a credit availability issue for customers and significant opportunities for the Group. The division relies heavily on specialist teams to address the separate business lines, either sourced externally or internally developed.

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

Given the nature of the assets financed, Covid-19 resulted in a material number of customers requesting some form of payment relief and new advances in the final month of the period being sharply reduced. However the SME sector has also been the focus of government support programmes and the Group has been authorised to provide loans under the Coronavirus Business Interruption Loan Scheme ('CBILS') and the Bounce Back Loan Scheme ('BBLS') and will be making advances under these programmes in the second half of the financial year.

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

The common themes of these diverse business lines are a deep understanding of their respective markets and customer needs, together with expertise in the valuation of any security, collections and asset recovery. In common with the rest of the Group, the division's focus is on the maintenance of strong credit standards and it does not pursue business volumes at the expense of margins.

INTERIM MANAGEMENT REPORT

2. LENDING REVIEW

Lending activity

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

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

Commercial Lending exposure has increased overall by 2.9% in the six-month period to £1,494.3 million (30 September 2019: £1,452.1 million). The new lending activity in the segment during the period is set out below.

	Six months ended 31 March 2020 £m	**Six months ended 31 March 2019 £m**	**Year ended 30 September 2019 £m**
SME lending	200.7	211.0	406.5
Development finance	197.8	160.7	362.9
Structured lending	8.0	17.6	49.7
Motor finance	74.8	66.0	148.9
	481.3	455.3	968.0

The Commercial Lending segment has seen a 5.7% growth in new advances compared to the first half of 2019. Growth in development finance was particularly strong (up 23.1%), with the operation continuing to mature through the second half of 2019 and into the current financial year.

SME lending

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

The Covid-19 outbreak reduced new business activity during March, both as a result of customer unwillingness to enter into new commitments and, in the leasing business, as a result of the practical difficulties of sourcing and delivering large pieces of equipment, some internationally, in a global lockdown.

2. LENDING REVIEW

As a result of these impacts, new asset finance leasing volumes reduced by 12.5% compared to the comparative period in 2019, to £125.0 million (2019 H1: £142.8 million). Investment in operating leases has also continued with £7.2 million of assets acquired in the period (2019 H1: £11.9 million). Short-term lending to professional services firms, however, grew 16.2% to £70.2 million (2019 H1: £60.4 million) as the Group continued to expand this business. As a result, across all products, SME lending decreased by 4.9% to £200.7 million (2019 H1: £211.0 million).

The Group has continued to focus on improving its operational procedures in this area, to deliver better customer service and enhance margins, focussing on people and processes and on improving the handling and use of data in the business to provide better targeting and analysis and to enhance customer experience.

This process was challenged by the Covid-19 crisis, which saw over half of the business's customers applying for some form of Covid-19 relief on payments. Relief in this market is normally given as an interest only period, where the customer continues to make payments. The financial issue for many of the customers, particularly in sectors such as construction, was the inability to generate income from the financed assets during the lockdown period, creating a liquidity shortfall. The long-term impact of this disruption is difficult to predict at this stage, but feedback from the business's enhanced customer contact programme is encouraging.

Following the period end the Group received authorisation to participate in the government-sponsored British Business Bank CBILS and BBLS schemes, providing funding to SMEs under a government guarantee. The Group anticipates significant amounts of lending under this scheme in the second half of the year to support its existing customers through the Covid-19 crisis and is proactively monitoring its customer base to identify those who might benefit from such a loan.

Lending activity in the second half of the financial year for the Group's existing products will be dependent on the nature and timing of any recovery but is likely to be less than would normally be expected. However, CBILS and BBLS lending will make up some of this shortfall. The priority of the operation will be the continuing support of its customers in the challenges they face preserving their businesses through the crisis.

Development finance

Activity in the Group's target market held up well in the half year, with increased enquiry levels and higher levels of new commitments, and prospects looking promising up to the end of February. At that point the impact of Covid-19 changed the market, with levels of lending in March being more subdued. However, demand for new housing appears to have rebounded, following the easing of the lockdown and longer-term sentiment amongst the Group's customers is less negative than might be expected. New projects continued to commence after the period end, while work continued on the majority of development sites throughout the crisis.

2. LENDING REVIEW

The Group's target customer is a small to medium sized developer of UK residential property. The typical types of projects funded have an average development value of approximately £7 million and are generally focussed on the more liquid parts of the residential market, avoiding developments with high unit values. While the business has been concentrated in South-East England, with 70.3% of balances at 31 March 2020 located in London and the South East, the Group's strategic objective is to lend more widely across the UK and this focus continued in the period. Central London property hot-spots have been generally avoided.

The Group engages monitoring surveyors to review project progress and costs on a regular basis through the build phase of each project, and these activities have generally continued though the Covid-19 period. Many projects have been subject to some level of delay, principally due to access, labour or supply issues, but overall the level of resilience in the customer base has been impressive. The majority of projects funded by the Group have continued to make progress through the Covid-19 period, though generally at a slower rate than would normally be expected.

Prospects for the second half of the year will depend on the level and nature of any recovery from the Covid-19 lockdown. Undrawn amounts on live facilities at 31 March 2020 of £343.2 million would be expected to flow through to advances during the second half of the year but these drawings might be delayed. The Group's post-offer pipeline of £222.2 million is still likely to result in completions, but the timing of the commencement of any new projects is uncertain.

The fundamental basis of the development finance proposition remains sound, with the current slowdown arising principally from practical issues. The demand for new housing will remain into the future and smaller developers have only a limited number of funding sources, which may reduce with some non-bank lenders previously active in the sector suffering from limited lending capacity as a result of the crisis. The Group believes the business is well placed to support its developer customers during and after the Covid-19 period.

Structured lending

The structured lending exposure has grown in the period by 7.8%, mostly as a result of additional drawings on extant facilities, although new facilities of £8.0 million came on stream during the period. These loans generally fund non-bank lenders, of various kinds, and as such facilities are carefully constructed to provide a buffer for the Group in the event of default in the ultimate customer population. The potential impact of a pervasive economic stress, such as that created by Covid-19, on exposures of this type is hard to gauge ; however the facilities are prudently structured, with first loss cover of over 25%, and the Group's experienced account managers are maintaining a high level of contact with the business's counterparties.

2. LENDING REVIEW

Motor finance

The Group's strategy for motor finance is to carefully target its offerings on those specialist propositions which are not addressed by mass-market lenders. Advances increased 13.3% on the first six months of 2019, while maintaining yield levels, representing a strong performance in the early months of the period, with a falling off in the final month. The level of activity in the automotive market through the Covid-19 crisis has reduced the potential scope of lending in the second half year.

Performance

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

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m
Asset leasing	513.4	451.4	492.2
Professions finance	49.9	48.4	46.2
Invoice finance	20.6	20.9	18.5
Unsecured business lending	22.7	18.7	19.3
Total SME lending	606.6	539.4	576.2
Development finance	502.3	426.0	506.5
Structured lending	95.0	56.1	88.1
Motor finance	290.4	262.4	281.3
	1,494.3	1,283.9	1,452.1

Margins in the segment generally have remained strong, continuing to increase as changes made to products in previous periods work through the books, reflecting the ongoing management of new business.

Credit quality in the development finance book has been good, and the overall performance of the projects has been in line with expectations. These accounts are monitored on a case-by-case basis by the Credit Risk function. At 31 March 2020, very few cases had been identified by the monitoring process as being likely to result in a loss, beyond a small number of purchased accounts where potential losses were identified on acquisition and allowed for in the purchase price and which remain in the portfolio.

While no Covid-19 specific credit concerns have been identified on particular accounts, the Group recognises the potential impact of increased economic uncertainty and execution risk on its portfolio. The average loan to gross development value for the portfolio at the period end, a measure of security cover, was 64.7% (31 March 2019: 63.9%). This gives the Group a significant cushion if any of the projects face challenges.

INTERIM MANAGEMENT REPORT

2. LENDING REVIEW

Arrears in Commercial Lending remain low with arrears in the asset finance leasing business at 0.27% and motor finance at 1.32% (31 March 2019: 1.66% and 1.27% respectively), comparable to those in the wider sector, with the FLA reporting average arrears for asset finance at 1.30% and car finance at 3.20% at 31 March 2020 (31 March 2019: 1.10% and 2.70% respectively). These arrears, however, do not reflect the impact of Covid-19 and substantial payment relief has been granted, in line with guidance from regulators. While these reliefs will reduce the potential for loss in the short term, it is unclear, as yet, what the longer-term impacts on some of these customers might be.

Performance in the structured lending operation has been in line with expectation with satisfactory pricing and no serious concerns with the operation of the facilities.

Outlook

The Group has continued to drive forward its Commercial Lending segment, with a performance in the period up to the Covid-19 outbreak which saw increasing lending and yield maintenance while asset performance remained good. Operational and technological capabilities were enhanced and processes to ensure good customer outcomes remained a priority, setting the business up for further growth.

The Covid-19 outbreak has had a serious impact on customers and their businesses, and the Group is committed to supporting them through this period, whether by arranging appropriate payment reliefs or with additional funding through the CBILS and BBLS schemes.

In the short-term it is likely that new lending activity will be depressed, but in the longer-term the Group has confidence in all its Commercial Lending activities to recover and to assist in the recovery of their various customer bases and the UK economy.

2.3 IDEM CAPITAL

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

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

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

INTERIM MANAGEMENT REPORT

2. LENDING REVIEW

New business

While the UK loan portfolio purchase market remained active in the period up to the Covid-19 outbreak, and the Group participated in the majority of significant tender processes, there were few opportunities which were particularly appealing, either because of pricing, the nature of the assets or the capital which might have been required.

The Group will only pursue transactions where its wider capabilities in administration and funding can provide a real benefit to the project and where the projected return is attractive in comparison to the other opportunities for the deployment of its capital.

The developing Covid-19 situation has suppressed the number of portfolios coming to market. This is expected to continue in the short term, though further, and potentially interesting, opportunities may arise once economic activity normalises.

During the period, no portfolio acquisitions were completed (2019 H1: none) although, as noted above, the division undertook a limited number of reviews of opportunities that were ultimately not progressed. The main focus of the business in the period was the careful management of its existing books and, at the end of the period, ensuring that appropriate processes and systems were in place to address the Covid-19 outbreak with customers.

Performance

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

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m
Second charge mortgage loans	191.0	245.7	217.6
Unsecured consumer loans	120.3	158.5	134.7
Motor finance	24.4	53.6	37.6
	335.7	457.8	389.9

The reduction in balances from March 2019 is a result of the scale of customer receipts from the brought forward portfolio. 120 month Estimated Remaining Collections on the segment's acquired consumer assets reduced from £430.1 million at 31 March 2019 to £324.6 million at the period end (note 27).

Customers' payments held up well during the period up to February, though the Covid-19 impact began to be observed in March 2020 collections. However, the long-term impact of the crisis is, as yet, uncertain. Whilst the division's second charge assets are well seasoned, mostly over ten years old, and so may be more resilient, the division's unsecured assets may be more vulnerable, and particular focus is given to ensuring appropriate outcomes for these customers.

2. LENDING REVIEW

Arrears on the segment's secured lending business remain in line with recent performance at 18.0% (30 September 2019: 17.2%, 31 March 2019: 15.5%). While this is higher than the average for the sector it reflects the seasoning of the balances, and the inclusion of accounts which were making full payments in the period but may have missed payments in the past. Average arrears for secured lending of 8.6% at 31 March 2020 were reported by the FLA (30 September 2019: 8.7%).

None of the division's consumer lending portfolios were considered as underperforming during the period, with strong levels of cash generation, but there is an expectation that this performance level may be impacted by Covid-19. The Group monitors actual cash receipts from acquired portfolios against those forecast in the evaluation which informed the purchase price. Up to 31 March 2020, such collections were 109.1% of those forecast to that point (30 September 2019: 109.8%, 31 March 2019: 109.8%).

Operational improvements have continued to be made in systems, processes and employment patterns, both to address the Covid-19 situation and generate operational efficiencies in future periods.

Outlook

The short-term focus of the Idem Capital division will be on ensuring its customers receive fair outcomes through the ongoing Covid-19 crisis. While the division will continue to investigate potential new portfolio acquisitions as they come to market, its expectation is that such opportunities will be scarce until the economy returns to a more normal state.

In the longer term, the Group believes that the loan purchase market will offer opportunities for Idem Capital to make investments in specialist portfolios, either by itself or with partners, where its ability to leverage the skill base of the wider group can generate good returns. However, such opportunities would be expected to arise on an irregular basis.

The division will maintain strict pricing and capital discipline in respect of new acquisitions whilst continuing the effective management of its existing assets, ensuring that returns are appropriate.

3. FUNDING REVIEW

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

This variety of funding options ensures that pricing and availability issues in any particular funding market can be mitigated, while maintaining the flexibility to fund strategic developments. In particular, it protects the Group from the effects of incidents such as the Covid-19 crisis, which has seen pricing in capital markets widen materially and emergency funding channelled principally through central bank lending to the UK banking sector.

In the period before the impact of the Covid-19 virus the Group sourced the majority of its new funding through the retail deposit market, which, together with continuing amortisation of its securitised funding, saw retail deposits increase to form 51.9% of all on balance sheet funding at 31 March 2020 (30 September 2020: 49.0%, 31 March 2019: 44.0%).

The overall UK outlook has continued to be unstable over the six-month period, with the general election, the continuing uncertainty over the final Brexit settlement and the Covid-19 crisis all affecting sentiment. In response the Group continued to adopt a conservative stance on liquidity through the period. £915.6 million of cash was available for liquidity and other purposes at the end of the period (30 September 2019: £872.1 million, 31 March 2019: £759.7 million). The Group's contingent liquidity policy will be kept under review as the ultimate outcome of the Covid-19 crisis becomes clearer and longer-term trends become more evident.

The Group's funding at 31 March 2020 is summarised as follows:

	31 March 2020 £m	**31 March 2019 £m**	**30 September 2019 £m**
Retail deposit balances	6,911.9	5,878.0	6,391.9
Securitised and warehouse funding	4,766.5	6,064.9	5,206.9
Central bank facilities	1,199.4	984.4	994.4
Tier 2 and retail bonds	446.3	445.7	446.1
Total on balance sheet funding	13,324.1	13,373.0	13,039.3
Off balance sheet central bank facilities	109.0	108.5	109.0
Other off balance sheet liquidity facilities	150.0	-	-
	13,583.1	13,481.5	13,148.3

In the short to medium term, the Group's principal source of funding will remain retail deposits, which have performed well in the early stages of the Covid-19 crisis. These will be supplemented by participation in Bank of England schemes to support lending into the UK economy, especially to SMEs. New public securitisations in the near term are unlikely, unless capital markets recover more quickly than expected.

3. FUNDING REVIEW

LIBOR, which had been the principal sterling reference rate used by the Group, is due to be withdrawn by the end of 2021, a timetable so far unaffected by the Covid crisis. All Group debt issuance since 2019 has been priced with reference to SONIA, the Sterling Overnight Index Average and, during the period, SONIA became the Group's principal reference rate for hedging operations.

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

3.1 RETAIL FUNDING

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

The volume of retail deposits has continued to grow during the period, with balances at 31 March 2020 8.1% higher than at the previous year end, at £6,911.9 million (30 September 2019: £6,391.9 million, 31 March 2019: £5,878.0 million). This has been achieved with a reduced funding cost, reflecting the improvements made to the Group's capacity and capability.

The Group's share of the overall UK savings market remains small, with household savings balances reported by the Bank of England increasing by 2.1% in the six months ended 31 March 2020 to £1,245.9 billion (30 September 2019: £1,220.7 billion), although these deposits remain overwhelmingly with clearing banks and building societies.

The Group's savings balances at the period end are analysed below.

	Average interest rate		**Proportion of deposits**	
	31 March 2020 %	**30 September 2019 %**	**31 March 2020 %**	**30 September 2019 %**
Fixed rate deposits	1.95%	2.02%	62.7%	65.0%
Variable rate deposits	1.34%	1.43%	37.3%	35.0%
All balances	1.74%	1.81%	100.0%	100.0%

The average initial term of fixed rate deposits at 31 March 2020 was 27 months (30 September 2019: 28 months). The reduction in funding costs shown above reflects an improvement in the Group's proposition and a general reduction across the market in rates for new fixed term deposits and easy access rates across the six-month period, as reported by the Bank of England.

3. FUNDING REVIEW

At 31 March 2020 the proportion of easy access deposits, which are repayable on demand, at 30.0%, was 2.2% higher than its level at the beginning of the period (30 September 2019: 27.8%) and represented £2,072.5 million of the balance (30 September 2019: £1,778.0 million). This percentage remains low relative to peers in the banking sector. The level of easy access products can be expected to continue to rise in future, as the Group generates richer behavioural data to support its liquidity requirement assumptions for this type of business.

The core route to market for the deposit proposition is through an online presence, with traffic driven by strong repeat business flows, a presence on price comparison websites and recommendations from industry savings experts. The Group also offers postal products, which tend to appeal to a different demographic to the online offering.

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

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

The Group's products, process and approach continue to be well regarded, both in the industry and by customers. During the period, Paragon Bank won the 'Best Monthly Interest Provider' award in the 2020 Moneynet awards, the third year in a row it had received this accolade, and was named 'Best Multi-Channel Savings Provider' at the 2020 Savings Champion Awards.

In customer feedback 88% of those opening a savings account with the Group in the period, who provided data, stated that they would 'probably' or 'definitely' take a second product (2019 H1: 89%, 2019 full year: 89%). The net promoter score in the same survey was +62, similar to the +63 in the first half of the preceding financial year (2019 full year: +65).

When customers with maturing savings balances in the year were surveyed, 90% stated that they would 'probably' or 'definitely' consider taking out a replacement product with the Group (2019 H1: 92%) with a net promoter score at maturity of +49, compared to +58 for the first half of the 2019 financial year (2019 full year: +53). The performance evidenced by this high NPS rating is particularly valuable to the Group, driving customer and deposit retention.

The Group's outsourced deposit administration platform continues to perform well, and its service levels have not been significantly impacted by Covid-19 to date. It provides a cost-effective, stable and scalable solution in the medium to long term. Overall, the savings proposition provides the Group with a stable funding platform, with a focus on term funding to manage interest rate risk and the ability to limit product availability to short periods of time, giving the funding channel flexibility and manageability.

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

3. FUNDING REVIEW

3.2 WHOLESALE FUNDING

The wholesale funding of the Group comprises securitisation funding, warehouse debt and retail and corporate bonds, each issued from time to time as appropriate. It has been one of the principal issuers of residential mortgage backed securities ('RMBS') in the UK over many years. The Group's Long-Term Issuer Default Rating was affirmed at BBB by Fitch in the period, albeit with a negative outlook, which was applied to all the major UK banks as a result of the Covid-19 crisis.

Following the UK general election in December 2019 the performance of the capital markets strengthened during the early part of 2020, with transaction volumes increasing and margins improving for issuers. However, the impact of Covid-19 has made the markets unattractive for new public issuance.

Two mature transactions have been refinanced during the period, with a third paid down shortly after the period end. These included one pre-2010 deal, Paragon Mortgages (No. 9), the Group's longest-running buy-to-let legacy securitisation. The other two transactions, Paragon Mortgages (No. 23) PLC and Paragon Mortgages (No. 24) PLC, had reached their expected maturity dates and were paid down in accordance with market expectations.

On 30 April 2020, following the period end, the Group completed a fully retained securitisation transaction, Paragon Mortgages (No. 27) PLC, resulting in the issue of £735.8 million of rated notes to group companies, which will be used as collateral in other funding transactions.

A further funding option is provided by wholesale warehouse funding, which the Group uses to provide standby capability, particularly in the event of market disruption elsewhere, where funds need to be deployed rapidly or as an alternative to retail deposit funding for liquidity purposes. The Group's £200.0 million warehouse facility was renewed for a further twelve months in October 2019.

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

3.3 CENTRAL BANK FACILITIES

During the period the Group has continued to make use of central bank funding. During March 2020 the Group drew £140.0 million under the Bank of England's Contingent Term Repo Facility ('CTRF'), activated by the Bank in response to the Covid-19 crisis. The Group has been authorised under the SME Term Funding scheme ('TFSME') and expects to make its first drawings in the second half of the financial year. These schemes provide access to funding appropriate for the Group's operations at rates determined by reference to the Bank Base Rate, making them particularly cost effective.

Drawings under the Term Funding Scheme ('TFS') remain in place and provide £944.4 million of the Group's funding (30 September 2019: £944.4 million, 31 March 2019: £944.4 million), with all drawings remaining in place until at least 2021. The Group also utilised the Indexed Long-Term Repo scheme ('ILTR') for six-month borrowings, with £115.0 million outstanding at the period end (30 September 2019: £50.0 million, 31 March 2019: £40.0 million).

3. FUNDING REVIEW

The Funding for Lending Scheme ('FLS'), which currently provides liquidity of £109.0 million (30 September 2019: £109.0 million, 31 March 2019: £108.5 million) will expire in the second half of the financial year. The terms of this facility are such that neither the drawing nor the liquidity provided appear on the Group's balance sheet.

The Group has also pre-positioned mortgage loans and certain other assets with the Bank of England to act as collateral for future drawings on central bank funding lines, including the TFSME, if and when required, providing access to liquidity or funding of up to £1,301.3 million.

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

3.4 SUMMARY

The impact of the Covid-19 crisis at the end of the period has demonstrated the value of the Group's diversified funding strategy. The Group's retail deposit franchise remains strong, whilst its ability to access Bank of England funding enables it to draw on all the principal UK Covid-19 related schemes. The period has also seen new sources of off-balance sheet liquidity activated.

The Group's funding position is designed to remain diverse, robust and adaptable; to provide funds to satisfy maturing liabilities; and to support the Group's development through the Covid-19 crisis and sustain its post-Covid-19 strategy in the longer term.

Further information on the Group's borrowings is given in note 15.

4. CAPITAL REVIEW

The principal objectives of the Group's capital policy are to provide appropriate returns to shareholders, ensure that the strength of its balance sheet is preserved, maintain strong regulatory capital and liquidity positions to safeguard its depositors and have sufficient capital available to meet its strategic objectives going forward. The safeguarding of this capital strength has been a fundamental objective of the Group's Covid-19 response.

For regulatory purposes the Group's capital comprises shareholders' equity and tier 2 bonds and may be supplemented, if appropriate, by the issue of further qualifying liabilities.

4.1 DIVIDEND AND DISTRIBUTION POLICY

The previously announced dividend policy remains in place. This policy would distribute 40% of consolidated earnings to shareholders in ordinary circumstances, achieving a dividend cover ratio of approximately 2.5 times.

However, given the present level of economic uncertainty due to Covid-19, emerging market practice and statements made by regulators, the Board has concluded that it would be imprudent for an interim dividend to be declared for the current year (2019 H1: 7.0 pence).

The Board will consider the appropriate level of dividend for the year as a whole when it reviews its annual results, capital resources, capital and liquidity requirements and the operating environment prior to publishing its results for the year ending 30 September 2020 in late 2020.

4.2 REGULATORY CAPITAL

The Group is subject to supervision by the PRA on a consolidated basis, as a group containing an authorised bank. As part of this supervision, the regulator issues individual capital guidance setting an amount of regulatory capital, defined under the international Basel III rules, implemented through the Capital Requirements Regulation and Directive ('CRD IV'), which the Group is required to hold relative to its risk weighted assets in order to safeguard depositors in the event of severe losses being incurred by the Group.

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

		31 March 2020 £m	31 March 2019 £m	30 September 2019 £m
CET1 Capital	Basic	983.3	917.9	922.0
	Fully loaded	950.8	896.7	900.8
Total Regulatory Capital ('TRC')	Basic	1,133.3	1,067.9	1,072.0
	Fully loaded	1,100.8	1,046.7	1,050.8

4. CAPITAL REVIEW

The Group's CET1 Capital comprises its equity shareholders' funds, adjusted as required by the CRD IV rules. TRC, in addition, includes tier 2 capital in the form of Tier 2 Bonds.

