PARAGON BANKING GROUP PLC

Half Year Financial Report

For the six months ended 31 March 2021

Strategic progress delivers record profits and strong new business pipelines

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 2021.

Nigel Terrington, Chief Executive of Paragon said:

"I am incredibly proud of these results. They reflect the hard work of our people during a challenging period as well as the success of our longstanding strategy to build a technology-enabled specialist banking group. We have delivered record half-year profits and go into the second half of 2021 with strong momentum, healthy new business pipelines and enhanced margins.

Our people continue to excel, maintaining both productivity and flexibility as we look to develop options for the future operating model of the Group. We look forward to the second half with strong capital ratios, prudent liquidity and with growing confidence as the UK emerges from the Covid crisis."

Financial highlights:

- Underlying profits increased 44.9% to a record high at the half-year of £82.9 million*
- Statutory profit before tax up 68.8% at £96.4 million (2020 H1: £57.1 million)
- Structural NIM enhancement resumed, up 3 basis points year-on-year to 232 basis points
- Underlying EPS increased 43.2% to 25.2 pence, while statutory EPS increased 66.5%*
- Capital base strengthened – CET1 now 16.0% (2020 H1: 14.4%)
- Impairment coverage ratio remains at 64 basis points, supported by higher post-model adjustments
- Interim dividend declared at 7.2p, being 50% of 2020's final dividend, in line with policy (2020 H1: nil)
- Share buy-back of up to £40.0 million announced

Operational highlights:

- New lending levels up 45.1% from H2 2020, now just below pre-pandemic run-rate
- Strong new business pipelines support momentum into the second half:
  - Buy-to-let pipeline up 17.3% from March 2020 at £0.93 billion
  - Development finance pipeline up 65.2% from March 2020 at £0.32 billion
- Retail savings deposits up 24.9% to £8.6 billion (2020 H1: £6.9 billion)

- First UK bank to issue a Green Capital Bond, replacing existing Tier-2 Bond. Total Capital Ratio 18.2% (2020 H1: 16.7%)

- Covid-related payment holidays reduced to negligible levels

- Further progress in digital platform change programme

* For underlying basis, see Appendix A

For further information, please contact:

Paragon Banking Group PLC
Nigel Terrington, Chief Executive
Richard Woodman, Chief Financial Officer
Tel: 0121 712 2000

Headland
Lucy Legh – 0778 857 7637
Del Jones – 0789 407 7816

The Group will be holding a meeting for sell-side analysts on 8 June 2021 at 9:30am, a recording of which will be available on the Group's website at www.paragonbankinggroup.co.uk/investors from 2:00pm. The presentation material will be available on the website from 7:00am on the same day.

Cautionary statement

Your attention is drawn to the cautionary statement set out at the end of this document.

OVERVIEW AND OUTLOOK

Overview

The six months to March 2021 saw a strong recovery in our trading volumes following the Covid-driven reductions in the second half of 2020, with the business trading efficiently through the latest lockdowns and restrictions. Volumes have increased, margins widened, and impairment charges reduced during the period. The Group's NIM has been widening over a number of years due to a changing business mix, stable yields and a developing savings deposit franchise. The loan portfolio has demonstrated strong resilience, but despite this, uncertainties remain about the prospects for SMEs and retail customers once Government Covid support schemes are unwound. The Group has therefore taken a prudent approach and as such impairment coverage levels have been maintained. Notwithstanding this continued cautious approach, the six months to March 2021 generated our highest ever interim operating profit.

Financial performance

Underlying profits (Appendix A) increased by 44.9% from £57.2 million in 2020 to £82.9 million in 2021. Total income rose 3.3%, net interest margin increased by 3 basis points to 232 basis points and costs increased by 5.3%. The higher share price has led to a normalisation of accruals for share-based remuneration which had been significantly reduced by Covid-related impacts last year.

Impairment coverage ratios remain at their 2020 year-end level (64 basis points), despite improvements in underlying modelled results. The approach to making post-model adjustments ('PMAs') to our IFRS 9 models has remained unchanged from the 2020 year-end position, however, an additional overlay has been added to reflect continued uncertainties. This resulted in an impairment charge of £6.0 million for the period, which compares to £30.0 million in the same period in 2020. The Board will keep the IFRS 9 models, PMAs and scenario weightings under review as the macro-economic position reflects the nature of the UK's emergence from the Covid period.

Fair value movements, which tend to zero over time, contributed a £13.5 million gain in the period, taking reported profit before tax to £96.4 million (68.8% higher than in 2020 H1).

Operational highlights

Whilst not fully recovering to pre-Covid levels, originations across the Group rose by 45.1% from their second half 2020 levels to £1.13 billion (2020 H1: £1.27 billion). Despite our risk appetite remaining tighter than pre-Covid levels throughout the six months, the period closed with strong new business pipelines in buy-to-let and development finance. These, coupled with a normalisation of risk appetites after the period end, support continued and increasing momentum into the second half.

Buy-to-let advances were 5.0% lower than the first half of 2020 at £714.9 million, although were 57.8% up on the second half of that year, with the period end pipeline rising 17.3% from its March 2020 level to £926.7 million.

OVERVIEW AND OUTLOOK

Our buy-to-let portfolio increased by 4.7% year-on-year to £10.9 billion as redemptions fell 8.6% to £359.2 million, representing an annualised attrition rate of 6.8% (2020 H1: 7.8%) as customer retention rates continued to improve.

Within the Commercial Lending division, motor, SME and structured lending volumes all fell year-on-year as they adapted to the pandemic in different ways. Development finance, which was less affected by the lockdowns, saw volumes grow 16.0% to £229.5 million and had a strong pipeline at 31 March 2021.

Credit and payment holidays

We have seen no material arrears or write-off changes in our various business lines since the 2020 year end and each portfolio is demonstrating improved behavioural scores when compared to March 2020. Approximately £40 million of customer balances remain subject to payment holidays, compared to £2.5 billion at the peak in 2020. The loan-to-value position of the buy-to-let portfolio continues to improve, reflecting strong house price appreciation since September 2020. The average loan-to-value has fallen to 64.4% from 67.7% in March 2020 and the loans with balances above 80% now represent just 2.9% of the book compared to 8.6% a year earlier.

Capital and funding

Paragon's strong savings deposit growth has been maintained, at increasingly attractive pricing, underpinning the margin improvement in the period and fully unwinding the adverse impacts of the 2020 base rate reductions. We remain excited about the development of the savings franchise and our potential to reduce the premium paid for deposit costs relative to the big UK banks.

We have also continued to refinance our legacy securitisations and fully retain new transactions, utilising the collateral created to support drawings on the Bank of England's TFSME programme. At the same time the original TFS drawings have largely been refinanced.

In March 2021, Fitch reaffirmed our corporate rating at BBB, and we were the first UK bank to see Fitch remove the negative watch comment. This had been added for all UK banks at the onset of the Covid pandemic.

During March, we became the first UK bank to issue a Green Capital Bond, demonstrating our commitment to sustainable finance. This replaced our existing Tier-2 Bond, which reaches its call date in September 2021. We believe the 2.875% reduction in the interest rate provides good evidence of the debt markets' increased confidence in our franchise, risk, diversification and strong financial position.

In addition to the recovery in earnings growth, a reduction in the deficit on our defined benefit pension scheme and risk weight reductions from refinancing legacy securitisations have also contributed to an increase in our CET1 ratio to 16.0% (2020 H1: 14.4%). Our total capital ratio has increased to 18.2%, and both ratios reflect an accrual for a 7.2 pence per share interim dividend, being half the level of the final dividend for 2020. This capital strength has also supported our decision to announce a share buy-back of up to £40.0 million.

OVERVIEW AND OUTLOOK

During the period we received the outcome from the 2020 capital review process ('C-SREP') undertaken by the PRA, which saw our Pillar 2A requirement falling to 0.86% at 31 March 2021 (31 March 2020: 2.96%). The surplus over our regulatory capital requirement exceeded £0.4 billion at the period end.

Our IRB process continues, with the Phase 2 documents for our buy-to-let application currently with the PRA for review.

Operational management

Whilst our people have largely worked from home during the reporting period, we have started a number of pilot exercises to determine the best way for Paragon to operate in the future, aimed at optimising the relationship between flexibility for our people and operational control and efficiency. We do not believe there will be a one-size-fits-all solution, and plan to update the market on our progress with our full-year results announcement.

Sustainability

In addition to issuing our first Green Bond and embedding its associated reporting framework, we have made further progress in rolling out sustainable products during the period. These initially focus on our largest asset class, buy-to-let, and include initiatives such as further advances for improving energy efficiency in homes in the private rented sector and increasing loan-to-value limits for the most efficient properties.

Technology

To support our growing business franchises, the Group has commenced a multi-year series of incremental development programmes to significantly enhance customer and intermediary engagement, thereby improving accessibility. In our retail deposit operation, we on-boarded the Mambu system during the period. This provides a digital cloud-based capability that we will use to supplement our existing systems and provide optionality as the savings market becomes increasingly digitised. Our replacement digital SME origination system is currently operating in pilot-mode, and we anticipate a full roll-out of this tech-enabled approach later in the year, together with upgraded development finance systems. The delivery of business-improving change projects, alongside growing organic activity, is a testament to the efforts and capabilities of our people. Investment in new digital capabilities to improve the customer journey and experience, as well as improving efficiency and enhancing decision-making processes, forms a crucial element of our strategy.

OVERVIEW AND OUTLOOK

Outlook

The strong performance in the first half of the year reflects the resilience of the business model both financially and operationally as the economy recovers from the Covid pandemic, with the Group being prudently provisioned should further macro shocks occur. The markets in which we operate have seen healthy quarter-on-quarter improvements in activity and our business has been building momentum, whilst maintaining our traditional prudent risk appetite. The Group has a strong capital base, high levels of liquidity and is well-positioned to capitalise on any opportunities that may emerge in the future. The Group is prudently managed and we continue to explore opportunities to develop the business further, building on the established strategy of a diversified and increasingly technology-enabled specialist bank.

INTERIM MANAGEMENT REPORT

1. BUSINESS 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 2021 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 2021 £m	Six months ended 31 March 2020 £m	Year ended 30 September 2020 £m	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m
Mortgage Lending	724.6	792.8	1,259.7	11,130.6	10,676.1	10,819.5
Commercial Lending	401.7	481.3	790.8	1,427.1	1,494.3	1,514.8
Idem Capital	-	-	-	258.6	335.7	297.1
	1,126.3	1,274.1	2,050.5	12,816.3	12,506.1	12,631.4

The first six months of the financial year have seen a 1.5% growth in the total loan book with a 2.5% year-on-year increase. This increase was despite the continuing impact of Covid on the UK economy. New advances were lower than their level in the comparative period but saw a 45.1% increase compared to the second half of the 2020 financial year as the impacts of the pandemic began to ease.

1.1 MORTGAGE LENDING

The core products of the Group's Mortgage Lending division are buy-to-let residential property mortgages, targeted at specialist landlords in the UK. During the period the Group also offered limited numbers of owner-occupied first and second charge mortgages on residential property. However, following the period end it withdrew from the second charge market entirely, to increase its buy-to-let focus. In all its offerings, the Group targets niche markets where its focus on detailed case-by-case underwriting and its robust and informed approach to property risk differentiate it from both mass market and other specialist lenders.

INTERIM MANAGEMENT REPORT

1. BUSINESS REVIEW

Housing and mortgage market

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

Despite this adverse climate, transaction volumes improved considerably with HM Land Registry reporting 775,000 residential property transactions in the six months, compared to 416,000 in the preceding half year. At the extreme, April 2020 saw 37,000 transactions, which had increased to 181,000 in March 2021. In their March 2021 Residential Market Survey RICS also note increased activity levels in the market and a positive outlook for property sales.

House prices rose steadily in the period, in contrast to the previous expectations of some forecasters, with the Nationwide House Price Index recording a year-on-year improvement of 5.7% to March 2021. Both Nationwide and RICS are forecasting continuing growth in the short term, although some caution remains as to the medium-term outlook as reliefs unwind.

This pattern was reflected in the mortgage market, where the Bank of England reported new approvals of £157.7 billion in the six months ended 31 March 2021, a substantial increase on the £111.7 billion reported for the previous six months. Particularly high volumes were reported in the last quarter of the 2020 calendar year as the transaction backlog from the summer lockdown worked through the system.

Across the mortgage market arrears and possessions reported by UK Finance (‘UKF’) remain at historically low levels, with the continuing availability of Covid reliefs helping mortgage holders to avoid financial distress. Based on their research, published in May 2021, UKF have concluded that the availability of payment holidays has fulfilled the purpose of enabling borrowers to stay out of arrears through the pandemic.

INTERIM MANAGEMENT REPORT

1. BUSINESS REVIEW

The private rented sector ('PRS') and the buy-to-let mortgage market

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

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

The Group is amongst a small number of specialist lenders addressing this sector, which is underserved by many of the larger lenders and which has seen supply constrained through the pandemic.

New issuance of buy-to-let mortgages followed the trend in the wider mortgage market, responding to the property market as a whole. New advances reported by UKF, at £21.5 billion for the six months ended 31 March 2021, were 31.1% higher than for the previous half year (2020 H2: £16.4 billion). This increase was principally driven by increased levels of advances for house purchase which comprised 38% of the total, compared to 23% in the previous six months. The level of new buy-to-let remortgages remained relatively stable.

In the lettings market RICS, in its March 2021 UK Residential Market Survey, forecast increasing levels of tenant demand, outstripping supply and leading to upward pressure on rents, with an expectation of average increases of 3% over the next twelve months, which will benefit affordability and cash flows for the Group's landlord customers.

Sentiment within the landlord community is positive. Independent research carried out for the Group in the first quarter of the 2021 calendar year suggested that, for the first time in four years, the percentage of landlords intending to increase the size of their portfolio in the next twelve months was greater than the percentage intending to reduce their investment, by 19% against 17% respectively. Amongst larger scale landlords this sentiment was more pronounced, with the number planning expansion at around 30%.

At the same time in the Group's tracking of sentiment amongst mortgage intermediaries for the quarter ended March 2021, 47% of brokers reported demand for buy-to-let mortgages as 'strong' or 'very strong', with only 12% reporting 'weak' or 'very weak' demand.

The UKF analysis of arrears and possessions published in May 2021 also provided analysis of buy-to-let cases, showing a similar picture to the wider mortgage market, with a significant uptake of payment holidays serving to keep arrears and possessions low, even nine months after these reliefs first became available.

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

1. BUSINESS REVIEW

Lending activity

The primary mortgage lending activity of the Group continues to be the provision of buy-to-let mortgages to specialist landlord customers. While the Group does provide other product types within the buy-to-let market and beyond, these are largely ancillary to the main thrust of lending. Consequently, the main focus of the division's lending operations through Covid has been in supporting its buy-to-let specialist customers.

The total amounts of the division's lending in the six month period are set out below.

	Six months ended 31 March 2021 £m	Six months ended 31 March 2020 £m	Year ended 30 September 2020 £m
Specialist buy-to-let	686.2	694.6	1,119.0
Simple buy-to-let	28.7	57.8	86.4
Total buy-to-let	714.9	752.4	1,205.4
Owner-occupied	1.0	0.3	0.3
Second charge	8.7	40.1	54.0
	724.6	792.8	1,259.7

Total lending in the segment declined by only 8.6% compared to the same period in the previous financial year, which was only impacted by Covid to a limited extent. Mortgage lending in the period was 55.2% higher than in the second half of 2020, as the property market began to recover, despite the ongoing Covid-based restrictions.

Buy-to-let

Buy-to-let lending overall fell by 5.0%, year-on-year, with specialist lending falling only 1.2%, despite the impact of Covid, particularly around the turn of the year. Volumes strengthened towards the end of the period, with the new business pipeline closing at £926.7 million, 17.3% higher than a year earlier (30 September 2020: £868.1 million, 31 March 2020: £789.8 million). Restrictions in lending imposed during the pandemic had all been reversed by the end of the period, with further developments introduced, helping to drive volumes.

Almost all of this pipeline (97.0%) related to specialist business (31 March 2020: 92.9%). With a more promising economic outlook for the UK and for the housing market in particular, prospects for the conversion of pipeline cases to actual loans also look more promising than at 31 March 2020. When coupled with the higher overall pipeline, this is likely to deliver strong volumes going into the second half of the financial year.

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1. BUSINESS REVIEW

Specialist intermediaries are the principal source of the Group's buy-to-let business, and it continues to develop its service proposition to ensure its business partners receive the service levels that they require. Regular research is carried out to monitor satisfaction levels and during the period this showed that 88% were satisfied with the ease of obtaining a response from the Group (2020 H1: 91%, 2020 full year: 91%), delivering a net promoter score at offer stage of +46 (2020 H1: +65, 2020 full year: +56), despite the impact of Covid. This drop is at least partly attributable to a sharp increase in applications ahead of the anticipated end of stamp duty relief and a desire from intermediaries for a particularly rapid response to beat the expected cut-off date.

The Group's relationship with its intermediaries was enhanced by its response to the pandemic, with research in the period finding that 66% of the intermediaries who responded believed that its response to the Covid crisis was better than that of other lenders (2020 H2: 70%).

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

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

During the period the Group launched its first range of green buy-to-let mortgages. These market-leading products have a maximum 80% loan-to-value ratio and are restricted to properties with an Energy Performance Certificate ('EPC') rating of C or higher. Green further advance products are also available on a similar basis.

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

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

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The Group's latest analysis identified EPC grades for 87.6% of its mortgage book by value at 31 March 2021 (30 September 2020: 85.1%). Of these 98.0% were graded E or higher (30 September 2020: 98.1%) with 36.8% rated A, B or C (30 September 2020: 37.7%). The slight reductions are principally a result of refining the data, with 39.7% of new originations in the six months having one of the top three grades (90.3% coverage).

The Group also monitors the potential physical risks to security values arising from climate change. This includes the assessment of a property's flood risk as part of the underwriting process. At 31 March 2021 approximately 2.3% by number of properties securing the Group's buy-to-let mortgages in England and Wales were considered to be at medium or high risk of flooding from the sea or rivers, based on data from the Environment Agency (30 September 2020: 2.2%).

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

The business is currently working with the Green Finance Institute on a number of industry initiatives to develop standards for mortgage products which would encourage energy and carbon efficiency for the future, and this work continues to inform the development of the Group's own buy-to-let product range.

Other lending

The division's other first and second charge mortgage lending is generally ancillary to the main buy-to-let focus and is carefully managed to ensure that only lending with appropriate risks and returns is undertaken, and that such lending provides an appropriate return on the Group's capital.

Lending in the Group's second charge mortgage operation was scaled back in summer 2020 in response to Covid, with people transferred to provide support to other business areas, and lending remaining low in the half year. Completions in the half year were £8.7 million compared to £40.1 million in the first half of 2020, and £13.9 million in the second half of that financial year. The Group took this opportunity to review the long-term strategic potential of second charge lending in light of its capital requirements and the Group's overall risk appetite and announced its withdrawal from this market in May 2021. Pipeline cases will generate a modest level of completions in the second half of the financial year.

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

1. BUSINESS REVIEW

Performance

The outstanding first and second charge mortgage balances in the segment at 31 March 2021 are set out below, analysed by business line.

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m
Post-2010 assets			
Buy-to-let	6,702.9	5,926.5	6,202.5
Owner-occupied	42.0	58.8	51.2
Second charge	168.6	186.2	182.6
	6,913.5	6,171.5	6,436.3
Legacy assets			
Buy-to-let	4,216.1	4,502.6	4,381.3
Owner-occupied	1.0	2.0	1.9
	11,130.6	10,676.1	10,819.5

Balances within the mortgage portfolio have continued to increase steadily. At 31 March 2021 loan balances in the division were 4.3% higher than a year earlier. Within this balance the overall buy-to-let portfolio had increased 4.7% year-on-year to £10,919.0 million (30 September 2020: £10,583.8 million, 31 March 2020: £10,429.1 million), with post-2010 originated assets now representing 61.4% of the total (31 March 2020: 56.8%).

The annualised redemption rate on buy-to-let mortgage assets remained stable in the six months to 31 March 2021 at 6.8% (2020 H1: 7.8%, 2020 Full Year: 6.6%). While this low level of redemptions may be attributable in some part to the Covid crisis, it maintains a pre-pandemic trend generated by the Group's careful management of its customer base as accounts reach the end of their fixed rate period.

Since March 2020, payment reliefs have been granted to 14,006 of the Group's buy-to-let accounts, with 5,347 of these requiring an extension. At 31 March 2021 only 270 accounts remain on payment relief, representing 0.4% of the book by number.

Arrears on the buy-to-let book remained low and broadly stable in the six months at 0.22%, despite the expiry of payment holiday arrangements (30 September 2020: 0.15%, 31 March 2020: 0.16%). These arrears remain very low compared to performance in the national buy-to-let market, with UKF reporting arrears of 0.54% across the sector at 31 March 2021 (30 September 2020: 0.52%, 31 March 2020: 0.41%).

While the performance metrics of the buy-to-let mortgage portfolio have remained positive throughout the period, the extent to which these have been influenced by UK Government interventions, such as furlough payments and other income supports underpinning tenant rental payments, funding from government-backed loan schemes accessed by landlords and the stamp duty holiday, cannot be established from data available. Therefore, the long-term prospects for the book, once these initiatives begin to be withdrawn remains subject to a significant level of uncertainty.

INTERIM MANAGEMENT REPORT

1. BUSINESS REVIEW

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

The loan-to-value coverage in the Group's buy-to-let book, at 64.4% (31 March 2020: 67.7%) provides a considerable buffer in the event of default. The levels of interest cover and stressed affordability in the portfolio suggest that its customers are also well placed to manage Covid-related impacts on their businesses in the longer term.

Second charge mortgage arrears increased marginally to 1.00% (31 March 2020: 0.51%, 30 September 2020: 0.62%) as the book continued to season, with performance remaining satisfactory. In the second charge portfolio 525 payment reliefs were granted, of which 281 were extended. At 31 March 2021, 37 of these accounts remain on payment relief, 1.3% of the accounts in that portfolio.

The Group continues to operate a receiver of rent process for buy-to-let assets, which helps to reduce the level of loss incurred by both it and, in turn, its landlord customers. This process gives the Group direct access to the rental flows from the underlying properties, while allowing tenants to stay in their homes. At 31 March 2021, 557 properties were managed by a receiver on the customer's behalf, a year-on-year reduction of 14.0% (31 March 2020: 648 properties). Almost of the current receivership arrangements relate to pre-2010 lending, with cases being resolved on a long-term basis to ensure the best outcome for the Group, its customers and their tenants. There were relatively low numbers of cases entering receivership in the period.

Outlook

While the division's performance was affected by Covid in the half year, the buy-to-let mortgage portfolio continued to grow, and credit quality remained strong. The business enters the second half of the year with a record pipeline and growing momentum and with enhancements to its proposition due to come on stream. At the same time, the combination of increasing transaction volumes, strong tenant demand and rental yields and positive landlord and broker sentiment point to a positive outlook in the Group's target market.

The Mortgage Lending business is well placed to accelerate out of the pandemic and generate high quality assets and returns for the Group, while contributing to the development and renewal of the nation's housing stock.

INTERIM MANAGEMENT REPORT

1. BUSINESS REVIEW

1.2 COMMERCIAL LENDING

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

The four major strands of the business comprise:

- 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 market

Within these sectors the Group's strategy 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.

In each of its markets the division's competitors are principally small banks and similarly 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 operates through specialist teams in each business area, with a common focus on credit standards, customer service, asset appraisal and collections and recovery linking the operations strategically.

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

The Group has provided CBILS and BBLS loans, primarily to existing customers, and has also been accredited to provide loans under the new Recovery Loans Scheme ('RLS') with RLS lending commencing in the second half of the financial year.

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

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

1. BUSINESS REVIEW

Lending activity

During the period, lending levels across the majority of the Commercial Lending business lines began to recover from the impact of Covid seen in the second half of 2020. While new business levels outside development finance had not recovered to the levels seen in the first half of the 2020 financial year, volumes in most areas had grown significantly from those seen in the six months ended 30 September 2020. Recovery was slowed by the impact of the second UK lockdown, which saw volumes particularly depressed in January and February 2021, though activity in March 2021 began to strengthen considerably.