The Group's capital requirements include the Pillar 1 + 2a amount, which is specific to the Group and is set by the regulator. This may include both variable and fixed components. At 31 March 2020, this requirement was £748.1 million on the transitional basis and £745.9 million on the fully loaded basis, similar to the position a year earlier (31 March 2019: £747.4 million and £746.4 million respectively).

The Group's capital must also cover the CRD IV buffers, the Counter-Cyclical ('CCyB') and Capital Conservation ('CCoB') buffers. These apply to all firms and are based on a percentage of risk weighted assets. During the period the CCyB was reduced to 0.0% by regulators in response to the Covid-19 pandemic (30 September 2019: 1.0%). The CCoB remained at 2.5% throughout the six months. The reduction in CCyB reduced the Group's capital requirement by £68.0 million. Further buffers may be set by the PRA on a firm by firm basis, but may not be disclosed.

The Group continues to maintain a healthy capital surplus, with the capital ratios set out below.

		31 March 2020	31 March 2019	30 September 2019
CET1 Ratio	Basic	14.4%	13.7%	13.7%
	Fully loaded	14.0%	13.4%	13.4%
Total Capital Ratio	Basic	16.7%	16.0%	15.9%
	Fully loaded	16.2%	15.6%	15.7%
UK Leverage Ratio	Basic	7.0%	6.5%	6.7%
	Fully loaded	6.8%	6.4%	6.6%

The increase in capital ratios in the period demonstrates that the capital effect of additional provision for credit losses arising as a result of the Covid-19 crisis has been outweighed by trading profits, a gain on the Group's defined benefit pension liability and the absence of a proposed interim dividend.

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

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

4. CAPITAL REVIEW

4.3 LIQUIDITY

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

Indicator	31 March 2020	31 March 2019	30 September 2019	Regulatory minimum
LCR – Liquidity coverage ratio	219%	134%	138%	100%
NSFR – Net stable funding requirement	115%	112%	115%	100% *

* not yet a binding requirement

This shows the available liquidity at the period end to be well in excess of regulatory minimums, with the steps taken to enhance liquidity in response to the Covid-19 situation significantly increasing ratios.

4.4 CAPITAL OUTLOOK

Over past years the Group has prioritised the maintenance of strong capital and liquidity positions, which has ensured that it is well placed to deal with Covid-19 related stresses.

This position is built upon strong, carefully managed businesses and a flexible funding base. The position is kept under regular review by the Board in light of the level and form of capital demanded by current business, regulatory and economic conditions, as well as the Group's strategic objectives.

This will deliver a capital position which is prudent and sustainable, protecting the viability of the Group's business, for the benefit of all its stakeholders.

INTERIM MANAGEMENT REPORT

5. FINANCIAL REVIEW

The Group's trading performance for the six months ended 31 March 2020 was not significantly impacted by the Covid-19 pandemic, with income and margins generally in line with expectations. However, the requirement under IFRS 9 to provide for future expected losses on loan accounts resulted in higher provisions and lower income recognition, with the inherent requirement to forecast the ultimate outturn of the crisis introducing greater estimation uncertainty into the period's results. These overlays reduce interest income by £3.7 million and increase loan impairments by £24.0 million. The impact of Covid-19 is included in the Group's definition of underlying results, which, for the six-month period to 31 March 2020, only excludes an immaterial debit in respect of fair value movements.

The six months ended 31 March 2020 saw the Group's underlying profit (appendix A) reduce by 28.3% to £57.2 million (2019 H1: £79.8 million) while on the statutory basis profit before tax reduced by 20.7% to £57.1 million (2019 H1: £72.0 million), the smaller reduction being a result of the lower level of fair value losses on hedging instruments.

Earnings per share reduced by 21.8% to 17.6p (2019 H1: 22.5p) on the statutory basis, and by 29.6% to 17.6p excluding the effect of the fair value gains (2019 H1: 25.0p) (appendix A).

5.1 RESULTS FOR THE PERIOD

CONSOLIDATED RESULTS

For the six months ended 31 March 2020

	2020 H1 £m	2019 H1 £m
Interest receivable	251.1	249.2
Interest payable and similar charges	(109.7)	(111.1)
Net interest income	141.4	138.1
Other operating income	8.3	9.9
Total operating income	149.7	148.0
Operating expenses	(62.5)	(63.3)
Provisions for losses	(30.0)	(4.9)
	57.2	79.8
Fair value net (losses) / gains	(0.1)	(7.8)
Operating profit being profit on ordinary activities before taxation	57.1	72.0
Tax charge on profit on ordinary activities	(12.6)	(13.9)
Profit on ordinary activities after taxation	44.5	58.1

5. FINANCIAL REVIEW

	2020 H1	2019 H1
Basic earnings per share	17.6p	22.5p
Diluted earnings per share	17.3p	22.0p
Dividend – rate per share for the period	-	7.0p

Income

Total operating income increased by 1.1% to £149.7 million (2019 H1: £148.0 million). Within this, net interest income in the period increased by 2.4% to £141.4 million from £138.1 million for the six months ended 31 March 2019. This increase was achieved despite a largely stable average loan book, which rose by only 0.3% to £12,346.1 million (2019 H1: £12,313.1 million) (appendix B).

Annualised net interest margin ('NIM') improved in the six months to 31 March 2020 to 2.29% (2019 H1: 2.24%) (appendix B). This was a result of changes in product mix in the Group's balance sheet, with the proportion of higher margin new buy-to-let mortgage accounts increasing as the legacy book runs off while the Commercial Lending portfolio, where loans attract higher margins than the mortgage assets, represents a growing part of the overall portfolio.

These positive factors were, to some extent, offset by the reduced size of the Idem Capital portfolio and the potential impact of Covid-19 on the acquired consumer loans within it, which are treated as Purchased or Credit Impaired on acquisition ('POCI') under IFRS 9. Reforecasts of future cash generation from those assets at a lower level due to Covid-19 have generated a £3.7 million charge, representing the reversal of effective interest rate gains of previous periods.

Other operating income was £8.3 million for the six months, compared with £9.9 million in the corresponding period in 2019. The largest part of this reduction relates to account fee income, which is attributable to the changing profile of the portfolio.

Costs

Operating expenses for the period decreased by 1.3% to £62.5 million from £63.3 million for the six months ended 31 March 2019. The Group's average number of employees increased to 1,388 for the period, an increase of 1.8% over the comparable period in 2019 (2019 H1: 1,364). The increase in the Group's savings balance in the period (17.6% between 31 March 2019 and 31 March 2020) also increased operating costs, with the outsourced servicing fee set by reference to the balance outstanding. Charges for share based payments were reduced by £2.7 million. The Covid-19 crisis did not have a material impact on costs up to 31 March 2020.

The Group has continued to invest in IT infrastructure and operational resilience, an approach which has helped support its response to the Covid-19 pandemic. An updated broker portal for the mortgages division and new Treasury systems came on stream during the half year and developments continue, with enhancements to the SME lending customer experience a particular focus.

5. FINANCIAL REVIEW

The Group's IRB project continued through the period, with the first stage of its application submitted in March 2020. The period's costs include expenditure of over £1.1 million on this project, both in internal resources and on external advice.

This continuing investment meant that the Group's cost:income ratio in the period, at 41.8% (appendix C), was broadly similar to the 40.7% reported for the 2019 financial year and the 42.8% recorded in the first half of 2019. The control of operating costs remains a principal strategic priority of the Group and it applies a rigorous budgeting and monitoring process. Over the medium term, the Group targets improvements in the cost:income ratio, from scale and efficiency gains, but increases in regulatory burdens, IT investments and the impact of new operations means that progress to a lower ratio is unlikely to be linear.

Impairment provisions

Operationally, up to the impact of the Covid-19 crisis the Group had continued to see favourable trends in arrears performance, both in terms of new cases reducing and customers correcting past arrears. The careful management of loan books has remained a strategic priority, particularly as part of the Group's Covid-19 response. The credit performance of the books during the six month period was pleasing, with that of the buy-to-let book remaining exemplary, compared to market averages. Credit metrics on the Group's newer portfolios were also strong and in line with expectations.

The Group's impairment provisions are determined in accordance with IFRS 9. The standard requires firms to provide based on expected losses and an assessment of future economic conditions, and customer responses to them is fundamental to any provision calculation. Covid-19 is an unprecedented situation for the UK and global economy which has two main consequences for the provisioning process:

- There is little consensus on the economic outlook with respected commentators taking fundamentally different views on the nature and duration of the immediate economic shock and the recovery from it.
- There is no solid evidence as to how an economic disruption on this scale will affect customer behaviour or on the extent to which this will be mitigated by government and regulatory interventions.

It is normal practice, when forecasting credit losses under IFRS 9, to refer to previous customer behaviour under stressed circumstances. However, the lack of previous comparable events means that such an approach is not feasible in the present circumstances.

Up to the point of the impact of Covid-19 on the UK in March, the Group's provision data was largely positive, with charges remaining in line with expectations, while at 31 March 2020 its calculations, based on credit and performance data in the portfolios, continued to show a relatively benign position, with the economic shock not having impacted on the data significantly at that point.

5. FINANCIAL REVIEW

In order to compensate for this data deficiency and calculate an appropriate provision in the Covid-19 environment, the Group adopted the following approach:

- Firstly: Undertaking its normal IFRS9 impairment assessment, as described in the accounts for the year ended 30 September 2019, incorporating Multiple Economic Scenarios ('MES') based upon the economic outlook and forecasts publicly available before the rapid escalation of the Covid-19 situation in late March 2020 and based on the portfolio performance and characteristics at the period end. The outputs of these calculations are referred to below as the 'pre-Covid-19' impairments.

- Secondly: By constructing a further Covid-19 specific series of MES in early May when the Group had the benefit of a wider range of economic forecasts to review, including the Bank of England's 'Desk-top stress test scenario' published on 7 May 2020. These Covid-19 MES reflected different trajectories for the UK economy and key impairment drivers and were used as inputs into the Group's normal impairment models.

- Thirdly: each portfolio was considered separately to determine the requirement for additional provision given the data available on customer contacts (most notably in the form of payment holidays or other reliefs), the nature of the loan, the relative vulnerability of sectors customers operate within, the value of related security and the potential effectiveness of any relief schemes available to the customer.

As the last of these is clearly highly subjective at this point in the development of the Covid-19 situation, additional disclosures have been made to explain this impact.

This second set of provisioning outputs is referred to as the 'Covid-19' provision below.

Based on the pre-Covid-19 impairments a bad debt charge of £6.0 million was calculated, an increase of £1.1 million on the first half of 2019. This increased the cost of risk, before Covid-19 adjustments, by 2 basis points to 10 basis points, a low level, reflecting the strong credit performance delivered by the Group's underwriting approach in its various operating businesses.

Details of the Group's Covid-19 MES over the next five years are set out in note 11, but the following table sets out forecast quarterly GDP growth in each of the scenarios over the next two years to illustrate the economic trajectory implicit in each.

Scenario	**Rate of GDP increase / (decrease) for quarter ending**							
	Jun 20	**Sep 20**	**Dec 20**	**Mar 21**	**Jun 21**	**Sep 21**	**Dec 21**	**Mar 22**
	%	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Scenario 1	(14.3)	(7.9)	(4.5)	(0.3)	15.6	8.6	6.4	5.4
Scenario 2	(11.9)	(3.9)	(0.3)	3.0	15.6	6.4	3.7	3.8
Scenario 3	(17.5)	(11.3)	(7.7)	(3.3)	17.2	10.5	8.6	7.2
Scenario 4	(16.2)	(11.2)	(13.1)	(7.0)	12.0	7.4	12.2	8.8

The Bank of England desk top stress scenario shows an 11% average decline in GDP in 2020, with a two year recovery period to levels for the quarter ended 31 December 2019. It therefore lies broadly between Scenarios 3 and 4. In scenario 4 the Group has modelled a double-dip economic impact.

5. FINANCIAL REVIEW

As at 31 May 2020, the Group had agreed some form of Covid-19 payment relief with customers with balances of £2.7 billion, representing 21.3% of the total portfolio. These are summarised by division below.

	Current balances at 31 May 2020 £bn	Percentage with Covid-19 relief By number	Percentage with Covid-19 relief By value
Mortgages	10.6	17.8%	21.0%
Commercial Lending	1.6	22.1%	28.1%
Idem Capital	0.6	2.9%	7.7%
	12.8	9.3%	21.3%

Within the Commercial Lending segment 47.1% of SME lending customers, by value, had been granted some form of Covid-19 payment relief making this the area of the business with the highest incidence of reliefs. These reliefs predominantly consist of a short interest-only period, but around 16% of SME lending accounts granted relief received a full payment holiday.

Across the Group's businesses, a detailed process of customer engagement is underway, augmented by a series of surveys designed to give additional support to assumptions made in the absence of actual performance data.

Within the Mortgages division, which represents the largest amount of customers granted relief by value, the majority of such customers stated that they applied for payment holidays as a precautionary measure, with buy-to-let landlords seeking to mitigate the impact of any actual or potential disruption of rent receipts.

In the SME lending area, the part of the portfolio with the highest proportion of accounts receiving relief, the Group's analysis further identifies customers by segment and then by asset class. The distribution of Covid-19 reliefs in the portfolio by industry is summarised below.

Industry sector	Percentage of SME lending	Percentage with Covid-19 relief	Percentage with payment holidays
Construction	24.0%	63.6%	13.4%
Logistics and vehicle hire	18.3%	62.1%	16.0%
Manufacturing	11.1%	54.6%	31.1%
Legal services	6.5%	31.3%	7.2%
Public bodies	5.8%	0.6%	-
Hospitality, tourism and events	5.7%	60.5%	24.2%
Other industries	28.6%	43.5%	11.7%
	100.0%	50.7%	16.2%

The majority of the Covid-19 relief cases shown above, 91.2% by value, relate to leasing of hard assets, where the Group has security on a tangible asset of some kind.

5. FINANCIAL REVIEW

The Group considered the impact of the Covid-19 scenarios, the exposure profiles of its various books and the customer intelligence summarised above and determined that £24.0 million of additional provision should be made over and above the £6.0 million calculated on the normal basis. The distribution of the charges between segments is set out below.

Segment	Base case £m	Covid impact £m	Total provision £m	2019 H1 £m	2019 Full year £m
Mortgages	2.7	11.1	13.8	0.7	1.0
Commercial Lending	3.9	11.6	15.5	3.7	7.2
Idem Capital	(0.6)	1.3	0.7	0.5	(0.2)
Total	6.0	24.0	30.0	4.9	8.0

The relatively high provision level compared to the carrying balance in Commercial Lending reflects the lending profile of the assets and the level of relief requests shown above. The impact on Idem Capital is relatively less due to the reducing, highly seasoned balances and the level of POCI assets in the segment, which have suffered a reversal of previously taken interest, rather than an impairment charge.

The impact of this additional provision on the Group's net loan assets at 31 March 2020 is set out below:

Segment	Gross carrying value £m	Base case provision £m	Covid-19 provision increase £m	Total provision £m	Net carrying value £m
Mortgages	10,713.4	(26.2)	(11.1)	(37.3)	10,676.1
Commercial Lending	1,518.5	(12.6)	(11.6)	(24.2)	1,494.3
Idem Capital	340.9	(3.9)	(1.3)	(5.2)	335.7
Total	12,572.8	(42.7)	(24.0)	(66.7)	12,506.1

The differing levels of provision cover shown above reflect the differences in products across the segments, with secured assets, particularly those secured on residential property, requiring lower levels of provision, even under stress, due to the Group's levels of loan-to-value cover.

5. FINANCIAL REVIEW

The final provisions by stage are set out below:

Segment	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
31 March 2020					
Gross carrying balance	11,670.4	542.2	174.6	185.6	12,572.8
Impairment provision	(18.1)	(9.0)	(39.4)	(0.2)	(66.7)
Net carrying value	11,652.3	533.2	135.2	185.4	12,506.1
31 March 2019					
Gross carrying balance	11,692.6	440.7	185.6	258.2	12,577.1
Impairment provision	(5.5)	(3.5)	(42.5)	-	(51.5)
Net carrying value	11,687.1	437.2	143.1	258.2	12,525.6
30 September 2019					
Gross carrying balance	11,382.6	458.5	167.9	219.0	12,228.0
Impairment provision	(6.0)	(3.7)	(32.2)	-	(41.9)
Net carrying value	11,376.6	454.8	135.7	219.0	12,186.1

A more detailed breakdown of this staging, by segments and within stages, is set out in note 11.

The Group's swift operational response to Covid-19 has ensured that almost all the Group's customer-facing resource remains available, which should enable it to address emerging credit issues going forward, whether pandemic related or not, as effectively as possible.

Fair value movements

Yield curve movements during the period resulted in hedging instrument fair value net losses of £0.1 million (2019 H1: £7.8 million net losses), which do not affect cash flow. The fair value movements of hedged assets or liabilities are expected to trend to zero over time. As such this item represents a timing difference which is consistently excluded from the Group's definition of its underlying profit. The Group remains appropriately economically hedged.

Tax

Tax has been charged at an effective rate of 22.1%, compared with 19.3% for the corresponding period last year. Materially all of the Group's operations fall within the scope of UK taxation and the standard rate of corporation tax applying to the Group in both periods was 19.0%. The UK Government had legislated to reduce the tax rate to 17.0% from April 2020, but this was reversed following the 2020 budget. The impact of this reversal on the Group's deferred tax balances has been accounted for in the period.

5. FINANCIAL REVIEW

The increase in the effective rate of tax is principally a function of the increasing proportion of the Group's profit generated within its banking subsidiary, Paragon Bank PLC, and therefore subject to the 8.0% bank tax surcharge, in addition to its tax at the standard rate.

The Group has made all its tax and VAT payments and has not taken advantage of any of HMRC's Covid-19 related deferral schemes.

Results

Profits after taxation of £44.5 million (2019 H1: £58.1 million) have been transferred to equity, which totalled £1,122.0 million at the period end (31 March 2019: £1,087.0 million). This represents a tangible net asset value of £3.74 per share (31 March 2019: £3.54 per share) and a net asset value on the statutory basis of £4.41 per share (31 March 2019: £4.21 per share) (appendix D).

The information on related party transactions required by DTR 4.2.8(1) of the Disclosure Guidance and Transparency Rules is given in note 25.

5.2 SEGMENTAL RESULTS

The Group continues to manage its business through three divisions, which are the principal segments for which performance is monitored:

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

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

5. FINANCIAL REVIEW

The underlying operating profits of these divisions are detailed fully in note 2 and are summarised below.

	Six months to 31 March 2020 £m	Six months to 31 March 2019 £m	Year to 30 September 2019 £m
Segmental profit			
Mortgages	76.9	84.6	167.9
Commercial Lending	15.1	19.5	43.8
Idem Capital	9.6	22.8	48.0
	101.6	126.9	259.7
Gains on disposals	-	-	9.7
Unallocated central costs and other one-off items	(44.4)	(47.1)	(95.3)
	57.2	79.8	174.1

Mortgages

The Mortgages division has maintained a strong position in its market throughout the six months, despite the impact of Covid-19 at the end of the period. The division's operational strategy, and the gradual replacement of legacy assets by new originations in the portfolio, increased NIM by 13 basis points, while cost of risk, before the impact of Covid-19, had remained low. However, the impact of the virus at the end of the period generated impairment charges for the period of £13.8 million (2019 H1: £0.7 million).

The impact of this increased provision saw segmental profit decrease by 9.1% to £76.9 million, from the corresponding period in the previous year (2019 H1: £84.6 million).

Commercial Lending

Segmental profit in Commercial Lending was £15.1 million in the period (2019 H1: £19.5 million), with the decrease principally the result of higher provision charges. Total impairment provisions for the period were £15.5 million, compared to £3.7 million in the first half of 2019.

Average loan assets in the segment were 22.0% higher than in the first six months of the previous financial year, while a strategic focus on yield saw NIM in the division rise by 22 basis points compared with the six months ended 31 March 2019. Operationally, the division's cost base was broadly static, with scale benefits as newer business lines grew, together with growth and enhanced focus across the operation. Together these delivered a promising performance, before the exceptional levels of provisioning required by Covid-19.

INTERIM MANAGEMENT REPORT

5. FINANCIAL REVIEW

Idem Capital

Portfolios within the Idem Capital division continued to perform in line with expectations in the six months ended 31 March 2020. No new deals were completed, and the outstanding loan balance continued to run-off in the period, falling by 13.9% between September 2019 and March 2020. NIM reduced in the segment, a result of the mix variance created by the slower run-off speed of secured assets, which may have lower yields. This, together with the reduction in the average balance and Covid-19 provisioning, impacted on segment profit, which fell to £9.6 million (2019 H1: £22.8 million).

5.3 ASSETS AND LIABILITIES

The Group's assets and liabilities at the period end are summarised in the balance sheet below.

SUMMARY BALANCE SHEET
31 March 2020

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m
Intangible assets	170.5	171.4	171.1
Investments in customer loans	12,506.1	12,525.6	12,186.1
Derivative financial assets	538.1	751.3	592.4
Free cash	307.1	204.2	225.7
Other cash	899.7	867.8	999.7
Other assets	267.7	133.7	220.5
Total assets	14,689.2	14,654.0	14,395.5
Equity	1,122.0	1,087.0	1,108.4
Retail deposits	6,911.9	5,878.0	6,391.9
Borrowings	6,412.4	7,495.6	6,648.4
Pension deficit	28.3	31.9	34.5
Other liabilities	214.6	161.5	212.3
Total equity and liabilities	14,689.2	14,654.0	14,395.5

Changes in the balance sheet of the Group are principally driven by movements in its loan books. During the six month period the portfolio increased by 2.6%, as discussed in the lending review (section 2 above). This increase, together with the Group's liquidity and capital policy, determines its funding requirements and hence the level of its liabilities.

5. FINANCIAL REVIEW

Loan assets

The Group's loan assets include:

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

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

	31 March 2020 £m	**31 March 2019 £m**	**30 September 2019 £m**
Mortgages	10,676.1	10,783.9	10,344.1
Commercial Lending	1,494.3	1,283.9	1,452.1
Idem Capital	335.7	457.8	389.9
	12,506.1	12,525.6	12,186.1

An analysis of the Group's financial assets by type is shown in note 10. Movements in the Group's loan asset balances are discussed in the lending review (section 2) above.

Derivatives

Movements in derivative financial assets principally relate to the effect of changes in exchange rates on instruments forming cash flow hedges for the Group's floating rate notes, which decreased by £59.9 million over the six month period. These movements do not impact the Group's results, while the exchange movements have a broadly equal and opposite impact on borrowings.

There was also a £14.1 million increase in derivative liabilities, principally relating to the Group's hedging activities, largely offset by a £15.0 million increase in the hedging adjustment on loans to customers, included in sundry assets above.

5. FINANCIAL REVIEW

Funding

Movements in the Group's funding, including retail deposit balances and wholesale borrowings, are discussed in the funding review (section 3). The Group has continued to pursue a conservative liquidity policy in the period, resulting in strong levels of liquid assets being held throughout the period and this was increased towards the period end as part of its response to the Covid-19 situation.

Pension obligations

The IAS 19 valuation of the Group's pension scheme deficit reduced in the period, despite the unstable position of the capital markets at the period end. Market implied gilt yields, which are used to value future liabilities, moved in the opposite direction to bond yields, which are used to estimate the discount rates applied to them, and hence the discounted value of the liability reduced. This caused the £6.2 million reduction in the deficit to £28.3 million (30 September 2019: £34.5 million, 31 March 2019: £31.9 million).

While the valuation under IAS 19 is that which is required to be disclosed in the accounts, pension trustees generally use the technical provisions basis as provided in the Pensions Act 2004 to measure scheme liabilities. On this basis, the valuation of the deficit at 31 March 2020 was estimated at £37.2 million, an increase of £8.0 million in the period (30 September 2019: £29.2 million, 31 March 2019: £26.7 million), representing a 73.5% funding level (30 September 2019: 79.2%).