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

	Six months ended 31 March 2021 £m	Six months ended 31 March 2020 £m	Year ended 30 September 2020 £m
SME lending	155.5	200.7	288.0
Development finance	229.5	197.8	385.3
Structured lending	(12.1)	8.0	7.6
Motor finance	28.8	74.8	109.9
	401.7	481.3	790.8

As a result of this new business, and the amortisation of the existing loan book, the overall Commercial Lending balance declined by 5.2% in the period since the last year end.

SME lending

The SME lending business contributed a solid performance in the face of Covid-related constraints through the first half of the financial year, with certain business lines particularly affected by either reduced economic activity, logistical difficulties in equipment sourcing, payment deferrals reducing the need for finance or the availability of cost-effective CBILS and BBLS funding. Lending strengthened considerably towards the end of the period, with March seeing the highest level of applications since the impact of Covid and momentum building.

Overall, advances fell by 22.5% compared to the six months ended 31 March 2020, which was largely before the impact of Covid was felt. Compared to the six months ended 30 September 2020, however, advances increased by 78.1% as markets began to reopen and business confidence began to increase.

INTERIM MANAGEMENT REPORT

1. BUSINESS REVIEW

In the division's core asset leasing business volumes reduced by 14.5% to £106.9 million, compared to the comparative period (2020 H1: £125.0 million). This reflects the performance of the asset finance market in general, with the Finance and Leasing Association ('FLA') continuing to report depressed volumes through most of the period. Almost 15% of the Group's new asset leasing business was supported through CBILS, demonstrating the scheme's effectiveness. This level of business represents a significant recovery from the £41.1 million of new lending recorded in the second half of the 2020 financial year, boosted by an increase in confidence and a return to more normal activity levels in the operation's target industries, such as construction. Investment in operating leases has also continued with £4.6 million of assets acquired in the period (2020 H1: £7.2 million, 2020 full year: £12.9 million).

During the period, the Group has continued to advance loans under the UK Government-sponsored British Business Bank's CBILS and BBLS programmes to support SMEs potentially affected by the Covid pandemic. In the six months ended 31 March 2021 £26.3 million was advanced under these schemes (2020 H2: £25.9 million), backed by a government guarantee, of which £14.6 million was asset leasing business. The Group is aware of the widely-reported abuses of these schemes but has not so far been impacted itself. It continues to closely monitor its portfolio for any adverse indications.

After 31 March 2021 no new CBILS or BBLS loan applications can be accepted, but at the closing date the Group had a pipeline of loans which can still be completed in the second half year. The Group has been authorised to participate in the follow-on RLS programme, with products launched in April 2021. As with CBILS lending, RLS loans will have the benefit of an 80% government guarantee (after the proceeds of any business assets are applied for leasing balances), but unlike in CBILS lending customers will be required to meet interest payments from the outset of the loan. The Group expects to use the RLS to provide support to SME customers until 31 December 2021, the currently expected end date of the scheme.

Short-term lending to professional services firms outside the government supported schemes fell by 59.3% to £28.6 million (2020 H1: £70.2 million). This resulted from both the deferral of tax balances, where customers had customarily taken out short term loans to spread the impact, and of the wide availability of cheap CBILS and BBLS lending in the market. The availability of CBILS and BBLS also depressed other unsecured SME lending volumes. However, these are short-term effects and the underlying requirement for finance remains in the longer term.

The Group's programme of investment in the generation of system improvements and efficiency gains in this business continued despite the pandemic, with enhancements to the new lending process rolled out in April, offering improvements to customers and brokers. These included the launch of a new broker portal, providing enhanced functionality to business introducers. This programme will continue through the year enhancing controls, operational agility and the customer experience.

With the most recent forecasts from the FLA anticipating a recovery in asset finance lending over the second half of the financial year, the division's new business pipeline strengthening and system developments coming on line, the Group is optimistic for the businesses continuing recovery from the pandemic and its future growth prospects.

INTERIM MANAGEMENT REPORT

1. BUSINESS REVIEW

Development finance

The Group's activity in the development finance market remained robust throughout the period, although the restrictions imposed as a result of the Covid pandemic meant that many projects progressed more slowly than they might have done in normal times. This has, however created an element of pent-up demand moving into the second half of the financial year with advances, pipeline and enquiries all building through March into the new period. Market sentiment appears positive with developers generally optimistic about the future.

The Group's target customer in this market is a small to medium-sized developer of UK residential property. Projects currently in progress have an average development value of £7.8 million against which the Group has extended average facilities of £4.6 million, giving a substantial level of security cover. These projects are generally focussed on the more liquid parts of the residential market (houses and smaller blocks of flats), avoiding developments with high unit values.

While the business has been historically concentrated in the English Home Counties, with 66.3% of balances at 31 March 2021 (30 September 2020: 67.0%) located in London and the South East, the Group's strategic objective is to lend more widely across the UK. Central London property hot-spots have generally been avoided with less than 6% of the balance located in this area.

The Group has recently expanded its range of offerings to include projects in the £400,000 to £1,000,000 range, widening its potential market to include smaller, growing developers as they expand their businesses as well as expanding options for existing customers. It also reintroduced lending of up to 70% of total development value for the highest quality propositions. Together these will expand the range of projects the business is able to consider.

In order to protect its investments, the Group engages independent monitoring surveyors to review project progress and costs on a regular basis through the build phase of each project. The resilience of the Group's customers through the most recent phase of the Covid pandemic has been impressive with delays minimised and completed projects being taken to market.

During the latter part of the period, the volume of new proposals being received increased steadily, with the increased amount of undrawn approvals at the period end likely to lead to a positive start to the second half of the financial year. Undrawn amounts on live facilities at 31 March 2021 at £402.0 million were 5.5% higher than at the year end (30 September 2020: £380.9 million, 31 March 2020: £343.2 million) while the post-offer pipeline of £207.7 million was 21.2% higher (30 September 2020: £171.5 million).

Throughout the period the business invested in both people and systems, while increasing its national and regional coverage with the recruitment of experienced specialist relationship directors and portfolio managers. These initiatives will support the further growth of the business going forward. With the UK Government setting a target of at least 300,000 new homes completed each year and current building levels some 50,000 less than this, there is a clear need for the Group's customers to address this shortfall with its support.

INTERIM MANAGEMENT REPORT

1. BUSINESS REVIEW

The performance of the Group's development finance operation through the pandemic has demonstrated the attractiveness of the proposition going forward. The need for new housing in the UK will continue into the future and smaller developers, who may struggle with credit availability, will be called on to supply much of this demand. Sentiment in the market looks positive entering the second half of the financial year and the Group's business model, its investment in systems and people and the developments in its product range mean it is well-placed to support the aspirations of its developer customers going forward and to help support housing provision across the country.

Structured lending

The Group's structured lending exposure has reduced in the period, with one facility terminating and drawings on others reduced as a result of lower levels of business activity due to Covid. No new facilities were completed in the period, but the Group continues to explore further opportunities in this field.

Structured lending facilities 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, with first loss cover of at least 20% for all current cases. The impact of Covid has varied facility by facility, but the Group's experienced account managers have received regular reporting on the performance of security assets and maintained a high level of contact with the Group's customers throughout the crisis in order to safeguard its position.

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

Motor finance

Within the motor finance market the Group carefully targets its offerings on those specialist propositions which are not addressed by mass-market lenders, including specialist makes and vehicle types, such as light commercial vehicles, motorhomes and caravans. Levels of activity in the automotive market remained subdued in the period, with UK lockdowns impacting the markets for both new and used vehicles after a short-lived recovery in the last quarter of the 2020 financial year.

The Group's advances continued to decline with £28.8 million of completions, down 17.9% from the £35.1 million achieved in the second half of 2020 and far below the £74.8 million achieved in the six months ended 31 March 2020. This performance follows that of the wider motor finance market, with the FLA reporting falling volumes until February 2021, before a recovery beginning to take hold in March. It also reflects the Group's decision to tighten lending criteria and temporarily divert resources from the new business teams in the area to support the wider Group's customer servicing requirements through the pandemic, including the provision of payment reliefs.

1. BUSINESS REVIEW

Following the relaxation of UK lockdown restrictions, prospects for the second half of the year appear more positive as dealerships open for business, and economic activity in general increases. The Group is renewing its focus on its motor finance business to take advantage of this, with seconded teams returning to their roles in the motor finance new business area.

Performance

The loans within the Commercial Lending division, analysed by product type are set out below.

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m
Asset leasing	467.8	513.4	478.0
Professions finance	27.9	49.9	22.3
CBILS and BBLS	50.1	-	25.2
Invoice finance	14.3	20.6	13.5
Unsecured business lending	11.7	22.7	15.0
Total SME lending	571.8	606.6	554.0
Development finance	552.3	502.3	609.0
Structured lending	82.6	95.0	94.9
Motor finance	220.4	290.4	256.9
	1,427.1	1,494.3	1,514.8

The size of the Commercial Lending book reduced by 5.8% in the six months, principally as a result of restricted activity in some of the division's business lines through the winter lockdowns and the shorter term nature of some of the segment's products, leading to a more rapid run-off.

Credit quality in the development finance book remained good. Overall project progress remains in line with expectations and no significant impact on the disposal of completed developments has been noted. Accounts are regularly monitored and graded on a case-by-case basis by the Credit Risk function. At 31 March 2021 only two accounts had been identified as at risk of loss, both having been similarly identified at 30 September 2020.

While no Covid-specific credit concerns have been identified to date on individual development finance accounts, the Group recognises the potential impact of the current level of economic uncertainty, including the potential impact of the end of Stamp Duty relief on the property market, and execution risk on its portfolio. The Group continues to monitor these issues closely as they develop. The average loan to gross development value for the portfolio at the period end, a measure of security cover, was 62.4% (30 September 2020: 63.1%, 31 March 2020: 64.7%). This gives the Group a significant credit buffer if any of the projects encounter issues, either as a result of the pandemic or for any other reason.

1. BUSINESS REVIEW

Arrears in the division's finance leasing portfolios remain stable, even with the cessation of the majority of payment reliefs. Arrears on asset leasing business at 31 March 2021 stood at 0.86% (30 September 2020: 1.75%, 31 March 2020: 0.27%) and with those on the motor finance book at 2.25% (30 September 2020: 1.76%, 31 March 2020: 1.32%).

Since March 2020, payment reliefs have been granted to 3,061 of the division's asset finance customers, however only 333 required an extension. At 31 March 2021 only 54 accounts remain on payment relief, representing 0.7% of the book by number. In the motor finance portfolio 1,918 payment reliefs were granted, of which 376 were extended. At 31 March 2021, 96 accounts remain on payment relief, 0.6% of all accounts by number.

Up to the period end all CBILS and BBLS lending remained in its initial twelve-month period where interest payments were met by the UK Government. Payments from customers will begin to fall due in the second half of the financial year and the Group has appropriate systems, processes and resource in place to deal with any issues as they arise. Any emerging payment behaviours will be kept under close scrutiny.

For structured lending accounts, the Group carefully monitors the performance of the underlying asset pool on a monthly basis, to ensure its security is adequate. Performance in the half year has been in line with expectations, with a number of facilities showing improved metrics and with one facility previously assigned to IFRS 9 Stage 2 returning to Stage 1 and another redeeming at par.

Outlook

The Commercial Lending division has experienced a challenging twelve months, along with the rest of the UK economy. However, looking forward, sentiment in each of its markets is positive and there are signs of recovering activity levels, both for the Group and its markets more generally.

Work to develop the division's products and proposition have continued throughout the pandemic period and the business is well placed to take advantage of the post-Covid recovery with an increased business pipeline and momentum building.

INTERIM MANAGEMENT REPORT

1. BUSINESS REVIEW

1.3 IDEM CAPITAL

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

When considering portfolios for acquisition the Group currently focusses on those specialist loan portfolios which can augment the organic origination activities of the Group.

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

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

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

New business

Although the UK loan portfolio market remained active in the period, the impact of Covid significantly reduced activity levels, and complicated the pricing and execution of potential deals, discouraging vendors from coming to market. This was particularly the case for the more complex opportunities in which the Group would ordinarily be interested.

During the period, no portfolio acquisitions were completed (2020 H1: none) although the division considered a limited number of reviews of opportunities that were ultimately not progressed.

The main focus of the business throughout the six month period was the careful management of its existing books and ensuring that appropriate processes and systems remained in place to address the impact of the Covid outbreak on its customers, particularly those who are vulnerable or who have developed vulnerabilities as a result of the ongoing pandemic.

1. BUSINESS REVIEW

Performance

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

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m
Second charge mortgage loans	151.6	191.0	171.9
Unsecured consumer loans	98.1	120.3	109.7
Motor finance	8.9	24.4	15.5
	258.6	335.7	297.1

With no portfolios acquired in the period, balances in the division's loan books have continued to decline in the period as customers pay down their accounts. 120 month Estimated Remaining Collections on the segment's acquired consumer assets, which measures forecast undiscounted receipts, reduced to £260.1 million at 31 March 2021 from £324.6 million a year earlier, as the portfolios amortised.

Payment performance in the segment remained steady, with no further significant impacts from the ongoing Covid lockdowns.

Arrears on the segment's secured lending business continued to move marginally higher, in line with recent performance at 20.2% (30 September 2020: 18.8%, 31 March 2020: 18.0%). This is an inevitable result of the structure of these portfolios, which include accounts which were making full payments in the period but may have missed payments in the past, and where fully up-to-date accounts are more likely to redeem.

Over the course of the pandemic, payment reliefs were granted to 1,356 of the division's second charge customers, with 744 of these extended. At 31 March 2021 only 62 accounts remain on payment relief, representing only 0.6% of the book. In the motor finance portfolio 697 payment reliefs were granted, of which 177 were extended. At 31 March 2021, 33 accounts remain on payment relief, 0.7% of the total number.

None of the individual Idem Capital purchased loan portfolios were considered as underperforming in the period. The Group monitors actual cash receipts from acquired portfolios against those forecast in the evaluation which informed the purchase price. Up to 31 March 2021, such collections were 110.0% of those forecast to that point (30 September 2020: 109.8%, 31 March 2020: 109.1%), demonstrating the stability in cash flow from these portfolios.

The Group continues to invest in systems and people to ensure that these loans are serviced efficiently and effectively, and that appropriate customer outcomes are achieved, particularly for vulnerable customers.

1. BUSINESS REVIEW

Outlook

The Group will continue to consider portfolio acquisitions where these enhance its overall positioning, provide attractive returns and represent a productive use of capital. There is no requirement for the business to chase volumes and the Group is prepared to wait for appropriate opportunities to arise.

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

2. FUNDING REVIEW

The Group is principally funded by its retail deposit taking operation but also accesses a variety of other funding sources. This ensures that its funding position is both adaptable and sustainable as the business and its operating environment develop. This approach ensures that the Group can access cost-effective funding despite issues in any particular funding market, as well as raising funding for strategic initiatives on a timely basis.

During the period the Group continued to develop its funding position despite the ongoing impact of Covid. The deposit book has grown, with additional channels to market being added, maturing wholesale borrowings have been refinanced and the Group's first green bond has been issued. In addition, central bank funding has continued to be accessed to support SME lending.

The Group's funding at 31 March 2021 is summarised below.

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m
Retail deposit balances	8,631.2	6,911.9	7,856.6
Securitised and warehouse funding	2,767.0	4,766.5	3,928.3
Central bank facilities	2,244.4	1,199.4	1,854.4
Tier-2 and retail bonds	405.3	446.3	446.6
Repurchase agreements	50.0	-	-
Total on balance sheet funding	14,097.9	13,324.1	14,085.9
Off balance sheet central bank facilities	-	109.0	-
Other off balance sheet liquidity facilities	150.0	150.0	150.0
	14,247.9	13,583.1	14,235.9

The Group's funding balance has continued to move towards the retail savings market in the period, with an increase of 9.9% in retail deposits and further retirements of legacy securitisation arrangements. At the end of the period retail deposits had grown to form 61.2% of all on balance sheet funding (30 September 2020: 55.8%, 31 March 2020: 51.9%).

The Group has continued to maintain a prudent stance on liquidity through the period, with £1,895.1 million of cash available for liquidity and other purposes at 31 March 2021 (30 September 2020: £1,701.1 million, 31 March 2020: £915.6 million). The appropriate level of cash reserves continues to be monitored as part of the Group's capital and liquidity strategy, which will continue to take a conservative view of the economic outlook, including the future progress of the pandemic.

The Group's response to the expected withdrawal of LIBOR at the end of the calendar year is well progressed. While LIBOR had been the principal benchmark rate used by the Group, a transition to other, risk-free rates, notably rates linked to SONIA, has been ongoing for more than two years.

2. FUNDING REVIEW

No new LIBOR-linked derivative contracts have been entered into since February 2020 and remaining LIBOR-linked derivatives will transition to SONIA in accordance with the ISDA protocol. Meanwhile, the majority of the Group's LIBOR-linked borrowings have either been retired, transitioned or have an agreed transition process in place. A transition methodology for the Group's principal LIBOR-linked asset class, legacy buy-to-let mortgages, has been agreed and communicated to customers. Overall, the Group considers that it is well placed to meet the withdrawal deadline of 31 December 2021.

2.1 RETAIL DEPOSITS

The retail deposit market in the UK is large, deep and well developed. The Group considers it to be a reliable, scalable and cost-effective source of funding, which has remained fully functional throughout the Covid crisis. The Group's offering is centred on sterling household deposits and offers a variety of products including term deposits, ISAs and easy access accounts through a variety of in-house and external channels. The savings proposition is based on competitive rates and value for money, combined with the Group's strong customer service ethic and the protection provided to depositors by the Financial Services Compensation Scheme ('FSCS').

The cost of the Group's retail deposits have reduced in the period, reflecting both market trends and developments in the Group's proposition.

During the six months UK household savings balances reported by the Bank of England continued to increase with balances at 31 March 2021 reaching £1,364.0 billion, an increase of 5.9% in the period and an increase of 9.7% year-on-year. This has resulted from increased saving by consumers during the pandemic and has influenced market interest rates. Some of this increase is likely to be reversed as the UK economy returns to a more normal footing, but as a small participant the Group is less likely to be affected by this than larger banks and building societies.

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

	Average interest rate		Proportion of deposits	
	31 March 2021 %	30 September 2020 %	31 March 2021 %	30 September 2020 %
Fixed rate deposits	1.46	1.69	61.5	63.3
Variable rate deposits	0.46	0.72	38.5	36.7
All balances	1.08	1.34	100.0	100.0

The average initial term of fixed rate deposits at 31 March 2021 remained stable at 26 months (30 September 2020: 27 months). The reduction in funding costs reflects both the development of the Group's proposition and new business channels coming on stream and reductions in market savings rates more generally. Bank of England data shows the quoted average rate for new two-year term deposits at 31 March 2021 at 33 basis points, down from 46 basis points at 30 September 2020, with market easy access rates remaining at 7 basis points.

2. FUNDING REVIEW

At 31 March 2021 the proportion of easy access deposits, which are repayable on demand, at 32.6%, increased a little from its level at the beginning of the period (30 September 2020: 30.0%). Easy Access accounts represent £2,817.9 million of the total deposit balance (30 September 2020: £2,359.6 million). This increase is partly a result of the development of the Group's liquidity management processes and strategy, but also a reluctance from savers to commit to longer-term deposits while rates on offer in the market remain low.

The Group has grown its business in the period both through a focus on its in-house channel and through expanding its reach across other platforms. Significant infrastructure investment has enabled it to expand the number of external channels where it has a presence while still providing an effective and efficient service to the third party providers.

Offerings through these third party channels, which include investment platforms and savings marketplaces operated by digital banks, provide access to a different customer demographic to the Group's mainstream customers. This more diversified sourcing offers enhanced opportunities to manage inflows and costs. The Group has added three new relationships in the period, including one with Aviva Savings, bringing the total to seven. These channels now represent around 11% of the total deposit base and the Group has capacity to expand further in this area.

The Group regards the quality of its customer service as a vital component of its savings market strategy and conducts insight surveys throughout the customer journey. In this research 86% of customers opening a savings account with the Group in the period, who provided data, stated that they would 'probably' or 'definitely' take a second product (2020 H1: 88%, 2020 full year: 88%). The net promoter score for new customers in the period was +50, a reduction from the +62 achieved in the first half of the preceding financial year, but still significantly positive (2020 full year: +61). The fall in the NPS is principally attributable to increased volumes generated by sudden sharp rate cuts by NS&I in September 2020 which led to large numbers of their customers seeking alternative investments. The Group's experience was common to many other deposit takers and NPS scores returned to more normal levels later in the period.

Of customers with maturing savings balances in the period, 89% stated that they would 'probably' or 'definitely' consider taking out a replacement product with the Group (2020 H1: 90%) with a net promoter score at maturity of +52, compared to +49 for the first half of the 2020 financial year (2020 full year: +50).

These responses show that the quality of the Group's customer interaction operations position it well to retain customers and deposits in an active and competitive market.

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

2. FUNDING REVIEW

The Group's savings infrastructure, including its outsourced deposit administration system and its infrastructure supporting external savings platforms, continues to provide a solid and scalable basis for the business. Service standards have been maintained despite the effects of ongoing Covid restrictions, and servicing resources have continued to develop with the business.

The retail deposit funding stream provides a stable principal funding base for the Group's operations where volumes and rates can be effectively and flexibly managed. The operation will continue to develop on a strategic basis, expanding its offerings, addressing wider demographics and expanding its presence on third party platforms. This increasing diversification and the FSCS guarantee are likely to reduce the potential for liquidity impacts and the Group's profiling of its target customers suggests they may be more resilient than average in the event of future economic stresses.

2.2 CENTRAL BANK FACILITIES

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

During the period the Group's drawings under TFSME increased to £2,025.0 million (30 September 2020: £910.0 million). The scheme remains open for further drawings until December 2021 and the Group anticipates making further use of it through the second half of the financial year. As TFSME provides funding at or very close to base rate, it is a particularly cost-effective form of borrowing for lenders which, like the Group, wish to support their SME customers through the economic uncertainties of the pandemic.

Drawings under the Bank of England's original Term Funding Scheme ('TFS') which were due to mature in the current financial year began to be retired early during the period, improving the maturity profile of the Group's borrowings. The remaining TFS borrowings provide £219.4 million of the Group's funding (30 September 2020: £944.4 million, 31 March 2020: £944.4 million), but will be repaid during the next twelve months. The Group retains access to other Bank of England funding channels but did not utilise them in the period.

The Group expects to continue to make use of these facilities going forward, in accordance with the objectives of the schemes. Where using them is appropriate and cost-effective, mortgage loans pre-positioned with the Bank of England are available to act as collateral for future drawings, if and when required. This provides access to potential liquidity or funding of up to £1,929.2 million.

2. FUNDING REVIEW

2.3 WHOLESALE FUNDING

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

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

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

The new bond carries an interest rate of 4.375%, fixed for five years, and will count in full towards tier 2 capital for a five year period. It was rated BB+ by Fitch on issue.

The majority of the Group's £150.0 million 2016 Tier-2 Bond, which bear interest at 7.25% per annum and would begin to be amortised for capital purposes from September 2021, were acquired by the Group in a tender process during March 2021. The remainder will be redeemed at their call date in September 2021.

These transactions have the overall effect of reducing funding costs and placing tier 2 capital on a longer-term footing, as well as accessing the green bond market.

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

Two mature legacy securitisation transactions have been refinanced during the period, with a third paid down shortly after the period end. Notice of repayment of the final pre-2010 securitisation transaction remaining on the Group's balance sheet, Paragon Mortgages (No. 14) PLC was given in May 2021 and this is expected to be paid down in June 2021.

The only other LIBOR-linked deal, Paragon Mortgages (No. 25) PLC, is expected to transition to SONIA before the year end on a basis set out in the original transaction documents.

These transactions benefit the Group's overall long-term funding position by releasing cash collateral; removing LIBOR-linked liabilities ahead of transition; crystallising derivative positions, thereby reducing the Group's TRE for capital purposes; and releasing loan assets for use in creating eligible securities which can be used to access TFSME and other forms of funding.

2. FUNDING REVIEW

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

The Group renegotiated its £400.0 million warehouse funding facility during the period reducing the interest margin from 1.05% above LIBOR to 0.60% above LIBOR. This facility is used to provide standby capability, particularly in the event of market disruption elsewhere, where funds need to be deployed rapidly or as an alternative to retail deposit funding for liquidity purposes. The reduced rate will make such funding more cost effective going forward. This borrowing is expected to transition to a SONIA-linked basis in the second half of the financial year, under a methodology already agreed with the counterparty.