Other assets and liabilities

Sundry assets have increased since 30 September 2019 by £47.2 million. This results principally to: a £14.9 million growth in CRD deposits held at the Bank of England, which increases with the size of the Group's retail deposit base; the inclusion of a tax current debtor of £10.1 million, due to changes in payment on account arrangements and the impact of the reduced profit level on those arrangements; the £15.0 million movement in fair value hedging referred to above; and the recognition of £7.0 million of right of use assets on the adoption of IFRS 16 (note 29).

Within sundry liabilities, the absence of a current tax liability is offset by the lease liability recognised on transition to IFRS 16.

INTERIM MANAGEMENT REPORT

6. OPERATIONAL REVIEW

Developments in the Group's operational capabilities in the half year have been overshadowed by the impact of the Covid-19 pandemic from March 2020. The achievement of the Group's objectives is heavily reliant on its people, systems and governance structures, with a single framework covering all locations and operations. This framework has been successfully reconfigured in response to Covid-19.

Both before and during the Covid-19 situation the Group has continued to invest in its infrastructure, particularly in customer and broker facing systems, in order to generate operational efficiencies and improve customer experiences.

6.1 COVID-19 RESPONSE

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

The Group's operational functions faced two major challenges as a result of the Covid-19 situation; firstly, to develop processes and IT systems to deliver appropriate financial reliefs to customers, in line with the structures set out by the UK Government; and secondly, to enable working from home to be widely available amongst the workforce while preserving the Group's culture and retaining a strong compliance framework.

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

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

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

6. OPERATIONAL REVIEW

At 31 March 2020, the Group had enabled 90% of employees to work from home on a sustained basis whilst maintaining service levels for all its customers. Almost all the Group's offices have been temporarily closed with employees identified as critical being retained in a handful of premises, mostly in roles which require the employees' physical presence, such as those maintaining council waste disposal vehicles funding by SME lending. Other than these workshop personnel, almost all remaining on-site employees are based in the head office building in Solihull. Following the period end, the numbers working from home increased still further. The Group has not placed any employee on a furlough scheme and has no present intention of doing so.

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

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

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

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

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

INTERIM MANAGEMENT REPORT

6. OPERATIONAL REVIEW

6.2 MANAGEMENT AND PEOPLE

The achievement of the Group's strategic objectives relies on the strength of its governance and management processes and the quality of its people. Its strengths in these areas have formed the foundation of the Covid-19 response described above, highlighting the value of the Group's efforts in this area.

The Group has almost 1,400 employees, normally split between its Solihull head office and satellite locations across the UK, but currently mostly working from home, and it recognises the value these people bring to the business. The Group recognises the importance of continuing to enhance its strengths in this area and its development activities, including participation in several external initiatives, have continued through the half year and into the pandemic period.

Governance and management

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

Since 1 October 2019 the Company has been subject to the 2018 UK Corporate Governance Code (the 'Code'). This includes significant changes from the 2016 edition of the Code and work was undertaken during the year ended 30 September 2019 to ensure compliance with the Code. The enhancements made to the Group's governance arrangements in response to the Code will be discussed further in the 2020 Annual Report and Accounts. The Company has complied with the principles of the Code during the period.

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

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

6. OPERATIONAL REVIEW

In March 2020 Alison Morris was appointed to the Board and will formally take on the role of Audit Committee Chair once these Half-Year Results have been published. Alison is a qualified accountant and recently retired as a partner in PwC's Financial Services Assurance Practice. She joined PwC in 1982 and spent her entire career with the organisation in a range of internal and external audit roles across the Asset and Wealth Management practice and Banking and Capital Markets business unit. Following Alison’s appointment, women now comprise one third of the Board.

The handover from Peter to Alison is progressing well and it is hoped that a new Senior Independent Director appointment, subject to regulatory approval, will be announced during the summer of 2020. Once the handover in respect of that position is complete, Peter will retire from the Board with the thanks of the Chair and the Board for his commitment to the Group and his professionalism and dedication in the role of Audit Committee Chair and, latterly, Senior Independent Director.

Whilst the pandemic will clearly impact on review processes across the Group, the culture review signposted in the 2019 Annual Report and Accounts was well progressed by 31 March 2020, and will be reported on at the year end.

Equality and diversity

The Group’s diversity agenda continues to be an area of focus at board level and across the Group. During the period Alison Morris became the third female member of the Board of Directors, and in September 2019 the third progress report on the Group’s internal targets under the Women in Finance Charter was published on its website.

The number of female senior managers (using the Hampton-Alexander measure) fell slightly in the period, to 31.4% at 31 March 2020 (30 September 2019: 35.9%), principally as a result of a reorganisation of reporting lines, but the Group maintains its Women in Finance target of being consistently above 35% by January 2022.

The Group reported its full Gender Pay Gap information at the end of March 2020, despite the Covid-19 derogation granted by the UK Government, having already included the headline numbers in its Annual Report for the year ended 30 September 2019. These results, based on the April 2019 pay date, can be found on the ‘Corporate Responsibility’ section of the Group’s website.

The published data covered all the Group’s operations, going beyond the requirements of the legislation to provide a more complete view of its position. The median gender pay gap for the whole Group at 5 April 2019, at 33.9%, was similar to those for other smaller financial entities (5 April 2018: 30.7%). Analysis of the data indicated that this gap arose primarily from the low numbers of women in higher paying positions, principally within senior management, professional and technical roles, rather than unequal pay for similar jobs, and the Group’s internal development policies are focussed on enabling female employees to progress to such roles.

6. OPERATIONAL REVIEW

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

The Group has continued its internal diversity programmes throughout the period. Annual diversity awareness training is provided for managers and additional communication events are planned in the coming months. The Group carries out an annual voluntary and anonymous diversity survey of its employees with the 2019 survey, carried out in November, producing a response rate of 67% (2018: 72%), significantly above industry average. The 2020 survey will be conducted during the second half of 2020 and results will be reported at the year end. Actions to promote equal opportunities within recruitment, learning and career development continue to be an important element of the Group's people strategy.

Whilst the Group is pleased with progress to date in improving diversity, relative to other similar organisations, it recognises that there is still much work to do. It is confident, however, that the measures put in place will help provide individuals with the opportunities they deserve and the Group with the workforce it needs to achieve its strategic goals. A full list of the Group's diversity targets can be found on the 'Corporate Responsibility' section of the Group's website.

People and development

During the past six months average employee numbers have increased by 2.0% compared to the first half of 2019, as the Group sought to maintain operational efficiencies. It maintains its accreditation from the UK Living Wage Foundation, increasing minimum pay in line with the Foundation's most recent recommendations during the period.

From January 2020 the Group has also offered enhanced pension arrangements to employees, with a higher employer contribution rate for those saving at the maximum level. It was particularly pleasing that this led to 28.5% of the Group's employees increasing their level of retirement savings, doubling the number making a maximum contribution.

The Group's annual employee attrition rate of 15.3% (2019 H1: 16.1%) is below the national average. 30.9% of its people have been with the Group for more than ten years, with 14.3% having achieved over 20 years' service. This level of stability has been an important factor in supporting the Group's Covid-19 response, as well as in providing the specialist service its customers require, and is a valued component of its corporate culture. We believe this is due to the provision of quality development opportunities and ensuring the Group remains an organisation in which people want to work.

6. OPERATIONAL REVIEW

During the period the Group's People Forum acted as the principal conduit for employee opinions to be communicated to the Board. In November 2019 the Chair of the Board and the Chair of the Remuneration Committee attended a session at which executive pay was discussed and regular reports from the Forum are presented to the Board. Regular meetings of the Forum, conducted virtually, continue despite the Covid-19 situation. It is intended that the next employee forum meeting with board members will take place over the summer 2020.

The importance of employee development continues to be recognised. Regulatory and other training programmes have taken place internally to ensure employees remain competent to deliver good customer outcomes, with e-learning approaches ensuring that this can continue even in periods of home working.

The Group has continued to draw down on Apprenticeship Levy funds to support its development objectives. These were used to fund management development programmes certified with the Chartered Management Institute ('CMI') as well as programmes in business areas such as Mortgages (leading to the Financial Services Administration qualification) and IT.

At 31 March 2020 the Group had 47 apprentices registered under the levy scheme, utilising 51.3% of its levy pot in the past 12 months. Whilst a higher take up would be desirable, the requirement for apprentices to spend 20% of their time out of the business makes it challenging to identify suitable roles. In addition, at any time there are typically over 100 people completing professional qualifications with the aid of Group funding; with 110 such qualifications in progress at 31 March 2020.

Management development has been a core focus to support the Group's wider succession planning strategy, as well as developing more female employees to increase the pool of available internal candidates. During the period, work has continued to embed the internal mentoring programme, accredited by the CMI, which helps to support the Group's succession planning strategy and develop future leaders. The Group held a senior leadership networking event in October 2019 and continuing leadership development is planned in the second half of this financial year.

The Group places great importance on its role as a corporate citizen. It has continued to work with local secondary schools, colleges and universities, with industrial placements becoming a feature for some of the Group's specialist areas. It also runs a volunteering day scheme, where any employee may take a day's paid leave in connection with local and regional charitable activities. The first full year of the initiative ended in March 2020 and in that time 85 employees took part in volunteering schemes involving soup kitchens, schools and gardening in the community. Feedback to date has been very positive from both employees and the organisations involved.

6. OPERATIONAL REVIEW

6.3 ENVIRONMENT AND SOCIAL

Climate change

The Group continues to consider its exposure to risk from climate change and the transition to a low carbon economy which have the potential to impact both its customers and the business activities. These risks fall into two main groups:

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

During the period an internal Climate Change forum has been established. This includes senior management from across the business, representing both customer-facing, support and second line functions. The forum's remit includes:

- ensuring financial risk from climate change is managed effectively, including understanding and considering these financial risks within the context of the overall strategy and risk appetite
- reporting on the climate change agenda through to the Board's Risk and Compliance Committee

Several workstreams, reporting into the forum, have been set up, covering matters such as product design, risk evaluation at account level and external reporting, which will continue through the second half of the year.

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

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

Charitable activity

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

6. OPERATIONAL REVIEW

6.4 RISK MANAGEMENT

The effective management of risk is crucial to the achievement of the Group's strategic objectives, particularly in the current unprecedented Covid-19 environment. It operates a risk governance framework, designed around a formal three lines of defence model (business areas, Risk and Compliance function and Internal Audit) supervised at board level, and it has been a priority to ensure that this remains in place following the business and operational changes necessitated by the pandemic.

The focus of the risk management function since February 2020 has been on managing the challenges of operating in the face of the Covid-19 pandemic. The impacts of the pandemic are still being ascertained and the Group continues to respond to the ongoing challenges as these become clearer.

The Covid-19 outbreak and the steps which have had to be taken to address it increases business, credit and operational risk across the Group and the Group's Covid-19 governance programme includes a risk workstream, including a Covid-19 risk working group, reporting to the Risk and Compliance Committee at board level, to ensure these risks are identified, evaluated and are being adequately addressed.

The risk function has also been engaged, together with Internal Audit, in conducting ad hoc reviews to establish whether systems and processes redesigned in response to the crisis continue to meet the Group's control and compliance objectives.

More widely in the last six months, the Group has continued to make good progress in further developing its ability to manage all categories of risk in line with the development of the business. Although inevitably there has had to be some re-deployment of resource and priorities to meet the challenges of the pandemic, the Group is committed to continuing to deliver on the key risk projects described below:

- ongoing development of advanced models to enhance credit risk management and support the Group's continuing IRB application process
- enhancement of stress testing procedures to ensure the robustness of capital and liquidity positions
- continuing evolution and embedding of its risk appetite framework as part of its commitment to develop a comprehensive and fully integrated enterprise-wide risk management approach
- enhancement of its operational resilience capabilities. The response to the Covid-19 pandemic has reinforced the importance of strong resilience and the lessons learned from the Group's handling of the crisis will further assist in the ongoing refinement and embedding of the operational resilience framework
- maintenance and further development of effective cyber-security controls in response to heightened cyber-security risks as a result of the increasing sophistication and frequency of cyber-attacks affecting the financial services sector
- continuing the embedding of robust data protection processes and controls to ensure compliance with the Data Protection Act 2018

6. OPERATIONAL REVIEW

The principal challenges in the risk environment faced by the Group during the six-month period and going forward will inevitably be the various impacts of the Covid-19 pandemic, across all the Group's main risk areas. The longer-term implications of the global crisis in terms of economic downturn, potential changes to lending profiles, new business volumes and customer credit risk and the potential impacts on operational risk of new working patterns are being closely monitored. The Group continues to respond to the immediate challenges whilst considering how these might affect its future strategy.

Besides the risk issues directly related to Covid-19, however, there are a number of other key risks the Group is focussed on:

- the impact of continuing uncertainty as to the trade and business relationship with the EU at the end of the Brexit transition period, currently scheduled for 31 December 2020, and the associated impacts on the Group's businesses and the regulatory regimes it operates under
- the level of change in products, funding and operations which will be required in preparation for the withdrawal of LIBOR in 2021
- major regulatory developments including increased focus on the impact of climate change on managing financial risks

The Group is carefully monitoring and responding to these risks as they develop and considers itself well placed to mitigate their impact.

A summary of the principal risks and uncertainties faced by the Group is given on pages 57 and 58.

6.5 REGULATORY CHANGES

Paragon Bank, which, for regulatory purposes, includes most of the Group's activities, is authorised by the PRA and regulated by the PRA and the FCA. The Group is subject to consolidated supervision by the PRA and a number of its other subsidiaries are authorised and regulated by the FCA. As a result, current and projected regulatory changes, particularly the ongoing programme of revisions to the Basel supervisory regime, continue to pose a significant risk for the Group, both as a result of their impact and of the pace of change.

The governance and control structures within the Group continue to be developed to ensure that the impacts of all new regulatory requirements on the business are clearly understood and that appropriate preparations are made before implementation. Regular reports on key regulatory developments are received at both executive and board risk committees, assessing the potential implications for the Group, along with necessary actions.

Covid-19 has been a principal concern of UK and European regulators over the final part of the period and subsequently, with the PRA, FCA, European Banking Authority ('EBA'), European Securities and Markets Authority ('ESMA') and others making regulatory changes and providing advice in response to the crisis, generally with very short consultation and implementation periods. These have included far reaching and detailed directions on the conduct of customer accounts in these circumstances, including the nature of reliefs which might be appropriate. All these publications have been considered by the Group, any implications identified, and any changes required implemented within an appropriate timeframe.

6. OPERATIONAL REVIEW

Whilst the Group is impacted by a broad range of prudential and conduct regulations, given the nature of its operations, the following recent and current developments have the greatest potential impact:

- extensions to the Senior Managers and Certification Regime ('SMCR') covering the Group's regulated legal subsidiaries came into force in December 2019, with the establishment from March 2020 of a Directory of Certified Regime ('CR') staff. This increased both the responsibilities of a number of the Group's employees within the SMCR and the oversight activities required to ensure compliance with the extended rules. This has been successfully implemented with appropriate systems developed in the period and training modules for all impacted people being rolled out across the Group

- consultation papers were published by the Bank of England, PRA and FCA in December 2019 focussing on building operational resilience in the UK financial system and the individual firms and market infrastructures within it. This was accompanied by a separate consultation paper on outsourcing and third-party risk management. Significant work has already been undertaken to address both these areas and the Group continues to actively work to ensure it has the necessary arrangements in place to meet the best practice expectations of the papers. This work has had immediate practical benefit in informing the Group's Covid-19 response

- the continuing development of proposals, led by the Bank of England and the FCA, to establish SONIA as the primary sterling interest rate benchmark by the end of 2021, in place of LIBOR, continues to be monitored to assess the potential impact on the Group and its customers. It has been indicated that the 2021 deadline is unlikely to be affected by the Covid-19 crisis. This is discussed further in the funding section

- the treatment of vulnerable customers continues to be a strong focus for the FCA, and the Group continues to take its responsibilities in this regard seriously. There is ongoing review of the Group's arrangements to ensure that it meets all obligations appropriately

- the FCA proposals to make changes to the responsible lending rules and guidance in respect of mortgage customers, issued in March 2019. The Group is in the process of assessing their impact and determining what action may be required

- the FCA publication in October 2019 of new regulation in the motor finance industry in respect of commission structures and affordability assessments. The Group believes it is well-placed to address these requirements and continues to work to accommodate the changes

The Group, along with the rest of the UK corporate sector, does not yet have clear visibility on potential regulatory changes that may be introduced following the UK's departure from the EU. However, given its current business model and activities, it does not have any EU passporting issues that need to be considered.

6. OPERATIONAL REVIEW

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

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

7. CONCLUSION

The Group's priorities facing Covid-19 have been to support customers and suppliers, protect our people, safeguard the capital base and preserve the long-term value of the business. The Group was able to respond quickly, with great agility, with all products and services remaining available.

This performance would not have been possible without the experience, enthusiasm and commitment of the Group's people who have coped admirably with significant and rapid changes in the structure of their working lives and the demands made of them. The Group would like to thank all of them for their continuing contribution to its Covid-19 response.

Whilst it is difficult to predict the full impact of the pandemic, provisions for £27.7 million in additional charges have been made, based on careful economic modelling and customer analysis. Covid-19 relief arrangements have been put in place for customers facing challenges, and the Group is also providing funding to its SME customers through the UK Government's CBILS and BBLS schemes.

The Group made strong progress up to the point of the commencement of the UK lockdown, with lending volumes and yields broadly in line with expectations. With a high-quality loan book, 98% of which is secured, and strong capital and liquidity, the Group stands ready to meet the changing needs of our customers, employees, business partners and other stakeholders throughout this challenging period and into the next business cycle.

PRINCIPAL RISKS AND UNCERTAINTIES

There are a number of potential risks and uncertainties which could have a material impact on the Group's performance over the remaining six months of the financial year and could cause actual results to differ materially from expected and historical results. In the opinion of the directors these have changed materially from those described in section A2.2 of the annual report and accounts of the Group for the year ended 30 September 2019 due to the onset of the Covid-19 pandemic.

The pandemic impacts on the Group's assessment of its exposure under almost all the categories within its risk management framework. The particular impacts on both the Group and the wider UK and global economy continue to be quantified and the Group is monitoring closely how this impacts the overall risk profile. Given the uncertainties about the length of the pandemic, the evolving government and fiscal response and the impacts on customers and staff, the Group continues to assess its principal risks in light of the changing operating environment. The risks are summarised below.

The risk impacts of the Covid-19 pandemic are discussed in more detail in the Interim Management Report. In particular:

- the impact on the Group's markets and customers, including factors likely to affect lending volumes, is discussed in the Lending Review (section 2)
- the impact on credit risk and the consequential impacts on impairment and profitability are discussed in the 'Impairment' section of the Financial Review (section 5)
- the impact on the Group's operations, and the process of transition to a new basis of working, with the consequent impacts on operational and transition risk are discussed in section 6.1 of the operational review
- the response of the Group's risk management framework to the crisis is discussed in section 6.4

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 likely in the face of the global response to the Covid-19 pandemic and the related material uncertainties. 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. The rapid major reorganisation of the Group's operational capabilities in response to Covid-19 exposes it to this type of risk.

PRINCIPAL RISKS AND UNCERTAINTIES

Category	Risk	Description
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.

The Group has considered and responded to all these risks, mitigating the exposure as far as is practicable to ensure that its risk profile remains within the Board's stated risk appetite.

The impact on the Group's risk profile of the pandemic, and the steps taken to mitigate that impact are discussed throughout the Interim Management Report.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors confirm that, to the best of their knowledge:

- the condensed financial statements have been prepared in accordance with International Accounting Standard 34 – 'Interim Financial Reporting', issued by the IASB and as adopted and endorsed by the European Union;
- the Interim Management Report includes a fair review of the information required by Section 4.2.7R of the Disclosure Guidance and Transparency Rules, issued by the Financial Conduct Authority (that being an indication of important events that have occurred during the first six months of the current financial year and their impact on the condensed financial statements and a description of the principal risks and uncertainties for the remaining six months of the financial year); and
- the Interim Management Report includes a fair review of the information required by Section 4.2.8R of the Disclosure Guidance and Transparency Rules, issued by the Financial Conduct Authority (that being disclosure of related party transactions that have taken place in the first six months of the current financial year and that have materially affected the financial position or the performance of the enterprise during that period; and any changes in the related party transactions described in the last annual report which could do so).

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

PANDORA SHARP

Company Secretary

10 June 2020

Board of Directors

F J Clutterbuck	B A Ridpath	A C M Morris
P J N Hartill	F F Williamson	N S Terrington
H R Tudor	G H Yorston	R J Woodman

INDEPENDENT REVIEW REPORT TO PARAGON BANKING GROUP PLC

Conclusion

We have been engaged by the company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 31 March 2020 which comprises the consolidated income statement, consolidated statement of comprehensive income, consolidated balance sheet, consolidated cash flow statement, consolidated statement of movements in equity and the related explanatory notes.

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 31 March 2020 is not prepared, in all material respects, in accordance with IAS 34 *Interim Financial Reporting* as adopted by the EU and the Disclosure Guidance and Transparency Rules ("the DTR") of the UK's Financial Conduct Authority ("the UK FCA").

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity* issued by the Auditing Practices Board for use in the UK. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. We read the other information contained in the half-yearly financial report and consider whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the DTR of the UK FCA.

As disclosed in note 28, the annual financial statements of the Group are prepared in accordance with International Financial Reporting Standards as adopted by the EU. The directors are responsible for preparing the condensed set of financial statements included in the half-yearly financial report in accordance with IAS 34 as adopted by the EU.

Our responsibility

Our responsibility is to express to the company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

INDEPENDENT REVIEW REPORT TO PARAGON BANKING GROUP PLC

The purpose of our review work and to whom we owe our responsibilities

This report is made solely to the company in accordance with the terms of our engagement to assist the company in meeting the requirements of the DTR of the UK FCA. Our review has been undertaken so that we might state to the company those matters we are required to state to it in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company for our review work, for this report, or for the conclusions we have reached.

Simon Clark,
for and on behalf of KPMG LLP

Chartered Accountants
1 Snow Hill Queensway,
Birmingham,
B4 6GH

10 June 2020

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED INCOME STATEMENT
For the six months ended 31 March 2020 (Unaudited)

	Note	Six months to 31 March 2020 £m	Six months to 31 March 2019 £m	Year to 30 September 2019 £m
Interest receivable	3	251.1	249.2	505.7
Interest payable and similar charges	4	(109.7)	(111.1)	(227.3)
Net interest income		141.4	138.1	278.4
Other leasing income		9.4	9.0	18.3
Related costs		(7.9)	(7.0)	(14.5)
Net leasing income		1.5	2.0	3.8
Gain on derecognition of financial assets		-	-	9.7
Other income	5	6.8	7.9	15.4
Other operating income		8.3	9.9	28.9
Total operating income		149.7	148.0	307.3
Operating expenses		(62.5)	(63.3)	(125.2)
Provisions for losses	11	(30.0)	(4.9)	(8.0)
Operating profit before fair value items		57.2	79.8	174.1
Fair value net (losses)	6	(0.1)	(7.8)	(15.1)
Operating profit being profit on ordinary activities before taxation		57.1	72.0	159.0
Tax charge on profit on ordinary activities	7	(12.6)	(13.9)	(31.6)
Profit on ordinary activities after taxation		44.5	58.1	127.4

	Note	Six months to 31 March 2020	Six months to 31 March 2019	Year to 30 September 2019
Basic earnings per share	8	17.6p	22.5p	49.4p
Diluted earnings per share	8	17.3p	22.0p	48.2p
Dividend – rate per share for the period	21	-	7.0p	21.2p

The results for the periods shown above relate entirely to continuing operations.