The Group's retail bond issued in 2013 was repaid at maturity in December 2020. The Group also entered into a short-term £50.0 million sale and repurchase ('repo') transaction as part of its liquidity management activities, which was in place at the balance sheet date.

Overall, these activities reduced the Group's dependency on legacy securitisation debt while lowering funding costs and increasing average remaining maturities for its other borrowings. This demonstrates the adaptability of the Group's wholesale funding activities and the Group will continue to access all these funding sources on an opportunistic basis as appropriate.

2.4 SUMMARY

The Group's funding strategy has remained consistent through the period and it continues to develop its access to funds while maintaining its principal focus on the retail savings market. Activities in the period have seen maturing borrowings replaced, average rates improved and the green bond market accessed.

The Group is well placed to maintain this diverse, robust and adaptable strategy going forward and expects that this will enable the needs of its developing business into the future.

More details of these borrowings are given in note 15 to the financial information.

3. CAPITAL AND LIQUIDITY REVIEW

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

Coupled with a favourable result from the most recent regulatory review of the Group's capital position, this has meant that the Group has sufficient available resources to adopt a more normal capital and distribution policy going forward, and has announced both a resumption of the interim dividend and a share buy-back for the second half of the financial year.

For regulatory purposes the Group's capital comprises shareholders' equity and Tier-2 bonds, including the green bonds issued in the period. It has no outstanding AT1 issuance, but has the capacity to issue such securities, if considered appropriate, under an authority renewed by shareholders at the AGM held in February 2021.

3.1 REGULATORY CAPITAL

The Group has continued to maintain strong regulatory capital ratios throughout the period, with capital balances building as a result of its prudent approach to capital management through the Covid pandemic. During the period the PRA conducted a supervisory review of the Group's capital requirements, based on the ICAAP analysis. The results of this review were very positive, with the regulator sharply reducing its capital requirement based on its assessment of the Group's risk exposures and management systems.

The Group is subject to supervision by the PRA on a consolidated basis, as a group containing an authorised bank. As part of this supervision, the regulator sets a Total Capital Requirement ('TCR') which the Group must hold in order to safeguard depositors in the event of severe losses being incurred. This requirement includes elements determined based on the Group's Total Risk Exposure ('TRE') together with fixed elements. The TCR is defined under the international Basel III rules, which are currently implemented through the EU Capital Requirements Regulation and Directive ('CRD IV'), but are in the process of being transposed to the PRA Rulebook following Brexit.

Transitional relief on the adoption of IFRS 9 was granted to the Group, with the impact on capital of additional impairments being phased in over a five-year period, with only 30.0% of the effect being recognised in this, the second year (2020: 15.0%). Further measures were enacted in 2020 extending this relief to additional provisions created in that year in response to Covid.

3. CAPITAL AND LIQUIDITY REVIEW

The PRA requires firms to disclose capital measures both on the regulatory basis and as if these reliefs had not been given, referred to as the 'fully loaded' basis. The Group's principal capital measures, CET1 and Total Regulatory Capital ('TRC') are set out below on both bases.

	Regulatory basis			Fully loaded basis		
	31 March 2021	31 March 2020	30 September 2020	31 March 2021	31 March 2020	30 September 2020
	£m	£m	£m	£m	£m	£m
Capital						
CET1 capital	1,057.3	983.3	991.2	1,015.9	950.8	948.9
TRC	1,203.8	1,133.3	1,141.2	1,161.5	1,100.8	1,098.9
Requirement						
TCR	585.9	748.1	749.6	582.4	745.9	745.3

The Group's CET1 capital comprises its equity shareholders' funds, adjusted as required by the CRD IV rules and can be used for all capital purposes. TRC, in addition, includes tier 2 capital in the form of Tier-2 Bonds, including the green bonds issued in the period. This tier 2 capital can be used to meet up to 25% of the Group's TCR. The increase in both capital measures is driven by the positive trading performance over the six months.

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

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

The Group's CET1 capital must also cover the CRD IV buffers, the Counter-Cyclical ('CCyB') and Capital Conservation ('CCoB') buffers. These apply to all firms and are based on a percentage of TRE. During the period the CCoB remained at 2.5%, its long-term rate, while the CCyB remained at 0.0%, the rate set by regulators in response to the Covid pandemic. The long-term rate of the CCyB in normal circumstances is expected to be 2.0%. The capital requirement in respect of these CRD IV buffers reduced in the period to £165.4 million at 31 March 2021 (30 September 2020: £173.7 million) on the regulatory basis.

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

3. CAPITAL AND LIQUIDITY REVIEW

The Group's principal capital ratios on both bases, after allowing for the proposed interim dividend, are set out below.

	Regulatory basis			Fully loaded basis		
	31 March 2021	31 March 2020	30 September 2020	31 March 2021	31 March 2020	30 September 2020
CET1 Ratio	16.0%	14.4%	14.3%	15.5%	14.0%	13.7%
Total Capital Ratio	18.2%	16.7%	16.4%	17.7%	16.2%	15.9%
UK Leverage Ratio	7.7%	7.0%	7.1%	7.4%	6.8%	6.8%

All of the Group's ratios show strong improvement over the period. This reflects the impacts of profitable trading, a gain on the pension scheme liability, risk weighted asset reductions following the repackaging of legacy securitisations and a stabilisation of the IFRS 9 provision position.

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

The Group submitted the second stage of its application for the accreditation of its Internal Ratings Based ('IRB') approach to buy-to-let credit risk for capital adequacy purposes to the PRA in March 2021. The project continues to progress to plan and work will continue through the second half of the year.

3.2 LIQUIDITY

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

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

3. CAPITAL AND LIQUIDITY REVIEW

The LCR is a measure of short-term resilience which compares available highly liquid assets to forecast short-term outflows, calculated according to a prescribed formula, with a 30 day horizon. The monthly average of the Bank's LCR for the period was 175.8% compared to 162.0% during the first six months of the 2020 financial year, reflecting the steps taken during the second half of the 2020 year to enhance liquidity in response to the Covid pandemic (Year ended 30 September 2020: 173.7%).

The NSFR is a longer-term measure of liquidity with a one year horizon, supporting the management of balance sheet maturities. At 31 March 2021 the Bank's NSFR stood at 119.3% (30 September 2020: 114.7%, 31 March 2020: 115.2%), again reflecting the increases in the overall capital and liquidity position.

3.3 DIVIDEND AND DISTRIBUTION POLICY

The Group's dividend and distribution decisions in the 2020 financial year were dominated by the potential impact of the Covid pandemic. The strategic decision to build capital in response to the inherent risks posed by the virus meant that no interim dividend was declared for the year. At the 2020 year end a dividend was declared in line with the Group's stated policy of distributing around 40% of earnings to shareholders.

The Group has continued to manage its capital cautiously and has accumulated a capital and cash surplus over its requirements at 31 March 2021 to the level that it is considered appropriate to make distributions to its shareholders, both in the form of an interim dividend, and in a share buy-back, addressing the needs of different investor groups.

The Group's normal policy is that the interim dividend should, in normal circumstances, be equal to 50% of the preceding final dividend. Following a review of the capital position and forecasts, and considering the capital impacts of the stress testing carried out as part of the ICAAP and forecasting processes, the Board determined that a distribution in accordance with the Group's normal policy was appropriate.

It therefore declared an interim dividend for the year of 7.2 pence per share (2020 H1: nil), 50% of the 14.4p final dividend declared for 2020. This dividend will absorb £18.3 million of capital and will be paid on 23 July 2021 to shareholders on the register on 2 July 2021.

The directors have considered the distributable reserves of the Company and concluded that such a dividend is appropriate.

In addition, the Board has authorised a buyback of up to £40.0 million of shares in the market, initially to be held in treasury. The Group has the authority to make such purchases under a resolution approved by shareholders at the AGM in February 2021. Any purchases made under this programme will be announced through the Regulatory News Service ('RNS') of the London Stock Exchange on the day of the transaction.

3. CAPITAL AND LIQUIDITY REVIEW

3.4 CAPITAL OUTLOOK

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

The Group enters the second half of the financial year in a strong capital position. Capital and liquidity have continued to build throughout the period due to careful management of the position, the Tier-2 issuance has been replaced at a lower cost and the positive result of the regulatory review of the Group's capital management systems has resulted in a lowering of the minimum capital requirement.

This leaves the Group well capitalised, even allowing for a resumption of distributions to shareholders in the form of dividends and buy-backs, and for the return of CCyB requirements in the longer term. This capital position is both prudent and sustainable and helps ensure the viability of the business for the benefit of all stakeholders.

4. FINANCIAL REVIEW

The Group's trading performance before impairment charges for the six months ended 31 March 2021 demonstrates the continuing progress of the Group's businesses, in spite of the impact of the pandemic on the UK economy, with income and margins increasing generally in line with expectations. The impairment charge for the period returned to more normal levels, following the provision for the expected credit impacts of Covid in the 2020 accounts and, as a result, the Group's overall results were sharply improved.

The Group's underlying profit (Appendix A) for the six months ended 31 March 2021, at £82.9 million was 44.9% higher than the comparable period (2020 H1: £57.2 million), with the provision charge falling from £30.0 million in the first half of the 2020 financial year, when the Covid pandemic first impacted, to £6.0 million in the current period. On the statutory basis, which also includes the impact of fair value gains on hedging, profit before tax increased 68.8% to £96.4 million (2020 H1: £57.1 million).

Earnings per share increased by 66.5% to 29.3 pence (2020 H1: 17.6 pence) on the statutory basis, and by 43.2% to 25.2 pence excluding the effect of the fair value gains (2020 H1: 17.6 pence) (Appendix A).

4.2 RESULTS

CONSOLIDATED RESULTS
For the six months ended 31 March 2021

	2021 H1 £m	2020 H1 £m
Interest receivable	238.6	251.1
Interest payable and similar charges	(91.1)	(109.7)
Net interest income	147.5	141.4
Other operating income	7.2	8.3
Total operating income	154.7	149.7
Operating expenses	(65.8)	(62.5)
Provisions for losses	(6.0)	(30.0)
	82.9	57.2
Fair value net gains / (losses)	13.5	(0.1)
Operating profit being profit on ordinary activities before taxation	96.4	57.1
Tax charge on profit on ordinary activities	(22.2)	(12.6)
Profit on ordinary activities after taxation	74.2	44.5

4. FINANCIAL REVIEW

	2021 H1	2020 H1
Basic earnings per share	29.3p	17.6p
Diluted earnings per share	28.3p	17.3p
Dividend – rate per share for the period	7.2p	-

Income

The total operating income of the Group for the six months increased by 3.3% to £154.7 million (2020 H1: £149.7 million). This included a net interest income increase in the period of 4.3% to £147.5 million (2020 H1: £141.4 million). This increase was partly driven by the growth in the average loan book, which rose by 3.1% to £12,723.9 million (2020 H1: £12,346.1 million) (Appendix B), but also by the 3 basis point increase in annualised net interest margin ('NIM') recorded in the period. This increase fully unwound the temporary adverse impacts of the 2020 reduction in UK base rates, which affected NIM in the second half of the 2020 financial year.

NIM improved in the six months to 31 March 2021 to 232 basis points (2020 H1: 229 basis points) (Appendix B), with each of the Group's segments showing improved NIM in the period as a result of stability in product yields and tighter funding costs. Excluding the impact of the declining Idem Capital business, NIM increased by 6 basis points, from 214 basis points in the six months ended 31 March 2020, to 220 basis points in the current period.

Other operating income was £7.2 million for the six months, compared with £8.3 million in the first half of the 2020 financial year. The largest part of this reduction relates to third party servicing income, which is attributable to the reduction in size of the serviced portfolios.

Costs

Operating expenses for the period increased by 5.3% to £65.8 million (2020 H1: £62.5 million). Charges for share-based payments in the period were increased by £4.3 million, in excess of the total movement, following a low charge in 2020 as Covid impacted on vesting expectations and the associated (share price related) National Insurance charges.

The Group's average number of employees increased to 1,413 for the period, an increase of 1.8% over the comparable period in 2020 (2020 H1: 1,388). The growth in the Group's savings balance in the period (24.9% between 31 March 2020 and 31 March 2021) also increased operating costs, with the outsourced servicing fee set by reference to the balance outstanding. However, these increases were offset by reductions in other areas, including travel and accommodation and office running costs, which reflect the direct impacts of the pandemic and of the associated lockdowns.

Despite the impact of Covid, the Group has continued to invest in the development of systems to improve customer service and operational efficiency. During the period the digitisation of the Group's SME business commenced its pilot phase and the system to support the Group's deposit platform relationships also went live, enabling the broadening of this element of the deposit gathering strategy.

4. FINANCIAL REVIEW

Much of the Group's IT systems and infrastructure development is carried out by its experienced in-house resource, and the Group has therefore tended to capitalise less software than might be seen elsewhere in the sector, with more costs being taken immediately to profit. During the period software of £1.4 million was capitalised (2020 H1: £0.4 million, 2020 full year: £1.0 million).

The Group's IRB project made further progress through the period, with the second stage of the application for buy-to-let submitted in March 2021. Costs for the half year include expenditure of around £1.0 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 42.5% (Appendix C), was broadly similar to the 43.0% for the 2020 financial year and the 41.8% recorded in the six months ended 31 March 2020.

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

Impairment

The Group's charge for impairment in the six months, at £6.0 million, is much reduced from the charge in the comparable period in the previous year (2020 H1: £30.0 million). Accounting Standards require that losses are provided for on an expected basis, rather than an arising basis and losses attributable to the Covid crisis were provided as the impact of the pandemic was recognised. The ongoing development of the pandemic since 30 September 2020 has not provided significant evidence that the overall outturn will be worse than expected at that point, and thus the additional charge made in the half year is much more comparable to pre-Covid levels.

The absolute level of the balance sheet provision, at £82.4 million (30 September 2020: £81.8 million) has remained broadly similar across the half year, as has the coverage ratio, at 64 basis points (30 September 2020: 64 basis points, 31 March 2020: 53 basis points). To date, little of the provision established at the previous year end has been utilised in writing off defaulted accounts. However, the Group remains cautious on the future prospects of those loans for which provision is being carried. Support schemes from the UK Government remain in place and, as at 31 March 2021, no repayments for CBILS and BBLS loans had been required from customers. This means that significant uncertainty as to the future behaviour of the supported customers still exists and the Group considers it would be inappropriate to scale back its level of impairment coverage without hard evidence of both customer performance and a sustainable improvement in UK macro-economic conditions.

4. FINANCIAL REVIEW

Payment holidays and outcomes

The Group offered payment relief to a significant number of its customers during the initial period of the pandemic. Most of these came to an end before the previous year end on 30 September 2020, but some continued into the current period.

The Group has around 400 accounts remaining on payment holidays across all its portfolios at 31 March 2021, representing around £40.0 million of gross balances. Of these, 137 are in an initial three month relief period and the reminder in a secondary period. These represent a very small proportion of the over 21,000 accounts granted relief by the Group at some point in the last twelve months. During the six month period, which included the second Covid lockdown period in the UK, the Group granted 574 first time payment reliefs and 1,303 extensions, 367 of which related to cases granted their first relief in the period as well. Compared to the volume of requests in the first part of the pandemic this does not have a significant impact on the Group's exposures.

The position at 30 April 2021, the most recent available month end, is summarised in the table below. This analyses the values of accounts by payment relief status, which also highlights, for each of those groups, the relative change between the April 2021 arrears position and the 29 February 2020, pre-Covid position. Cases where the payment holiday has ended, but no payment is yet due, are shown separately.

	Currently business-as-usual			Between relief and BAU	Current relief	
	No relief	Single relief only	Extended relief		Extended	Original
	£ billion	£ billion	£ billion	£ billion	£ billion	£ billion
Balance	**10.57**	**1.65**	**0.81**	**0.01**	**0.03**	**0.01**
Proportion	*80.8%*	*12.6%*	*6.2%*	*0.1%*	*0.2%*	*0.1%*
% with arrears deterioration	0.8%	1.3%	8.0%	3.5%	3.1%	0.1%
% with arrears improvement	2.8%	1.1%	6.8%	1.8%	2.3%	5.5%

Payment holiday status (30 April 2021)

Of the accounts granted a single payment holiday, over 98% were up-to-date at 30 April 2021. This fell to over 90% of accounts with extended payment holidays. However, the level of volatility in these accounts noted at the year end has continued through the half year, both in terms of improving and worsening arrears, particularly for customers who had received extended payment holidays.

It is also clear that while many customers may have taken payment reliefs for precautionary reasons, these accounts may have been able to perform due to external support. Examples of this might include tenants of buy-to-let landlords accessing furlough payments to meet rent demands and SME customers using drawings under CBILS and BBLS schemes to meet day-to-day payments. These reliefs have a limited time scale and this level of performance may not be fully representative of the true position.

4. FINANCIAL REVIEW

As a result, management have maintained the approach of increasing the probability of default for this population above the levels suggested by the underlying models for those accounts which have taken a payment holiday extension. Such accounts have been transferred from Stage 1 to Stage 2 for impairment purposes.

Multiple economic scenarios and impacts

The setting of economic scenarios for the purposes of IFRS 9 in the current economic climate is difficult. The broad thrust of economic data for the UK over the past six months has been positive, but this has been in a period where government interventions have continued and there is continuing uncertainty over the direction the economy will take once these start to be withdrawn, with potentially radically different medium term outcomes.

To address these uncertainties the Group has adopted a two-part approach to its scenario setting. For the three main scenarios, central, upside and downside, a similar approach has been adopted to 'normal' year ends with the central scenario based on public forecasts and the upside and downside scenarios more benign or severe variants of this. This follows the general sentiment towards the UK economy, assuming a continuing of the easing of Covid restrictions and no significant impact from a third wave of infections.

The severe scenario has been set to represent a potential negative outturn, either for the economy, for the pandemic, or for both. This is largely based on the Bank of England's stress testing scenarios, but with a less optimistic outlook on house prices. This scenario stands for a radically different future course for the UK, which is plausible and potentially has a very different impact on the Group's customers.

The weightings applied to each scenario have been held at those used at 30 September 2020, in the light of the continuing economic uncertainty described above. The forecast economic assumptions within each scenario, and the weightings applied, are set out in more detail in note 11.

To illustrate the impact of these scenarios, the impairment provision at 31 March 2021 before post-model adjustments ('PMA's) has been recalculated weighting each of the central scenario and the severe scenario at 100%, with the results shown below.

	Provision before PMAs £m	Cover ratio
Weighted average	54.9	0.43%
Central scenario	40.7	0.32%
Severe scenario	96.2	0.75%

4. FINANCIAL REVIEW

Post-model adjustments ('PMAs')

It is important to note that the impairment model focusses principally on the impact of future economic changes on the portfolio. Where accounts are currently only being kept from defaulting by external short-term support measures they may still default when these are removed, despite an improved economic climate. Therefore the Group applies PMAs, based on its experience and its understanding of current customer positions, to allow for the possibility of such cases not being identified by the modelling approach. At 30 September 2020 these overlays were applied to specific account types where it was felt there was a risk of the modelled probabilities of default being understated.

The Group has reconsidered its methodologies for calculating overlays in the light of economic movements in the period. It is clear that the positive movements in economic indicators such as house prices and UK GDP in the period, both in actual and forecast terms have had a positive impact on the modelled outputs for cases benefitting from support measures without any broader evidence of improvement in the underlying credit quality of the customer balances being available. It was therefore decided to scale up the level of PMAs to address the potentially increased divergence between model outputs and underlying credit quality on such cases.

The total level of PMAs applied are summarised below.

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m
Initial Covid overlay	-	24.0	-
Overlay for payment relief and lagged effects	18.5	-	19.8
March 2021 uplift	9.0	-	-
Total PMAs	27.5	24.0	19.8

In order to illustrate the combined effect of the weightings and PMAs applied in the Group's impairment calculations, the calculation at 31 March 2021 has been sensitised to show the impact of the PMA uplift, the use of alternative scenario weightings and a combination of the two (note 11) with the potential for a future Covid-related crash excluded. The first uses the same PMA methodology as was used at 30 September 2020 (Sensitivity A), the second the more optimistic weightings used at 30 September 2018 (Sensitivity B) but unchanged PMAs, while the third uses both the more benign economics and the lower level of PMAs. The September 2018 weightings, which were also used at March 2019, are used as an illustration of weightings which might be used where the overall economic outlook is generally positive to neutral.

4. FINANCIAL REVIEW

These scenarios are set out in more detail in the notes with the results summarised below.

	Total provision	Difference	Cover ratio	Difference
Reported provision	£82.4m	-	0.64%	-
Sensitivity A *Based on actual weightings but excluding March 2021 PMA uplift*	£73.4m	£9.0m	0.57%	7bp
Sensitivity B *Based on 1 October 2018 weightings and including March 2021 PMA uplift*	£73.0m	£9.4m	0.57%	7bp
Sensitivity C *Based on 1 October 2018 weightings but excluding March 2021 PMA uplift*	£64.0m	£18.4m	0.50%	16bp

Ratios and trends

The combination of approach to economic forecasting described above and the approach to the continuing uncertainty over accounts which have had payment relief or other government support has resulted in the provision amount and cover ratios broadly aligned with those at the 2020 year end.

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m	30 September 2019 £m
Calculated provision	54.9	42.7	62.0	41.9
PMAs	27.5	24.0	19.8	-
Total	82.4	66.7	81.8	41.9
Cover ratio	**0.64%**	**0.53%**	**0.64%**	**0.34%**

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

4. FINANCIAL REVIEW

Fair values

There have been significant movements in spot and forward interest rates in the period which have resulted in fair value net gains of £13.5 million as a result of the Group's hedging activities (2020 H1: £0.1 million net losses). These movements do not affect cash flow and the fair value items are expected to trend to zero over the lives of the related instruments. 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.

Taxation

The Group's effective rate for the period was 23.0%, broadly similar to the 22.1% charge in the corresponding period last year. Materially all 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%. While the UK Government has announced an increase in the basic rate of corporation tax to 25% from 2023, this was not enacted at the balance sheet date.

The effect of the rate change on the Group's deferred tax assets and liabilities will be accounted for in the second half of the financial year, but the impact is not expected to be significant (note 7).

Longer term, the rate of tax that will apply to the Group remains uncertain. While the basic rate of corporation tax will increase from 19% to 25%, HM Treasury has announced that it is considering changes to the 8% Bank Surcharge in light of this increase, but firm proposals are not expected until the autumn of 2021 at the earliest.

Result

Profits after taxation of £74.2 million (2020 H1: £44.5 million) have been transferred to equity, which totalled £1,203.8 million at the period end (31 March 2020: £1,122.0 million). This represents a tangible net asset value of £4.07 per share (31 March 2020: £3.74 per share) and a net asset value on the statutory basis of £4.74 per share (31 March 2020: £4.41 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.

4. FINANCIAL REVIEW

4.2 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 2021

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m
Intangible assets	170.5	170.5	170.1
Investments in customer loans	12,816.3	12,506.1	12,631.4
Derivative financial assets	180.7	538.1	463.3
Cash	2,103.0	1,206.8	1,925.0
Other assets	218.3	267.7	315.7
Total assets	15,488.8	14,689.2	15,505.5
Equity	1,203.8	1,122.0	1,156.0
Retail deposits	8,631.2	6,911.9	7,856.6
Other borrowings	5,466.8	6,412.4	6,229.7
Derivatives financial liabilities	76.2	94.6	132.4
Pension deficit	11.8	28.3	20.4
Other liabilities	99.0	120.0	110.4
Total equity and liabilities	15,488.8	14,689.2	15,505.5

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 1.5%, with growth in Mortgage Lending a broadly stable position in Commercial Lending and a continuing amortisation of the Idem Capital portfolio. This is discussed in more detail in the lending review (Section 1 above). This increase, together with the Group's liquidity and capital policy, determines its funding requirements and hence the level of its liabilities.

Funding structure and cash resources

The Group's funding increased by 0.1% during the six months ended 31 March 2021 reflecting the broadly stable state of the balance sheet and the Group's continuing cautious outlook on funding and liquidity. The proportion represented by retail deposits increased to 61.2% in accordance with the Group's long-term funding strategy (30 September 2020: 55.8%). The continuing caution on liquidity also resulted in a £178.0 million increase cash balance in the period. Movements in funding balances are discussed in more detail in Section 2 of this report.