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
For the six months ended 31 March 2020 (Unaudited)

	Note	Six months to 31 March 2020 £m	Six months to 31 March 2019 £m	Year to 30 September 2019 £m
Profit for the period		44.5	58.1	127.4
Other comprehensive income				
Items that will not be reclassified subsequently to profit or loss				
Actuarial gain / (loss) on pension scheme	17	5.6	(12.9)	(16.5)
Tax thereon		(0.4)	1.8	2.4
		5.2	(11.1)	(14.1)
Items that may be reclassified subsequently to profit or loss				
Cash flow hedge (losses) / gains taken to equity		(0.6)	(0.9)	0.5
Tax thereon		0.2	0.2	(0.1)
Reclassification on derecognition		-	-	(0.9)
Tax thereon		-	-	0.2
		(0.4)	(0.7)	(0.3)
Other comprehensive income / (expenditure) for the period net of tax		4.8	(11.8)	(14.4)
Total comprehensive income for the period		49.3	46.3	113.0

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEET
31 March 2020 (Unaudited)

	Note	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m	1 October 2018 £m
Assets					
Cash – central banks	9	812.7	704.0	816.4	895.9
Cash – retail banks	9	394.1	368.0	409.0	414.7
Loans to customers	10	12,585.3	12,544.4	12,250.3	12,076.5
Derivative financial assets	12	538.1	751.3	592.4	855.7
Sundry assets		108.4	45.9	92.8	19.0
Current tax assets		10.1	-	-	-
Deferred tax assets		4.2	5.4	6.2	-
Property, plant and equipment		65.8	63.6	57.3	56.8
Intangible assets	13	170.5	171.4	171.1	169.3
Total assets		14,689.2	14,654.0	14,395.5	14,487.9
Liabilities					
Short-term bank borrowings		0.2	0.6	1.0	1.1
Retail deposits	14	6,919.7	5,878.7	6,395.8	5,292.4
Derivative financial liabilities	12	94.6	30.9	80.5	4.7
Asset backed loan notes	15	3,887.3	5,143.0	4,419.4	5,554.7
Secured bank borrowings	15	879.2	921.9	787.5	935.6
Retail bond issuance	15	296.6	296.3	296.5	296.1
Corporate bond issuance	15	149.7	149.4	149.6	149.3
Central bank facilities	15	1,199.4	984.4	994.4	1,024.4
Sundry liabilities	16	112.2	112.4	112.7	114.4
Current tax liabilities		-	17.5	15.2	21.4
Deferred tax liabilities		-	-	-	0.8
Retirement benefit obligations	17	28.3	31.9	34.5	19.5
Total liabilities		13,567.2	13,567.0	13,287.1	13,414.4
Called-up share capital	18	261.7	281.8	261.6	281.6
Reserves	19	893.2	908.1	887.3	895.9
Own shares	20	(32.9)	(102.9)	(40.5)	(104.0)
Total equity		1,122.0	1,087.0	1,108.4	1,073.5
Total liabilities and equity		14,689.2	14,654.0	14,395.5	14,487.9

The condensed financial statements for the half year were approved by the Board of Directors on 10 June 2020.

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED CASH FLOW STATEMENT
For the six months ended 31 March 2020 (Unaudited)

	Note	Six months to 31 March 2020 £m	Six months to 31 March 2019 £m	Year to 30 September 2019 £m
Net cash flow generated by operating activities	2	196.6	177.3	397.9
Net cash (utilised) / generated by investing activities	3	(1.1)	(1.3)	8.3
Net cash (utilised) by financing activities	4	(213.3)	(414.1)	(491.3)
Net (decrease) in cash and cash equivalents		(17.8)	(238.1)	(85.1)
Opening cash and cash equivalents		1,224.4	1,309.5	1,309.5
Closing cash and cash equivalents		1,206.6	1,071.4	1,224.4
Represented by balances within				
Cash	9	1,206.8	1,072.0	1,225.4
Short-term bank borrowings		(0.2)	(0.6)	(1.0)
		1,206.6	1,071.4	1,224.4

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF MOVEMENTS IN EQUITY
For the six months ended 31 March 2020 (Unaudited)

Six months ended 31 March 2020

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Cash flow hedging reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m
Transactions arising from								
Profit for the period	-	-	-	-	-	44.5	-	44.5
Other comprehensive income	-	-	-	-	(0.4)	5.2	-	4.8
Total comprehensive income	-	-	-	-	(0.4)	49.7	-	49.3
Transactions with owners								
Dividends paid (note 21)	-	-	-	-	-	(35.9)	-	(35.9)
Shares cancelled	-	-	-	-	-	-	-	-
Own shares purchased	-	-	-	-	-	-	-	-
Exercise of share awards	0.1	0.2	-	-	-	(7.4)	7.6	0.5
Charge for share based remuneration	-	-	-	-	-	0.1	-	0.1
Tax on share based remuneration	-	-	-	-	-	(0.4)	-	(0.4)
Net movement in equity in the period	0.1	0.2	-	-	(0.4)	6.1	7.6	13.6
Opening equity	261.6	68.3	50.3	(70.2)	3.0	835.9	(40.5)	1,108.4
Closing equity	261.7	68.5	50.3	(70.2)	2.6	842.0	(32.9)	1,122.0

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF MOVEMENTS IN EQUITY
For the six months ended 31 March 2020 (Unaudited) (Continued)

Six months ended 31 March 2019

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Cash flow hedging reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m
Transactions arising from								
Profit for the period	-	-	-	-	-	58.1	-	58.1
Other comprehensive income	-	-	-	-	(0.7)	(11.1)	-	(11.8)
Total comprehensive income	-	-	-	-	(0.7)	47.0	-	46.3
Transactions with owners								
Dividends paid (note 21)	-	-	-	-	-	(35.9)	-	(35.9)
Shares cancelled	-	-	-	-	-	-	-	-
Own shares purchased	-	-	-	-	-	-	-	-
Exercise of share awards	0.2	0.3	-	-	-	(1.2)	1.1	0.4
Charge for share based remuneration	-	-	-	-	-	2.8	-	2.8
Tax on share based remuneration	-	-	-	-	-	(0.1)	-	(0.1)
Net movement in equity in the period	0.2	0.3	-	-	(0.7)	12.6	1.1	13.5
Opening equity								
As previously reported	281.6	65.8	28.7	(70.2)	3.3	890.7	(104.0)	1,095.9
Change of accounting policy	-	-	-	-	-	(22.4)	-	(22.4)
As restated	281.6	65.8	28.7	(70.2)	3.3	868.3	(104.0)	1,073.5
Closing equity	281.8	66.1	28.7	(70.2)	2.6	880.9	(102.9)	1,087.0

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF MOVEMENTS IN EQUITY
For the six months ended 31 March 2020 (Unaudited) (Continued)

Year ended 30 September 2019

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Cash flow hedging reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m
Transactions arising from								
Profit for the year	-	-	-	-	-	127.4	-	127.4
Other comprehensive income	-	-	-	-	(0.3)	(14.1)	-	(14.4)
Total comprehensive income	-	-	-	-	(0.3)	113.3	-	113.0
Transactions with owners								
Dividends paid (note 21)	-	-	-	-	-	(54.0)	-	(54.0)
Shares cancelled	(21.6)	-	21.6	-	-	(95.5)	95.5	-
Own shares purchased	-	-	-	-	-	-	(34.3)	(34.3)
Exercise of share awards	1.6	2.5	-	-	-	(2.5)	2.3	3.9
Charge for share based remuneration	-	-	-	-	-	5.9	-	5.9
Tax on share based remuneration	-	-	-	-	-	0.4	-	0.4
Net movement in equity in the year	(20.0)	2.5	21.6	-	(0.3)	(32.4)	63.5	34.9
Opening equity								
As previously reported	281.6	65.8	28.7	(70.2)	3.3	890.7	(104.0)	1,095.9
Change of accounting policy	-	-	-	-	-	(22.4)	-	(22.4)
As restated	281.6	65.8	28.7	(70.2)	3.3	868.3	(104.0)	1,073.5
Closing equity	261.6	68.3	50.3	(70.2)	3.0	835.9	(40.5)	1,108.4

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS
For the six months ended 31 March 2020 (Unaudited)

1. GENERAL INFORMATION

The condensed financial statements are prepared for Paragon Banking Group PLC ('the Company') and its subsidiary companies (together 'the Group') on a consolidated basis.

The condensed financial statements for the six months ended 31 March 2020 and for the six months ended 31 March 2019 and the balance sheet information as at 1 October 2018 have not been audited, as defined in section 434 of the Companies Act 2006.

The figures shown above for the year ended 30 September 2019 are not statutory accounts. A copy of the statutory accounts for the year has been delivered to the Registrar of Companies. The auditors reported on those statutory accounts and their report was unqualified, did not draw attention to any matters by way of emphasis and did not contain an adverse statement under sections 498 (2) or 498 (3) of the Companies Act 2006.

This half-yearly financial report is also available on the Group's website at www.paragonbankinggroup.co.uk. As previously advised, the half-yearly financial report is available online only, to help to reduce the environmental impact of shareholder communication.

The remaining notes to the accounts are organised in to three sections:

- Analysis – providing further analysis and information on the amounts shown in the primary financial statements
- Capital and Financial Risk – providing information on the Group's management of operational and regulatory capital and its principal financial risks
- Basis of preparation – providing details of the Group's accounting policies and of how they have been applied in the preparation of the condensed financial statements

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2020 (Unaudited)

The notes set out below give more detailed analysis of the balances shown in the primary financial statements and further information on how they relate to the operations, results and financial position of the Group.

2. SEGMENTAL RESULTS

The Group analyses its operations, both for internal management information 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 equipment leasing activities, development finance, structured lending and other offerings targeted towards SME customers, together with its motor finance business
- Idem Capital, including loan assets acquired from third parties and legacy assets which share certain credit characteristics with them

Dedicated financing and administration costs of each of these businesses are allocated to the segment. Shared central costs are not allocated between segments, and neither is income from central cash balances nor the carrying costs of unallocated savings balances.

Loans to customers and operating lease assets are allocated to segments, as are dedicated securitisation funding arrangements and their related cross-currency basis swaps and cash balances.

Other assets are not allocated between segments.

All of the Group's operations are conducted in the UK, all revenues arise from external customers and there are no inter-segment revenues. No customer contributes more than 10% of the revenue of the Group.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2020 (Unaudited)

2. SEGMENTAL RESULTS (Continued)

Financial information about these business segments, prepared on the same basis as used in the consolidated accounts of the Group, is shown below.

Six months ended 31 March 2020

	Mortgages	Commercial Lending	Idem Capital	Unallocated items	Total
	£m	£m	£m	£m	£m
Interest receivable	177.0	55.5	15.7	2.9	251.1
Interest payable	(81.2)	(16.8)	(2.5)	(9.2)	(109.7)
Net interest income	95.8	38.7	13.2	(6.3)	141.4
Other operating income	3.3	4.7	0.3	-	8.3
Total operating income	99.1	43.4	13.5	(6.3)	149.7
Direct costs	(8.4)	(12.8)	(3.2)	(38.1)	(62.5)
Provisions for losses	(13.8)	(15.5)	(0.7)	-	(30.0)
	76.9	15.1	9.6	(44.4)	57.2

Six months ended 31 March 2019

	Mortgages	Commercial Lending	Idem Capital	Unallocated items	Total
	£m	£m	£m	£m	£m
Interest receivable	170.9	44.7	30.2	3.4	249.2
Interest payable	(81.2)	(14.3)	(3.8)	(11.8)	(111.1)
Net interest income	89.7	30.4	26.4	(8.4)	138.1
Other operating income	3.3	5.7	0.9	-	9.9
Total operating income	93.0	36.1	27.3	(8.4)	148.0
Direct costs	(7.7)	(12.9)	(4.0)	(38.7)	(63.3)
Provisions for losses	(0.7)	(3.7)	(0.5)	-	(4.9)
	84.6	19.5	22.8	(47.1)	79.8

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2020 (Unaudited)

2. SEGMENTAL RESULTS (Continued)

Year ended 30 September 2019

	Mortgages £m	Commercial Lending £m	Idem Capital £m	Unallocated items £m	Total £m
Interest receivable	342.1	95.7	61.3	6.6	505.7
Interest payable	(164.3)	(30.7)	(7.0)	(25.3)	(227.3)
Net interest income	177.8	65.0	54.3	(18.7)	278.4
Other operating income	6.8	11.0	1.4	9.7	28.9
Total operating income	184.6	76.0	55.7	(9.0)	307.3
Direct costs	(15.7)	(25.0)	(7.9)	(76.6)	(125.2)
Provisions for losses	(1.0)	(7.2)	0.2	-	(8.0)
	167.9	43.8	48.0	(85.6)	174.1

The segmental profits disclosed above reconcile to the consolidated results as shown below:

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m
Results shown above	57.2	79.8	174.1
Fair value items	(0.1)	(7.8)	(15.1)
Operating profit	57.1	72.0	159.0

The assets of the segments listed above are:

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m	1 October 2018 £m
Mortgages	11,489.2	11,833.9	11,279.9	11,598.2
Commercial Lending	1,533.0	1,326.6	1,488.4	1,166.7
Idem Capital	335.7	457.8	389.9	539.6
Total segment assets	13,357.9	13,618.3	13,158.2	13,304.5
Unallocated assets	1,331.3	1,035.7	1,237.3	1,183.4
Total assets	14,689.2	14,654.0	14,395.5	14,487.9

An analysis of the Group's loan assets by type and segment is shown in note 10.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2020 (Unaudited)

3. INTEREST RECEIVABLE

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m
Interest receivable in respect of			
Loans and receivables	224.3	221.3	449.3
Finance leases	21.7	22.0	44.5
Factoring income	1.3	1.4	3.1
Interest on loans to customers	247.3	244.7	496.9
Other interest receivable	3.8	4.5	8.8
Total interest on financial assets	251.1	249.2	505.7

The above interest arises from:

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m
Financial assets held at amortised cost	229.4	227.2	461.2
Finance leases	21.7	22.0	44.5
	251.1	249.2	505.7

4. INTEREST PAYABLE AND SIMILAR CHARGES

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m
On retail deposits	64.4	53.9	114.2
On asset backed loan notes	24.4	34.6	63.4
On bank loans and overdrafts	1.2	2.4	9.6
On corporate bonds	5.4	5.5	10.9
On retail bonds	9.3	9.3	18.6
On central bank facilities	3.7	4.1	8.0
Total interest on financial liabilities	108.4	109.8	224.7
On pension scheme deficit (note 17)	0.3	0.3	0.5
Discounting on contingent consideration	0.2	0.2	0.5
Discounting on lease liabilities	0.1	-	-
Other finance costs	0.7	0.8	1.6
	109.7	111.1	227.3

All interest on financial liabilities relates to financial liabilities carried at amortised cost.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2020 (Unaudited)

5. OTHER INCOME

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m
Loan account fee income	3.0	3.9	7.2
Broker commissions	1.1	0.9	2.2
Third party servicing	2.6	2.7	5.0
Other income	0.1	0.4	1.0
	6.8	7.9	15.4

6. FAIR VALUE NET (LOSSES)

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m
Ineffectiveness of fair value hedges (note 12)			
Portfolio hedges of interest rate risk			
Deposit hedge	(0.4)	(0.1)	(0.2)
Loan hedge	2.2	(3.0)	(6.3)
	1.8	(3.1)	(6.5)
Ineffectiveness of cash flow hedges	-	-	-
Other hedging movements	0.6	(2.5)	(5.8)
Net (losses) on other derivatives	(2.5)	(2.2)	(2.8)
	(0.1)	(7.8)	(15.1)

The fair value net (loss) represents the accounting volatility on derivative instruments which are matching risk exposure on an economic basis generated by the requirements of IAS 39. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting has not been adopted or is not achievable on certain items. The losses and gains are primarily due to timing differences in income recognition between the derivative instruments and the economically hedged assets and liabilities. Such differences will reverse over time and have no impact on the cash flows of the Group.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2020 (Unaudited)

7. TAX CHARGE ON PROFIT ON ORDINARY ACTIVITIES

Income tax for the six months ended 31 March 2020 is charged at an effective rate of 22.1% (six months ended 31 March 2019: 19.3%, year ended 30 September 2019: 19.9%), representing the best estimate of the annual effective rate of income tax expected for the full year, applied to the pre-tax income of the period.

The standard rate of corporation tax in the UK applicable to the Group in the period was 19.0% (2019 H1: 19.0%), based on currently enacted legislation. During the period, legislation was substantively enacted, reversing the reduction in the tax rate to 17.0% which had been due to come into effect from April 2020. The effects of the increases in the expected rate for the year from 18.0% to 19.0%, and the expected rate in future years from 17.0% to 19.0% on deferred tax balances have been accounted for in the period.

The increase in the effective rate of tax is principally attributable to the increased proportion of the Group's profit earned in its banking subsidiary, Paragon Bank PLC, and therefore subject to the banking surcharge.

A change in the legislation governing the timing payments on account in respect of UK corporation tax applied to the Group for the first time in the current period. As a result, the 31 March 2020 balance sheet shows a debtor in respect of current tax.

8. EARNINGS PER SHARE

Earnings per ordinary share is calculated as follows:

	31 March 2020	31 March 2019	30 September 2019
Profit for the period (£m)	44.5	58.1	127.4
Basic weighted average number of ordinary shares ranking for dividend during the period (m)	253.2	258.1	257.6
Dilutive effect of the weighted average number of share options and incentive plans in issue during the period (m)	4.2	6.5	6.7
Diluted weighted average number of ordinary shares ranking for dividend during the period (m)	257.4	264.6	264.3
Earnings per ordinary share - basic	17.6p	22.5p	49.4p
- diluted	17.3p	22.0p	48.2p

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9. CASH AND CASH EQUIVALENTS

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m	30 September 2018 £m
Balances with central banks	812.7	704.0	816.4	895.9
Balances with other banks	394.1	368.0	409.0	414.7
	1,206.8	1,072.0	1,225.4	1,310.6

Only 'Free Cash' is unrestrictedly available for the Group's general purposes. Cash received in respect of loan assets funded through warehouse facilities and securitisations is not immediately available, due to the terms of those arrangements. This cash is shown as 'securitisation cash' below.

Balances with central banks includes deposits which form part of the liquidity buffer of Paragon Bank PLC and are therefore not available for the Group's general purposes. Free cash may also be deposited at the Bank of England.

Cash held by the Trustees of the Paragon Employee Share Ownership Plans may only be used to invest in the shares of the Company, pursuant to the aims of those plans. This is shown as 'ESOP cash' below.

The total 'Cash and Cash Equivalents' balance may be analysed as shown below.

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m	30 September 2018 £m
Free cash	307.1	204.2	225.7	238.0
Securitisation cash	290.3	309.6	353.1	338.8
Liquidity buffer	608.5	555.5	646.4	724.9
ESOP cash	0.9	2.7	0.2	8.9
	1,206.8	1,072.0	1,225.4	1,310.6

Cash and cash equivalents are allocated to Stage 1 assets. The probabilities of default have been assessed to be so low as to require no significant impairment provision.

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10. LOANS TO CUSTOMERS

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m	1 October 2018 £m
Loans to customers	12,506.1	12,525.6	12,186.1	12,100.6
Fair value adjustments from portfolio hedging	79.2	18.8	64.2	(24.1)
	12,585.3	12,544.4	12,250.3	12,076.5

The Group's loan assets at 31 March 2020, analysed between the segments described in note 2 are as follows:

	Mortgages £m	Commercial Lending £m	Idem Capital £m	Total £m
At 31 March 2020				
First mortgages	10,489.9	-	-	10,489.9
Consumer loans	186.2	-	311.3	497.5
Motor finance	-	290.4	24.4	314.8
Asset finance	-	513.4	-	513.4
Development finance	-	502.3	-	502.3
Other commercial loans	-	188.2	-	188.2
Loans to customers	10,676.1	1,494.3	335.7	12,506.1
At 31 March 2019				
First mortgages	10,624.8	-	-	10,624.8
Consumer loans	159.1	-	404.2	563.3
Motor finance	-	262.4	53.6	316.0
Asset finance	-	451.4	-	451.4
Development finance	-	426.0	-	426.0
Other commercial loans	-	144.1	-	144.1
Loans to customers	10,783.9	1,283.9	457.8	12,525.6

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10. LOANS TO CUSTOMERS (Continued)

	Mortgages	Commercial Lending	Idem Capital	Total
	£m	£m	£m	£m
At 30 September 2019				
First mortgages	10,172.5	-	-	10,172.5
Consumer loans	171.6	-	352.3	523.9
Motor finance	-	281.3	37.6	318.9
Asset finance	-	492.2	-	492.2
Development finance	-	506.5	-	506.5
Other commercial loans	-	172.1	-	172.1
Loans to customers	10,344.1	1,452.1	389.9	12,186.1
At 1 October 2018				
First mortgages	10,308.3	-	-	10,308.3
Consumer loans	141.2	-	447.0	588.2
Motor finance	-	256.4	72.8	329.2
Asset finance	-	402.3	-	402.3
Development finance	-	352.9	-	352.9
Other commercial loans	-	119.7	-	119.7
Loans to customers	10,449.5	1,131.3	519.8	12,100.6

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11. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS

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').

The Group's approach to impairment provision on loans to customers, in accordance with IFRS 9, is set out in note 23 to the annual accounts. This includes an outline of the calculations used and a definition of terms.

There have been no significant changes in overall approach since the 2019 year end. However, the particular impacts of Covid-19 on the 31 March 2020 position have necessitated more detailed consideration of whether the Group's normal approach would generate sufficient provision in the unusual circumstances.

This has included the consideration of additional information on current and potential future performance of customer accounts. Data included information on payment reliefs granted and analysis of direct contacts with customers. These were considered in the light of government support schemes available to customers and advice from regulatory bodies on the treatment of such cases.

IFRS 9 Analysis

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 are 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 are made based on the ECLs over the full life of the loan
- For credit impaired assets, provisions are made on the basis of lifetime ECLs

For assets which are '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.

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11. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (Continued)

Impairments by stage

An analysis of the Group's loan portfolios between these stages is set out below.

	Stage 1 £m	Stage 2 * £m	Stage 3 * £m	POCI £m	Total £m
31 March 2020					
Gross loan book					
Mortgages	10,120.5	447.8	129.9	15.2	10,713.4
Commercial Lending	1,412.1	81.8	15.0	9.6	1,518.5
Idem Capital	137.8	12.6	29.7	160.8	340.9
Total	11,670.4	542.2	174.6	185.6	12,572.8
Impairment provision					
Mortgages	(1.9)	(6.3)	(29.1)	-	(37.3)
Commercial Lending	(16.0)	(2.3)	(5.7)	(0.2)	(24.2)
Idem Capital	(0.2)	(0.4)	(4.6)	-	(5.2)
Total	(18.1)	(9.0)	(39.4)	(0.2)	(66.7)
Net loan book					
Mortgages	10,118.6	441.5	100.8	15.2	10,676.1
Commercial Lending	1,396.1	79.5	9.3	9.4	1,494.3
Idem Capital	137.6	12.2	25.1	160.8	335.7
Total	11,652.3	533.2	135.2	185.4	12,506.1
Coverage ratio					
Mortgages	0.02%	1.41%	22.40%	-	0.35%
Commercial Lending	1.13%	2.81%	38.00%	2.08%	1.59%
Idem Capital	0.15%	3.17%	15.49%	-	1.53%
Total	0.16%	1.66%	22.57%	0.11%	0.53%

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11. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (Continued)

	Stage 1 £m	Stage 2 * £m	Stage 3 * £m	POCI £m	Total £m
31 March 2019					
Gross loan book					
Mortgages	10,280.8	384.2	138.8	11.7	10,815.5
Commercial Lending	1,231.1	38.4	8.4	14.6	1,292.5
Idem Capital	180.7	18.1	38.4	231.9	469.1
Total	11,692.6	440.7	185.6	258.2	12,577.1
Impairment provision					
Mortgages	(0.4)	(2.2)	(29.0)	-	(31.6)
Commercial Lending	(4.8)	(0.8)	(3.0)	-	(8.6)
Idem Capital	(0.3)	(0.5)	(10.5)	-	(11.3)
Total	(5.5)	(3.5)	(42.5)	-	(51.5)
Net loan book					
Mortgages	10,280.4	382.0	109.8	11.7	10,783.9
Commercial Lending	1,226.3	37.6	5.4	14.6	1,283.9
Idem Capital	180.4	17.6	27.9	231.9	457.8
Total	11,687.1	437.2	143.1	258.2	12,525.6
Coverage ratio					
Mortgages	-	0.57%	20.89%	-	0.29%
Commercial Lending	0.39%	2.08%	35.71%	-	0.67%
Idem Capital	0.17%	2.76%	27.34%	-	2.41%
Total	0.05%	0.79%	22.90%	-	0.41%

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11. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (Continued)

	Stage 1 £m	Stage 2 * £m	Stage 3 * £m	POCI £m	Total £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
Coverage ratio					
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%

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

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 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.