4. FINANCIAL REVIEW

Derivatives

Movements in derivative financial assets principally arise from the retirement of certain of the Group's currency denominated floating rate notes and their related hedging instruments in the period. These swaps decreased by £292.3 million over the six month period. These movements do not impact the Group's results but do reduce the TRE for capital purposes and have therefore reduced capital requirements and improved capital ratios.

Derivative assets used for interest rate hedging increased by £9.7 million, while interest rate hedging liabilities reduced by £56.2 million, both principally as a result of interest rate movements. This net £66.0 million movement was largely offset by a £51.6 million reduction in the hedging adjustment on loans to customers, included in sundry assets above, and a £7.3 million reduction in the hedging adjustment on retail deposits, included in sundry liabilities.

Pension obligations

The net liability in respect of the Group's defined benefit pension scheme ('the Plan'), valued in accordance with IAS 19, reduced by £8.6 million in the six month period, resulting in an accounting deficit of £11.8 million (30 September 2020: 20.4 million, 31 March 2020: £28.3 million). This was principally a result of an increase in the discount rate used, which is set on the basis of market bond yields.

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, which includes the effect of the charge given over the Group's head office building, the Plan showed a surplus at 31 March 2021 of £9.7 million, compared to a deficit of £9.7 million at 30 September 2020, meaning that the scheme was fully funded on that basis.

The Plan was closed to new members in 2002 and a consultation is currently taking place to mitigate the Group's exposure to future service costs under the scheme. Details of any changes will be given with the year end results, when this process will have concluded.

Other assets and liabilities

Sundry assets have reduced by £97.4 million since 30 September 2020. This arises principally from movements in swap rates which generated the £56.2 million movement in the fair value hedging adjustment on assets referred to above and generated a £42.2 million reduction in collateral deposits as a result of the increased value of derivative liabilities.

Sundry liabilities reduced by £11.4 million over the six month period, the largest element being the settlement of brought forward contingent consideration balances.

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4.3 SEGMENT PERFORMANCE

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

	Six months to 31 March 2021 £m	Six months to 31 March 2020 £m	Year to 30 September 2020 £m
Segmental profit			
Mortgage Lending	92.4	76.9	154.3
Commercial Lending	37.6	15.1	45.9
Idem Capital	8.7	9.6	19.6
	138.7	101.6	219.8
Unallocated central costs and other one-off items	(55.8)	(44.4)	(99.8)
	82.9	57.2	120.0

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

Mortgage Lending

The Mortgage Lending division continued to maintain its market position through the period and benefitted from the tightening of the Group's overall funding costs. Coupled with the division's operational strategy, and the gradual replacement of legacy assets by new originations in the portfolio, this led to an increase of 6 basis points in segmental NIM, and a 7.6% increase in net interest to £103.1 million (2020 H1: £95.8 million).

With mortgage accounts continuing to perform well in the period, provision charges reduced significantly, though not yet to pre-Covid levels, with a charge for the period of £4.9 million (2020 H1: £13.8 million), reflecting the continued use of PMAs in estimating expected credit losses.

Together these changes saw segmental profit increase by 20.2% from the corresponding period in the previous year to £92.4 million (2020 H1: £76.9 million).

4. FINANCIAL REVIEW

Commercial Lending

The profit of the Commercial Lending segment in the period was £37.6 million, increased by 149.0% from the result in the first half of 2020 (2020 H1: £15.1 million). This arose from both an improvement in NIM and a reduction in provision charges.

The average loan balance across the period, at £1,471.0 million, was similar to that through the first half of 2020 (2020 H1: £1,473.2 million). This included significant changes in mix between the division's business lines, including a 15.1% increase in the average development finance balance. Annualised NIM in the period increased from 5.25% to 6.32% as a result of tighter funding costs, the continuing operational focus on yield and changes in the product mix of the book delivered a 20.2% increase in net interest to £46.5 million (2020 H1: £38.7 million).

Total impairment provisions for the period were £1.3 million, a reduction from the £15.5 million charged in the comparative period. With accounts continuing to perform, no factors have been identified which would lead to additional cases being provided and provision levels have been largely maintained. However, with many SME customers potentially having been in receipt of CBILS and BBLS funds, it is too early to conclude that this positive performance will continue as these drawings are exhausted.

Idem Capital

All the portfolios within the Idem Capital division continued to run off in the period, with no new transactions completing. This led to a 23.4% reduction in average loan balance for the half year compared to the same period in 2020. Net interest fell by 18.2% to £10.8 million (2020 H1: £13.2 million) as a result. The 2020 outcome included the effects of a Covid-related reduction in expected future cash flows, leading to a write down of future interest, which has not been repeated in the 2021 results.

Average annualised NIM improved from 7.28% in the half year to 31 March 2020 to 7.77% in the current period. The long-term period-on-period decline of NIM in this division was temporarily halted by the effect of the inclusion of the interest write down noted above in the results for 2020.

Asset performance in the period has been encouraging, with accounts continuing to pay down as expected and no significant additional Covid provisioning requirements identified, creating a write-back of provision of £0.2 million, largely on redeeming accounts (2020 H1: charge of £0.7 million).

Overall, these factors restricted the decline in the segment profit to 9.4%, with a contribution of £8.7 million to the Group result (2020 H1: £9.6 million).

5. OPERATIONAL REVIEW

While the Group's business has inevitably been impacted by Covid and the changing levels of restrictions imposed in the UK, it has been a priority of the Group to maintain business-as-usual, as far as possible. This has largely been achieved and has played a large part in delivering the results for the period.

This has left the Group in a good position as it moves in to the second half of the financial year and restrictions begin to ease. It is still too early to say how the experiences of the pandemic will impact on the Group's business model in the longer term, but plans are already in hand to develop working models for the future.

5.1 OPERATIONS

The Group employs just over 1,400 employees, with the majority normally based in its Solihull offices. However, since the beginning of the Covid pandemic approximately 90% of employees have worked from home.

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

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

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

The wellbeing and safety of employees has been the priority of the leadership team over the past year and this will continue as plans are established for a phased return to the office from June, in line with the Government's guidelines. The Group intends to pilot various approaches to flexible working using a hybrid operating model, in order to identify the best outcome for its customers, shareholders, and its people. These pilots will continue throughout 2021 with business performance and employee feedback shaping the overall future way of working for the Group.

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

5. OPERATIONAL REVIEW

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

Throughout the pandemic the Group's strategy has focussed on customer outcomes, particularly for more vulnerable customers and it was particularly pleasing that the Group's FOS complaints data shows no significant increase in the period. The number of complaint cases reported to FOS in the six months ended 31 December 2020, the most recent reporting period, was 60 with an uphold rate of 43.3% while the number for the six months ended 30 June 2020 was 40, with an uphold rate of 41.3%.

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

5.2 GOVERNANCE

The Group continues to operate under business continuity arrangements as a result of the pandemic; with board and committee meetings being held remotely since March 2020. The impact of the pandemic on all the Group's stakeholders has continued to be an area of significant focus for the Board and the Group's ongoing response has been thoroughly reviewed. The Group's 2021 Annual General Meeting was held in February on a closed basis, in accordance with UK Government guidance and the Board regrets that shareholders could not be given the opportunity to attend in person. However, shareholders were encouraged to participate in the meeting by completing and returning their proxy voting terms and were able to view the meeting online. Shareholders were also invited to submit questions in advance on the business to be considered at the meeting.

The Group continues to be subject to the 2018 UK Corporate Governance Code ('the Code') and the Group's procedures for compliance with the Code are set out in the Annual Report and Accounts for 2020. The Group continued to comply with the principles of the Code during the period.

Board of Directors

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

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

5. OPERATIONAL REVIEW

Following these changes, the Board has three female directors, including the Chair of the Board, out of a total of eight board members, forming 37.5% of the Board.

Remuneration policy

The PRA remuneration rules applicable to the Group are changing with effect from 1 October 2021. This is a result both of the reduction in the asset threshold defining a Level 2 bank from £15 billion to £13 billion, announced by the PRA in December 2020, which brings the Group within the scope of more onerous rules, and of the development of the rules themselves in response to CRD V. In response a full gap analysis is being performed against the updated rules, with affected members of staff being identified. While some of the required changes to remuneration policies were prospectively approved at the 2020 AGM, any further changes required will be submitted to the Remuneration Committee for review and approval in September 2021. Any changes will be reported on in the Directors' Remuneration Report for the year and in the Remuneration Section of the Pillar 3 report for the year as appropriate.

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

5.3 PEOPLE

Equality and diversity

Diversity within the Group continues to be an area of focus at board level and across all areas of the business. The Group's Equality, Diversity and Inclusion ('EDI') Network, made up of representatives from across the Group, was established in October 2020, and its purpose is to:

- Raise awareness and understanding at all levels of the Group of what equality, diversity and inclusion in the workplace means
- Provide feedback and advice to leadership of the business on the issues affecting employees from underrepresented groups
- Support the delivery of initiatives to improve equality, diversity and inclusion across the Group
- Promote the Group externally as a diverse and inclusive place to work

The EDI Network has so far run communications campaigns, launched new unconscious bias and inclusive workplace training workshops and agreed a plan of further actions to promote equal opportunities within recruitment, learning and career development. Richard Rowntree, Managing Director, Mortgages, took on the role as Executive Sponsor for Diversity in February 2021.

5. OPERATIONAL REVIEW

The Group published its Gender Pay Gap report in March 2021 and reported a mean pay gap of 40.7% at 5 April 2020 (2019: 41.3%) and median gap of 36.9% (2019: 33.9%). The Group's 2020 gender pay measures are similar to those for 2019 and remain larger than senior management would like. The gender pay gap is predominately due to the seniority and nature of positions occupied by men and women in the organisation and one of the principal objectives of the Group's diversity initiatives is to investigate ways of developing female talent in specialisms where women have historically been underrepresented.

At senior levels of the organisation the representation of women, measured against the Hampton Alexander target of boards having 33% female representation, is encouraging (37.5% as at March 2021). The Group is also a signatory to the Women in Finance Charter, sponsored by HM Treasury and has set the target of achieving 35% of women in senior positions, using the Hampton Alexander definition by January 2022 (34.6% as at March 2021). It was pleasing to note that in the final Hampton Alexander review, published in February 2021, the Group's senior management gender diversity ranked tenth out of 38 financial services companies in the FTSE 350.

The Group is committed to progressing the careers of women both internally and across the financial services sector and has a number of initiatives in place to support this. The Group continues to have mentors and mentees involved in the 'Women Ahead 30% Club', cross-company mentoring scheme, a number of female senior leaders have been involvement in The Women's Association's 'For the Women' campaign and Nigel Terrington, the Group's CEO, has been involved in their Executive Challenge project, which gives girls between the ages of 12-17 the chance to connect with and learn from executive directors.

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 and welcomes the additional impetus provided by the EDI Network. 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 'Sustainability' section of the Group's website.

People and development

Communication with employees has been critical to the Group's ability to operate successfully throughout the pandemic; senior management have provided regular updates to employees throughout the year, and feedback has been gathered through regular employee wellbeing pulse surveys. In addition, senior management, including Board members, have attended regular meetings of the Group's People Forum. A Groupwide employee engagement survey had been planned for early 2021; this has been postponed until June given the third national lockdown and the Group's priority on employees' welfare.

The Group's average number of employees in the period has increased by 2.5% compared to the equivalent period in 2020, despite the complexities of recruiting and onboarding people during pandemic working conditions.

5. OPERATIONAL REVIEW

The Group's attrition rate remains improved on previous years with 6.9% turnover in the first half of the year (2020 H1: 15.3%). While some of this change may be attributable to constraints in the employment market due to the pandemic, the Group's turnover rate has historically remained below the average for the sector. This can be attributed to the development opportunities available to employees and the strong corporate culture that is fostered by the Group's leadership. Over 30% of the Group's people have been employed for more than ten years, with 12.9% having achieved over 20 years' service. The stability within the Group is a valued component of its corporate culture and has been an important factor in supporting its business through the pandemic; as well as in providing the specialist service its customers require.

In December 2020 all eligible employees were awarded a £1,000 share award in recognition of their contribution throughout a challenging 2020. The shares were awarded to 97% of employees and will vest in December 2023.

As at March 2021 81% of employees were enrolled in the work-save pension. The default investment option of the plan was reviewed in the period and changes have been made to reflect closer alignment with the Group's environmental, social and governance policies. A further 8% of employees are members of the Group's final salary pension scheme, meaning that around 90% of employees are receiving the Group's support to save for their retirement.

During the period the Group's People Forum has continued to act as the principal conduit for employee opinions to be communicated to senior management and the Board. In February 2021 a suggestion made by the People Forum to increase the provision of Christmas Eve leave and New Year's Eve leave from a half day to a full day received the support of the Executive and this will commence from December 2021. Senior management and Board members continue to attend People Forum meetings regularly to seek feedback and provide strategic updates. Subjects covered in meetings during the period include the Group's technology strategy and its plans for a return to office-based working.

Employee development continues to be a priority for the Group with most learning continuing to be delivered virtually and a number of new initiatives being rolled out. The Group's ability to deliver learning online has been enhanced with the launch of its new learning management system ('LMS') in February 2021. This new LMS offers libraries of resources that employees can use for self-directed learning, as well as being used for regulatory eLearning.

During the period the Group has launched three development programmes: a new leadership programme aimed at all current leaders and line managers; a new programme for high-potential employees; and another cohort of the existing Team Leader Academy, aimed at employees aspiring to their first step into people management.

5. OPERATIONAL REVIEW

The Group continues to make use of the Apprenticeship Levy scheme, with 21 apprentices registered at 31 March 2021. In addition to this there will be a further draw down in April 2021 to cover 27 apprentices including 12 aspiring team leaders. The Group utilised 34% of its available levy pot in the past twelve months, with the Group's ability to access funds restricted partly by the practical difficulties caused by the Covid pandemic, but also partly by the terms of the scheme, under which it is difficult for the Group to identify suitable roles for funding. The Group is also currently supporting 135 individuals with funding to complete professional qualifications across various bodies, with CeMap students the most numerous.

5.4 SUSTAINABILITY

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

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

Climate change

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

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

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

The Green Bond Framework, published in the period, reflects the Group's commitment to embed sustainability throughout its strategy, operations, and product offerings including funding and capital raising activities. The recently established Sustainability Committee, under the oversight of the Executive Risk Committee, is responsible for the Framework.

Developments in sustainable products and climate-related exposures are discussed in the relevant business reviews.

While the Group is not required to report on climate change risk and exposures under the TCFD framework until its 2022 year end, it intends to move towards that position in its 2021 disclosures.

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Social engagement

Despite the difficulties for fund-raisers created by the pandemic, the Group's Charity Committee raised over £43,000 for Macmillan Cancer Support, the Group's chosen charity for the 2020 calendar year. This was a significant increase from the amounts raised by employees in previous years and included several new virtual activities to help support employee engagement and team collaboration.

For the 2021 calendar year the Group is supporting the Alzheimer's Society and the Charity Committee continues to adapt its fundraising approach to cope with evolving working practices.

The Group continues to actively consider how community involvement can be enhanced on an ongoing basis in a Covid-safe way as peoples' lives slowly return to normal.

5.5 RISK MANAGEMENT

The effective management of risk is crucial to the achievement of the Group's strategic objectives, particularly in the current ongoing Covid 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 this model has provided an effective framework to oversee the business and operational changes necessitated by the pandemic.

Inevitably the principal challenges in the risk environment faced by the Group during the six-month period and going forward remain the various impacts of Covid across all of its main risk areas. The longer-term implications of the global crisis in terms of economic impacts on the business, potential changes to lending profiles, new business volumes and customer credit risk and the potential impacts on operational risk of changed working patterns continue to be closely monitored. The Group responds to the immediate challenges of the pandemic as they emerge whilst considering how any of these might affect its future strategy. These include:

- Risks involved in planning a Covid-safe return to office-based working and related implications for the longer-term workplace strategy as lockdown eases according to the UK Government roadmap
- Management of the remaining payment holidays in accordance with regulatory initiatives together with working closely with all customers impacted by Covid to determine forbearance solutions that are tailored to individual customer circumstances and that are aligned to regulatory guidance and expectation
- Risks arising related to the provision of CBILS and BBLS, as customer repayments begin, and to the implementation of RLS lending including process changes and underwriting decisions
- Revision of credit policies and decisioning to reflect the challenges in applying existing lending criteria in the current economic climate

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During the period the Group conducted a review of its exposure to issues relating to defective cladding on high-rise buildings, where such buildings form the security for mortgage loans. Exposure on the existing mortgage book has been quantified, with accounts secured on potentially affected buildings over six storeys high comprising less than 0.5% of the balance. Underwriting guidelines have been reviewed to ensure they remain in line with emerging best practice. Overall, the Group is well placed to manage these risks.

Despite the demands of managing pandemic-related risks, the Group has continued to make good progress in further developing its ability to manage all categories of risk as the business develops. Whilst the pandemic has provided its own unique set of challenges including re-deployment of resource and priorities, the Group is committed to continuing to deliver on key risk management initiatives including:

- Operational readiness of the Group for zero or negative interest rates following the publication of the PRA’s ‘Dear CEO’ letter in February 2021
- Strategy and operational and conduct implications for change in product design, funding and operations in transitioning all LIBOR-linked customers to an alternative rate following the withdrawal of LIBOR in December 2021
- Ongoing embedding of operational resilience capabilities. This has included refinement of critical business services and tolerances and ensuring these considerations are embedded as part of day-to-day operations, together with enhancement of the Group’s technology
- Addressing the impact of climate change on managing financial risks following the adoption of climate change as a principal business risk during 2020
- Continuing to develop advanced models and embed the overarching model risk framework to enhance credit risk management and support the Group’s IRB application process, with Phase 2 of the Buy-to-Let application submitted to the PRA in March 2021
- Evolution and embedding of the Group’s approach to managing the risks and oversight of its outsourced relationships and important suppliers
- Enhancing stress testing procedures within the Group to ensure the robustness of capital and liquidity positions
- Ensuring that the Group’s cyber-security controls and data protection approach continue to remain effective in the face of the rapidly evolving challenges in these areas

It remains a priority of the Group to ensure that its risk management framework evolves in line with the strategic development of the business. During the period, an externally facilitated benchmarking exercise was carried out, confirming that in the majority of areas, the framework was effective and proportionate in terms of both maturity and operation. However, the Group will continue to enhance the entity-wide risk management framework over the coming years and has added further to its permanent resource during the period to facilitate this programme.

5. OPERATIONAL REVIEW

The Group continues to review its exposure to emerging developments in the Brexit process as further clarity is received as to future dealings with the EU. However, the end of the transition period on 31 December 2020 has caused no immediate impact to the Group. While the Group does not have operations outside the UK it has continued to review the capital, liquidity and operational implications of the stresses which might be caused by the process. The Board has kept the situation under ongoing review throughout the period and continues to do so, and considers that the Group is well placed to address the challenges. However, the long-term outcome of the Brexit process remains uncertain and it will remain subject to ongoing monitoring as the position develops.

A summary of the principal risks and uncertainties faced by the Group, required by DTR 4.2.7(2) of the Disclosure and Transparency Rules, is set out on pages 157 to 161. These risks have not changed significantly since those disclosed at the year end.

5.6 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 has continued to be a principal concern of UK and European regulators over the last six months 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.

Whilst the Group is affected by a broad range of prudential and conduct regulations, given the nature of its operations, in addition to the consequences of Covid the following recent and current developments have the greatest potential impact:

- The Bank of England's Monetary Policy Committee confirmed in February 2021 that negative rates still form part of its monetary policy tool. In response, the PRA issued a 'Dear CEO' letter requesting firms initiate the implementation of tactical solutions to process zero and negative rates by August 2021. The Group is well positioned to meet this deadline

5. OPERATIONAL REVIEW

- In order to manage the impact of the withdrawal of LIBOR by December 2021, a project is in progress to transfer all customers with LIBOR-linked accounts to alternative rates by this deadline. The Group has a significant legacy LIBOR-linked mortgage book but is confident that it is well-placed to meet the regulatory timeframes and operational requirements to ensure an orderly transition while ensuring the fair treatment of customers
- The PRA remuneration rules applicable to the Group are changing, both as a result of the reduction in the asset threshold defining a Level 2 bank from £15 billion to £13 billion, announced by the PRA in December 2020, bringing the Group within the scope of more onerous rules, and of the development of the rules themselves in response to CRD V. In response a full gap analysis is being performed against the updated rules, with affected members of staff being identified. While some of the required changes to remuneration policies were prospectively approved at the 2020 AGM, any further changes required will be submitted to the Remuneration Committee for review and approval in September 2021
- The treatment of vulnerable customers continues to be a strong focus for the FCA, with further guidance having been finalised in February 2021. The Group continues to take its responsibilities in this regard seriously. Significant work has already been undertaken to map existing procedures, controls and training provisions to deliver against these enhanced expectations
- Good progress continues to be made in developing and enhancing operational resilience capability across the Group. Due to Covid, the consultation period for proposed PRA and FCA requirements was extended with final rules published in March 2021. Initial analysis indicates these do not differ materially from the consultation paper and the Group continues to deliver against the agreed plan to ensure compliance. The Group is committed to strengthening its operational resilience as a core priority particularly given the practical benefit this infrastructure has provided in informing the Group's Covid response

On a longer-term basis, in February 2021 the Bank of England began the consultation process for the incorporation of the prudential regulation regime previously set out in European legislation (including CRD IV) into the PRA Rulebook, following Brexit. While the expectation is that the majority of requirements will be directly transcribed, the PRA has indicated its willingness to depart from the EU text where it believes such a departure would enhance regulatory oversight in the UK. The Group will continue to monitor this process and respond as appropriate.

The Bank of England has also published a discussion paper concerning its future approach to setting a minimum requirement for own funds and eligible liabilities ('MREL') for banking firms. The current size and potential for future growth of the Group means it may be required to issue MREL at some point in the future. The Group submitted a response to this consultation in March setting out the potential negative impacts of the proposal on the competitiveness of mid-tier firms from the low level of the threshold, the high cost of MREL issuance for mid-tier firms and the shortness of the transition period. The Group will consider the final proposals when they are published and respond accordingly.

Overall, the Group considers that it is well placed to respond to upcoming regulatory developments and ensure compliance in line with required timescales.

6. CONCLUSION

The Group is extremely proud of the results achieved over the past six months. They reflect the hard work of all its people during a challenging period as well as the success of the longstanding strategy to build a diversified, technology enabled, specialist banking group. A record first half profit has been delivered and the Group enters the second half of the financial year with strong momentum, healthy new business pipelines and enhanced margins.

Our people continue to excel, maintaining both productivity levels and flexibility as we look to develop the future operating model options for the Group. We can look forward to the second half cautiously provisioned, with strong capital ratios and prudent liquidity and with growing confidence as the UK emerges from the Covid crisis.

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)
- 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 as the persons responsible within the Company.

MARIUS VAN NIEKERK

Company Secretary

8 June 2021

Board of Directors

F J Clutterbuck	H R Tudor
(Chair of the Board)	*(Non-executive director, Chair of the Remuneration Committee and Senior Independent Director)*
B A Ridpath	G H Yorston
(Non-executive director)	*(Non-executive director)*
A C M Morris	P A Hill
(Non-executive director and Chair of the Audit Committee)	*(Non-executive director and Chair of Risk and Compliance Committee)*
N S Terrington	R J Woodman
(Chief Executive Officer)	*(Chief Financial Officer)*

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 2021 which comprises 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 2021 is not prepared, in all material respects, in accordance with IAS 34 *Interim Financial Reporting* adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union 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 latest annual financial statements of the Group were prepared in accordance with International Financial Reporting Standards as adopted by the EU and the next annual financial statements will be prepared in accordance with International Financial Reporting Standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union and in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006. The directors are responsible for preparing the condensed set of financial statements included in the half-yearly financial report in accordance with IAS 34 adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union.

INDEPENDENT REVIEW REPORT TO PARAGON BANKING GROUP PLC

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.