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11. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (Continued)

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 a significant increase in credit risk ('SICR') has nonetheless been identified from other information and accounts more than one month in arrears, which are automatically deemed to have an SICR.

	< 1 month arrears £m	> 1 <= 3 months arrears £m	Total £m
31 March 2020			
Gross loan book			
Mortgages	386.1	61.7	447.8
Commercial Lending	72.2	9.6	81.8
Idem Capital	6.8	5.8	12.6
Total	465.1	77.1	542.2
Impairment provision			
Mortgages	(3.1)	(3.2)	(6.3)
Commercial Lending	(2.0)	(0.3)	(2.3)
Idem Capital	(0.1)	(0.3)	(0.4)
Total	(5.2)	(3.8)	(9.0)
Net loan book			
Mortgages	383.0	58.5	441.5
Commercial Lending	70.2	9.3	79.5
Idem Capital	6.7	5.5	12.2
Total	459.9	73.3	533.2
Coverage ratio			
Mortgages	0.80%	5.19%	1.41%
Commercial Lending	2.77%	3.13%	2.81%
Idem Capital	1.47%	5.17%	3.17%
Total	1.12%	4.93%	1.66%

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11. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (Continued)

	< 1 month arrears £m	> 1 <= 3 months arrears £m	Total £m
31 March 2019			
Gross loan book			
Mortgages	328.6	55.6	384.2
Commercial Lending	33.3	5.1	38.4
Idem Capital	8.7	9.4	18.1
Total	370.6	70.1	440.7
Impairment provision			
Mortgages	(1.0)	(1.2)	(2.2)
Commercial Lending	(0.2)	(0.6)	(0.8)
Idem Capital	(0.2)	(0.3)	(0.5)
Total	(1.4)	(2.1)	(3.5)
Net loan book			
Mortgages	327.6	54.4	382.0
Commercial Lending	33.1	4.5	37.6
Idem Capital	8.5	9.1	17.6
Total	369.2	68.0	437.2
Coverage ratio			
Mortgages	0.30%	2.16%	0.57%
Commercial Lending	0.60%	11.76%	2.08%
Idem Capital	2.30%	3.19%	2.76%
Total	0.38%	3.00%	0.79%

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
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11. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (Continued)

	< 1 month arrears £m	> 1 <= 3 months arrears £m	Total £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
Coverage ratio			
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%

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.

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11. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (Continued)

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, but such accounts are included in Stage 3 as they are classified as defaulted for regulatory purposes.

Accounts which no longer meet default criteria but which are being retained in Stage 3 for a probationary period are included with the > 3 month arrears accounts below.

	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m
31 March 2020				
Gross loan book				
Mortgages	17.5	95.8	16.6	129.9
Commercial Lending	7.3	-	7.7	15.0
Idem Capital	25.2	-	4.5	29.7
Total	50.0	95.8	28.8	174.6
Impairment provision				
Mortgages	(1.7)	(21.9)	(5.5)	(29.1)
Commercial Lending	(1.4)	-	(4.3)	(5.7)
Idem Capital	(2.6)	-	(2.0)	(4.6)
Total	(5.7)	(21.9)	(11.8)	(39.4)
Net loan book				
Mortgages	15.8	73.9	11.1	100.8
Commercial Lending	5.9	-	3.4	9.3
Idem Capital	22.6	-	2.5	25.1
Total	44.3	73.9	17.0	135.2
Coverage ratio				
Mortgages	9.71%	22.86%	33.13%	22.40%
Commercial Lending	19.18%	-	55.84%	38.00%
Idem Capital	10.32%	-	44.44%	15.49%
Total	11.40%	22.86%	40.97%	22.57%

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11. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (Continued)

	> 3 month arrears £m	RoR managed £m	Realisations £m	Total £m
31 March 2019				
Gross loan book				
Mortgages	6.4	115.1	17.3	138.8
Commercial Lending	0.6	-	7.8	8.4
Idem Capital	28.2	-	10.2	38.4
Total	35.2	115.1	35.3	185.6
Impairment provision				
Mortgages	(0.5)	(22.3)	(6.2)	(29.0)
Commercial Lending	-	-	(3.0)	(3.0)
Idem Capital	(1.8)	-	(8.7)	(10.5)
Total	(2.3)	(22.3)	(17.9)	(42.5)
Net loan book				
Mortgages	5.9	92.8	11.1	109.8
Commercial Lending	0.6	-	4.8	5.4
Idem Capital	26.4	-	1.5	27.9
Total	32.9	92.8	17.4	143.1
Coverage ratio				
Mortgages	7.81%	19.37%	35.84%	20.89%
Commercial Lending	-	-	38.46%	35.71%
Idem Capital	6.38%	-	85.29%	27.34%
Total	6.53%	19.37%	50.71%	22.90%

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
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11. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (Continued)

	> 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
Coverage ratio				
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%

The security values available to reduce exposure at default in the calculation shown above for stage 3 accounts are set out below. The estimated value of the security represents, for each account, the lesser of the valuation estimate and the exposure at default in Scenario 1 (31 March 2020) or the Central scenario (31 March 2019 and 30 September 2019). Security values are based on the most recent valuation of the relevant asset held by the Group, indexed or depreciated as appropriate.

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m
First mortgages	69.9	65.9	65.7
Second mortgages	14.3	16.5	14.0
Asset finance	4.1	2.3	2.2
Motor finance	1.2	0.9	1.0
	89.5	85.6	82.9

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
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11. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (Continued)

The RoR managed accounts are being managed to ensure the optimal resolution for landlords, tenants and lenders and this long-term, stable situation underpinned their treatment as not impaired under IAS 39, but the existence of the RoR arrangement causes the accounts to be treated as defaulted for regulatory purposes. The Group's RoR arrangements are described in more detail below.

Idem Capital balances with over three months arrears comprise principally second charge mortgage accounts originated over ten years ago which have been over three months in arrears for some time. These accounts are generally making regular payments and have significant levels of equity in the underlying property which reduces the required provision to the value shown above. It is expected that a high proportion of these accounts will eventually redeem naturally, either on the sale of the property or by the satisfaction of the amount due through instalment payments.

Buy-to-let receiver of rent cases (Stage 3)

The following table analyses the number and gross carrying value of RoR managed accounts shown above by the date of the receivers' appointment, illustrating this position.

	31 March 2020		31 March 2019		30 September 2019	
	No.	£m	No.	£m	No.	£m
Managed accounts						
Appointment date						
2010 and earlier	384	65.5	452	80.9	402	70.5
2011 to 2013	82	15.7	102	20.4	86	17.3
2014 to 2016	31	4.5	36	5.2	31	4.5
2016 and later	63	10.1	70	8.6	84	14.0
Total managed accounts	560	95.8	660	115.1	603	106.3
Accounts in the process of realisation	84	14.7	91	14.6	80	11.9
	644	110.5	751	129.7	683	118.2

Receiver of rent accounts in the process of realisation at the period end are included under that heading in the Stage 3 tables above.

In addition to the cases analysed above, 4 POCI accounts also had a receiver of rent appointed (31 March 2019: 2, 30 September 2019: 3), making a total of 648.

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11. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (Continued)

Movements in impairment provision

The movements in the impairment provision calculated under IFRS 9 are set out below.

	Mortgages	Commercial Lending	Idem Capital	Total
	£m	£m	£m	£m
At 30 September 2019	26.8	10.7	4.4	41.9
Provided in period	13.7	15.8	1.2	30.7
Amounts written off	(3.2)	(2.3)	(0.4)	(5.9)
Assets derecognised	-	-	-	-
At 31 March 2020	37.3	24.2	5.2	66.7
At transition – 1 October 2018	36.1	6.6	11.5	54.2
Provided in period	1.1	3.7	0.8	5.6
Amounts written off	(5.6)	(1.7)	(1.0)	(8.3)
Asset derecognised	-	-	-	-
At 31 March 2019	31.6	8.6	11.3	51.5
At transition – 1 October 2018	36.1	6.6	11.5	54.2
Provided in period	1.2	7.2	0.3	8.7
Amounts written off	(6.5)	(3.1)	(7.4)	(17.0)
Assets derecognised	(4.0)	-	-	(4.0)
At 30 September 2019	26.8	10.7	4.4	41.9

Accounts are considered to be written off for accounting purposes when standard enforcement processes have been completed, subject to any amount retained in respect of expected salvage receipts.

The difference between the amount shown above and the profit and loss account charge for the period is amounts recovered on previously written off accounts of £0.7m (31 March 2019: £0.7m, 30 September 2019: £0.7m).

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11. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (Continued)

A more detailed analysis of these movements by IFRS 9 stage on a consolidated basis for the six months ended 31 March 2020, the six months ended 31 March 2019, and the year ended 30 September 2019 are set out below.

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Loss allowance at 30 September 2019	6.0	3.7	32.2	-	41.9
New assets originated or purchased	2.2	-	-	-	2.2
Changes in loss allowance					
Transfer to stage 1	0.7	(0.5)	(0.2)	-	-
Transfer to stage 2	(0.4)	0.5	(0.1)	-	-
Transfer to stage 3	(0.2)	(0.6)	0.8	-	-
Changes due to credit risk	9.8	5.9	12.6	0.2	28.5
Write offs	-	-	(5.9)	-	(5.9)
Assets derecognised	-	-	-	-	-
Loss allowance at 31 March 2020	18.1	9.0	39.4	0.2	66.7

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Loss allowance at 1 October 2018	4.9	2.6	46.7	-	54.2
New assets originated or purchased	1.8	-	-	-	1.8
Changes in loss allowance					
Transfer to stage 1	0.6	(0.6)	-	-	-
Transfer to stage 2	(0.2)	0.2	-	-	-
Transfer to stage 3	(0.3)	(0.3)	0.6	-	-
Changes due to credit risk	(1.3)	1.6	3.5	-	3.8
Write offs	-	-	(8.3)	-	(8.3)
Assets derecognised	-	-	-	-	-
Loss allowance at 31 March 2019	5.5	3.5	42.5	-	51.5

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11. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (Continued)

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Loss allowance at 1 October 2018	4.9	2.6	46.7	-	54.2
New assets originated or purchased	4.4	-	-	-	4.4
Changes in loss allowance					
Transfer to stage 1	0.5	(0.5)	-	-	-
Transfer to stage 2	(0.3)	0.4	(0.1)	-	-
Transfer to stage 3	(0.5)	(0.4)	0.9	-	-
Changes due to credit risk	(2.9)	3.3	3.9	-	4.3
Write offs	-	-	(17.0)	-	(17.0)
Assets derecognised	(0.1)	(1.7)	(2.2)	-	(4.0)
Loss allowance at 30 September 2019	6.0	3.7	32.2	-	41.9

The principal factor generating the increase in the loss allowance in the period is the impact of the Covid-19 crisis, which has led to increased loss expectations across all of the Group's portfolios. These expectations include a significant degree of uncertainty arising from the direction of the UK economy and its potential impact on the Group's customers.

These increases in expected losses have also led to increased numbers of accounts having an SICR identified and therefore being transferred from stage 1 to stage 2.

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11. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (Continued)

The movements in the Loans to Customers balances in respect of which these loss allowances have been made are set out below.

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Balances at 30 September 2019	11,382.6	458.5	167.9	219.0	12,228.0
New assets originated or purchased	1,209.4	-	-	-	1,209.4
Changes in staging					
Transfer to stage 1	193.9	(192.7)	(1.2)	-	-
Transfer to stage 2	(333.3)	335.4	(2.1)	-	-
Transfer to stage 3	(18.5)	(18.5)	37.0	-	-
Redemptions and repayments	(809.7)	(42.4)	(22.0)	(43.1)	(917.2)
Goodwill adjustment	-	-	-	-	-
Assets derecognised	-	-	-	-	-
Write offs	-	-	(5.9)	-	(5.9)
Other changes	46.0	1.9	0.9	9.7	58.5
Balance at 31 March 2020	11,670.4	542.2	174.6	185.6	12,572.8
Loss allowance	(18.1)	(9.0)	(39.4)	(0.2)	(66.7)
Carrying value	11,652.3	533.2	135.2	185.4	12,506.1

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Balances at 1 October 2018	11,274.1	397.8	188.2	294.7	12,154.8
New assets originated or purchased	1,205.3	-	-	-	1,205.3
Changes in staging					
Transfer to stage 1	129.8	(129.0)	(0.8)	-	-
Transfer to stage 2	(188.1)	190.4	(2.3)	-	-
Transfer to stage 3	(13.4)	(10.0)	23.4	-	-
Redemptions and repayments	(745.6)	(17.9)	(14.8)	(56.7)	(835.0)
Goodwill adjustment	-	-	-	(2.7)	(2.7)
Assets derecognised	-	-	-	-	-
Write offs	-	-	(8.3)	-	(8.3)
Other changes	30.5	9.4	0.2	22.9	63.0
Balance at 31 March 2019	11,692.6	440.7	185.6	258.2	12,577.1
Loss allowance	(5.5)	(3.5)	(42.5)	-	(51.5)
Carrying value	11,687.1	437.2	143.1	258.2	12,525.6

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11. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (Continued)

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Balances at 1 October 2018	11,274.1	397.8	188.2	294.7	12,154.8
New assets originated or purchased	2,443.2	-	-	4.1	2,447.3
Changes in staging					
Transfer to stage 1	100.8	(97.5)	(3.3)	-	-
Transfer to stage 2	(240.0)	243.4	(3.4)	-	-
Transfer to stage 3	(27.1)	(18.6)	45.7	-	-
Redemptions and repayments	(1,586.1)	(30.0)	(29.6)	(110.1)	(1,755.8)
Goodwill adjustment	-	-	-	(2.7)	(2.7)
Assets derecognised	(636.8)	(39.4)	(14.1)	(14.7)	(705.0)
Write offs	-	-	(17.0)	-	(17.0)
Other changes	54.5	2.8	1.4	47.7	106.4
Balance at 30 September 2019	11,382.6	458.5	167.9	219.0	12,228.0
Loss allowance	(6.0)	(3.7)	(32.2)	-	(41.9)
Carrying value	11,376.6	454.8	135.7	219.0	12,186.1

Other changes includes interest and similar charges.

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11. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (Continued)

Economic impacts

Impairment provision is calculated on a forward-looking expected loss basis, based on expected economic conditions in multiple internally coherent scenarios. The Group uses four distinct economic scenarios chosen to represent the range of possible outcomes and allow for the impact of economic asymmetry in the calculations.

As the Group does not have an internal economics function, in developing its economic scenarios it considers analysis from reputable external sources to form a general market consensus which informs its central scenario. These sources include forecasts produced by the Office of Budget Responsibility ('OBR') and the PRA as well as private sector economic research bodies.

In normal circumstances, the central scenario is the economic forecast used within the Group for planning purposes and represents its expectation of the most likely outcome. The upside and downside scenarios are less likely variants developed from this base case. The final scenario represents a protracted slump and is derived from the Bank of England's annual stress testing scenarios.

In the unprecedented economic situation created by the Covid-19 pandemic, the Group has replaced its normal economic scenarios. It first generated a base scenario from post-Covid economic projections and then created three variants on this, one less severe and two more severe, each representing differing levels of impact on the economy and timings of recovery. The scenarios were calibrated against the desk-top stress test scenario published by the Bank of England. As the methodology differs from the normal selection of scenarios, the names Scenario 1, 2, 3 and 4 have been adopted. Scenario 1 equates broadly to the base case with Scenario 2 as less severe and Scenarios 3 and 4 as more severe.

Weightings ascribed to scenarios were determined as part of the development of these Covid-19 scenarios. It should be noted that Scenario 4 in the Covid-19 scenarios is based on a potential outcome and is less severe than the previous 'Severe Downside' scenario based on the PRA once in 2000 year stress test. Therefore, the Covid-19 scenario carries a higher probability.

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11. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (Continued)

The economic variables comprising each scenario, and their projected average rates of increase (or decrease) for the first five years of the forecast period are set out below.

31 March 2020

	Scenario 1	Scenario 2	Scenario 3	Scenario 4
Weighting applied	*40%*	*10%*	*35%*	*15%*
Economic driver				
Gross Domestic Product ('GDP') (increase)	1.6%	1.9%	1.5%	1.0%
House Price Index ('HPI') (increase)	1.8%	1.7%	(0.9)%	(5.1)%
Bank Base Rate ('BBR')	0.4%	0.5%	0.3%	0.1%
Consumer Price Inflation ('CPI')	1.6%	1.8%	1.2%	1.1%
Unemployment (rate)	5.5%	5.0%	6.3%	7.3%
Secured lending (annual change)	3.7%	4.3%	2.8%	1.5%
Consumer credit (annual change)	6.1%	7.6%	3.8%	0.3%

30 September 2019

	Central scenario	Upside scenario	Downside scenario	Severe downside scenario
Weighting applied	*40%*	*20%*	*35%*	*5%*
Economic driver				
Gross Domestic Product ('GDP') (increase)	1.7%	2.2%	1.0%	(0.1)%
House Price Index ('HPI') (increase)	3.3%	5.5%	(0.1)%	(5.3)%
Bank Base Rate ('BBR')	0.8%	1.9%	0.5%	0.0%
Consumer Price Inflation ('CPI')	2.1%	1.8%	2.5%	3.1%
Unemployment (rate)	3.9%	3.5%	5.6%	8.0%
Secured lending (annual change)	3.6%	4.2%	2.7%	1.4%
Consumer credit (annual change)	6.1%	7.6%	3.8%	0.3%

31 March 2019

	Central scenario	Upside scenario	Downside scenario	Severe downside scenario
Weighting applied	*40%*	*30%*	*25%*	*5%*
Economic driver				
Gross Domestic Product ('GDP') (increase)	1.7%	2.2%	1.0%	(0.1)%
House Price Index ('HPI') (increase)	3.1%	5.3%	(0.5)%	(5.9)%
Bank Base Rate ('BBR')	0.9%	1.8%	0.5%	0.0%
Consumer Price Inflation ('CPI')	2.0%	1.7%	2.5%	3.1%
Unemployment (rate)	4.0%	3.5%	5.6%	8.0%
Secured lending (annual change)	3.2%	3.7%	2.4%	1.3%
Consumer credit (annual change)	8.5%	10.6%	5.1%	0.1%

After the end of the initial five year period, the final BBR and the final rate of change in the other measures are assumed to continue into the future in each scenario.

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11. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (Continued)

To illustrate the levels of non-linearity in the various scenarios, the maximum and minimum quarterly levels for each variable over the five year period are set out below.

31 March 2020

	Scenario 1		Scenario 2		Scenario 3		Scenario 4	
	Max %	Min %	Max %	Min %	Max %	Min %	Max %	Min %
Economic driver								
GDP	15.6	(14.3)	15.6	(11.9)	17.2	(17.5)	12.2	(16.2)
HPI	5.0	(4.0)	4.0	(2.0)	4.0	(10.0)	3.0	(20.0)
BBR	0.8	0.1	1.0	0.1	0.8	0.1	0.5	(0.4)
CPI	2.1	0.5	2.5	0.5	2.0	0.0	2.3	(0.3)
Unemployment	7.9	4.9	7.9	4.5	9.0	4.9	9.0	6.0
Secured lending	3.9	3.3	4.8	3.7	3.8	1.7	3.7	(1.2)
Consumer credit	6.3	6.0	8.8	6.7	5.7	1.5	4.8	(5.2)

30 September 2019

	Central scenario		Upside scenario		Downside scenario		Severe downside scenario	
	Max %	Min %	Max %	Min %	Max %	Min %	Max %	Min %
Economic driver								
GDP	1.9	1.2	3.1	1.2	1.6	(1.0)	1.3	(4.7)
HPI	4.3	0.7	9.7	0.9	4.9	(4.7)	5.7	(17.8)
BBR	0.8	0.8	2.5	0.8	0.5	0.5	0.0	0.0
CPI	2.2	2.0	2.2	1.4	3.2	2.0	4.9	2.0
Unemployment	4.1	3.8	3.9	3.5	6.1	4.2	9.2	4.5
Secured lending	3.9	3.2	4.8	3.3	3.8	1.7	3.7	(1.2)
Consumer credit	6.3	6.0	8.8	6.2	6.0	1.5	5.9	(5.2)

31 March 2019

	Central scenario		Upside scenario		Downside scenario		Severe downside scenario	
	Max %	Min %	Max %	Min %	Max %	Min %	Max %	Min %
Economic driver								
GDP	1.9	1.3	3.0	1.9	1.6	(1.0)	1.3	(4.7)
HPI	4.3	1.0	9.2	2.7	4.8	(5.2)	5.7	(17.8)
BBR	1.3	0.8	2.5	1.0	0.8	0.5	0.0	0.0
CPI	2.1	1.9	2.1	1.2	3.1	2.0	4.9	2.0
Unemployment	4.1	3.9	3.8	3.4	6.1	4.6	9.2	4.5
Secured lending	3.4	2.9	4.3	3.0	3.4	1.4	3.5	(1.2)
Consumer credit	9.3	8.1	11.8	9.1	7.2	3.0	4.2	(5.2)

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11. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (Continued)

The asymmetry in the models is demonstrated by comparing the calculated impairment provision with that which would have been produced using Scenario 1 / the Central scenario alone, 100% weighted.

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m
Calculated provision	66.7	51.5	41.9
100% weighted Scenario 1 / Central scenario	55.7	48.1	37.7
Effect of multiple economic scenarios	11.0	3.4	4.2

Were 100% probability to be attributed to Covid-19 Scenario 4, the most severe scenario, the provision would be £33.7m greater at £100.4m.

12. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m	30 September 2018 £m
Derivative financial assets	538.1	751.3	592.4	855.7
Derivative financial liabilities	(94.6)	(30.9)	(80.5)	(4.7)
	443.5	720.4	511.9	851.0
Of which:				
Cross-currency basis swaps	522.8	740.4	582.7	829.7
Interest rate swaps in hedging relationships	(76.6)	(20.2)	(70.7)	19.4
Other interest rate swaps	(3.3)	0.2	(0.1)	1.9
Foreign exchange swaps	0.6	-	-	-
	443.5	720.4	511.9	851.0

All hedging relationships and strategies at 30 September 2019 described in the 2019 Group Accounts have continued in the period.

The Group's securitisation borrowings are denominated in sterling, euros and US dollars. All currency borrowings are swapped at inception so that they have the effect of sterling borrowings. These swaps provide an effective hedge against exchange rate movements, but the requirement to carry them at fair value leads, when exchange rates have moved significantly since the issue of the notes, to large balances for the swaps being carried in the balance sheet. This is currently the case with both euro and US dollar swaps, although the debit balance is compensated for by retranslating the borrowings at the current exchange rate.

These compensating differences gave rise to the exchange differences shown in note 22.

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13. INTANGIBLE ASSETS

Intangible assets at net book value comprise:

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m	30 September 2018 £m
Goodwill	164.4	164.6	164.4	162.2
Computer software	2.2	2.1	2.4	2.1
Other intangibles	3.9	4.7	4.3	5.0
Total assets	170.5	171.4	171.1	169.3

The balance for goodwill at 31 March 2020 shown above includes £113.0m in respect of the Asset Finance Cash Generating Unit (‘CGU’) and £49.8m in respect of the Development Finance CGU. As a result of the Covid-19 situation the Group determined that these balances should be retested for impairment in accordance with IAS 36. These tests were conducted in the same way as those described in note 29 to accounts for the year ended 30 September 2019, using updated forecasts reflecting the impact of Covid-19. The levels of business activity in these forecasts are considered by management to form a reasonable basis for the assessment of goodwill. The revised key assumptions are set out below.