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 Ryder
for and on behalf of KPMG LLP

Chartered Accountants
66 Queen Square
Bristol
BS1 4BE

8 June 2021

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF PROFIT OR LOSS
For the six months ended 31 March 2021 (Unaudited)

	Note	Six months to 31 March 2021 £m	Six months to 31 March 2020 £m	Year to 30 September 2020 £m
Interest receivable	3	238.6	251.1	491.7
Interest payable and similar charges	4	(91.1)	(109.7)	(213.6)
Net interest income		147.5	141.4	278.1
Other leasing income		9.6	9.4	19.2
Related costs		(8.5)	(7.9)	(16.2)
Net leasing income		1.1	1.5	3.0
Other income	5	6.1	6.8	14.0
Other operating income		7.2	8.3	17.0
Total operating income		154.7	149.7	295.1
Operating expenses		(65.8)	(62.5)	(126.8)
Provisions for losses	11	(6.0)	(30.0)	(48.3)
Operating profit before fair value items		82.9	57.2	120.0
Fair value net gains / (losses)	6	13.5	(0.1)	(1.6)
Operating profit being profit on ordinary activities before taxation		96.4	57.1	118.4
Tax charge on profit on ordinary activities	7	(22.2)	(12.6)	(27.1)
Profit on ordinary activities after taxation		74.2	44.5	91.3

	Note	Six months to 31 March 2021	Six months to 31 March 2020	Year to 30 September 2020
Basic earnings per share	8	29.3p	17.6p	36.0p
Diluted earnings per share	8	28.3p	17.3p	35.6p
Dividend – rate per share for the period	21	7.2p	-	14.4p

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 2021 (Unaudited)

	Note	Six months to 31 March 2021 £m	Six months to 31 March 2020 £m	Year to 30 September 2020 £m
Profit for the period		74.2	44.5	91.3
Other comprehensive income				
Items that will not be reclassified subsequently to profit or loss				
Actuarial gain / (loss) on pension scheme	17	7.8	5.6	(7.4)
Tax thereon		(1.5)	(0.4)	2.1
		6.3	5.2	(5.3)
Items that may be reclassified subsequently to profit or loss				
Cash flow hedge (losses) taken to equity		(2.9)	(0.6)	(0.6)
Tax thereon		0.6	0.2	0.1
		(2.3)	(0.4)	(0.5)
Other comprehensive income / (expenditure) for the period net of tax		4.0	4.8	(5.8)
Total comprehensive income for the period		78.2	49.3	85.5

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEET
31 March 2021 (Unaudited)

	Note	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m	30 September 2019 £m
Assets					
Cash – central banks	9	1,832.3	812.7	1,637.1	816.4
Cash – retail banks	9	270.7	394.1	287.9	409.0
Loans to customers	10	12,874.4	12,585.3	12,741.1	12,250.3
Derivative financial assets	12	180.7	538.1	463.3	592.4
Sundry assets		88.8	108.4	128.0	92.8
Current tax assets		3.0	10.1	5.7	-
Deferred tax assets		3.7	4.2	6.2	6.2
Property, plant and equipment		64.7	65.8	66.1	57.3
Intangible assets	13	170.5	170.5	170.1	171.1
Total assets		15,488.8	14,689.2	15,505.5	14,395.5
Liabilities					
Short-term bank borrowings		0.1	0.2	0.4	1.0
Retail deposits	14	8,634.3	6,919.7	7,867.0	6,395.8
Derivative financial liabilities	12	76.2	94.6	132.4	80.5
Asset backed loan notes	15	2,011.3	3,887.3	3,270.5	4,419.4
Secured bank borrowings	15	755.7	879.2	657.8	787.5
Retail bond issuance	15	237.0	296.6	296.8	296.5
Corporate bond issuance	15	168.3	149.7	149.8	149.6
Central bank facilities	15	2,244.4	1,199.4	1,854.4	994.4
Repurchase agreements	15	50.0	-	-	-
Sundry liabilities	16	95.9	112.2	100.0	112.7
Current tax liabilities		-	-	-	15.2
Retirement benefit obligations	17	11.8	28.3	20.4	34.5
Total liabilities		14,285.0	13,567.2	14,349.5	13,287.1
Called-up share capital	18	262.0	261.7	261.8	261.6
Reserves	19	976.9	893.2	932.0	887.3
Own shares	20	(35.1)	(32.9)	(37.8)	(40.5)
Total equity		1,203.8	1,122.0	1,156.0	1,108.4
Total liabilities and equity		15,488.8	14,689.2	15,505.5	14,395.5

The condensed financial statements for the half year were approved by the Board of Directors on 8 June 2021.

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED CASH FLOW STATEMENT
For the six months ended 31 March 2021 (Unaudited)

	Note	Six months to 31 March 2021 £m	Six months to 31 March 2020 £m	Year to 30 September 2020 £m
Net cash flow generated by operating activities	22	691.7	196.6	1,028.7
Net cash (utilised) by investing activities	23	(2.3)	(1.1)	(2.8)
Net cash (utilised) by financing activities	24	(511.1)	(213.3)	(325.7)
Net increase / (decrease) in cash and cash equivalents		178.3	(17.8)	700.2
Opening cash and cash equivalents		1,924.6	1,224.4	1,224.4
Closing cash and cash equivalents		2,102.9	1,206.6	1,924.6
Represented by balances within				
Cash	9	2,103.0	1,206.8	1,925.0
Short-term bank borrowings		(0.1)	(0.2)	(0.4)
		2,102.9	1,206.6	1,924.6

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF MOVEMENTS IN EQUITY
For the six months ended 31 March 2021 (Unaudited)

Six months ended 31 March 2021

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Cash flow hedging reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m
Transactions arising from								
Profit for the period	-	-	-	-	-	74.2	-	74.2
Other comprehensive income	-	-	-	-	(2.3)	6.3	-	4.0
Total comprehensive income	-	-	-	-	(2.3)	80.5	-	78.2
Transactions with owners								
Dividends paid (note 21)	-	-	-	-	-	(36.5)	-	(36.5)
Own shares purchased	-	-	-	-	-	-	-	-
Exercise of share awards	0.2	0.5	-	-	-	(2.6)	2.7	0.8
Charge for share based remuneration	-	-	-	-	-	4.4	-	4.4
Tax on share based remuneration	-	-	-	-	-	0.9	-	0.9
Net movement in equity in the period	0.2	0.5	-	-	(2.3)	46.7	2.7	47.8
Opening equity	261.8	68.7	50.3	(70.2)	2.5	880.7	(37.8)	1,156.0
Closing equity	262.0	69.2	50.3	(70.2)	0.2	927.4	(35.1)	1,203.8

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF MOVEMENTS IN EQUITY
For the six months ended 31 March 2021 (Unaudited) (Continued)

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)
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 2021 (Unaudited) (Continued)

Year ended 30 September 2020

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Cash flow hedging reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m
Transactions arising from								
Profit for the year	-	-	-	-	-	91.3	-	91.3
Other comprehensive income	-	-	-	-	(0.5)	(5.3)	-	(5.8)
Total comprehensive income	-	-	-	-	(0.5)	86.0	-	85.5
Transactions with owners								
Dividends paid (note 21)	-	-	-	-	-	(35.9)	-	(35.9)
Own shares purchased	-	-	-	-	-	-	(5.2)	(5.2)
Exercise of share awards	0.2	0.4	-	-	-	(7.7)	7.9	0.8
Charge for share based remuneration	-	-	-	-	-	2.7	-	2.7
Tax on share based remuneration	-	-	-	-	-	(0.3)	-	(0.3)
Net movement in equity in the year	0.2	0.4	-	-	(0.5)	44.8	2.7	47.6
Opening equity	261.6	68.3	50.3	(70.2)	3.0	835.9	(40.5)	1,108.4
Closing equity	261.8	68.7	50.3	(70.2)	2.5	880.7	(37.8)	1,156.0

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS
For the six months ended 31 March 2021 (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 2021 and for the six months ended 31 March 2020 have not been audited, as defined in section 434 of the Companies Act 2006.

The figures shown above for the year ended 30 September 2020 and 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 2021 (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 INFORMATION

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:

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

Dedicated financing and administration costs of each of these businesses are allocated to the segment. Shared central costs are not allocated between segments, nor is income from central cash balances or the carrying costs of unallocated savings balances.

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 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 2021 (Unaudited)

2. SEGMENTAL INFORMATION (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 2021

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Unallocated items £m	Total £m
Interest receivable	168.4	57.1	12.3	0.8	238.6
Interest payable	(65.3)	(10.6)	(1.5)	(13.7)	(91.1)
Net interest income	103.1	46.5	10.8	(12.9)	147.5
Other operating income	2.9	4.1	0.2	-	7.2
Total operating income	106.0	50.6	11.0	(12.9)	154.7
Direct costs	(8.7)	(11.7)	(2.5)	(42.9)	(65.8)
Provisions for losses	(4.9)	(1.3)	0.2	-	(6.0)
	92.4	37.6	8.7	(55.8)	82.9

Six months ended 31 March 2020

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Unallocated items £m	Total £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

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2021 (Unaudited)

2. SEGMENTAL RESULTS (Continued)

Year ended 30 September 2020

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Unallocated Items £m	Total Segments £m
Interest receivable	344.9	112.9	30.4	3.5	491.7
Interest payable	(154.9)	(30.8)	(4.3)	(23.6)	(213.6)
Net interest income	190.0	82.1	26.1	(20.1)	278.1
Other operating income	6.5	9.9	0.6	-	17.0
Total operating income	196.5	92.0	26.7	(20.1)	295.1
Direct costs	(16.4)	(24.4)	(6.3)	(79.7)	(126.8)
Provisions for losses	(25.8)	(21.7)	(0.8)	-	(48.3)
	154.3	45.9	19.6	(99.8)	120.0

The segmental profits disclosed above reconcile to the consolidated results as set out below.

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m
Results shown above	82.9	57.2	120.0
Fair value items	13.5	(0.1)	(1.6)
Operating profit	96.4	57.1	118.4

The assets of the segments were:

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m	30 September 2019 £m
Mortgage Lending	11,490.8	11,489.2	11,488.2	11,279.9
Commercial Lending	1,466.0	1,533.0	1,554.3	1,488.4
Idem Capital	258.6	335.7	297.1	389.9
Total segment assets	13,215.4	13,357.9	13,339.6	13,158.2
Unallocated assets	2,273.4	1,331.3	2,165.9	1,237.3
Total assets	15,488.8	14,689.2	15,505.5	14,395.5

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 2021 (Unaudited)

3. INTEREST RECEIVABLE

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m
Interest receivable in respect of			
Loans and receivables	216.6	224.3	440.4
Finance leases	20.1	21.7	44.3
Factoring income	1.1	1.3	2.4
Interest on loans to customers	237.8	247.3	487.1
Other interest receivable	0.8	3.8	4.6
Total interest on financial assets	238.6	251.1	491.7

The above interest arises from:

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m
Financial assets held at amortised cost	218.5	229.4	447.4
Finance leases	20.1	21.7	44.3
	238.6	251.1	491.7

4. INTEREST PAYABLE AND SIMILAR CHARGES

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m
On retail deposits	63.1	64.4	129.7
On asset backed loan notes	10.0	24.4	42.2
On bank loans and overdrafts	3.8	1.2	5.4
On corporate bonds	5.4	5.4	10.9
On retail bonds	8.2	9.3	18.5
On central bank facilities	0.9	3.7	4.5
On repurchase agreements	-	-	-
Total interest on financial liabilities	91.4	108.4	211.2
On pension scheme deficit (note 17)	0.2	0.3	0.4
Discounting on contingent consideration	0.1	0.2	0.4
Discounting on lease liabilities	0.1	0.1	0.2
Other finance costs	(0.7)	0.7	1.4
	91.1	109.7	213.6

All interest payable 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 2021 (Unaudited)

5. OTHER INCOME

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m
Loan account fee income	2.8	3.0	5.7
Broker commissions	1.0	1.1	1.7
Third party servicing	2.1	2.6	5.0
Other income	0.2	0.1	1.6
	6.1	6.8	14.0

All loan account fee income arises from financial assets held at amortised cost.

6. FAIR VALUE NET GAINS / (LOSSES)

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m
Ineffectiveness of fair value hedges (note 12)			
Portfolio hedges of interest rate risk			
Deposit hedge	(0.2)	(0.4)	0.2
Loan hedge	3.9	2.2	0.1
	3.7	1.8	0.3
Ineffectiveness of cash flow hedges	-	-	-
Other hedging movements	6.7	0.6	(2.9)
Net gains / (losses) on other derivatives	3.1	(2.5)	1.0
	13.5	(0.1)	(1.6)

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

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2021 (Unaudited)

7. TAX CHARGE ON PROFIT ON ORDINARY ACTIVITIES

Income tax for the six months ended 31 March 2021 is charged at an effective rate of 23.0% (six months ended 31 March 2020: 22.1%, year ended 30 September 2020: 22.9%), 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% (2020 H1: 19.0%), based on currently enacted legislation. During the year ended 30 September 2020, legislation was substantively enacted, reversing the reduction in the tax rate to 17.0% which had been due to come into effect from April 2020. The effects of the increases in the standard rate for the year ended 30 September 2020 from 18.0% to 19.0%, and the expected rate in subsequent years from 17.0% to 19.0% on deferred tax balances have been accounted for in the year ended 30 September 2020.

The increase in the standard rate of corporation tax in the UK to 25.0% from April 2023, announced in March 2021 had not been substantially enacted at 31 March 2021 and its impact is therefore not yet accounted for in these accounts. It is anticipated that an additional deferred tax credit of around £0.3m and an additional credit to equity of £0.5m will be accounted for when the legislative process is substantially complete, expected to be in the second half of the current financial year.

8. EARNINGS PER SHARE

Earnings per ordinary share is calculated as follows:

		31 March 2021	31 March 2020	30 September 2020
Profit for the period (£m)		74.2	44.5	91.3
Basic weighted average number of ordinary shares ranking for dividend during the period (m)		253.3	253.2	253.6
Dilutive effect of the weighted average number of share options and incentive plans in issue during the period (m)		8.8	4.2	2.5
Diluted weighted average number of ordinary shares ranking for dividend during the period (m)		262.1	257.4	256.1
Earnings per ordinary share	- basic	29.3p	17.6p	36.0p
	- diluted	28.3p	17.3p	35.6p

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2021 (Unaudited)

9. CASH AND CASH EQUIVALENTS

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m	30 September 2019 £m
Balances with central banks	1,832.3	812.7	1,637.1	816.4
Balances with other banks	270.7	394.1	287.9	409.0
	2,103.0	1,206.8	1,925.0	1,225.4

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

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 2021 £m	31 March 2020 £m	30 September 2020 £m	30 September 2019 £m
Available cash	1,895.1	915.6	1,701.1	872.1
Securitisation cash	207.2	290.3	223.4	353.1
ESOP cash	0.7	0.9	0.5	0.2
	2,103.0	1,206.8	1,925.0	1,225.4

Cash and cash equivalents are classified as Stage 1 exposures (see note 11) for the purposes of impairment provisioning. The probabilities of default have been assessed to be so low as to require no significant impairment provision.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2021 (Unaudited)

10. LOANS TO CUSTOMERS

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m	30 September 2019 £m
Loans to customers	12,816.3	12,506.1	12,631.4	12,186.1
Fair value adjustments from portfolio hedging	58.1	79.2	109.7	64.2
	12,874.4	12,585.3	12,741.1	12,250.3

The Group's loan assets at 31 March 2021, analysed between the segments described in note 2, are set out below.

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Total £m
At 31 March 2021				
First mortgages	10,962.0	-	-	10,962.0
Consumer loans	168.6	-	249.7	418.3
Motor finance	-	220.4	8.9	229.3
Asset finance	-	467.8	-	467.8
Development finance	-	552.3	-	552.3
Other commercial loans	-	186.6	-	186.6
Loans to customers	11,130.6	1,427.1	258.6	12,816.3
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

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10. LOANS TO CUSTOMERS (Continued)

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Total £m
At 30 September 2020				
First mortgages	10,636.9	-	-	10,636.9
Consumer loans	182.6	-	281.6	464.2
Motor finance	-	256.9	15.5	272.4
Asset finance	-	478.0	-	478.0
Development finance	-	609.0	-	609.0
Other commercial loans	-	170.9	-	170.9
Loans to customers	10,819.5	1,514.8	297.1	12,631.4
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

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11. IMPAIRMENT PROVISION 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 19 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 2020 year end. At that time, as discussed in the 2020 annual accounts, it was necessary for the Group to depart from its normal provisioning methodology due to the impact of the Covid crisis, both on the Group's customers and on the metrics used to determine credit quality. A broadly similar approach has been applied in determining provision at 31 March 2021.

In extreme or unprecedented economic conditions, such as the Covid pandemic, it is likely that mechanical models will be less predictive of outcomes as the historical data used for modelling will be insufficiently representative of current conditions and this proved to be the case. In these circumstances, management carefully review all outputs to ensure provision is adequate and make appropriate adjustments when this is not the case.

At 31 March 2021 the effects of the material reductions in GDP, and in economic activity in the UK more generally since the onset of the Covid crisis had not yet been evidenced in customer credit performance and defaults, due to the lagging effect of ongoing government policy interventions. Where customers were given payment reliefs, arrears and adverse credit indicators were not recorded by the Group or other lenders, meaning that both internal credit metrics and external credit bureau data might not accurately reflect a customer's credit position leading to modelled PDs being underestimated. At the same time the actual performance of economic indicators over the six month period has been generally upward, meaning that the starting point for economic forecasts is higher than at 30 September 2020.

While forecast economics assume the current economic situation as a starting point, the generally upward trend of the forecasts also tends to reduce PDs, in a way that may not be justifiable where an underlying credit issue on an account has not emerged, which may result in default as government support initiatives unwind.

In reviewing the subsequent payment patterns of accounts that have been granted Covid-related reliefs, it has been evident that there is higher payment volatility (both in terms of account improvement and deterioration) so whilst credit risk is increased, it is not significant in scale in all cases. The Group has reflected this position by applying PD floors to its payment holiday population in the main portfolios at Stage 1, and moved accounts with payment holiday extensions to Stage 2, again with floors reflecting extrapolations of recent cohort experience to allow for the potential under-recognition of losses caused by these effects.

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

While the approach to applying these overlays at 31 March 2021 has remained broadly consistent to that at 30 September 2020, their scale has been uplifted to allow for the generally reduced level of modelled PDs, due to the more benign economic outlook and hence the potential additional under provision on those accounts where a loss or default is being suppressed by reliefs.

In determining whether an account has an SICR in the Covid environment the granting of Covid-related reliefs, including payment holidays and similar arrangements, may mean that an SICR may exist without this being reflected in either arrears performance or credit bureau data. The Group has accepted the advice of UK regulatory bodies that the grant of initial Covid 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.

For customers who have been granted extended payment reliefs, whether these are currently in place or have expired, the account has been placed in Stage 2, regardless of other indicators, as a result of the analysis described above. This aligns the Group's approach to regulatory guidance which suggested that while initial payment reliefs should not automatically be taken as an indication of an SICR, an extension to such a relief was more likely to be so.

This overall approach remains consistent with that taken at 30 September 2020. In reviewing account performance since the year end the Group has not yet identified any positive evidence which would cause it to begin to unwind this position. It will be reviewed going forward as other government economic interventions are scaled back and the post-relief credit characteristics of such accounts become more evident.

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 (those which were 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 PROVISION ON LOANS TO CUSTOMERS (Continued)

Impairments by stage

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

	Stage 1 £m	Stage 2 * £m	Stage 3 * £m	POCI £m	Total £m
31 March 2021					
Gross loan book					
Mortgage Lending	10,063.9	980.0	121.3	14.0	11,179.2
Commercial Lending	1,352.0	79.8	17.7	6.7	1,456.2
Idem Capital	107.2	7.4	27.7	121.0	263.3
Total	11,523.1	1,067.2	166.7	141.7	12,898.7
Impairment provision					
Mortgage Lending	(4.5)	(16.0)	(28.1)	-	(48.6)
Commercial Lending	(17.3)	(2.7)	(8.7)	(0.4)	(29.1)
Idem Capital	(0.2)	(0.3)	(4.2)	-	(4.7)
Total	(22.0)	(19.0)	(41.0)	(0.4)	(82.4)
Net loan book					
Mortgage Lending	10,059.4	964.0	93.2	14.0	11,130.6
Commercial Lending	1,334.7	77.1	9.0	6.3	1,427.1
Idem Capital	107.0	7.1	23.5	121.0	258.6
Total	11,501.1	1,048.2	125.7	141.3	12,816.3
Coverage ratio					
Mortgage Lending	0.04%	1.63%	23.17%	-	0.43%
Commercial Lending	1.28%	3.38%	49.15%	5.97%	2.00%
Idem Capital	0.19%	4.05%	15.16%	-	1.79%
Total	0.19%	1.78%	24.60%	0.28%	0.64%

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

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

	Stage 1 £m	Stage 2 * £m	Stage 3 * £m	POCI £m	Total £m
31 March 2020					
Gross loan book					
Mortgage Lending	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					
Mortgage Lending	(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					
Mortgage Lending	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					
Mortgage Lending	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%

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

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

	Stage 1 £m	Stage 2 * £m	Stage 3 * £m	POCI £m	Total £m
30 September 2020					
Gross loan book					
Mortgage Lending	9,822.6	903.2	127.0	15.0	10,867.8
Commercial Lending	1,384.2	132.3	20.2	6.7	1,543.4
Idem Capital	122.9	9.9	28.9	140.3	302.0
Total	11,329.7	1,045.4	176.1	162.0	12,713.2
Impairment provision					
Mortgage Lending	(5.0)	(12.6)	(30.7)	-	(48.3)
Commercial Lending	(17.0)	(3.0)	(8.2)	(0.4)	(28.6)
Idem Capital	(0.2)	(0.2)	(4.5)	-	(4.9)
Total	(22.2)	(15.8)	(43.4)	(0.4)	(81.8)
Net loan book					
Mortgage Lending	9,817.6	890.6	96.3	15.0	10,819.5
Commercial Lending	1,367.2	129.3	12.0	6.3	1,514.8
Idem Capital	122.7	9.7	24.4	140.3	297.1
Total	11,307.5	1,029.6	132.7	161.6	12,631.4
Coverage ratio					
Mortgage Lending	0.05%	1.40%	24.17%	-	0.44%
Commercial Lending	1.23%	2.27%	40.59%	5.97%	1.85%
Idem Capital	0.16%	2.02%	15.57%	-	1.62%
Total	0.20%	1.51%	24.65%	0.25%	0.64%

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

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. Additional provision arising on these assets post-acquisition is shown as 'Impairment provision' above.

Idem Capital loans include acquired consumer and motor finance loans together with legacy (originated pre-2010) second charge mortgage and unsecured consumer loans. Legacy assets and acquired loans which were performing on acquisition are included in the staging analysis above.

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

Acquired portfolios within the Mortgage Lending and Idem Capital segments which were largely non-performing at acquisition, and which were purchased at a deep discount to face value, are shown as POCI assets above. Although no provision is shown above for such assets, the effect of the discount on purchase is included in the gross value ensuring that the carrying value is substantially less than the current balances due from customers and the level of cover is considerable.

Analysis of Stage 2 loans

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

Cases which have been greater than one month in arrears in the last three months, but which are not at the balance sheet date are shown as 'recent arrears' in the tables below.

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

Levels of Stage 2 assets increased substantially during the early part of the Covid outbreak, with balances at 31 March 2021 significantly higher than at 31 March 2020, though broadly aligned to those at 30 September 2020. The principal trigger driving these increases has been the allocation of accounts with extended payment holidays to Stage 2, as described above. These are shown in the < 1 month arrears column in the table below. As fewer extensions were granted after 30 September 2020, the rate of increase of such Stage 2 cases has been much reduced in the period.

While the numbers of Stage 2 arrears accounts across the portfolios have increased since September 2020 in the Mortgage Lending segment as payment reliefs unwind, levels remain far lower than those seen in March 2020 in more normal payment conditions.

Coverage levels in Stage 2 across the portfolios have increased significantly since 31 March 2020 particularly for '< 1 month arrears' cases with the imposition of PD floors to accounts with payment holiday extensions from 30 September 2020 having a significant impact and levels continuing to build since then. Coverage ratios of '> 1 < = 3 months arrears' cases have been varied due to the composition of the relatively small balances, particularly in the Commercial Lending and Idem Capital divisions.