- The level of business activity in the Asset Finance CGU assumes a compound annual growth rate (‘CAGR’) for new business over the five-year period of 12.0%, the same value assumed 30 September 2019
- The level of business activity in the Development Finance CGU assumes a CAGR for new commitments over the five-year period of 15.6%, compared with 18.3% used at 30 September 2019
- In both CGUs cash flows beyond the five-year budget are extrapolated using a constant growth rate of 1.5% (30 September 2019: 1.9%) which does not exceed the long term average growth rates for the markets in which the businesses are active
- The discount rate in both tests is based on third party estimates of the implied industry cost of capital. The pre-tax discount rate applied to the cash flow projection is 13.5% (30 September 2019: 13.2%)

As an illustration of the sensitivity of these impairment tests to movements in the key assumptions:

- the Group has calculated that a 20.0% reduction in profit levels in the Asset Finance CGU coupled with a 341 basis point increase in the pre-tax discount rate would eliminate the headroom in the projection. In the testing carried out at 30 September 2019, a 24.0% reduction in profit levels coupled with a 370 basis point increase in the pre-tax discount rate would have that effect
- Management believes any reasonably possible change in the key assumptions in the Development Finance CGU would not cause the recoverable amount of the development finance cash generating unit to fall below the balance sheet carrying value. This was also the case in the testing carried out at 30 September 2019

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14. RETAIL DEPOSITS

The Group's retail deposits, held by Paragon Bank PLC, were received from customers in the United Kingdom and are denominated in sterling. The deposits comprise principally term deposits and 120 day notice accounts. The method of interest calculation on these deposits is analysed as follows:

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m	30 September 2018 £m
Fixed rate	4,333.7	4,092.5	4,154.4	3,643.1
Variable rates	2,578.2	1,785.5	2,237.5	1,653.5
	6,911.9	5,878.0	6,391.9	5,296.6

The weighted average interest rate on retail deposits, analysed by charging method, was:

	31 March 2020 %	31 March 2019 %	30 September 2019 %	30 September 2018 %
Fixed rate	1.95	1.99	2.02	1.94
Variable rates	1.34	1.41	1.43	1.36
All deposits	1.74	1.81	1.81	1.76

The contractual maturity of these deposits is analysed below.

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m	30 September 2018 £m
Amounts repayable				
In less than three months	489.0	570.6	466.6	256.8
In more than three months but not more than one year	2,188.9	2,220.0	2,088.4	2,024.7
In more than one year, but not more than two years	1,224.5	994.2	1,158.0	1,010.6
In more than two years, but not more than five years	937.0	708.5	900.9	655.3
Total term deposits	4,839.4	4,493.3	4,613.9	3,947.4
Repayable on demand	2,072.5	1,384.7	1,778.0	1,349.2
	6,911.9	5,878.0	6,391.9	5,296.6
Fair value adjustments for portfolio hedging	7.8	0.7	3.9	(4.2)
	6,919.7	5,878.7	6,395.8	5,292.4

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15. BORROWINGS

On 20 March 2020, Fitch Ratings confirmed the Group's Long-Term Issuer Default Rating at BBB. It downgraded its senior unsecured debt rating to BBB- (from BBB) and the rating of the £150.0m Tier 2 Bond to BB+ (from BBB-) following the application of updated bank rating criteria.

All borrowings described in the Group Accounts for the year ended 30 September 2019 remained in place throughout the period, except as noted below.

During the period the Group continued to access the Indexed Long-Term Repo ('ILTR') scheme provided by the Bank of England.

It also drew down £140.0m under the Bank of England Contingent Term Repo Facility ('CTRF'). This is a facility for collateralised drawings introduced by the Bank of England in response to the Covid-19 situation. The drawing has a term of 3 months and bears interest at 0.15% above bank base rate. The Group has also been authorised to participate in the SME Term Funding Scheme (TFSME) with drawings expected in the second half of the current financial year.

Of the Group's borrowings at 30 September 2019, the mortgage backed floating rate notes issued by Paragon Mortgages (No. 23) PLC were repaid in October 2019 and those issued by Paragon Mortgages (No. 9) PLC in February 2020. In March 2020 notice was given of the Group's intention to repay the remaining notes issued by Paragon Mortgages (No. 24) PLC and this took place on 15 April 2020, after the end of the period. In each case, this followed the purchase of the entity's loan assets by other group companies.

On 24 October 2019, the Group's £200.0m warehouse funding facility, drawn by Paragon Seventh Funding on Bank of America Merrill Lynch, was renewed for a further 12 month commitment period on substantially the same terms as set out in the Group Accounts for the year ended 30 September 2019.

Repayments made in respect of the Group's borrowings are shown in note 24.

During the period, the Group entered into a back-to-back long / short repo transaction with a UK bank. This provides £150.0m of liquidity and encumbers £28.5m of Group assets, but does not appear on the Group's balance sheet.

16. SUNDRY LIABILITIES

Sundry liabilities include £36.9m of amounts falling due after more than one year (31 March 2019: £38.8m; 30 September 2019: £38.8m).

Total sundry liabilities include £19.5m in respect of deferred consideration, of which £12.0m falls due after more than one year (31 March 2019: £21.3m; 30 September 2019: £23.7m), and £6.4m in respect of lease liabilities (31 March 2019: £nil, 30 September 2019: £nil), of which £4.8m falls due after more than one year (31 March 2019: £nil, 30 September 2019: £nil) (note 29).

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2020 (Unaudited)

17. RETIREMENT BENEFIT OBLIGATIONS

The defined benefit obligation at 31 March 2020 has been calculated on a year-to-date basis. Since the last IAS 19 actuarial valuation at 30 September 2019, there have been movements in financial conditions, requiring an adjustment to the actuarial assumptions underlying the calculation of the defined benefit obligation at 31 March 2020. In particular, over the period since the 30 September 2019 actuarial valuation, the discount rate has increased by 45 basis points per annum, whereas expectations of long-term inflation have reduced by around 20 basis points.

In addition, the defined benefit obligation takes into account the preliminary results of the Plan's statutory funding valuation as at 31 March 2019, which results in a reduction in forecast Plan liabilities.

The net effect of these changes, together with the Group's contribution and the performance of the plan assets, has resulted in the value of the defined benefit obligation at 31 March 2020 reducing from that at 30 September 2019. The impact of allowing for the preliminary results of the 2019 valuation and the change in actuarial assumptions has been recognised as an actuarial gain in other comprehensive income.

The movements in the deficit on the defined benefit plan during the six month period ended 31 March 2020 are summarised below.

	Six months to 31 March 2020 £m	Six months to 31 March 2019 £m	Year to 30 September 2019 £m
Opening pension deficit	34.5	19.5	19.5
Employer contributions	(2.2)	(2.2)	(4.6)
Amounts posted to profit and loss			
Service cost	1.0	0.9	1.6
Past service cost	-	0.2	0.3
Net funding cost (note 4)	0.3	0.3	0.5
Administrative expenses	0.3	0.3	0.7
Amounts posted to other comprehensive income			
Return on plan assets not included in interest	13.8	0.2	(6.6)
Experience (gain) on liabilities	(1.3)	-	-
Actuarial (gain) / loss from changes in financial assumptions	(18.1)	14.1	24.5
Actuarial (gain) from changes in demographic assumptions	-	(1.4)	(1.4)
Closing pension deficit	28.3	31.9	34.5

Past service cost during 2019 relates to the cost of GMP equalisation, discussed in note 41 to the Group Accounts.

Pursuant to the recovery plan agreed with the Trustee of the pension plan, the Group has effectively granted a first charge over its freehold head office building as security for its agreed contributions. No account of this charge is taken in the calculation of the above deficit.

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2020 (Unaudited)

18. CALLED-UP SHARE CAPITAL

Movements in the issued share capital in the period were:

	Six months to 31 March 2020 Number	Six months to 31 March 2019 Number	Year to 30 September 2019 Number
Ordinary shares of £1 each			
Opening share capital	261,573,351	281,596,936	281,596,936
Shares issued	127,256	168,094	1,606,849
Shares cancelled	-	-	(21,630,434)
Closing share capital	261,700,607	281,765,030	261,573,351

During the period, the Company issued 127,256 shares (six months ended 31 March 2019: 168,094; year ended 30 September 2019: 1,606,849) to satisfy options granted under Sharesave schemes for a consideration of £322,725 (six months ended 31 March 2019: £475,660; year ended 30 September 2019: £4,075,843).

19. RESERVES

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m	1 October 2018 £m
Share premium account	68.5	66.1	68.3	65.8
Capital redemption reserve	50.3	28.7	50.3	28.7
Merger reserve	(70.2)	(70.2)	(70.2)	(70.2)
Cash flow hedging reserve	2.6	2.6	3.0	3.3
Profit and loss account	842.0	880.9	835.9	868.3
	893.2	908.1	887.3	895.9

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
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20. OWN SHARES

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m
Treasury shares			
At 30 September 2019	23.0	91.8	91.8
Shares purchased	-	-	26.7
Shares cancelled	-	-	(95.5)
At 31 March 2020	23.0	91.8	23.0
ESOP shares			
At 30 September 2019	17.5	12.2	12.2
Shares purchased	-	-	7.6
Options exercised	(7.6)	(1.1)	(2.3)
At 31 March 2020	9.9	11.1	17.5
Total at 31 March 2020	32.9	102.9	40.5
Total at 30 September 2019	40.5	104.0	104.0
Number of shares held			
Treasury	5,218,702	20,800,284	5,218,702
ESOP	2,190,231	2,517,608	3,912,516
Total at 31 March 2020	7,408,933	23,317,892	9,131,218

21. EQUITY DIVIDEND

Amounts recognised as distributions to equity shareholders in the period:

	Six months to 31 March 2020 £m	Six months to 31 March 2019 £m	Year to 30 September 2019 £m
Final dividend for the year ended 30 September 2019 of 14.2p per share	35.9	-	-
Final dividend for the year ended 30 September 2018 of 13.9p per share	-	35.9	35.9
Interim dividend for the year ended 30 September 2019 of 7.0p per share	-	-	18.1
	35.9	35.9	54.0

No interim dividend is proposed for the period (2019: 7.0p per share), for the reasons set out in note 26(a).

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For the six months ended 31 March 2020 (Unaudited)

22. NET CASH FLOW FROM OPERATING ACTIVITIES

	Six months to 31 March 2020 £m	Six months to 31 March 2019 £m	Year to 30 September 2019 £m
Profit before tax	57.1	72.0	159.0
Non-cash items included in profit, and other adjustments			
Depreciation of property, plant and equipment	1.7	0.8	1.5
Profit on disposal of property, plant and equipment	-	-	-
Amortisation of intangible assets	1.0	1.3	2.4
Foreign exchange movements on borrowings	(59.3)	(88.2)	(124.8)
Other non-cash movements on borrowings	0.4	0.8	3.6
Impairment losses on loans to customers	30.0	4.9	8.0
Charge for share based remuneration	0.1	2.8	5.9
Gain on derecognition	-	-	(9.7)
Derecognition of cash flow hedge	-	-	(0.9)
Net (increase) / decrease in operating assets			
Assets held for leasing	(2.4)	(7.3)	(0.9)
Loans to customers	(350.0)	(432.7)	(792.0)
Derivative financial instruments	54.3	104.4	169.7
Fair value of portfolio hedges	(15.0)	(42.9)	(88.3)
Other receivables	(16.0)	(26.9)	(73.8)
Net increase / (decrease) in operating liabilities			
Retail deposits	520.0	581.4	1,095.3
Derivative financial instruments	14.1	26.2	75.8
Fair value of portfolio hedges	3.9	4.9	8.1
Other liabilities	(6.8)	(2.6)	(1.6)
Cash generated by operations	233.1	198.9	437.3
Income taxes (paid)	(36.5)	(21.6)	(39.4)
Net cash flow generated by operating activities	196.6	177.3	397.9

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
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23. NET CASH FLOW USED IN INVESTING ACTIVITIES

	Six months to 31 March 2020 £m	Six months to 31 March 2019 £m	Year to 30 September 2019 £m
Proceeds from sales of operating property, plant and equipment	0.1	-	-
Purchases of operating property, plant and equipment	(0.8)	(0.3)	(1.1)
Purchases of intangible assets	(0.4)	(1.0)	(2.0)
Residual disposal	-	-	11.4
Net cash (utilised) / generated by investing activities	(1.1)	(1.3)	8.3

24. NET CASH FLOW FROM FINANCING ACTIVITIES

	Six months to 31 March 2020 £m	Six months to 31 March 2019 £m	Year to 30 September 2019 £m
Shares issued	0.5	0.4	3.9
Dividends paid (note 21)	(35.9)	(35.9)	(54.0)
Issue of asset backed floating rate notes	-	-	362.5
Repayment of asset backed floating rate notes	(473.5)	(324.8)	(591.1)
Movement on central bank facilities	205.0	(40.0)	(30.0)
Movement on other bank facilities	91.6	(13.8)	(148.3)
Capital element of lease payments	(1.0)	-	-
Purchase of own shares (note 20)	-	-	(34.3)
Net cash (utilised) by financing activities	(213.3)	(414.1)	(491.3)

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
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25. RELATED PARTY TRANSACTIONS

In the six months ended 31 March 2020, the Group has continued the related party relationships described in note 52 on page 228 of the Annual Report and Accounts of the Group for the financial year ended 30 September 2019. Related party transactions in the period comprise the compensation of the Group's key management personnel, the acceptance of retail deposits from certain non-executive directors, and transactions with the Group Pension Plan.

There have been no changes in these relationships which could have a material effect on the financial position or performance of the Group in the period.

The maximum amount of retail deposits accepted from non-executive directors during the period, and the amount at 31 March 2020, was £500,000 (30 September 2019: £nil).

Except for the transactions referred to above, there have been no related party transactions in the six months ended 31 March 2020.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2020 (Unaudited)

The notes below describe the processes and measurements which the Group uses to manage its capital position and its exposure to credit risk. It should be noted that certain capital measures, which are presented to illustrate the Group's position, are not covered by the Independent Review Report. Where this is the case, the relevant disclosures are marked as such.

26. CAPITAL MANAGEMENT

The Group's objectives in managing capital are:

- To ensure that the Group has sufficient capital to meet its operational requirements and strategic objectives
- To safeguard the Group's ability to continue as a going concern, so that it can continue to provide returns to shareholders and benefits for other stakeholders
- To provide an adequate return to shareholders by pricing products and services commensurately with the level of risk
- To ensure that sufficient regulatory capital is available to meet any externally imposed requirements

The Group's response to the Covid-19 situation has been planned and executed with the protection of its capital base and its long-term viability as an over-arching priority.

The Group sets the amount of capital in proportion to risk, availability and cost. The Group manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets, having particular regard to the relative costs and availability of debt and equity finance at any given time. In order to maintain or adjust the capital structure the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares, issue or redeem other capital instruments, such as retail or corporate bonds, or sell assets to reduce debt.

The Group is subject to regulatory capital rules imposed by the PRA on a consolidated basis as a group containing an authorised bank. This is discussed further below.

(a) Dividend policy

The Company is committed to a long term sustainable dividend policy. Ordinarily, dividends will increase in line with earnings, subject to the requirements of the business and the availability of cash resources. The Board reviews the policy at least twice a year in advance of announcing its results, taking into account the Group's strategy, capital requirements, principal risks and the objective of enhancing shareholder value. In determining the level of dividend for any year, the Board expects to follow the dividend policy, but will also take into account the level of available retained earnings in the Company, its cash resources and the cash and capital requirements inherent in its business plans.

The distributable reserves of the Company comprise its profit and loss account balance and, other than the requirement for Paragon Bank PLC to retain an appropriate level of regulatory capital, there are no restrictions preventing profits elsewhere in the Group from being distributed to the parent.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
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26. CAPITAL MANAGEMENT (Continued)

Since the year ended 30 September 2018, the Company has adopted a policy of paying out approximately 40% of its basic earnings per share as dividend (a dividend cover ratio of around 2.5 times), in the absence of any idiosyncratic factors which might make such a dividend inappropriate. This policy is reviewed by the Board at least annually. The Company considers it has access to sufficient cash resources to pay dividends at this level and that its distributable reserves are abundant for this purpose.

To provide greater transparency, the Company has also indicated that its interim dividend per share will normally be 50% of the previous final dividend, in the absence of any indicators which might make such a level of payment inappropriate (note 21).

In respect of the current financial year, the Board considered the exceptional level of uncertainty in the UK and global economy, together with the public statements of government and regulatory bodies and emerging market practice and concluded that, while the capital position and liquidity position of the Company remain strong, it would not be advisable to declare an interim dividend. The Board will consider an appropriate dividend for the entire year at the time of its next review of dividend policy before announcing its results in late 2020, by which time more will be known about the extent, duration and impact of the Covid-19 crisis and its effect on the Group's customers, results and future prospects.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2020 (Unaudited)

26. CAPITAL MANAGEMENT (Continued)

(b) **Return on tangible equity ('RoTE')**

RoTE is defined by the Group by comparing the profit after tax for the period, adjusted for amortisation charged on intangible assets, to the average of the opening and closing equity positions, excluding intangible assets and goodwill.

The Group's consolidated annualised RoTE for the six months ended 31 March 2020 is derived as follows:

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m	30 September 2018 £m
Profit for the period	44.5	58.1	127.4	145.8
Amortisation of intangible assets	1.0	1.3	2.4	2.1
Adjusted profit	45.5	59.4	129.8	147.9
Divided by				
Opening equity	1,108.4	1,073.5	1,073.5	1,009.4
Opening intangible assets	(171.1)	(169.3)	(169.3)	(104.4)
Opening tangible equity	937.3	904.2	904.2	905.0
Closing equity	1,122.0	1,087.0	1,108.4	1,095.9
Closing intangible assets	(170.5)	(171.4)	(171.1)	(169.3)
Closing tangible equity	951.5	915.6	937.3	926.6
Average tangible equity	944.4	909.9	920.7	915.8
Return on tangible equity	9.6%	13.1%	14.1%	16.1%

(c) **Regulatory capital**

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

The Group's regulatory capital is monitored by the Board of Directors, 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.

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SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2020 (Unaudited)

26. CAPITAL MANAGEMENT (Continued)

The tables below demonstrate that at 31 March 2020 the Group's total regulatory capital of £1,133.3m (31 March 2019: £1,067.9m, 30 September 2019: £1,072.0m) was comfortably in excess of the amounts required by the regulator, including £748.1m in respect of Pillar 1 and Pillar 2a capital (31 March 2019: £747.4m, 30 September 2018: £742.9m), which is comprised of fixed and variable elements (none of these amounts are covered by the independent review report).

The CRR also requires firms to hold additional capital buffers, including a Capital Conservation Buffer ('CCoB') of 2.5% of risk weighted assets (at 31 March 2020) and a Counter Cyclical Buffer ('CCyB'), currently 0.0% of risk weighted assets (30 September 2019: 1.0%). Firm specific buffers may also be required.

The Group's regulatory capital differs from its equity as certain adjustments are required by the CRR or the regulator. A reconciliation of the Group's equity to its regulatory capital determined in accordance with CRD IV at 31 March 2020 is set out below.

	Note	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m	1 October 2018 £m
Total equity	§	1,122.0	1,087.0	1,108.4	1,073.5
Deductions					
Proposed dividend	21	-	(18.1)	(35.8)	(35.8)
IFRS 9 transitional relief	*	32.5	21.2	21.2	21.2
Intangible assets	13	(170.5)	(171.4)	(171.1)	(169.3)
Prudent valuation adjustments	β	(0.7)	(0.8)	(0.7)	(0.9)
Common Equity Tier 1 ('CET1') capital		983.3	917.9	922.0	888.7
Other tier 1 capital		-	-	-	-
Total Tier 1 capital		983.3	917.9	922.0	888.7
Corporate bond		150.0	150.0	150.0	150.0
Total Tier 2 capital		150.0	150.0	150.0	150.0
Total regulatory capital ('TRC')		1,133.3	1,067.9	1,072.0	1,038.7

§ Including results for the six months ended 31 March 2020 which have been verified by the Group's external auditor for regulatory purposes.

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

β 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.

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26. CAPITAL MANAGEMENT (Continued)

The total risk exposure calculated under the CRD IV framework, against which this capital is held, and the proportion of this exposure it represents, are calculated as shown below.

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m	1 October 2018 £m
Credit risk				
Balance sheet assets	6,079.0	6,053.9	5,997.2	5,756.3
Off balance sheet	96.3	59.5	85.5	87.8
IFRS 9 transitional relief	22.0	10.5	10.5	10.5
Total credit risk	6,197.3	6,123.9	6,093.2	5,854.6
Operational risk	516.6	485.1	516.6	485.1
Market risk	-	-	-	-
Other	91.3	91.1	114.0	105.1
Total risk exposure ('TRE')	6,805.2	6,700.1	6,723.8	6,444.8
Solvency ratios	**%**	**%**	**%**	**%**
CET1	14.4	13.7	13.7	13.8
TRC	16.7	16.0	15.9	16.2

This table is not covered by the Independent Review Report

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2020 (Unaudited)

26. CAPITAL MANAGEMENT (Continued)

On a fully loaded basis (excluding the effect of IFRS 9 transitional relief) the Group's capital ratios would be:

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m	1 October 2018 £m
CET1 Capital	983.3	917.9	922.0	888.7
Add back: IFRS 9 relief	(32.5)	(21.2)	(21.2)	(21.2)
Fully loaded CET1 Capital	950.8	896.7	900.8	867.5
TRC	1,133.3	1,067.9	1,072.0	1,038.7
Add back: IFRS 9 relief	(32.5)	(21.2)	(21.2)	(21.2)
Fully loaded TRC	1,100.8	1,046.7	1,050.8	1,017.5
Total risk exposure	6,805.2	6,700.1	6,723.8	6,444.8
Add back: IFRS 9 relief	(22.0)	(10.5)	(10.5)	(10.5)
Fully loaded TRE	6,783.2	6,689.6	6,713.3	6,434.3
Fully loaded Solvency ratios	%	%	%	%
CET1	14.0	13.4	13.4	13.5
Total regulatory capital	16.2	15.6	15.7	15.8

This table is not covered by the Independent Review Report

The total regulatory capital at 31 March 2020 on the fully loaded basis of £1,100.8m was in excess of the Pillar 1 & 2a requirement of £745.9m on the same basis (amounts not covered by the Independent Review Report).

The CRD IV risk weightings for credit risk exposures are calculated using the Standardised Approach. Operational risk is calculated using the Basic Indicator Approach.