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

	< 1 month arrears	Recent arrears	> 1 <= 3 months arrears	Total
	£m	£m	£m	£m
31 March 2021				
Gross loan book				
Mortgage Lending	948.2	12.7	19.1	980.0
Commercial Lending	73.6	1.6	4.6	79.8
Idem Capital	3.4	0.8	3.2	7.4
Total	1,025.2	15.1	26.9	1,067.2
Impairment provision				
Mortgage Lending	(15.1)	(0.6)	(0.3)	(16.0)
Commercial Lending	(2.2)	-	(0.5)	(2.7)
Idem Capital	(0.1)	-	(0.2)	(0.3)
Total	(17.4)	(0.6)	(1.0)	(19.0)
Net loan book				
Mortgage Lending	933.1	12.1	18.8	964.0
Commercial Lending	71.4	1.6	4.1	77.1
Idem Capital	3.3	0.8	3.0	7.1
Total	1,007.8	14.5	25.9	1,048.2
Coverage ratio				
Mortgage Lending	1.59%	4.72%	1.57%	1.63%
Commercial Lending	2.99%	-	10.87%	3.38%
Idem Capital	2.94%	-	6.25%	4.05%
Total	1.70%	3.97%	3.72%	1.78%

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

	< 1 month arrears	Recent arrears	> 1 <= 3 months arrears	Total
	£m	£m	£m	£m
31 March 2020				
Gross loan book				
Mortgage Lending	386.1	9.7	52.0	447.8
Commercial Lending	72.2	0.3	9.3	81.8
Idem Capital	6.8	1.3	4.5	12.6
Total	465.1	11.3	65.8	542.2
Impairment provision				
Mortgage Lending	(3.1)	(0.4)	(2.8)	(6.3)
Commercial Lending	(2.0)	-	(0.3)	(2.3)
Idem Capital	(0.1)	-	(0.3)	(0.4)
Total	(5.2)	(0.4)	(3.4)	(9.0)
Net loan book				
Mortgage Lending	383.0	9.3	49.2	441.5
Commercial Lending	70.2	0.3	9.0	79.5
Idem Capital	6.7	1.3	4.2	12.2
Total	459.9	10.9	62.4	533.2
Coverage ratio				
Mortgage Lending	0.80%	4.12%	5.38%	1.41%
Commercial Lending	2.77%	-	3.23%	2.81%
Idem Capital	1.47%	-	6.67%	3.17%
Total	1.12%	3.54%	5.17%	1.66%

CONDENSED FINANCIAL STATEMENTS

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

	< 1 month arrears	Recent arrears	> 1 <= 3 months arrears	Total
	£m	£m	£m	£m
30 September 2020				
Gross loan book				
Mortgage Lending	879.9	5.9	17.4	903.2
Commercial Lending	113.2	10.5	8.6	132.3
Idem Capital	4.8	1.6	3.5	9.9
Total	997.9	18.0	29.5	1,045.4
Impairment provision				
Mortgage Lending	(12.0)	(0.2)	(0.4)	(12.6)
Commercial Lending	(2.5)	(0.1)	(0.4)	(3.0)
Idem Capital	(0.1)	-	(0.1)	(0.2)
Total	(14.6)	(0.3)	(0.9)	(15.8)
Net loan book				
Mortgage Lending	867.9	5.7	17.0	890.6
Commercial Lending	110.7	10.4	8.2	129.3
Idem Capital	4.7	1.6	3.4	9.7
Total	983.3	17.7	28.6	1,029.6
Coverage ratio				
Mortgage Lending	1.36%	3.39%	2.30%	1.40%
Commercial Lending	2.21%	0.95%	4.65%	2.27%
Idem Capital	2.08%	-	2.86%	2.02%
Total	1.46%	1.67%	3.05%	1.51%

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

Analysis of Stage 3 loans

The table below analyses the accounts in Stage 3 between those:

- In the process of sale or other enforcement procedures ('Realisations')
- Where a receiver of rent ('RoR') has been appointed by the Group to manage the property on the customers' behalf
- Which are being managed on a long-term basis and where full recovery is possible, but which are considered to meet regulatory default criteria at the balance sheet date ('>3 month arrears')
- which no longer meet regulatory default criteria but which are being retained in Stage 3 for a probationary period ('Probation')

In these disclosures probation accounts have been analysed separately for the first time, in order to provide better information for users.

RoR accounts in Stage 3 may be fully up-to-date with full recovery possible. These accounts are included in Stage 3 as they are classified as defaulted for regulatory purposes.

The impact of Covid on the number and value of Stage 3 accounts has been limited so far. Payment reliefs have prevented arrears being recorded and other enforcement activities have been limited by government intervention.

The completion of payment relief periods has led to some increase in > 3 month arrears cases, particularly in the Mortgage Lending business, although this is offset by the continuing realisations from the receiver of rent portfolio.

Coverage levels in Mortgage Lending and Idem Capital remain broadly stable compared with 31 March 2020 and 30 September 2020. The coverage ratio for Commercial Lending is subject to fluctuations as the number of cases is relatively low and the ratio can be significantly influenced by individual cases.

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

	Probation	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m	£m
31 March 2021					
Gross loan book					
Mortgage Lending	3.3	23.1	81.3	13.6	121.3
Commercial Lending	1.3	6.9	-	9.5	17.7
Idem Capital	1.1	23.3	-	3.3	27.7
Total	5.7	53.3	81.3	26.4	166.7
Impairment provision					
Mortgage Lending	(0.2)	(2.1)	(20.4)	(5.4)	(28.1)
Commercial Lending	(0.5)	(3.3)	-	(4.9)	(8.7)
Idem Capital	-	(2.6)	-	(1.6)	(4.2)
Total	(0.7)	(8.0)	(20.4)	(11.9)	(41.0)
Net loan book					
Mortgage Lending	3.1	21.0	60.9	8.2	93.2
Commercial Lending	0.8	3.6	-	4.6	9.0
Idem Capital	1.1	20.7	-	1.7	23.5
Total	5.0	45.3	60.9	14.5	125.7
Coverage ratio					
Mortgage Lending	6.06%	9.09%	25.09%	39.71%	23.17%
Commercial Lending	38.46%	47.83%	-	51.58%	49.15%
Idem Capital	-	11.16%	-	48.48%	15.16%
Total	12.28%	15.01%	25.09%	45.08%	24.60%

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

	Probation £m	> 3 month arrears £m	RoR managed £m	Realisations £m	Total £m
31 March 2020					
Gross loan book					
Mortgage Lending	5.3	12.2	95.8	16.6	129.9
Commercial Lending	1.2	6.1	-	7.7	15.0
Idem Capital	1.3	23.9	-	4.5	29.7
Total	7.8	42.2	95.8	28.8	174.6
Impairment provision					
Mortgage Lending	(0.2)	(1.5)	(21.9)	(5.5)	(29.1)
Commercial Lending	(0.3)	(1.1)	-	(4.3)	(5.7)
Idem Capital	-	(2.6)	-	(2.0)	(4.6)
Total	(0.5)	(5.2)	(21.9)	(11.8)	(39.4)
Net loan book					
Mortgage Lending	5.1	10.7	73.9	11.1	100.8
Commercial Lending	0.9	5.0	-	3.4	9.3
Idem Capital	1.3	21.3	-	2.5	25.1
Total	7.3	37.0	73.9	17.0	135.2
Coverage ratio					
Mortgage Lending	3.77%	12.30%	22.86%	33.13%	22.40%
Commercial Lending	25.00%	18.03%	-	55.84%	38.00%
Idem Capital	-	10.88%	-	44.44%	15.49%
Total	6.41%	12.32%	22.86%	40.97%	22.57%

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

	Probation	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m	£m
30 September 2020					
Gross loan book					
Mortgage Lending	6.5	12.9	86.7	20.9	127.0
Commercial Lending	3.2	11.2	-	5.8	20.2
Idem Capital	1.0	24.3	-	3.6	28.9
Total	10.7	48.4	86.7	30.3	176.1
Impairment provision					
Mortgage Lending	(0.3)	(1.5)	(20.8)	(8.1)	(30.7)
Commercial Lending	(0.9)	(4.1)	-	(3.2)	(8.2)
Idem Capital	-	(2.8)	-	(1.7)	(4.5)
Total	(1.2)	(8.4)	(20.8)	(13.0)	(43.4)
Net loan book					
Mortgage Lending	6.2	11.4	65.9	12.8	96.3
Commercial Lending	2.3	7.1	-	2.6	12.0
Idem Capital	1.0	21.5	-	1.9	24.4
Total	9.5	40.0	65.9	17.3	132.7
Coverage ratio					
Mortgage Lending	4.62%	11.63%	23.99%	38.76%	24.17%
Commercial Lending	28.12%	36.61%	-	55.17%	40.59%
Idem Capital	-	11.52%	-	47.22%	15.57%
Total	11.21%	17.36%	23.99%	42.90%	24.65%

The security values available to reduce exposure at default in the calculation shown above for Stage 3 accounts are set out below. The estimated value of the security represents, for each account, the lesser of the valuation estimate and the exposure at default in Central scenario (31 March 2021 and 30 September 2020) or Scenario 1 (31 March 2020). Security values are based on the most recent valuation of the relevant asset held by the Group, indexed or depreciated as appropriate.

	31 March 2021	31 March 2020	30 September 2020
	£m	£m	£m
First mortgages	70.4	69.9	71.9
Second mortgages	17.2	14.3	17.3
Asset finance	4.4	4.1	6.7
Motor finance	1.9	1.2	1.5
	93.9	89.5	97.4

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

The RoR managed accounts are being managed to ensure the optimal resolution for landlords, tenants and lenders and have largely reached a long-term, stable position, but the existence of the RoR arrangement causes the accounts to be treated as defaulted for regulatory purposes. The Group's RoR arrangements are described in more detail below.

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

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

Where a buy-to-let mortgage customer in England or Wales falls into arrears on their account the Group has the power to appoint a receiver of rent under the Law of Property Act. The receiver will then manage the property on behalf of the customer, collecting rents and remitting them to make payments on the account. While the receiver has the power to sell the property, in many cases they will operate it as a buy-to-let on at least a short to medium term basis, potentially longer, depending on the individual circumstances of the case. This causes less disruption to the tenants and may result in the mortgage account returning to performing status and the property being handed back to the customer.

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

	31 March 2021		31 March 2020		30 September 2020	
	Number	£m	Number	£m	Number	£m
Managed accounts						
Appointment date						
2010 and earlier	350	59.1	384	65.5	369	62.4
2011 to 2013	64	10.7	82	15.7	72	12.4
2014 to 2016	27	3.9	31	4.5	29	4.2
2016 and later	46	7.6	63	10.1	46	7.7
Total managed accounts	487	81.3	560	95.8	516	86.7
Accounts in the process of realisation	69	13.1	84	14.7	104	19.7
	556	94.4	644	110.5	620	106.4

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

In addition to the cases analysed above, 1 POCI account also had a receiver of rent appointed (31 March 2020: 4, 30 September 2020: 3), making a total of 557 (30 September 2020: 623).

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

Movements in impairment provision

The movements in the impairment provision calculated under IFRS 9, analysed by business segments, are set out below.

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Total £m
At 30 September 2020	48.3	28.6	4.9	81.8
Provided in period	4.9	1.8	-	6.7
Amounts written off	(4.6)	(1.3)	(0.2)	(6.1)
At 31 March 2021	48.6	29.1	4.7	82.4
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)
At 31 March 2020	37.3	24.2	5.2	66.7
At 30 September 2019	26.8	10.7	4.4	41.9
Provided in period	25.8	22.7	1.3	49.8
Amounts written off	(4.3)	(4.8)	(0.8)	(9.9)
At 30 September 2020	48.3	28.6	4.9	81.8

Accounts are considered to be written off for accounting purposes if a balance remains once standard enforcement processes have been completed, subject to any amount retained in respect of expected salvage receipts. This has no effect on the net carrying value, only on the amounts reported as gross loan balances and accumulated impairment provisions.

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 2020: £0.7m, 30 September 2020: £1.5m).

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11. IMPAIRMENT PROVISION 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 2021, the six months ended 31 March 2020, and the year ended 30 September 2020 are set out below.

These tables, and the matching tables analysing movements in gross balances, have been compiled by comparing opening and closing balances on each account and analysing the movements between them.

Changes due to credit risk includes all changes in model parameters whether related to account performance, external credit data or model assumptions, including economic scenarios and weightings.

There have been no changes in models creating significant movements in balances in the period.

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Loss allowance at 30 September 2020	22.2	15.8	43.4	0.4	81.8
New assets originated or purchased	5.7	-	-	-	5.7
Changes in loss allowance					
Transfer to Stage 1	3.6	(1.5)	(2.1)	-	-
Transfer to Stage 2	(1.0)	2.0	(1.0)	-	-
Transfer to Stage 3	(0.1)	(0.5)	0.6	-	-
Changes on stage transfer	(2.9)	1.8	4.9	-	3.8
Changes due to credit risk	(5.5)	1.4	1.3	-	(2.8)
Write offs	-	-	(6.1)	-	(6.1)
Loss allowance at 31 March 2021	22.0	19.0	41.0	0.4	82.4

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

	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 on stage transfer	(0.5)	2.0	3.2	-	4.7
Changes due to credit risk	10.3	3.9	9.4	0.2	23.8
Write offs	-	-	(5.9)	-	(5.9)
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 30 September 2019	6.0	3.7	32.2	-	41.9
New assets originated or purchased	10.2	-	-	-	10.2
Changes in loss allowance					
Transfer to Stage 1	0.9	(0.7)	(0.2)	-	-
Transfer to Stage 2	(1.2)	1.3	(0.1)	-	-
Transfer to Stage 3	(0.5)	(0.4)	0.9	-	-
Changes on stage transfer	(0.5)	7.5	6.2	-	13.2
Changes due to credit risk	7.3	4.4	14.3	0.4	26.4
Write offs	-	-	(9.9)	-	(9.9)
Loss allowance at 30 September 2020	22.2	15.8	43.4	0.4	81.8

The level of loss allowances has remained broadly stable through the six month period. The availability of payment holidays and other reliefs more widely has tended to reduce mobility between categories and potentially troubled accounts have generally not moved through to resolution and write off. PD floors allow for these impacts to remain in place but also have a damping effect on movements.

As noted above accounts which have had extended payment reliefs have been included Stage 2, when otherwise they would have qualified for Stage 1.

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

Stage 2 amounts at 31 March 2021 include £661.2m of balances with extended payment reliefs which were identified as having an SICR for this reason only (31 March 2020: £nil, 30 September 2020: £576.3m).

Overall the impact of the PMAs including PD floors and the transfer of additional accounts to the life-time ECL provisioning required by Stage 2 has increased the total provision by £27.5m from £54.9m which would have been indicated had only the Group's standard SICR tests been used (31 March 2020: £nil, 30 September 2020: Increase of £19.8m).

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 2020	11,329.7	1,045.4	176.1	162.0	12,713.2
New assets originated or purchased	1,079.1	-	-	-	1,079.1
Changes in staging					
Transfer to Stage 1	116.9	(109.2)	(7.7)	-	-
Transfer to Stage 2	(215.7)	223.0	(7.3)	-	-
Transfer to Stage 3	(18.3)	(21.2)	39.5	-	-
Redemptions and repayments	(974.8)	(89.2)	(29.6)	(29.0)	(1,122.6)
Write offs	-	-	(6.1)	-	(6.1)
Other changes	206.2	18.4	1.8	8.7	235.1
Balance at 31 March 2021	11,523.1	1,067.2	166.7	141.7	12,898.7
Loss allowance	(22.0)	(19.0)	(41.0)	(0.4)	(82.4)
Carrying value	11,501.1	1,048.2	125.7	141.3	12,816.3

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

	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)
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 30 September 2019	11,382.6	458.5	167.9	219.0	12,228.0
New assets originated or purchased	2,071.4	-	-	-	2,071.4
Changes in staging					
Transfer to Stage 1	202.3	(200.1)	(2.2)	-	-
Transfer to Stage 2	(846.2)	849.2	(3.0)	-	-
Transfer to Stage 3	(42.6)	(20.5)	63.1	-	-
Redemptions and repayments	(1,488.3)	(54.1)	(42.0)	(78.1)	(1,662.5)
Write offs	-	-	(9.9)	-	(9.9)
Other changes	50.5	12.4	2.2	21.1	86.2
Balance at 30 September 2020	11,329.7	1,045.4	176.1	162.0	12,713.2
Loss allowance	(22.2)	(15.8)	(43.4)	(0.4)	(81.8)
Carrying value	11,307.5	1,029.6	132.7	161.6	12,631.4

Other changes includes interest and similar charges.

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

Economic impacts

Impairment provision under IFRS 9 is calculated on a forward-looking ECL basis, based on expected economic conditions in multiple internally coherent scenarios. While the provision calculation is intended to address all possible future economic outcomes, the Group, in common with most other lenders, uses a small number of differing scenarios as representatives of this universe of potential outturns.

The Group uses four distinct economic scenarios chosen to represent the range of possible outcomes and allow for the impact of economic asymmetry in the calculations. Each scenario comprises a number of economic parameters and while models for different portfolios may not use all of the variables, the set, as a whole, is defined for the Group and must be consistent.

As the Group does not have an internal economics function, in developing its economic scenarios it considers analysis from reputable external sources to form a general market consensus which informs its central scenario. These sources include data and forecasts produced by the Office of Budget Responsibility ('OBR') and the PRA as well as private sector economic research bodies. The Group also takes account of public statements from bodies such as the Bank of England and the UK Government to inform its final position.

The central scenario used for IFRS 9 impairment purposes is the same scenario which forms the basis of its business planning and forecasting and will therefore generally carry the highest probability weighting. In its March 2021 forecasting cycle (the 'April reforecast') the Group has adopted a central economic scenario derived using a broadly equivalent approach to that used in September 2020, with the starting point of the scenario updated to reflect the actual movements of economic variables in the six months. Compared to the central scenario adopted at 30 September 2020, the new central forecast is broadly similar across the five year period, but with an additional degree of optimism in the very short-term. This upgrade for the early months of the new central scenario is a result of the better than predicted opening position and of the progress made in combatting the pandemic in the UK, including the success of the vaccination programme to date.

The upside and downside scenarios continue to be derived from the central scenario, as they have been in previous periods. However, for the April reforecast these scenarios are not as markedly different in shape as at September 2020, with a greater level of consensus as to the shape and timing of the post-Covid trajectory of the UK economy emerging among analysts and commentors.

The severe scenario has been derived from the stress testing scenarios published by the Bank of England, as in previous periods. From the commentary published with the Bank of England scenarios the Group understands the scenario to be intentionally less severe than those previously published and, in particular, the projection for house prices, one of the most influential variables in the Group's modelling was less harsh than previously seen. Therefore, the Group flexed the forecast for IFRS 9 purposes to include a more severe house price impact.

Following a review of the weightings of the different scenarios, set against the overall potential for variability in the future economic outlook, the Group decided to maintain the scenario weightings used at 30 September 2020. The 15% weighting assigned to the severe scenario reflects the fact that the underlying Bank of England stress is not calibrated on a once in 200 year basis, but is rather less severe.

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

The weightings attached to each scenario are set out below

	31 March 2021	30 September 2020	31 March 2020
Central Scenario	40%	40%	40%
Upside Scenario	10%	10%	10%
Downside Scenario	35%	35%	35%
Severe Scenario	15%	15%	15%
	100%	100%	100%

The economic variables comprising each scenario, and their average projected values in each of the first five years of the forecast period are set out below. Values are shown for the twelve months ending on 31 March or 30 September in each year as appropriate.

31 March 2021

Gross Domestic Product ('GDP') (year-on-year change)

	2021 %	2022 %	2023 %	2024 %	2025 %
Central scenario	11.4	4.3	2.0	1.9	2.1
Upside scenario	12.2	3.5	2.0	2.0	2.0
Downside scenario	10.3	4.8	2.5	1.9	2.1
Severe scenario	6.7	7.7	3.6	1.8	1.9

House Price Index ('HPI') (year-on-year change)

	2021 %	2022 %	2023 %	2024 %	2025 %
Central scenario	0.4	1.3	2.8	2.9	3.2
Upside scenario	3.8	3.5	4.7	4.6	2.9
Downside scenario	(4.8)	(6.3)	(0.6)	2.1	2.0
Severe scenario	(15.3)	(11.1)	(6.9)	(0.6)	0.9

Bank Base Rate ('BBR') (rate)

	2021 %	2022 %	2023 %	2024 %	2025 %
Central scenario	0.1	0.1	0.3	0.6	0.8
Upside scenario	0.1	0.3	0.8	1.0	1.0
Downside scenario	0.1	0.1	0.1	0.3	0.4
Severe scenario	(0.1)	(0.1)	0.0	0.1	0.2

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

Consumer Price Inflation ('CPI') (rate)

	2021 %	2022 %	2023 %	2024 %	2025 %
Central scenario	1.7	2.0	1.9	2.1	2.0
Upside scenario	1.9	2.2	2.2	2.0	2.0
Downside scenario	1.3	1.5	2.0	2.2	2.3
Severe scenario	0.9	0.3	1.1	1.6	1.9

Unemployment (rate)

	2021 %	2022 %	2023 %	2024 %	2025 %
Central scenario	6.9	5.3	4.8	4.4	4.3
Upside scenario	5.8	5.4	4.8	4.4	4.3
Downside scenario	7.9	6.5	5.7	5.0	4.8
Severe scenario	11.8	10.4	7.1	5.2	4.8

Secured lending (annual change)

	2021 %	2022 %	2023 %	2024 %	2025 %
Central scenario	4.9	3.9	3.4	3.1	3.1
Upside scenario	5.4	5.1	4.5	4.0	3.6
Downside scenario	3.6	3.0	2.7	3.3	3.8
Severe scenario	0.2	(2.3)	(0.4)	1.7	2.5

Consumer credit (annual change)

	2021 %	2022 %	2023 %	2024 %	2025 %
Central scenario	(0.6)	3.9	5.0	5.9	6.1
Upside scenario	0.7	5.8	7.0	7.6	8.2
Downside scenario	(1.8)	2.8	2.0	2.0	2.0
Severe scenario	5.1	3.2	1.0	2.2	4.5

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

31 March 2020

Gross Domestic Product ('GDP') (year-on-year change)

	2020	**2021**	**2022**	**2023**	**2024**
	%	**%**	**%**	**%**	**%**
Central scenario	(6.7)	9.0	2.9	1.5	1.5
Upside scenario	(3.3)	7.4	2.5	1.5	1.5
Downside scenario	(10.0)	10.9	3.3	1.5	1.5
Severe scenario	(11.9)	10.1	3.9	1.5	1.5

House Price Index ('HPI') (year-on-year change)

	2020	**2021**	**2022**	**2023**	**2024**
	%	**%**	**%**	**%**	**%**
Central scenario	(1.7)	(0.5)	3.0	4.5	3.8
Upside scenario	(0.4)	0.5	2.0	3.5	3.0
Downside scenario	(6.0)	(5.0)	0.3	2.5	3.8
Severe scenario	(9.8)	(13.8)	(5.3)	1.3	2.3

Bank Base Rate ('BBR') (rate)

	2020	**2021**	**2022**	**2023**	**2024**
	%	**%**	**%**	**%**	**%**
Central scenario	0.1	0.1	0.2	0.7	0.8
Upside scenario	0.1	0.2	0.6	0.8	1.0
Downside scenario	0.1	0.1	0.1	0.4	0.8
Severe scenario	0.0	(0.4)	0.1	0.2	0.5

Consumer Price Inflation ('CPI') (rate)

	2020	**2021**	**2022**	**2023**	**2024**
	%	**%**	**%**	**%**	**%**
Central scenario	0.6	1.4	1.9	2.0	2.0
Upside scenario	0.8	1.6	2.1	2.2	2.5
Downside scenario	0.2	0.8	1.4	1.8	1.8
Severe scenario	0.1	0.2	1.2	1.8	2.3

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

Unemployment (rate)

	2020	2021	2022	2023	2024
	%	%	%	%	%
Central scenario	6.8	5.5	5.0	5.0	5.0
Upside scenario	6.2	4.8	4.8	4.6	4.5
Downside scenario	8.2	6.8	6.1	5.3	5.0
Severe scenario	8.5	8.1	7.4	6.6	6.1

Secured lending (annual change)

	2020	2021	2022	2023	2024
	%	%	%	%	%
Central scenario	3.4	3.6	3.7	3.9	3.9
Upside scenario	4.2	4.7	4.3	4.1	4.0
Downside scenario	2.1	1.9	2.7	3.5	3.8
Severe scenario	0.2	(0.7)	1.3	3.0	3.7

Consumer credit (annual change)

	2020	2021	2022	2023	2024
	%	%	%	%	%
Central scenario	6.0	6.1	6.1	6.2	6.3
Upside scenario	7.9	8.7	7.6	7.1	6.7
Downside scenario	2.9	1.9	3.7	4.9	5.6
Severe scenario	(1.8)	(4.4)	0.1	2.8	4.7

30 September 2020

Gross Domestic Product ('GDP') (year-on-year change)

	2021	2022	2023	2024	2025
	%	%	%	%	%
Central scenario	4.9	5.7	2.2	1.5	1.4
Upside scenario	6.0	5.4	2.4	1.5	1.5
Downside scenario	2.1	9.3	2.9	1.3	1.5
Severe scenario	0.2	9.5	2.2	1.4	1.3

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

House Price Index ('HPI') (year-on-year change)

	2021 %	2022 %	2023 %	2024 %	2025 %
Central scenario	(0.8)	0.3	4.0	4.0	3.8
Upside scenario	1.3	1.3	3.0	3.3	3.8
Downside scenario	(3.5)	(7.0)	(0.1)	3.8	3.8
Severe scenario	(11.8)	(13.8)	(5.3)	1.5	3.8

Bank Base Rate ('BBR') (rate)

	2021 %	2022 %	2023 %	2024 %	2025 %
Central scenario	0.1	0.1	0.4	0.8	0.8
Upside scenario	0.1	0.4	0.7	0.9	1.0
Downside scenario	0.1	0.1	0.1	0.3	0.8
Severe scenario	0.0	(0.2)	0.1	0.2	0.6

Consumer Price Inflation ('CPI') (rate)

	2021 %	2022 %	2023 %	2024 %	2025 %
Central scenario	0.9	1.7	2.2	2.1	2.1
Upside scenario	1.2	2.1	2.1	2.2	2.1
Downside scenario	0.7	1.3	1.8	2.1	2.0
Severe scenario	(0.1)	0.7	1.5	2.0	2.0

Unemployment (rate)

	2021 %	2022 %	2023 %	2024 %	2025 %
Central scenario	7.1	5.3	5.0	5.0	4.4
Upside scenario	6.3	4.8	4.6	4.5	4.1
Downside scenario	8.2	6.5	5.7	5.0	4.8
Severe scenario	8.5	7.8	7.0	6.3	5.5

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

Secured lending (annual change)

	2021 %	2022 %	2023 %	2024 %	2025 %
Central scenario	3.6	3.7	3.8	3.9	3.9
Upside scenario	4.7	4.5	4.2	4.1	4.0
Downside scenario	1.8	2.3	3.2	3.7	3.8
Severe scenario	(0.9)	0.2	2.3	3.4	3.7

Consumer credit (annual change)

	2021 %	2022 %	2023 %	2024 %	2025 %
Central scenario	6.0	6.1	6.1	6.3	6.3
Upside scenario	8.7	8.2	7.3	6.9	6.7
Downside scenario	1.8	2.8	4.3	5.4	5.7
Severe scenario	(4.6)	(2.3)	1.6	4.0	4.8

After the end of the initial five year period, the final rate or rate of change (as appropriate) is assumed to continue into the future in each scenario.