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26. CAPITAL MANAGEMENT (Continued)

The following table below shows the calculation of the UK leverage ratio, based on the consolidated balance sheet assets adjusted as shown below:

	Note	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m	1 October 2018 £m
Total balance sheet assets		14,689.2	14,654.0	14,395.5	14,487.9
Add: Credit fair value adjustments on loans to customers	10	-	-	-	24.1
Debit fair value adjustments on retail deposits	14	-	-	-	4.2
Adjusted balance sheet assets		14,689.2	14,654.0	14,395.5	14,516.2
Less: Derivative assets	12	(538.1)	(751.3)	(592.4)	(855.7)
Central bank deposits	9	(812.7)	(704.0)	(816.4)	(895.9)
Cash Ratio Deposits		(12.8)	(9.1)	(11.4)	(6.2)
Accrued interest on sovereign exposures		-	(0.2)	(0.2)	(0.4)
On-balance sheet items		13,325.6	13,189.4	12,975.1	12,758.0
Less: Intangible assets	13	(170.5)	(171.4)	(171.1)	(169.3)
Total on balance sheet exposures		13,155.1	13,018.0	12,804.0	12,588.7
Derivative assets	12	538.1	751.3	592.4	855.7
Potential future exposure on derivatives		95.7	151.2	120.0	172.1
Total derivative exposures		633.8	902.5	712.4	1,027.8
Post offer pipeline at gross notional amount		822.9	810.4	903.4	817.7
Adjustment to convert to credit equivalent amounts		(664.1)	(674.9)	(739.2)	(569.2)
Off balance sheet items		158.8	135.5	164.2	248.5
Tier 1 capital		983.3	917.9	922.0	888.7
Total leverage exposure before IFRS 9 relief		13,947.7	14,056.0	13,680.6	13,865.0
IFRS 9 relief		39.9	25.8	25.8	25.8
Total leverage exposure		13,987.6	14,081.8	13,706.4	13,890.8
UK leverage ratio		7.0%	6.5%	6.7%	6.4%

This table is not covered by the Independent Review Report

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26. CAPITAL MANAGEMENT (Continued)

The fully loaded leverage ratio is calculated as follows:

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m	1 October 2018 £m
Fully loaded tier 1 capital	950.8	896.7	900.8	867.5
Total leverage exposure before IFRS 9 relief	13,947.7	14,056.0	13,680.6	13,865.0
Fully loaded UK leverage exposure	6.8%	6.4%	6.6%	6.3%

This table is not covered by the Independent Review Report

The regulatory capital disclosures in these condensed financial statements relate only to the consolidated position for the Group. Individual entities within the Group are also subject to supervision on a standalone basis. All such entities complied with the requirements to which they were subject during the period.

This leverage ratio is prescribed by the PRA and differs from the Basel/CRR ratio due to the exclusion of central bank deposits from exposures.

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27. CREDIT RISK

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

The Group's credit risk is primarily attributable to its loans to customers. There are no significant concentrations of credit risk to individual counterparties due to the large number of customers included in the portfolios.

The Group's loan assets at 31 March 2020, 31 March 2019 and 30 September 2019 are analysed as follows:

	31 March 2020		31 March 2019		30 September 2019	
	£m	%	£m	%	£m	%
Buy-to-let mortgages	10,429.1	83.4%	10,548.0	84.2%	10,101.9	82.9%
Owner occupied mortgages	60.8	0.5%	76.8	0.6%	70.6	0.6%
Total first mortgages	10,489.9	83.9%	10,624.8	84.8%	10,172.5	83.5%
Second charge mortgage loans	377.2	3.0%	404.8	3.2%	389.2	3.2%
Loans secured on residential property	10,867.1	86.9%	11,029.6	88.0%	10,561.7	86.7%
Development finance	502.3	4.0%	426.0	3.4%	506.5	4.1%
Loans secured on property	11,369.4	90.9%	11,455.6	91.4%	11,068.2	90.8%
Asset finance loans	488.3	3.9%	433.6	3.5%	472.9	3.9%
Motor finance loans	314.8	2.5%	316.0	2.5%	318.9	2.6%
Aircraft mortgages	25.1	0.2%	17.8	0.1%	19.3	0.2%
Structured lending	95.0	0.8%	56.1	0.4%	88.1	0.7%
Invoice finance	20.6	0.2%	20.9	0.2%	18.5	0.1%
Total secured loans	12,313.2	98.5%	12,300.0	98.1%	11,985.9	98.3%
Professions finance	49.9	0.4%	48.4	0.4%	46.2	0.4%
Other unsecured commercial loans	22.7	0.2%	18.7	0.2%	19.3	0.2%
Unsecured consumer loans	120.3	0.9%	158.5	1.3%	134.7	1.1%
Total loans to customers	12,506.1	100.0%	12,525.6	100.0%	12,186.1	100.0%

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2020 (Unaudited)

27. CREDIT RISK (Continued)

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

Development finance loans are secured by a first charge (or similar Scottish security) over the development property and various charges over the build.

Asset finance loans and motor finance loans are effectively secured by the financed asset, while aircraft mortgages are secured by a charge on the aircraft funded.

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

Professions finance are generally short term unsecured loans made to firms of lawyers and accountants for working capital purposes.

Other unsecured consumer loans include unsecured loans either advanced by Group companies or acquired from their originators at a discount.

There are no significant concentrations of credit risk to individual counterparties due to the large number of customers included in the portfolios. All lending is to customers within the UK. The total gross carrying value of the Group's Loans to Customers due from customers with total portfolio exposures over £10.0m is analysed below by product type.

	31 March 2020 £m	**31 March 2019 £m**	**30 September 2019 £m**
Buy-to-let mortgages	153.4	210.3	149.7
Development finance	177.8	201.9	212.7
Structured lending	77.8	46.0	78.8
Asset finance	-	-	-
	409.0	458.2	441.2

The threshold of £10.0m is used internally for monitoring large exposures.

The fall in large buy-to-let exposures between 31 March 2019 and 31 March 2020 is principally a result of the derecognition of the PM12 assets in June 2019 which included elements of several large portfolios.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2020 (Unaudited)

27. CREDIT RISK (Continued)

Credit grading

An analysis of the Group's loans to customers by absolute level of credit risk at 31 March 2020 is set out below. The analysed amount represents gross carrying amount.

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
31 March 2020					
Very low risk	8,862.7	110.0	20.0	46.8	9,039.5
Low risk	1,287.9	57.1	9.3	22.6	1,376.9
Moderate risk	772.3	116.0	8.6	37.8	934.7
High risk	322.6	155.9	58.0	39.4	575.9
Very high risk	44.3	45.8	48.3	30.5	168.9
Not graded	380.6	57.4	30.4	8.5	476.9
Total gross carrying amount	11,670.4	542.2	174.6	185.6	12,572.8
Impairment	(18.1)	(9.0)	(39.4)	(0.2)	(66.7)
Total loans to customers	11,652.3	533.2	135.2	185.4	12,506.1
31 March 2019					
Very low risk	8,866.7	73.5	9.7	51.9	9,001.8
Low risk	1,309.2	59.2	9.4	30.8	1,408.6
Moderate risk	822.5	98.0	11.7	57.5	989.7
High risk	398.4	143.7	97.2	63.4	702.7
Very high risk	98.2	52.4	35.5	49.8	235.9
Not graded	197.6	13.9	22.1	4.8	238.4
Total gross carrying amount	11,692.6	440.7	185.6	258.2	12,577.1
Impairment	(5.5)	(3.5)	(42.5)	-	(51.5)
Total loans to customers	11,687.1	437.2	143.1	258.2	12,525.6
30 September 2019					
Very low risk	8,693.9	92.8	26.5	49.4	8,862.6
Low risk	1,267.2	77.5	6.7	26.5	1,377.9
Moderate risk	781.9	75.0	9.3	45.2	911.4
High risk	353.2	153.0	67.9	48.5	622.6
Very high risk	86.0	47.0	44.0	38.7	215.7
Not graded	200.4	13.2	13.5	10.7	237.8
Total gross carrying amount	11,382.6	458.5	167.9	219.0	12,228.0
Impairment	(6.0)	(3.7)	(32.2)	-	(41.9)
Total loans to customers	11,376.6	454.8	135.7	219.0	12,186.1

27. CREDIT RISK (Continued)

Gradings above are based on credit scorecards or internally assigned risk ratings as appropriate for the individual asset class. These measures are calibrated across product types and used internally to monitor the Group's overall credit risk profile against its risk appetite.

These gradings represent current credit quality on an absolute basis and this may result in assets in higher IFRS 9 stages with low risk grades, especially where a case qualifies through breaching, for example, an arrears threshold but is making regular payments. This will apply especially to stage 3 cases reported in note 11, other than those shown as 'realisations'.

Examples of these cases include fully up-to-date receiver of rent cases, customers who may be up to date on accounts with other lenders and accounts where the default on the Group's loan has yet to impact on external credit score.

A small proportion of the loan book (3.8%) is classed as 'not graded' above. This rating relates to loans that have been fully underwritten at origination but where the customer falls outside the automated assessment techniques used post-completion. The increase in this value since 30 September 2019 relates principally to administrative issues on buy-to-let accounts which arise from time to time and which the Group is taking steps to resolve. This disclosure is expected to be developed further in future.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2020 (Unaudited)

27. CREDIT RISK (Continued)

Credit characteristic by portfolio

Loans secured on residential property

An analysis of the indexed Loan-To-Value ('LTV') ratio for those loan accounts secured on residential property by value at 31 March 2020 is set out below. LTVs for second charge mortgages are calculated allowing for the interest of the first charge holder, based on the most recent first charge amount held by the Group, while for acquired accounts the effect of any discount on purchase is allowed for.

	31 March 2020		31 March 2019		30 September 2019	
	First Mortgages	Second charge mortgages	First Mortgages	Second charge mortgages	First Mortgages	Second charge mortgages
	%	%	%	%	%	%
LTV ratio						
Less than 70%	52.2	68.0	53.8	64.1	54.3	66.5
70% to 80%	39.2	19.8	34.3	18.5	36.2	18.5
80% to 90%	6.6	8.6	9.6	10.3	7.2	8.9
90% to 100%	0.4	1.9	0.5	3.5	0.6	2.7
Over 100%	1.6	1.7	1.8	3.6	1.7	3.4
	100.0	100.0	100.0	100.0	100.0	100.0
Average LTV ratio	67.6	64.6	67.7	66.6	67.3	65.7
Buy-to-let	67.7		67.8		67.4	
Owner-occupied	52.1		53.4		53.2	

The regionally indexed LTVs shown above are affected by changes in house prices, with the Nationwide house price index, for the UK as a whole, registering an increase of 2.0% during the six months ended 31 March 2020 and annual increases of 3.0% in the year ended 31 March 2020 and 0.2% in the year ended 30 September 2019.

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SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2020 (Unaudited)

27. CREDIT RISK (Continued)

The geographical distribution of the Group's residential mortgage assets by gross carrying value is set out below.

	First Charge			Second Charge		
	31 March 2020	31 March 2019	30 September 2019	31 March 2020	31 March 2019	30 September 2019
	%	%	%	%	%	%
East Anglia	3.2	3.1	3.2	3.4	3.4	3.3
East Midlands	5.4	5.3	5.3	6.2	6.3	6.3
Greater London	18.6	18.7	18.9	8.1	7.4	7.8
North	3.3	3.4	3.3	4.0	4.4	4.2
North West	10.4	10.2	10.1	7.6	8.4	8.0
South East	31.6	31.4	31.9	38.8	36.5	37.7
South West	8.8	9.1	8.9	8.1	8.0	7.9
West Midlands	5.3	5.0	5.1	7.3	7.7	7.6
Yorkshire and Humberside	8.5	9.1	8.6	5.9	6.5	6.2
Total England	95.1	95.3	95.3	89.4	88.6	89.0
Northern Ireland	0.1	0.1	0.1	1.7	2.0	1.9
Scotland	1.6	1.3	1.4	5.3	5.8	5.6
Wales	3.2	3.3	3.2	3.6	3.6	3.5
	100.0	100.0	100.0	100.0	100.0	100.0

Development finance

Development finance loans do not require customers to make payments during the life of the loan, therefore arrears and past due measures cannot be used to monitor credit risk. Instead, cases are monitored on an individual basis by management and Credit Risk. The average Loan To Gross Development Value ('LTGDV') ratio for the portfolio at the period end, a measure of security cover, is analysed below.

	31 March 2020		31 March 2019		30 September 2019	
	By value	By number	By value	By number	By value	By number
	%	%	%	%	%	%
LTGDV						
50% or less	10.2	5.6	2.0	2.2	8.5	3.4
50% to 60%	19.3	12.1	14.2	18.0	18.2	15.5
60% to 65%	27.6	34.9	46.1	48.3	31.6	39.1
65% to 70%	35.1	39.5	27.2	23.0	32.3	32.4
70% to 75%	4.7	6.0	5.0	6.8	6.8	8.2
Over 75%	3.1	1.9	5.5	1.7	2.6	1.4
	100.0	100.0	100.0	100.0	100.0	100.0

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2020 (Unaudited)

27. CREDIT RISK (Continued)

The average LTGDV cover at the period end was 64.7% (31 March 2019: 63.9%, 30 September 2019: 64.8%).

LTGDV is calculated by comparing the current expected end of term exposure with the latest estimate of the value of the completed development based on surveyors' reports.

At 31 March 2020, the development finance portfolio comprised 215 accounts (31 March 2019: 178, 30 September 2019: 207) with a total carrying value of £502.3m (31 March 2019: £426.0m, 30 September 2019: £506.5m). Of these accounts, only three were included in stage 2 at 31 March 2020 (31 March 2019: six, 30 September 2019: six), with one account included as stage 3 (31 March 2019: none, 30 September 2019: none). In addition, three accounts acquired in the Titlestone purchase had been classified as POCI (31 March 2019: three, 30 September 2019: three). An allowance for these losses was made in the IFRS 3 fair value calculation.

The geographical distribution of the Group's development finance loans by gross carrying value is set out below.

	31 March 2020 %	31 March 2019 %	30 September 2019 %
East Anglia	3.5	2.8	3.1
East Midlands	3.7	3.8	2.9
Greater London	6.7	17.7	12.1
North	1.5	-	1.0
North West	0.2	-	0.1
South East	63.6	51.1	56.8
South West	14.3	12.2	13.9
West Midlands	3.4	9.7	7.2
Yorkshire and Humberside	1.6	1.1	1.5
Total England	98.5	98.4	98.6
Northern Ireland	-	-	-
Scotland	1.5	1.6	1.4
Wales	-	-	-
	100.0	100.0	100.0

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2020 (Unaudited)

27. CREDIT RISK (Continued)

Asset finance and Motor finance

Asset and motor finance lending includes finance lease and hire purchase arrangements, which are accounted for as finance leases under IFRS 16 (2019: IAS 17).

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.

	31 March 2020 %	31 March 2019 %	30 September 2019 %
Commercial vehicles	31.3	26.3	30.3
Construction plant	34.1	37.0	34.8
Technology	7.0	8.6	7.8
Manufacturing	6.4	5.7	6.1
Print and paper	4.2	6.1	4.8
Refuse disposal vehicles	4.8	6.1	5.2
Other vehicles	3.5	3.0	3.0
Agriculture	2.6	1.9	2.7
Other	6.1	5.3	5.3
	100.0	100.0	100.0

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

Structured lending

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

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

	31 March 2020	31 March 2019	30 September 2019	30 September 2018
Number of transactions	8	5	8	3
Total facilities (£m)	154.9	60.2	135.0	52.5
Carrying value (£m)	95.0	56.1	88.1	38.7

The maximum advance under these facilities was 75% of the underlying assets.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2020 (Unaudited)

27. CREDIT RISK (Continued)

These accounts do not have a requirement to make regular payments, operating on a revolving basis. The performance of each loan is monitored monthly on a case by case basis by the Group's Credit Risk function, assessing compliance with covenants relating to both the customers 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 31 March 2020 there were no significant concerns regarding the credit performance of these facilities.

Unsecured consumer loans

Almost all the Group's unsecured consumer loan assets are part of purchased debt portfolios where the consideration paid will have been based on the credit quality and performance of the loans at the point of the transaction. Collections on purchased accounts have been comfortably in excess of those implicit in the purchase prices.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2020 (Unaudited)

27. CREDIT RISK (Continued)

Arrears performance

The number of accounts in arrears by asset class, based on the most commonly quoted definition of arrears for the type of asset, at 31 March 2020, 31 March 2019 and 30 September 2019, compared to the industry averages at those dates published by UK Finance ('UKF') and the Finance and Leasing Association ('FLA'), was:

	31 March 2020 %	31 March 2019 %	30 September 2019 %
First mortgages			
Accounts more than three months in arrears			
Buy-to-let accounts including receiver of rent cases	0.16	0.12	0.18
Buy-to-let accounts excluding receiver of rent cases	0.10	0.04	0.07
Owner-occupied accounts	3.34	2.99	2.44
UKF data for mortgage accounts more than three months in arrears			
Buy-to-let accounts including receiver of rent cases	0.41	0.41	0.42
Buy-to-let accounts excluding receiver of rent cases	0.37	0.37	0.37
Owner-occupied accounts	0.82	0.87	0.81
All mortgages	0.74	0.78	0.73
Second charge mortgage loans			
Accounts more than 2 months in arrears			
All accounts	14.23	14.04	14.08
Post-2010 originations	0.51	0.41	0.38
Legacy cases	19.97	19.34	19.85
Purchased assets	17.07	15.52	16.05
FLA data for second mortgages	8.60	9.10	8.70
Motor finance loans			
Accounts more than 2 months in arrears			
All accounts	4.57	6.05	5.25
Originated cases	1.32	1.27	1.27
Purchased assets	12.55	12.01	12.13
FLA data for consumer hire purchase	3.20	2.70	2.70
Asset finance loans			
Accounts more than 2 months in arrears	0.27	1.66	0.43
FLA data for business lease/hire purchase loans	1.30	1.10	1.10

No published industry data for asset classes comparable to the Group's other books has been identified. Where revised data at 31 March 2019 or 30 September 2019 has been published by the FLA or UKF, the comparative industry figures above have been amended.

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

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SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2020 (Unaudited)

27. CREDIT RISK (Continued)

It should be noted that, where customers have been allowed to defer payments as part of Covid-19 reliefs, these deferrals are not included in arrears measures above.

The Group calculates its headline arrears measure for buy-to-let mortgages, shown above, based on the numbers of accounts three months or more in arrears, including purchased 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 second charge mortgages loans include 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 (which will be treated as POCI under IFRS 9) but is less applicable for some 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 assets are set out below. These are derived from the same models and assumptions used in the effective interest rate calculations. ERCs are set out both for all purchased consumer portfolios and for those classified as POCI under IFRS 9.

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m	30 September 2018 £m
All purchased consumer assets				
Carrying value	258.7	331.2	291.1	364.2
84 month ERC	305.1	395.5	342.3	434.9
120 month ERC	344.8	446.5	387.5	489.6
POCI assets only				
Carrying value	151.7	190.0	168.3	204.4
84 month ERC	192.6	248.1	214.1	269.9
120 month ERC	220.9	283.9	246.0	306.2

Amounts shown include loans disclosed as consumer loans and first mortgages (note 10).

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2020 (Unaudited)

The notes set out below describe the accounting basis on which the Group prepares its accounts, the particular accounting policies adopted by the Group and the principal judgements and estimates which were required in the preparation of the condensed financial information.

They also include other information describing how the condensed financial information has been prepared required by legislation and accounting standards.

28. ACCOUNTING POLICIES

The condensed financial statements are presented in accordance with the requirements of International Accounting Standard 34 – 'Interim Financial Reporting'.

The Group prepares its annual financial statements in accordance with International Financial Reporting Standards as endorsed by the European Union, as required by UK company law. Despite the UK's exit from the European Union, this requirement remains in place for the time being. The condensed financial statements have been prepared on the basis of the accounting policies set out in the Annual Report and Accounts of the Group for the year ended 30 September 2019, except for the adoption of IFRS 16 – 'Leases' ('IFRS 16'), described in note 29. This basis is expected to be used in the preparation of the financial statements of the Group for the year ending 30 September 2020.

Comparability of information

As described in note 29 below, the balance sheet information at 30 September 2018, 30 September 2019 and 31 March 2019 and the profit and loss information for the periods ended on these dates is not required to be restated on the adoption of IFRS 16. The information presented is derived in accordance with IAS 17 - 'Leases' ('IAS 17'), and therefore may not be directly comparable with the balance sheet at 31 March 2020 and the profit and loss account for the six months then ended which are prepared under IFRS 16.

New and revised reporting standards

No new or revised reporting standards significantly affecting the Group's accounting have been issued since the approval of the Group's financial statements for the year ended 30 September 2019.

29. CHANGES IN ACCOUNTING STANDARDS

The Group is required to adopt IFRS 16, which replaces IAS 17, the standard currently governing the accounting for operating and finance leases, in preparing its financial statements for the year ending 30 September 2020. It has transitioned to the new standard with effect from 1 October 2019, in accordance with the transitional provisions set out in the standard, using the modified retrospective approach, and has therefore applied this standard in the preparation of this half year report.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2020 (Unaudited)

29. CHANGES IN ACCOUNTING STANDARDS (Continued)

Lessor accounting

The standard addresses accounting by lessees and lessors, but the provisions for lessor accounting are little changed from those in IAS 17 and so the accounting for the Group's finance lease receivables is largely unaffected.

Lessee accounting

Accounting by lessees is changed significantly, with a right of use asset recognised on the balance sheet for all leases, representing the right to use the underlying asset. This includes leases previously treated as operating leases and not recognised on the balance sheet under the previous standard. The right of use asset on initial recognition is based on the discounted value of future lease payments. It is recognised within fixed assets and depreciated over the term of the lease.

A corresponding liability arises representing the present value of future lease commitments and is recognised within other liabilities. This balance is reduced over the life of the lease by lease payments made and the unwinding of the initial discount is recognised in interest expense.

Under IAS 17, the Group disclosed arrangements to lease office buildings, equipment and motor vehicles as operating leases and these have been restated in accordance with IFRS 16. Additionally, the Group has undertaken an exercise to identify potential lease agreements arising from service contracts it holds. No such arrangements were identified. The Group has no involvement as a lessee in finance leases.

The Group has made use of practical expedients within IFRS 16 when performing its transition accounting. These include the right to exclude contracts that have not previously been classified as leases before the implementation date, and the ability to exclude leases of low value and those with a short term.

At transition, on 1 October 2019, the Group recognised a right of use asset of £7.0m and a corresponding liability of £7.3m, in accordance with the provisions of IFRS 16 paragraph C5(b), referred to as the modified respective approach. Under this approach, there is no impact on equity on transition.

The difference between the asset and liability on recognition represents amounts prepaid or accrued in respect of lease rentals in the Group's balance sheet at 30 September 2019.

The discount rate used to derive the right of use asset was 2.5% based on a 5-year corporate bond yield, while the minimum lease payments used were materially similar to those disclosed as operating lease commitments at 30 September 2019 in note 51 to the annual accounts for the year then ended, except that irrecoverable VAT was excluded.

There was no immediate tax impact from transition and the Group's regulatory capital is unaffected. Under IFRS 16, the amount charged to profit and loss represents depreciation on the ROU asset and a finance charge on the liability instead of rents or similar charges. While this is a change of classification, the overall effect on profit is insignificant. There is no impact on reported cash flows, nor on earnings per share.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2020 (Unaudited)

29. CHANGES IN ACCOUNTING STANDARDS (Continued)

IFRS 16 does not require the restatement of comparative information and therefore all balance sheets and results for periods on or before 30 September 2019 are presented in accordance with IAS 17.

Accounting changes at 1 October 2018

The accounting changes affecting equity at 1 October 2018 relate to the adoption of IFRS 9 – 'Financial Instruments' and IFRS 15 – 'Revenue' and are described in detail in note 62 to the accounts for the year ended 30 September 2019.

30. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The critical accounting estimates and judgements affecting the condensed financial information are the same as those described in notes 64 and 65 to the accounts of the Group for the year ended 30 September 2019. However, the economic impact of the Covid-19 pandemic, which began to significantly affect the UK economy just before the period end, has both increased the levels of uncertainty affecting those judgments and estimate and reduced the availability of information on which they can be based as at 31 March 2020.

The Group's judgements relating to Significant Increase in Credit Risk and estimates relating to impairment losses on customers loans, income recognition and impairment of goodwill are particularly affected by Covid-19, and these considerations are set out below.

(a) **Significant Increase in Credit Risk ('SICR')**

Under IFRS 9, the directors are required to assess where a credit obligation has suffered a Significant Increase in Credit Risk ('SICR'). The directors' assessment is based primarily on changes in the calculated probability of default, but also includes consideration of other qualitative indicators and the adoption of the backstop assumption in the Standard that all cases which are more than 30 days overdue have an SICR, for account types where days overdue is an appropriate measure.

If additional accounts were determined to have an SICR, these balances would attract additional impairment provision and the overall provision charge would be higher.