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

31 March 2021

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max %	Min %	Max %	Min %	Max %	Min %	Max %	Min %
Economic driver								
GDP	18.1	1.9	20.7	1.9	16.5	1.9	14.3	(0.3)
HPI	7.4	(3.8)	8.6	1.1	3.4	(10.0)	3.5	(20.2)
BBR	0.8	0.1	1.0	0.1	0.5	0.1	0.2	(0.1)
CPI	2.1	1.4	2.3	1.6	2.3	1.0	2.0	0.2
Unemployment	7.8	4.2	5.9	4.2	8.5	4.6	11.9	4.5
Secured lending	5.3	3.0	5.5	3.5	4.0	2.5	2.7	(2.5)
Consumer credit	6.1	(3.4)	8.2	(2.5)	4.6	(5.9)	9.2	0.3

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

31 March 2020

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	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 2020

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max %	**Min %**	**Max %**	**Min %**	**Max %**	**Min %**	**Max %**	**Min %**
Economic driver								
GDP	18.0	(7.6)	18.8	(5.9)	17.8	(15.1)	20.5	(17.9)
HPI	5.0	(4.0)	4.0	0.0	4.0	(10.0)	4.0	(20.0)
BBR	0.8	0.1	1.0	0.1	1.0	0.1	0.8	(0.4)
CPI	2.4	0.6	2.3	0.7	2.3	0.2	2.3	(0.3)
Unemployment	7.6	4.0	7.0	4.0	9.0	4.5	9.0	5.3
Secured lending	3.9	3.5	4.8	4.0	3.8	1.7	3.7	(1.2)
Consumer credit	6.3	6.0	8.8	6.7	5.7	1.5	4.8	(5.2)

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

	31 March 2021 £m	**31 March 2020 £m**	**30 September 2020 £m**
Provision using central scenario 100% weighted			
Mortgage Lending	37.2	28.9	37.2
Commercial Lending	27.6	23.0	26.7
Idem Capital	3.4	3.8	3.5
	68.2	55.7	67.4
Calculated impairment provision	82.4	66.7	81.8
Effect of multiple economic scenarios	14.2	11.0	14.4

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

To illustrate the potential impact of differing future economic scenarios on the total impairment, the provisions which would be calculated if each of the economic scenarios were 100% weighted are shown below.

Scenarios	31 March 2021 Provision £m	31 March 2021 Difference £m	30 September 2020 Provision £m	30 September 2020 Difference £m
Central	68.2	(14.2)	67.4	(14.4)
Upside	58.4	(24.0)	58.0	(23.8)
Downside	87.9	5.5	82.4	0.6
Severe downside	123.7	41.3	134.3	52.5

The weighted average of these 100% weighted provisions need not equal the weighted average ECL due to the impact of the differing PDs on staging. However due to the impact of post-model stage adjustments at 30 September 2020, the effect on the PD SICR test of 100% weighting has not been taken into account in these calculations.

In order to illustrate the impact of scenario weightings and the effect of PMAs on the outcomes, the impairment provision requirements were sensitised using alternative weightings and different PMA calibrations.

- Sensitivity A is based on the weightings used in the provision modelling, but with PMAs determined on the same basis as 30 September 2020
- Sensitivity B is based on the weightings used at IFRS 9 transition on 1 October 2018, but uses the 31 March 2021 PMA basis. The use of the 2018 weighting is intended to represent a more settled outlook than has been evident in recent years
- Sensitivity C uses both the benign 2018 scenario weightings and the 30 September 2020 basis for PMAs

The weightings used, and the results of applying these sensitivities to the 31 March 2021 scenarios are set out below.

	Weighting Central	Weighting Upside	Weighting Downside	Weighting Severe Downside	Impairment £m	Difference £m
As reported	40%	10%	35%	15%	82.4	-
Sensitivity A	40%	10%	35%	15%	73.4	(9.0)
Sensitivity B	40%	30%	25%	5%	73.0	(9.4)
Sensitivity C	40%	30%	25%	5%	64.0	(18.4)

The sensitivities above are intended as mathematical illustrations of the impact of weightings and PMAs on the Group's modelling. They do not necessarily represent alternative potential impairment values as other factors might also need to be considered in arriving at a final provision figure if circumstances differed from those at the balance sheet date.

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12. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m	30 September 2019 £m
Derivative financial assets	180.7	538.1	463.3	592.4
Derivative financial liabilities	(76.2)	(94.6)	(132.4)	(80.5)
	104.5	443.5	330.9	511.9
Of which:				
Cross-currency basis swaps	153.0	522.8	445.3	582.7
Interest rate swaps in hedging relationships	(51.6)	(76.6)	(115.6)	(70.7)
Other interest rate swaps	3.0	(3.3)	1.0	(0.1)
Currency futures	0.1	0.6	0.2	-
	104.5	443.5	330.9	511.9

All hedging relationships and strategies at 30 September 2020 described in note 20 to the 2020 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.

13. INTANGIBLE ASSETS

Intangible assets at net book value comprise:

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m	30 September 2019 £m
Goodwill	164.4	164.4	164.4	164.4
Computer software	3.0	2.2	2.2	2.4
Other intangibles	3.1	3.9	3.5	4.3
Total assets	170.5	170.5	170.1	171.1

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13. INTANGIBLE ASSETS (Continued)

The balance for goodwill at 31 March 2021 shown above includes £113.0m in respect of the SME Lending Cash Generating Unit ('CGU') and £49.8m in respect of the Development Finance CGU. While the overall short-term economic outlook for these businesses has improved since September 2020 the changes in the Group's forecasts of activity for these units suggested that these balances should be retested for impairment in accordance with IAS 36 for good order.

These tests were conducted in the same way as those described in note 26 to the 2020 Group Accounts, using the updated forecasts. The levels of business activity in these forecasts are considered by management to form a reasonable basis for the assessment of goodwill based on past experience and the current economic environment. The revised key assumptions are set out below.

- The level of business activity in the SME Lending CGU assumes a compound annual growth rate ('CAGR') for new business over the five-year period of 19.0%, a small reduction from the 19.7% assumed at 30 September 2020
- The level of business activity in the Development Finance CGU assumes a CAGR for new commitments over the five-year period of 18.8%, compared with 16.9% used at 30 September 2020
- In both CGUs cash flows beyond the five-year budget are extrapolated using a constant growth rate of 1.9% (30 September 2020: 1.5%) 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 SME Lending cash flow projection is 13.5% (30 September 2020: 15.0%) while that applied to the Development Finance CGU was 13.4% (30 September 2020: 14.2%)

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

- The Group has calculated that a 10.0% reduction in profit levels in the SME Lending CGU coupled with a 150 basis point increase in the pre-tax discount rate would eliminate the headroom in the projection. In the testing carried out at 30 September 2020, a 10.0% reduction in profit levels coupled with a 100 basis point increase in the pre-tax discount rate would 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 2020

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14. RETAIL DEPOSITS

The Group's retail deposits, held by Paragon Bank PLC, were received from customers in the UK and are denominated in sterling. The deposits comprise principally term deposits, and notice and easy access accounts. The method of interest calculation on these deposits is analysed below.

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m	30 September 2019 £m
Fixed rate	5,312.8	4,333.7	4,975.9	4,154.4
Variable rates	3,318.4	2,578.2	2,880.7	2,237.5
	8,631.2	6,911.9	7,856.6	6,391.9

The weighted average interest rate on retail deposits at 31 March 2021, analysed by charging method, is set out below.

	31 March 2021 %	31 March 2020 %	30 September 2020 %	30 September 2019 %
Fixed rate	1.46	1.95	1.69	2.02
Variable rates	0.46	1.34	0.72	1.43
All deposits	1.08	1.74	1.34	1.81

The contractual maturity of these deposits is analysed below.

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m	30 September 2019 £m
Amounts repayable				
In less than three months	670.1	489.0	565.0	466.6
In more than three months but not more than one year	2,947.4	2,188.9	2,725.6	2,088.4
In more than one year, but not more than two years	1,599.4	1,224.5	1,541.6	1,158.0
In more than two years, but not more than five years	596.4	937.0	664.8	900.9
Total term deposits	5,813.3	4,839.4	5,497.0	4,613.9
Repayable on demand	2,817.9	2,072.5	2,359.6	1,778.0
	8,631.2	6,911.9	7,856.6	6,391.9
Fair value adjustments for portfolio hedging	3.1	7.8	10.4	3.9
	8,634.3	6,919.7	7,867.0	6,395.8

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15. BORROWINGS

On 12 March 2021, Fitch Ratings confirmed the Group's Long-Term Issuer Default Rating at BBB. The outlook was upgraded from negative to stable. It affirmed its senior unsecured debt rating at BBB- and the rating of the 2016 £150.0m Tier-2 Bond at BB+.

All borrowings described in the Group Accounts for the year ended 30 September 2020 remained in place throughout the period, except as noted below.

Since 30 September 2020 the Group has made further drawings under the Bank of England Term Funding Scheme for SMEs ('TFSME'), increasing its borrowings under the scheme to £2,025.0m. Borrowings of £725.0m under the original Bank of England Term Funding Scheme ('TFS') which were due for settlement in the current financial year were repaid.

During the period the Group also continued to have access to the Indexed Long-Term Repo ('ILTR') scheme provided by the Bank of England, but did not make any drawings.

On 25 March 2021 the Company issued £150.0m of Fixed Rate Callable Subordinated Tier-2 Notes due 2031 at par. These Notes bear interest at a rate of 4.375% per annum until 25 September 2026 after which interest will be payable at a rate which is 3.956% over that payable on UK Government bonds of similar duration at that time. These Notes are callable at the option of the Company between 25 June 2026 and 25 September 2026 and may be called at any time in the event of certain tax or regulatory changes. The Notes are unsecured and subordinated to all creditors of the Company other than the Tier-2 Notes issued in 2016, with which they rank equally. The Notes are rated BB+ by Fitch. The proceeds of the Notes will be utilised in accordance with the Group's Green Bond Framework, which is available on its investor website at www.paragonbankinggroup.co.uk/resources/paragon-group/documents/green-bond/paragong reenbondframeworkmarch2021.

At the same time as this issuance the Group purchased £130.9m of nominal value of its 2016 Tier-2 Notes by market tender for a total consideration of £134.6m. These Notes have been derecognised and the premium paid taken to profit and loss as interest payable and similar charges. The Group intends to redeem its remaining 2016 Bonds at their call date in September 2021.

In March 2021 the Group's warehouse loan facility, held by Paragon Seventh Funding Limited was renegotiated and the margin payable on drawings reduced to 0.60% above LIBOR from 1.05% above LIBOR. This facility is expected to transition to a SONIA-referenced basis in the second half of the year.

During the period the Group also entered into a £50.0m short-term repurchase agreement for liquidity management purposes using certain of its retained notes as security. The terms of this transaction were such that the assets were not derecognised, and a borrowing is shown on the Group's balance sheet. Fees were charged at a rate of 0.40% per annum on the principal balance.

The Group's £60.0m retail bond was repaid in full at its due date of 5 December 2020.

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15. BORROWINGS (Continued)

On 11 November 2020 a Group company, Paragon Mortgages (No. 28) PLC, issued £703.1m of rated sterling mortgage backed floating rate notes, analysed below, at par.

Class	Fitch rating	Moody's rating	Interest margin above compounded SONIA	Principal value £m
A	AAA	Aaa	0.95%	623.8
B	AA	Aa1	1.35%	39.7
C	A	Aa3	1.65%	21.6
D	BBB-	Baa1	1.95%	18.0
				703.1

All of the above notes were retained by the Group. This gives the Group access to additional liquidity, as described in note 57 to the 2020 Group Accounts.

Of the Group's borrowings at 30 September 2020, the mortgage backed floating rate notes issued by Paragon Mortgages (No. 11) PLC were repaid in October 2020 and those issued by Paragon Mortgages (No. 15) PLC in December 2020. In March 2021 notice was given of the Group's intention to repay the remaining notes issued by Paragon Mortgages (No. 13) PLC and this took place on 15 April 2021, after the end of the period. In each case, this followed the purchase of the entity's loan assets by other group companies.

Following the end of the period, on 24 May 2021, notice was given of the Group's intention to repay the remaining notes issued by Paragon Mortgages (No. 14) PLC and this is expected to take place in June 2021.

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

During the period agreement was reached with the holders of the debt of Paragon Second Funding Limited to convert the reference rate from LIBOR to SONIA on broadly similar economic terms. This was not accounted for as a modification, as permitted by IFRS 9.

16. SUNDRY LIABILITIES

Sundry liabilities include £28.0m of amounts falling due after more than one year (31 March 2020: £36.9m; 30 September 2020: £30.7m).

Total sundry liabilities include £11.5m in respect of contingent consideration (31 March 2020: £19.5m, 30 September 2020: £13.5m), of which £6.2m falls due after more than one year (31 March 2020: £12.0m, 30 September 2020: £10.3m), and £5.4m in respect of lease liabilities (31 March 2020: £6.4m, 30 September 2020: £5.6m), of which £3.8m falls due after more than one year (31 March 2020: £4.8m, 30 September 2020: £4.1m).

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17. RETIREMENT BENEFIT OBLIGATIONS

The defined benefit obligation at 31 March 2021 has been calculated on a year-to-date basis. Since the last IAS 19 actuarial valuation at 30 September 2020, 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 2021. In particular, over the period since the 30 September 2020 actuarial valuation, the discount rate has increased by 40 basis points per annum, whereas expectations of long-term inflation have increased by a lower amount, around 35 basis points.

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 2021 reducing substantially from that at 30 September 2020. The impact of allowing for the changes 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 2021 are summarised below.

	Six months to 31 March 2021 £m	Six months to 31 March 2020 £m	Year to 30 September 2020 £m
Opening pension deficit	20.4	34.5	34.5
Employer contributions	(2.6)	(2.2)	(24.5)
Amounts posted to profit and loss			
Current service cost	1.1	1.0	2.0
Net funding cost (note 4)	0.2	0.3	0.4
Administrative expenses	0.5	0.3	0.6
Amounts posted to other comprehensive income			
Return on plan assets not included in interest	(2.7)	13.8	1.8
Experience (gain) on liabilities	-	(1.3)	(1.6)
Actuarial (gain) / loss from changes in financial assumptions	(5.1)	(18.1)	6.0
Actuarial (gain) / loss from changes in demographic assumptions	-	-	1.2
Closing pension deficit	11.8	28.3	20.4

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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18. CALLED-UP SHARE CAPITAL

Movements in the issued share capital in the period were:

	Six months to 31 March 2021 Number	Six months to 31 March 2020 Number	Year to 30 September 2020 Number
Ordinary shares of £1 each			
Opening share capital	261,777,972	261,573,351	261,573,351
Shares issued	219,779	127,256	204,621
Closing share capital	261,997,751	261,700,607	261,777,972

During the period, the Company issued 219,779 shares (six months ended 31 March 2020: 127,256; year ended 30 September 2020: 204,621) to satisfy options granted under Sharesave schemes for a consideration of £751,254 (six months ended 31 March 2020: £322,725; year ended 30 September 2020: £585,315).

19. RESERVES

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m	30 September 2019 £m
Share premium account	69.2	68.5	68.7	68.3
Capital redemption reserve	50.3	50.3	50.3	50.3
Merger reserve	(70.2)	(70.2)	(70.2)	(70.2)
Cash flow hedging reserve	0.2	2.6	2.5	3.0
Profit and loss account	927.4	842.0	880.7	835.9
	976.9	893.2	932.0	887.3

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20. OWN SHARES

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m
Treasury shares			
At 30 September 2020	23.0	23.0	23.0
Shares purchased	-	-	-
Shares cancelled	-	-	-
At 31 March 2021	23.0	23.0	23.0
ESOP shares			
At 30 September 2020	14.8	17.5	17.5
Shares purchased	-	-	5.2
Options exercised	(2.7)	(7.6)	(7.9)
At 31 March 2021	12.1	9.9	14.8
Total at 31 March 2021	35.1	32.9	37.8
Total at 30 September 2020	37.8	40.5	40.5
Number of shares held			
Treasury	5,218,702	5,218,702	5,218,702
ESOP	3,056,632	2,190,231	3,636,218
Total at 31 March 2021	8,275,334	7,408,933	8,854,920

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21. EQUITY DIVIDEND

Amounts recognised as distributions to equity shareholders in the period:

	Six months to 31 March 2021 £m	Six months to 31 March 2020 £m	Year to 30 September 2020 £m
Final dividend for the year ended 30 September 2020 of 14.4p per share	36.5	-	-
Final dividend for the year ended 30 September 2019 of 14.2p per share	-	35.9	35.9
Interim dividend for the year ended 30 September 2020 of 0.0p per share	-	-	-
	36.5	35.9	35.9

An interim dividend of 7.2p is proposed for the period (2020: £nil per share), for the reasons set out in note 26(a). This will be paid on 23 July 2021 with a record date of 2 July 2021. The amount expected to be absorbed by this dividend, based on the number of shares in issue at the balance sheet date is £18.3m (31 March 2020: £nil). The interim dividend will be recognised in the accounts when it is paid.

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22. NET CASH FLOW FROM OPERATING ACTIVITIES

	Six months to 31 March 2021 £m	Six months to 31 March 2020 £m	Year to 30 September 2020 £m
Profit before tax	96.4	57.1	118.4
Non-cash items included in profit, and other adjustments			
Depreciation of property, plant and equipment	2.0	1.7	3.5
Profit on disposal of property, plant and equipment	-	-	-
Amortisation of intangible assets	1.0	1.0	2.0
Foreign exchange movements on borrowings	(289.4)	(59.3)	(136.8)
Other non-cash movements on borrowings	(1.9)	0.4	1.5
Impairment losses on loans to customers	6.0	30.0	48.3
Charge for share based remuneration	4.4	0.1	2.7
Net (increase) / decrease in operating assets			
Assets held for leasing	1.7	(2.4)	(3.2)
Loans to customers	(190.9)	(350.0)	(493.6)
Derivative financial instruments	282.6	54.3	129.1
Fair value of portfolio hedges	51.6	(15.0)	(45.5)
Other receivables	39.2	(16.0)	(35.6)
Net increase / (decrease) in operating liabilities			
Retail deposits	774.6	520.0	1,464.7
Derivative financial instruments	(56.2)	14.1	51.9
Fair value of portfolio hedges	(7.3)	3.9	6.5
Other liabilities	(5.1)	(6.8)	(39.1)
Cash generated by operations	708.7	233.1	1,074.8
Income taxes (paid)	(17.0)	(36.5)	(46.1)
Net cash flow generated by operating activities	691.7	196.6	1,028.7

Cash flows relating to plant and equipment held for leasing under operating leases are classified as operating cash flows.

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23. NET CASH FLOW USED IN INVESTING ACTIVITIES

	Six months to 31 March 2021 £m	Six months to 31 March 2020 £m	Year to 30 September 2020 £m
Proceeds from sales of operating property, plant and equipment	-	0.1	0.1
Purchases of operating property, plant and equipment	(0.9)	(0.8)	(1.9)
Purchases of intangible assets	(1.4)	(0.4)	(1.0)
Net cash (utilised) by investing activities	(2.3)	(1.1)	(2.8)

24. NET CASH FLOW FROM FINANCING ACTIVITIES

	Six months to 31 March 2021 £m	Six months to 31 March 2020 £m	Year to 30 September 2020 £m
Shares issued	0.7	0.5	0.6
Dividends paid (note 21)	(36.5)	(35.9)	(35.9)
Repayment of asset backed floating rate notes	(970.3)	(473.5)	(1,013.3)
Issue of Corporate Bond	149.2	-	-
Redemption of Corporate Bonds	(130.9)	-	-
Redemption of Retail Bonds	(60.0)	-	-
Movement on repurchase agreements	50.0	-	-
Movement on central bank facilities	390.0	205.0	860.0
Movement on other bank facilities	97.8	91.6	(130.1)
Capital element of lease payments	(1.2)	(1.0)	(2.0)
Purchase of own shares (note 20)	-	-	(5.2)
Sale of shares	0.1	-	0.2
Net cash (utilised) by financing activities	(511.1)	(213.3)	(325.7)

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25. RELATED PARTY TRANSACTIONS

In the six months ended 31 March 2021, the Group has continued the related party relationships described in note 48 on page 230 of the Group's 2020 Annual Report and Accounts. 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.

Retail deposits of £51,000 by directors were outstanding at the period end (31 March 2020: £500,000, 30 September 2020: £301,000) and the maximum outstanding in the period was £301,000 (31 March 2020: £500,000, 30 September 2020: £500,000).

Except for the transactions referred to above, there have been no related party transactions in the six months ended 31 March 2021.

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SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2021 (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 continuing response to the Covid situation has been planned and executed with the protection of its capital base and its long-term viability as key strategic priorities.

The Group sets 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

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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.

The Group's dividend and distribution decisions in the 2020 financial year were dominated by the potential impact of the Covid pandemic. The strategic decision to build capital in response to the inherent risks posed by the virus meant that no interim dividend was declared for the year. However, at the 2020 year end a dividend was declared in line with the Group's stated policy.

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).

Following a review of the capital position and forecasts, and considering the capital impacts of the stress testing carried out as part of the ICAAP and forecasting processes, the Board determined that an interim distribution in accordance with this policy was appropriate. It therefore declared an interim dividend for the year of 7.2p per share (2020 H1: nil), 50% of the 14.4p final dividend declared for 2020.

In addition, the Board has authorised a buyback of up to £40.0 million of shares in the market, initially to be held in treasury.

The directors have considered the distributable reserves of the Company and concluded that these distributions are appropriate.

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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.