In determining whether an account has a SICR in the Covid-19 environment the granting of Covid-19 reliefs, including payment holidays and similar arrangements, may mean that a SICR may exist without this being reflected in either arrears performance or credit bureau data. The Group has accepted the advice of UK regulatory bodies that the grant of Covid-19 relief does not, of itself, indicate an SICR, but has carefully considered internal credit and customer data to determine whether there might be any accounts with SICR not otherwise identified by the process.

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SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
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30. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

(b) **Impairment losses on loans to customers**

Impairment losses on loans are calculated based on statistical models, applied to the present status, performance and management strategy for the loans concerned which are used to determine each loan's PD and LGD.

Internal information used will include number of months arrears, qualitative information, such as possession by a first charge holder on a second charge mortgage or where a buy-to-let case is under the control of a receiver of rent, the receiver's present and likely future strategy for the property (e.g. keeping current tenants in place, refurbish and relet, immediate sale etc).

External information used includes customer specific data, such as credit bureau information as well as more general economic data.

Key internal assumptions in the models relate to estimates of future cash flows from customers' accounts, their timing and, for secured accounts, the expected proceeds from the realisation of the property or other charged assets. These cash flows will include payments received from the customer, and, for buy-to-let cases where a receiver of rent is appointed, rental receipts from tenants, after allowing for void periods and running costs. These key assumptions are based on observed data from historical patterns and are updated regularly based on new data as it becomes available.

In addition, the directors consider how appropriate past trends and patterns might be in the current economic situation and make any adjustments they believe are necessary to reflect current and expected conditions.

All of this information may be impacted by Covid-19, its economic effect on customers and the forms of the reliefs given to ameliorate that impact. These may both change the underlying data and impact on the derivation of metrics normally used to monitor credit performance.

The accuracy of the impairment calculations would therefore be affected by unexpected changes to the economic situation, variances between the models used and the actual results, or assumptions which differ from the actual outcomes. In particular, if the impact of economic factors such as employment levels on customers is worse than is implicit in the model then the number of accounts requiring provision might be greater than suggested by the model, while falls in house prices, over and above any assumed by the model might increase the provision required in respect of accounts currently provided. Similarly, if the account management approach assumed in the modelling cannot be adopted the provision required may be different. In the uncertain economic environment created by the Covid-19 pandemic, the potential for such differences is greater than in a more stable economic climate.

In order to provide forward looking economic inputs to the modelling of the ECL, the Group must derive a set of scenarios which are internally coherent. The Group addresses these requirements using four distinct economic scenarios chosen to represent the range of possible outcomes. These scenarios at 31 March 2020 have been derived specifically in light of the Covid-19 situation, modelling a variety of possible outcomes. It should be noted, however, that there is currently little agreement between economists on the longer-term prospects for the UK and there is unlikely to be so until the country's path out of lockdown becomes clearer.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2020 (Unaudited)

30. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

The variables are used for two purposes in the IFRS 9 calculations:

- They are applied as inputs in the models which generate PD values, where those found by statistical analysis to have the most predictive value are used
- They are used as part of the calculation where the variable has a direct impact on the expected loss calculation, such as the house price index

The economic variables will also inform assumptions about the Group's approach to account management given a particular scenario.

In addition to uncertainty created by the economic scenarios, the Group recognises that the present situation lies outside the range of situations considered when it originally derived its IFRS 9 approach to impairment. It therefore considered, for each class of asset, whether any adjustment to the normal approach was required to ensure sufficient provision was created and also reviewed other available data, both from account performance and customer feedback to form a view of the underlying reasons for observed customer behaviours and of their future intentions and prospects.

The position after considering all these matters is set out in note 11, together with further information on the Group's approach. The Covid-19 economic scenarios described above and their impact on the overall provision are also set out in that note.

(c) Effective interest rates

In order to determine the EIR applicable to loans and borrowings an estimate must be made of the expected life of each asset or liability and hence the cash flows relating thereto, including those relating to early redemption charges. For purchased loan accounts this will involve estimating the likely future credit performance of the accounts at the time of acquisition. These estimates are based on historical data and reviewed regularly. For purchased accounts historical data obtained from the vendor will be examined. The accuracy of the EIR applied would therefore be compromised by any differences between actual repayment profiles and those predicted, which in turn would depend directly or indirectly (in the case of borrowings) on customer behaviour.

In the case of purchased loan accounts, the assessment of future cash flows is significantly complicated by the uncertain impacts of Covid-19. The likely future cash flows have been assessed by the management on the basis of available performance data and customer contacts. The amount of income recognised to date at 31 March 2020 has been revised to allow for reduced future collections based on these assessments.

No evidence has so far been identified which would require the adjustment of EIR income for other products as a result of Covid-19.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2020 (Unaudited)

30. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

To illustrate the potential impact of variability of the estimate, the amortised cost values were recalculated by changing one factor in the EIR calculation and keeping all others at their current levels. This exercise indicated that:

- A reduction of the assumed average lives of loans secured on residential property by three months would reduce balance sheet assets by £7.7m (30 September 2019: £7.2m), while an increase of the assumed asset lives of such assets by three months would increase balance sheet assets by £7.9m (30 September 2019: £6.0m)
- An increase of 50% in the number of five year fixed rate buy-to-let loan assets assumed to redeem before the end of the fixed rate period, generating additional early redemption charges would increase balance sheet assets by £6.2m (30 September 2019: £4.2m)
- A reduction (or increase) in estimated cash flows from purchased loan assets of 5% would reduce (or increase) balance sheet assets by £8.8m (30 September 2019: £12.5m)

As any of these changes would, in reality, be accompanied by movements in other factors, actual outcomes may differ from these estimates.

(d) **Impairment of goodwill**

The carrying value of goodwill recognised on acquisitions is verified by use of an impairment test based on the projected cash flows for the cash generating unit, based on management forecasts and other assumptions including a discount factor. This test must be revisited when any changes in economic or operational performance have a potential impact on the results. The impact of Covid-19 is the type of event which would demand such retesting and that was undertaken in compiling this financial information, as described in note 13.

The accuracy of this impairment calculation would be compromised by any differences between the forecasts used and the levels of business activity that the cash generating unit is able to achieve in practice. The impact of Covid-19 means that there is a greater risk of inaccuracy in compiling these forecasts. This test will also be affected by the accuracy of the discount factor used.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2020 (Unaudited)

31. GOING CONCERN BASIS

The business activities of the Group, its current operations and those factors likely to affect its future results and development, together with a description of its financial position and funding position, are described in the Interim Management Report on pages 4 to 56. The principal risks and uncertainties affecting the Group in the forthcoming six months are described on pages 57 and 58.

Note 55 to the accounts for the year ended 30 September 2019 includes an analysis of the Group's working capital position and policies, while notes 56 to 59 include a detailed description of its funding structures, its use of financial instruments, its financial risk management objectives and policies and its exposure to credit, interest rate and liquidity risk. Notes 64 and 65 to those accounts discusses critical accounting judgements and estimates affecting the results and financial position disclosed therein. The position and policies described in these notes remain materially unchanged to the date of this half-yearly report, subject to the changes in funding described in note 15.

Financial forecasts

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

The Group makes extensive use of stress testing in compiling and reviewing its forecasts. This stress testing approach was recently reviewed in detail as part of the annual Internal Capital Adequacy Assessment Process ('ICAAP') cycle.

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

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

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2020 (Unaudited)

31. GOING CONCERN BASIS (CONTINUED)

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

- A reduction in new business volumes of 10% across all products for the whole of the forecast period, stressing the Group's cost:income ratio to ensure that it remained profitable and could meet its obligations with reduced new income flows
- An additional margin squeeze arising from increasing interest payable on new deposits by 0.1% from October 2020 onwards, without a corresponding increase in interest receivable. This stresses both the cost coverage and, to some extent, short to medium term liquidity on the assumption that higher market rates result in higher outflows on the lower rate extant book
- New business increases of 10% across key product lines (buy-to-let mortgages, development finance and SME lending), ensuring that even with sustained additional cash outflows, the Group is able to meet its liquidity requirements over the forecast horizon
- Two scenarios for higher impairment charges:
  - the first based on the IFRS 9 scenario 4, the severe macro-economic scenario, which factors in no government mitigation, but includes the impact of the forecast economic variables at face value. This scenario has a broadly similar severity to the stress testing done as part of the ICAAP
  - the second incorporating the Group's best estimates of the offsetting Covid-19 mitigations (including furloughs, payment holidays, self-employed support, and other economic measures) to give a realistic forecast view under worst case economics

These stresses did not include management actions which might mitigate the impact of the adverse assumptions used. They were designed to demonstrate how such stresses would affect the Group's financing, capital and liquidity positions and highlight any areas which might impact the Group's going concern assessment. Under all of these scenarios, the Group was able to meet its obligations over the forecast horizon and maintain a surplus over its regulatory requirements for both capital and liquidity.

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

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2020 (Unaudited)

31. GOING CONCERN BASIS (CONTINUED)

Availability of funding and liquidity

The Group's retail deposits of £6,911.9m (note 14) are repayable within five years, with 68.7% (£4,750.4m) of this balance payable within twelve months of the balance sheet date. The liquidity exposure represented by these deposits is closely monitored, a process supervised by the Asset and Liability Committee. The Group is required to hold liquid assets in Paragon Bank to mitigate this liquidity risk. At 31 March 2020, Paragon Bank held £608.5m of balance sheet assets for liquidity purposes, all of which comprised central bank deposits (note 9). A further £109.0m of liquidity was provided by the Bank of England Funding for Lending Scheme, which expires in June 2020, with the long/short repo arrangement described in note 15 making another £150.0m available. This brings the total available to £867.5m.

Paragon Bank manages its liquidity in line with the Board's risk appetite and the requirements of the PRA, which are formally documented in the Board's approved Individual Liquidity Adequacy Assessment Process ('ILAAP'). The Bank maintains a liquidity framework that includes a short to medium term cash flow requirement analysis, a longer-term funding plan and access to the Bank of England's liquidity insurance facilities, where pre-positioned assets give access to an additional £1,301.3m of further drawings.

The Group's securitisation funding structures ensure that a substantial proportion of its originated loan portfolio is match funded. Repayment of the securitisation borrowings is restricted to funds generated by the underlying assets and there is limited recourse to the Group's general funds. Recent and current loan originations utilising the Group's available warehouse facilities are refinanced through securitisation or retail deposits from time to time.

The earliest maturity of any of the Group's working capital debt is in December 2020, when the oldest of the Group's retail bond issues matures, with £60.0m falling due.

The Group's cash analysis continues to show strong free cash balances, even after allowing for significant discretionary cash outflows, and its securitisation investments produce substantial cash inflows.

The Group has demonstrated its ability to raise retail and corporate bond debt when required through its Euro Medium Term Note Programme and other programmes, while it most recently accessed the UK long-term securitisation debt market in July 2019. The Group's access to debt is also enhanced by its corporate BBB rating affirmed by Fitch Ratings in March 2020 and its status as an issuer is evidenced by the BB+ rating of its £150.0 million Tier 2 bond.

At 31 March 2020, the Group had free cash balances of £307.1m immediately available for use (note 9).

As described in note 26, the Group's capital base is subject to consolidated supervision by the PRA. Its capital at 31 March 2020 was in excess of regulatory requirements and group forecasts show this continuing to be the case.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2020 (Unaudited)

31. GOING CONCERN BASIS (CONTINUED)

Going Concern assessment

Accounting standards require the directors to assess the Group's ability to continue to adopt the going concern basis of accounting. In performing this assessment, the directors consider all available information about the future, the possible outcomes of events and changes in conditions and the realistically possible responses to such events and conditions that would be available to them, having regard to those aspects of the 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' published by the Financial Reporting Council in September 2014 applicable to half-yearly reporting.

In order to assess the appropriateness of the going concern basis the directors considered the Group's financial position, the cash flow requirements laid out in its forecasts, its access to funding, the assumptions underlying the forecasts and potential risks affecting them. In particular, in assessing the going concern status of the Group at 31 March 2020, the Group's analysis of its potential exposure to impacts of the Covid-19 situation was considered in detail.

After performing this assessment, the directors concluded that it was appropriate for them to continue to adopt the going concern basis in preparing the half-yearly report.

32. FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The Group's financial assets and financial liabilities are valued on one of two bases, defined by IFRS 9:

- Financial assets and liabilities carried at fair value through profit and loss ('FVTPL')
- Financial assets and liabilities carried at amortised cost

IFRS 7 – 'Financial Instruments: Disclosures' requires that, where assets are measured at fair value, these measurements should be classified using a fair value hierarchy reflecting the inputs used, and defines three levels.

- Level 1 measurements are unadjusted market prices
- Level 2 measurements are derived from directly or indirectly observable data, such as market prices or rates
- Level 3 measurements rely on significant inputs which are not derived from observable data

As quoted prices are not available for level 2 and 3 measurements, the valuation is derived from cash flow models based, where possible, on independently sourced parameters. The accuracy of the calculation would therefore be affected by unexpected market movements or other variances in the operation of the models or the assumptions used.

The Group had no financial assets or liabilities in the period ended 31 March 2020 or the year ended 30 September 2019 carried at fair value and valued using level 3 measurements, other than contingent consideration amounts (note 16).

The Group has not reclassified any of its measurements during the period.

The methods by which fair value is established for each class of financial assets and liabilities are set out below.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2020 (Unaudited)

32. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

(a) **Assets and liabilities carried at fair value**

The following table summarises the Group's financial assets and liabilities which are carried at fair value.

	Note	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m
Financial assets				
Derivative financial assets	12	538.1	751.3	592.4
		538.1	751.3	592.4
Financial liabilities				
Derivative financial liabilities	12	94.6	30.9	80.5
Contingent consideration		19.5	23.5	23.7
		114.1	54.4	104.2

Derivative financial assets and liabilities

Derivative financial instruments are stated at their fair values in the accounts. The Group uses a number of techniques to determine the fair values of its derivative assets and liabilities, for which observable prices in active markets are not available. These are principally present value calculations based on estimated future cash flows arising from the instruments, discounted using a risk adjusted interest rate.

The principal inputs to these valuation models are LIBOR and SONIA benchmark interest rates for the currencies in which the instruments are denominated, being sterling, euros and dollars. The cross-currency basis swaps have a notional principal related to the outstanding currency borrowings and therefore the estimated rate of repayment of these notes also affects the valuation of the swaps. However, the variability in this input does not have a significant impact on the valuation, compared to other inputs.

In order to determine the fair values, the management applies valuation adjustments to observed data where that data would not fully reflect the attributes of the instrument being valued, such as particular contractual features or the identity of the counterparty. The management reviews the models used on an ongoing basis to ensure that the valuations produced are reasonable and reflect all relevant factors. These valuations are based on market information and they are therefore classified as level 2 measurements. Details of these assets are given in note 12.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2020 (Unaudited)

32. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

Contingent consideration

The value of the contingent considerations shown in note 18 are required to be stated at fair value in the accounts. These amounts are valued based on the expected outcomes of the performance tests set out in respective sale and purchase agreements, discounted as appropriate. The most significant inputs to these valuations are the Group's forecasts on future activity relating to business generated by operational units acquired, business derived as a result of the vendor's contacts or other goodwill, and any other new business flows which are or might be attributable to the acquisition agreement, which are drawn from the overall Group forecasting model. As such, these are classified as unobservable inputs and the valuations classified as level 3 measurements.

(b) **Assets and liabilities carried at amortised cost**

The fair values for financial assets and liabilities held at amortised cost, other than those where carrying values are so low that any difference would be immaterial, determined in accordance with the methodologies set out above are summarised below.

	31 March 2020		31 March 2019		30 September 2019	
	Carrying amount £m	Fair value £m	Carrying amount £m	Fair value £m	Carrying amount £m	Fair value £m
Financial assets						
Cash	1,206.8	1,206.8	1,072.0	1,072.0	1,225.4	1,225.4
Loans to customers	12,506.1	12,706.0	12,525.6	12,666.8	12,186.1	12,370.1
	13,712.9	13,912.8	13,597.6	13,738.8	13,411.5	13,595.5
Financial liabilities						
Short term bank borrowings	0.2	0.2	0.6	0.6	1.0	1.0
Asset backed loan notes	3,887.3	3,887.3	5,143.0	5,143.0	4,419.4	4,419.4
Secured bank borrowings	879.2	879.2	921.9	921.9	787.5	787.5
Retail deposits	6,911.9	6,938.1	5,878.0	5,900.4	6,391.9	6,408.9
Corporate and retail bonds	446.3	473.4	445.7	468.8	446.1	474.9
	12,124.9	12,178.2	12,389.2	12,434.7	12,045.9	12,091.7

32. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

Cash, bank loans and securitisation borrowings

The fair values of cash and cash equivalents, bank loans and overdrafts and asset backed loan notes, which are carried at amortised cost are considered to be not materially different from their book values. In arriving at that conclusion market inputs have been considered but because all the assets mature within three months of the year end and the interest rates charged on financial liabilities reset to market rates on a quarterly basis, little difference arises.

While the Group's asset backed loan notes are listed, the quoted prices for an individual note may not be indicative of the fair value of the issue as a whole, due to the specialised nature of the market in such instruments and the limited number of investors participating in it.

As these valuation exercises are not wholly market-based, they are considered to be level 2 measurements.

Loans to customers

To assess the likely fair value of the Group's loan assets in the absence of a liquid market, the directors have considered the estimated cash flows expected to arise from the Group's investments in its loans to customers based on a mixture of market based inputs, such as rates and pricing and non-market based inputs such as redemption rates. Given the mixture of observable and non-observable inputs these are considered to be level 3 measurements.

Corporate debt

The Group's retail and corporate bonds are listed on the London Stock Exchange and there is presently a reasonably liquid market in the instruments. It is therefore appropriate to consider that the market price of these borrowings constitutes a fair value. As this valuation is based on a market price, it is considered to be a level 1 measurement.

Retail deposits

To assess the likely fair value of the Group's retail deposit liabilities, the directors have considered the estimated cash flows expected to arise based on a mixture of market-based inputs, such as rates and pricing and non-market-based inputs such as withdrawal rates. Given the mixture of observable and non-observable inputs, these are considered to be level 3 measurements.

ADDITIONAL FINANCIAL INFORMATION (APPENDICES)

For the six months ended 31 March 2020

Additional financial information supporting the amounts shown in the interim management report but not forming part of the condensed financial statements.

A. UNDERLYING PROFIT

The Group reports underlying profit excluding fair value accounting adjustments arising from its hedging arrangements and certain one-off items of income and costs relating to asset sales and acquisitions.

The fair value adjustments arise principally as a result of market interest rate movements, outside the Group's control. They are profit neutral over time and are not included in operating profit for management reporting purposes. They are also disregarded by many external analysts.

The transactions relating to the asset disposals and acquisitions do not form part of the day-to-day activities of the Group and, therefore, their removal provides greater clarity on the Group's operational performance.

This definition of 'underlying' has been chosen following consideration of the needs of investors and analysts following the Group's shares, and because management feel it better represents the underlying economic performance of the Group's business.

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m
Profit on ordinary activities before tax	57.1	72.0	159.0
Less: Gain on disposal of financial assets	-	-	(9.7)
Add back: Fair value adjustments	0.1	7.8	15.1
Underlying profit	57.2	79.8	164.4

Underlying basic earnings per share, calculated on the basis of underlying profit charged at the overall effective tax rate, is derived as follows.

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m
Underlying profit	57.2	79.8	164.4
Tax at effective rate (note 7)	(12.6)	(15.4)	(32.7)
Underlying earnings	44.6	64.4	131.7
Basic weighted average number of shares (note 8)	253.2	258.1	257.6
Underlying earnings per share	17.6p	25.0p	51.1p

ADDITIONAL FINANCIAL INFORMATION (APPENDICES)
For the six months ended 31 March 2020

A. UNDERLYING PROFIT (CONTINUED)

Underlying return on tangible equity is derived using underlying earnings calculated on the same basis.

	Six months to 31 March 2020 £m	Six months to 31 March 2019 £m	Year to 30 September 2019 £m
Underlying earnings	44.6	64.4	131.7
Amortisation of intangible assets	1.0	1.3	2.4
Adjusted underlying earnings	45.6	65.7	134.1
Average tangible equity (note 26(b))	944.4	909.9	920.7
Underlying RoTE (annualised)	9.7%	14.4%	14.6%

B. INCOME STATEMENT RATIOS

Net interest margin ('NIM') and cost of risk (impairment charge as a percentage of average loan balance) for the Group and its segments are calculated as follows:

Six months to 31 March 2020

	Mortgages £m	Commercial Lending £m	Idem Capital £m	Total £m
Opening loans to customers (note 10)	10,344.1	1,452.1	389.9	12,186.1
Closing loans to customers (note 10)	10,676.1	1,494.3	335.7	12,506.1
Average loans to customers	10,510.1	1,473.2	362.8	12,346.1
Net interest	95.8	38.7	13.2	141.4
NIM	1.82%	5.25%	7.28%	2.29%
Impairment provision	13.8	15.5	0.7	30.0
Cost of risk	0.26%	2.10%	0.39%	0.49%

ADDITIONAL FINANCIAL INFORMATION (APPENDICES)

For the six months ended 31 March 2020

B. INCOME STATEMENT RATIOS (Continued)

Six months to 31 March 2019

	Mortgages	Commercial Lending	Idem Capital	Total
	£m	£m	£m	£m
Opening loans to customers (note 10)	10,449.5	1,131.3	519.8	12,100.6
Closing loans to customers (note 10)	10,783.9	1,283.9	457.8	12,525.6
Average loans to customers	10,616.7	1,207.6	488.8	12,313.1
Net interest	89.7	30.4	26.4	138.1
Annualised NIM	1.69%	5.03%	10.80%	2.24%
Impairment provision	0.7	3.7	0.5	4.9
Cost of risk (annualised)	0.01%	0.61%	0.20%	0.08%

Year to 30 September 2019

	Mortgages	Commercial Lending	Idem Capital	Total
	£m	£m	£m	£m
Opening loans to customers (note 10)	10,449.5	1,131.3	519.8	12,100.6
Closing loans to customers (note 10)	10,344.1	1,452.1	389.9	12,186.1
Average loans to customers	10,396.8	1,291.7	454.9	12,143.4
Net interest	177.8	65.0	54.3	278.4
Annualised NIM	1.71%	5.03%	11.94%	2.29%
Impairment provision	1.0	7.2	(0.2)	8.0
Cost of risk (annualised)	0.01%	0.56%	(0.04)%	0.07%

Not all net interest is allocated to segments (see note 2).

ADDITIONAL FINANCIAL INFORMATION (APPENDICES)

For the six months ended 31 March 2020

C. COST:INCOME RATIO

Cost:income ratio is derived as follows:

	31 March 2020	31 March 2019	30 September 2019
Operating expenses (£m)	62.5	63.3	125.2
Total operating income (£m)	149.7	148.0	307.3
Cost / Income	41.8%	42.8%	40.7%

Underlying cost:income ratio is derived as follows:

	31 March 2020 £m	31 March 2019 £m	30 September 2019 £m
Cost – as above	62.5	63.3	125.2
Income – as above	149.7	148.0	307.3
Gain on disposal of financial asset	-	-	(9.7)
Adjusted income	149.7	148.0	297.6
Underlying cost:income ratio	41.8%	42.8%	42.1%

D. NET ASSET VALUE

	Note	31 March 2020	31 March 2019	30 September 2019
Total equity (£m)		1,122.0	1,087.0	1,108.4
Outstanding issued shares (m)	18	261.7	281.8	261.6
Treasury shares (m)	20	(5.2)	(20.8)	(5.2)
Shares held by ESOP schemes (m)	20	(2.2)	(2.5)	(3.9)
		254.3	258.5	252.5
Net asset value per £1 ordinary share		£4.41	£4.21	£4.39
Tangible equity (£m)	26	951.5	915.6	937.3
Tangible net asset value per £1 ordinary share		£3.74	£3.54	£3.71