It effectively reflects a return on equity as if all intangible assets are eliminated immediately against reserves. As this is similar to the approach used for the capital of financial institutions it is widely used in the sector.

The Group's consolidated annualised RoTE for the six months ended 31 March 2021 is derived as follows:

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m	30 September 2019 £m
Profit for the period	74.2	44.5	91.3	127.4
Amortisation of intangible assets	1.0	1.0	2.0	2.4
Adjusted profit	75.2	45.5	93.3	129.8
Divided by				
Opening equity	1,156.0	1,108.4	1,108.4	1,073.5
Opening intangible assets	(170.1)	(171.1)	(171.1)	(169.3)
Opening tangible equity	985.9	937.3	937.3	904.2
Closing equity	1,203.8	1,122.0	1,156.0	1,108.4
Closing intangible assets	(170.5)	(170.5)	(170.1)	(171.1)
Closing tangible equity	1,033.3	951.5	985.9	937.3
Average tangible equity	1,009.6	944.4	961.6	920.7
Return on tangible equity	14.9%	9.6%	9.7%	14.1%

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26. CAPITAL MANAGEMENT (Continued)

(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'). Following the UK's exit from the EU in December 2020 the PRA launched a consultation in February 2021 which would result in the Basel III rules being applied in the UK through the PRA Rulebook.

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

The tables below demonstrate that at 31 March 2021 the Group's total regulatory capital of £1,203.8m (31 March 2020: £1,133.3m, 30 September 2020: £1,141.2m) was comfortably in excess of the amounts required by the regulator, including £585.9m in respect of its Total Capital Requirement ('TCR') (31 March 2020: £748.1m, 30 September 2020: £749.6m), which is comprised of fixed and variable elements (none of these amounts are covered by the independent review report).

During the period the Group's TCR reduced from 10.8% of Total Risk Exposure ('TRE') at 30 September 2020 to 8.9% of TRE at 31 March 2021, principally as a result of the regulator's most recent review of the Group's risk profile and exposures.

The CRR also requires firms to hold additional capital buffers, including a Capital Conservation Buffer ('CCoB') of 2.5% of TRE (at 31 March 2021) and a Counter Cyclical Buffer ('CCyB'), currently 0.0% of TRE (30 September 2020: 0.0%). Firm specific buffers may also be required.

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26. CAPITAL MANAGEMENT (Continued)

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 2021 is set out below.

	Note	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m	30 September 2019 £m
Total equity	§	1,203.8	1,122.0	1,156.0	1,108.4
Deductions					
Proposed dividend	21	(18.3)	-	(36.4)	(35.8)
IFRS 9 transitional relief	*	41.4	32.5	42.3	21.2
Intangible assets	13	(170.5)	(170.5)	(170.1)	(171.1)
Software relief	†	1.2	-	-	-
Prudent valuation adjustments	β	(0.3)	(0.7)	(0.6)	(0.7)
Common Equity Tier 1 ('CET1') capital		1,057.3	983.3	991.2	922.0
Other tier 1 capital		-	-	-	-
Total Tier 1 capital		1,057.3	983.3	991.2	922.0
Corporate bond		169.1	150.0	150.0	150.0
Eligibility cap	Φ	(22.6)	-	-	-
Total Tier 2 capital		146.5	150.0	150.0	150.0
Total regulatory capital ('TRC')		1,203.8	1,133.3	1,141.2	1,072.0

§ Including results for the six months ended 31 March 2021 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 and of the impact of Covid-related IFRS 9 impairment provisions over a five year period. This is explained more fully in note 54 (c) to the 2020 Group Accounts.

† Under a relief enacted by the EU in December 2020 an amount in respect of software assets in intangibles is added back to capital. This is calculated in accordance with Article 36 (1) (b) of the CRR. In a statement issued on 30 December 2020 the PRA advised UK firms not to take this additional capital into account in decision making and in February 2021 commenced a consultation on proposals to rescind the relief.

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.

Φ CRD IV restricts the amount of tier 2 capital which is eligible for regulatory purposes to 25% of TCR.

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26. CAPITAL MANAGEMENT (Continued)

The TRE amount calculated under the CRD IV framework against which this capital is held, and the proportion of these assets it represents, are calculated as shown below.

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m	30 September 2019 £m
Credit risk				
Balance sheet assets	5,899.6	6,079.0	6,171.7	5,997.2
Off balance sheet	111.2	96.3	104.1	85.5
IFRS 9 transitional relief	41.4	22.0	42.3	10.5
Total credit risk	6,052.2	6,197.3	6,318.1	6,093.2
Operational risk	544.3	516.6	544.3	516.6
Market risk	-	-	-	-
Other	19.5	91.3	85.7	114.0
Total risk exposure (‘TRE’)	6,616.0	6,805.2	6,948.1	6,723.8
Solvency ratios	**%**	**%**	**%**	**%**
CET1	16.0	14.4	14.3	13.7
TRC	18.2	16.7	16.4	15.9

This table is not covered by the Independent Review Report

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

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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 2021 £m	31 March 2020 £m	30 September 2020 £m	30 September 2019 £m
CET1 Capital	1,057.3	983.3	991.2	922.0
Add back: IFRS 9 relief	(41.4)	(32.5)	(42.3)	(21.2)
Fully loaded CET1 Capital	1,015.9	950.8	948.9	900.8
TRC	1,203.8	1,133.3	1,141.2	1,072.0
Add back: IFRS 9 relief	(41.4)	(32.5)	(42.3)	(21.2)
Impact on Tier 2 eligibility	(0.9)	-	-	-
Fully loaded TRC	1,161.5	1,100.8	1,098.9	1,050.8
Total risk exposure	6,616.0	6,805.2	6,948.1	6,723.8
Add back: IFRS 9 relief	(41.4)	(22.0)	(42.3)	(10.5)
Fully loaded TRE	6,574.6	6,783.2	6,905.8	6,713.3
Fully loaded Solvency ratios	**%**	**%**	**%**	**%**
CET1	15.5	14.0	13.7	13.4
Total regulatory capital	17.7	16.2	15.9	15.7

This table is not covered by the Independent Review Report

The TRC at 31 March 2021 on the fully loaded basis of £1,161.5m (31 March 2020: £1,100.8m, 30 September 2020: £1,098.9m) was in excess of the TCR of £582.4m (31 March 2020: £745.9m, 30 September 2020: £745.3m) on the same basis (amounts not covered by the Independent Review Report).

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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 2021 £m	31 March 2020 £m	30 September 2020 £m	30 September 2019 £m
Total balance sheet assets		15,488.8	14,689.2	15,505.5	14,395.5
Less: Derivative assets	12	(180.7)	(538.1)	(463.3)	(592.4)
Central bank deposits	9	(1,832.3)	(812.7)	(1,637.1)	(816.4)
Cash Ratio Deposits		(19.3)	(12.8)	(15.1)	(11.4)
Accrued interest on sovereign exposures		-	-	-	(0.2)
On-balance sheet items		13,456.5	13,325.6	13,390.0	12,975.1
Less: Intangible assets	13	(170.5)	(170.5)	(170.1)	(171.1)
Software relief		1.2	-	-	-
Total on balance sheet exposures		13,287.2	13,155.1	13,219.9	12,804.0
Derivative assets	12	180.7	538.1	463.3	592.4
Potential future exposure on derivatives		42.7	95.7	92.3	120.0
Total derivative exposures		223.4	633.8	555.6	712.4
Post offer pipeline at gross notional amount		1,118.4	822.9	949.1	903.4
Adjustment to convert to credit equivalent amounts		(916.3)	(664.1)	(773.8)	(739.2)
Off balance sheet items		202.1	158.8	175.3	164.2
Tier 1 capital		1,057.3	983.3	991.2	922.0
Total leverage exposure before IFRS 9 relief		13,712.7	13,947.7	13,950.8	13,680.6
IFRS 9 relief		41.4	39.9	42.3	25.8
Total leverage exposure		13,754.1	13,987.6	13,993.1	13,706.4
UK leverage ratio		7.7%	7.0%	7.1%	6.7%

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 2021 £m	31 March 2020 £m	30 September 2020 £m	30 September 2019 £m
Fully loaded tier 1 capital	1,015.9	950.8	948.9	900.8
Total leverage exposure before IFRS 9 relief	13,712.7	13,947.7	13,950.8	13,680.6
Fully loaded UK leverage exposure	7.4%	6.8%	6.8%	6.6%

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 2021, 31 March 2020 and 30 September 2020 are analysed below.

	31 March 2021		31 March 2020		30 September 2020	
	£m	%	£m	%	£m	%
Buy-to-let mortgages	10,919.0	85.2%	10,429.1	83.4%	10,583.8	83.8%
Owner occupied mortgages	43.0	0.3%	60.8	0.5%	53.1	0.4%
Total first charge residential mortgages	10,962.0	85.5%	10,489.9	83.9%	10,636.9	84.2%
Second charge mortgage loans	320.2	2.5%	377.2	3.0%	354.5	2.8%
Loans secured on residential property	11,282.2	88.0%	10,867.1	86.9%	10,991.4	87.0%
Development finance	552.3	4.3%	502.3	4.0%	609.0	4.8%
Loans secured on property	11,834.5	92.3%	11,369.4	90.9%	11,600.4	91.8%
Asset finance loans	440.4	3.4%	488.3	3.9%	452.0	3.6%
Motor finance loans	229.3	1.8%	314.8	2.5%	272.4	2.2%
Aircraft mortgages	27.4	0.2%	25.1	0.2%	26.0	0.2%
Structured lending	82.6	0.7%	95.0	0.8%	94.9	0.7%
Invoice finance	14.3	0.1%	20.6	0.2%	13.5	0.1%
Total secured loans	12,628.5	98.5%	12,313.2	98.5%	12,459.2	98.6%
Professions finance	27.9	0.2%	49.9	0.4%	22.3	0.2%
CBILS and BBLS	50.1	0.4%	-	-	25.2	0.2%
Other unsecured commercial loans	11.7	0.1%	22.7	0.2%	15.0	0.1%
Unsecured consumer loans	98.1	0.8%	120.3	0.9%	109.7	0.9%
Total loans to customers	12,816.3	100.0%	12,506.1	100.0%	12,631.4	100.0%

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 2021 £m	31 March 2020 £m	30 September 2020 £m
Buy-to-let mortgages	175.9	153.4	154.3
Development finance	199.3	177.8	240.0
Structured lending	60.7	77.8	72.7
Asset finance	-	-	-
	435.9	409.0	467.0

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

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27. CREDIT RISK (Continued)

Credit grading

An analysis of the Group's loans to customers by absolute level of credit risk at 31 March 2021 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 2021					
Very low risk	8,954.9	545.2	23.3	44.1	9,567.5
Low risk	1,230.1	89.6	5.7	18.3	1,343.7
Moderate risk	748.0	175.7	10.6	27.5	961.8
High risk	258.0	140.7	48.6	26.3	473.6
Very high risk	44.3	44.4	45.4	19.6	153.7
Not graded	287.8	71.6	33.1	5.9	398.4
Total gross carrying amount	11,523.1	1,067.2	166.7	141.7	12,898.7
Impairment	(22.0)	(19.0)	(41.0)	(0.4)	(82.4)
Total loans to customers	11,501.1	1,048.2	125.7	141.3	12,816.3
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
30 September 2020					
Very low risk	8,771.2	453.3	20.8	45.9	9,291.2
Low risk	1,229.2	120.9	10.7	21.7	1,382.5
Moderate risk	742.2	184.7	12.1	32.8	971.8
High risk	285.2	143.9	50.7	32.0	511.8
Very high risk	48.3	67.9	49.9	22.9	189.0
Not graded	253.6	74.7	31.9	6.7	366.9
Total gross carrying amount	11,329.7	1,045.4	176.1	162.0	12,713.2
Impairment	(22.2)	(15.8)	(43.4)	(0.4)	(81.8)
Total loans to customers	11,307.5	1,029.6	132.7	161.6	12,631.4

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SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
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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 (3.1%) 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. This is slightly increased from the 2.9% classified as ungraded at 30 September 2020 partly as a result of lending to smaller SMEs where a grading may not be available. This disclosure is expected to be developed further in future periods.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2021 (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 2021 is set out below. LTVs for second charge mortgages are calculated allowing for the interest of the first charge holder, based on the most recent first charge amount held by the Group, while for acquired accounts the effect of any discount on purchase is allowed for.

	31 March 2021		31 March 2020		30 September 2020	
	First Mortgages	Second Charge Mortgages	First Mortgages	Second Charge Mortgages	First Mortgages	Second Charge Mortgages
	%	%	%	%	%	%
LTV ratio						
Less than 70%	69.5	80.0	52.2	68.0	59.9	74.5
70% to 80%	27.7	14.5	39.2	19.8	35.9	16.7
80% to 90%	1.2	2.8	6.6	8.6	2.3	5.2
90% to 100%	0.3	0.9	0.4	1.9	0.4	1.2
Over 100%	1.3	1.8	1.6	1.7	1.5	2.4
	100.0	100.0	100.0	100.0	100.0	100.0
Average LTV ratio	64.3	60.0	67.6	64.6	65.7	62.2
Buy-to-let	64.4		67.7		65.8	
Owner-occupied	45.6		52.1		49.2	

The regionally indexed LTVs shown above are affected by changes in house prices, with the Nationwide house price index, for the UK as a whole, registering an increase of 2.7% during the six months ended 31 March 2021 and annual increases of 5.7% in the year ended 31 March 2021 and 5.0% in the year ended 30 September 2020.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2021 (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 2021	31 March 2020	30 September 2020	31 March 2021	31 March 2020	30 September 2020
	%	%	%	%	%	%
East Anglia	3.2	3.2	3.2	3.3	3.4	3.3
East Midlands	5.4	5.4	5.4	6.2	6.2	6.1
Greater London	18.8	18.6	18.7	8.2	8.1	8.2
North	3.2	3.3	3.2	4.0	4.0	3.9
North West	10.4	10.4	10.4	7.3	7.6	7.4
South East	31.7	31.6	31.6	39.4	38.8	39.5
South West	8.6	8.8	8.7	8.2	8.1	8.0
West Midlands	5.4	5.3	5.4	7.1	7.3	7.3
Yorkshire and Humberside	8.2	8.5	8.4	5.9	5.9	5.9
Total England	94.9	95.1	95.0	89.6	89.4	89.6
Northern Ireland	0.1	0.1	0.1	1.8	1.7	1.7
Scotland	1.8	1.6	1.7	5.1	5.3	5.2
Wales	3.2	3.2	3.2	3.5	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 2021		31 March 2020		30 September 2020	
	By value	By number	By value	By number	By value	By number
	%	%	%	%	%	%
LTGDV						
50% or less	5.3	4.9	10.2	5.6	7.6	4.8
50% to 60%	24.4	17.9	19.3	12.1	22.4	13.2
60% to 65%	43.0	46.2	27.6	34.9	34.0	41.0
65% to 70%	23.1	26.9	35.1	39.5	31.3	36.1
70% to 75%	1.9	2.7	4.7	6.0	2.8	4.0
Over 75%	2.3	1.4	3.1	1.9	1.9	0.9
	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 2021 (Unaudited)

27. CREDIT RISK (Continued)

The average LTGDV cover at the period end was 62.4% (31 March 2020: 64.7%, 30 September 2020: 63.1%).

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

At 31 March 2021, the development finance portfolio comprised 223 accounts (31 March 2020: 215, 30 September 2020: 229) with a total carrying value of £552.3m (31 March 2020: £502.3m, 30 September 2020: £609.0m). Of these accounts, only 8 were included in Stage 2 at 31 March 2021 (31 March 2020: 3, 30 September 2020: 7), with 1 account included as Stage 3 (31 March 2020: 1, 30 September 2020: 1). In addition, 1 account acquired in the Titlestone purchase had been classified as POCI (31 March 2020: 3, 30 September 2020: 1). 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 2021	31 March 2020	30 September 2020
	%	%	%
East Anglia	5.0	3.5	5.1
East Midlands	3.3	3.7	5.5
Greater London	8.9	6.7	8.2
North	2.1	1.5	1.8
North West	0.9	0.2	0.4
South East	57.4	63.6	58.8
South West	15.4	14.3	14.0
West Midlands	4.9	3.4	4.0
Yorkshire and Humberside	0.9	1.6	1.1
Total England	98.8	98.5	98.9
Northern Ireland	-	-	-
Scotland	1.2	1.5	1.1
Wales	-	-	-
	100.0	100.0	100.0

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SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
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27. CREDIT RISK (Continued)

Asset finance and Motor finance

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

	31 March 2021 %	31 March 2020 %	30 September 2020 %
Commercial vehicles	33.2	31.3	32.0
Construction plant	32.8	34.1	33.7
Technology	6.6	7.0	6.9
Manufacturing	6.7	6.4	6.7
Refuse disposal vehicles	5.2	4.8	4.8
Other vehicles	4.1	3.5	3.6
Print and paper	3.1	4.2	3.7
Agriculture	2.9	2.6	2.9
Other	5.4	6.1	5.7
	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 presented below.

	31 March 2021	31 March 2020	30 September 2020	30 September 2019
Number of transactions	7	8	8	8
Total facilities (£m)	121.8	154.9	139.0	135.0
Carrying value (£m)	82.6	95.0	94.9	88.1

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

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SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
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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 2021 2 of these facilities were identified as Stage 2 (31 March 2020: 3, 30 September 2020: 4) with the remainder in Stage 1.

CBILS and BBLS

Loans under these schemes, which were launched in 2020 as a response to the impact of Covid on UK SMEs, have the benefit of guarantees underwritten by the UK Government.

The Group offers term loans and asset finance loans under the CBIL scheme. Interest and fees are paid by the UK Government for the first twelve months and the government guarantee caps the lender's losses at up to 80% of the outstanding balance.

Loans under the BBL scheme are six year term loans at a standard 2.5% per annum interest rate. The UK Government pays the interest on the loan for the first twelve months and provides lenders with a guarantee covering the whole outstanding balance.

The Group's outstanding CBILS and BBLS loans at 31 March 2021 were:

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m
CBILS			
Term loans	29.3	-	20.6
Asset finance	15.6	-	1.0
Total CBILS	44.9	-	21.6
BBLS	5.2	-	3.6
	50.1	-	25.2

At 31 March 2021, 98.4% of these accounts were considered to be performing accounts (30 September 2020: 100.0%).

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
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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 2021, 31 March 2020 and 30 September 2020, compared to the industry averages at those dates published by UK Finance ('UKF') and the Finance and Leasing Association ('FLA'), was:

	31 March 2021 %	31 March 2020 %	30 September 2020 %
First mortgages			
Accounts more than three months in arrears			
Buy-to-let accounts including receiver of rent cases	0.22	0.16	0.15
Buy-to-let accounts excluding receiver of rent cases	0.19	0.10	0.10
Owner-occupied accounts	4.06	3.34	3.72
UKF data for mortgage accounts more than three months in arrears			
Buy-to-let accounts including receiver of rent cases	0.54	0.41	0.52
Buy-to-let accounts excluding receiver of rent cases	0.51	0.37	0.50
Owner-occupied accounts	0.92	0.82	0.90
All mortgages	0.85	0.74	0.82
Second charge mortgage loans			
Accounts more than 2 months in arrears			
All accounts	15.74	14.23	14.77
Post-2010 originations	1.00	0.51	0.62
Legacy cases	22.18	19.97	21.17
Purchased assets	19.22	17.07	17.85
FLA data for second mortgages	8.90	8.60	8.40
Motor finance loans			
Accounts more than 2 months in arrears			
All accounts	4.69	4.57	4.58
Originated cases	2.25	1.32	1.76
Purchased assets	13.69	12.55	13.10
Asset finance loans			
Accounts more than 2 months in arrears	0.86	0.27	1.75
FLA data for business lease/hire purchase loans	0.90	1.30	1.70

No published industry data for asset classes comparable to the Group's other books has been identified. Where revised data at 31 March 2020 or 30 September 2020 has been published by the FLA or UKF, the comparative industry figures above have been amended.

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

CONDENSED FINANCIAL STATEMENTS

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27. CREDIT RISK (Continued)

It should be noted that, where customers have been allowed to defer payments as part of Covid 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 ('ERCs') is commonly used as a measure of the value of a portfolio. This is defined as the sum of the undiscounted cash flows expected to be received over a specified future period. In the Group's view, this measure may be suitable for heavily discounted, unsecured, distressed portfolios (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 ERCs value 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 2021 £m	31 March 2020 £m	30 September 2020 £m	30 September 2019 £m
All purchased consumer assets				
Carrying value	208.9	258.7	235.3	291.1
84 month ERCs	249.0	305.1	277.8	342.3
120 month ERCs	277.7	344.8	313.7	387.5
POCI assets only				
Carrying value	126.1	151.7	139.8	168.3
84 month ERCs	160.8	192.6	176.9	214.1
120 month ERCs	182.3	220.9	203.7	246.0

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 2021 (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 condensed financial statements are required to be prepared as the basis of the accounting policies expected to be used in the production of the financial statements for the year. Therefore, they have been prepared on the basis of accounting policies set out in the Annual Report and Accounts of the Group for the year ended 30 September 2020, except for the adoption of the amendments to IFRS 9 and IAS 39 described in note 29 below.

The Group is required to prepare its financial statements for the year ending 30 September 2021 in accordance with International Financial Reporting Standards ('IFRS') in conformity with the requirements of the Companies Act 2006. They must also be prepared in accordance with IFRS adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union ('EU'). In the financial years reported on this will also mean that, in the Group's circumstances, the financial statements also accord with IFRS as approved by the International Accounting Standards Board.

The "requirements of the Companies Act 2006" here means accounts being prepared in accordance with "international accounting standards" as defined in section 474(1) of that Act, as it applied immediately before IP Completion Day (the end of the UK's transition period following its departure from the EU) ('IPCD'), including where the Company also makes use of standards which have been adopted for use within the United Kingdom in accordance with regulation 1(5) of the International Accounting Standards and European Public Limited Liability Company (Amendment etc.) (EU Exit) Regulations 2019, subsequent to the IPCD.

Under the Listing Rules of the FCA, despite the UK's exit from the EU on 31 January 2020, the EU endorsed IFRS regime remains applicable to the Group until its first financial year commencing after the IPCD on 31 December 2020.

Therefore, while EU endorsed IFRS applies to these financial statements, those for the year ending 30 September 2022 will instead be prepared under 'UK-adopted international accounting standards'.

The changes in the way that the basis of preparation is described, which result from the UK's exit from the EU, including the move to UK-adopted international accounting standards from the Group's financial year commencing 1 October 2021, do not represent a change in the basis of accounting which would necessitate a prior year restatement.

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SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2021 (Unaudited)

28. ACCOUNTING POLICIES (Continued)

Comparability of information

The balance sheet information at 30 September 2019, was not required to be restated on the adoption of IFRS 16 on 1 October 2020. The information presented is derived in accordance with IAS 17 – 'Leases' ('IAS 17'), and therefore may not be directly comparable with the balance sheets at 31 March 2021, 30 September 2020 and 31 March 2020 which are prepared under IFRS 16.

New and revised reporting standards

Other Standards and interpretations in issue but not effective do not address matters relevant to the Group's accounting and reporting.

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 2020.

29. CHANGES IN ACCOUNTING STANDARDS

In August 2020 the IASB issued a further amendment to IAS 39 'Interest Rate Benchmark Reform – Phase 2'. This amendment sets out accounting requirements for the treatment of IBOR-linked financial assets and liabilities under the amortised cost method and IBOR related hedge accounting when a firm replaces the IBOR linkage in the underlying instruments with a replacement benchmark. It is therefore potentially applicable to the Group's LIBOR-linked loan assets and those FRN liabilities where interest is charged on the basis of LIBOR or other IBOR rates. It also affects the Group's LIBOR (and other IBOR) referenced derivative assets and liabilities and the hedging relationships which they form part of.

The intention of the standard is that, where the transition is effectively a like for like replacement, no windfall gain or loss should occur on transition, and hedging relationships should be able to continue.

This amendment is effective from the Group's financial year ending 30 September 2022 but has been endorsed by both the EU and the UK and has been early adopted by the Group as permitted. The Group has utilised, and will continue to utilise, the provisions of the amendment as it transitions its IBOR-linked assets and liabilities. The impact of the amendment will depend upon the IBOR related assets, liabilities and hedging relationships at the point at which transition occurs.

CONDENSED FINANCIAL STATEMENTS

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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 63 and 64 to the accounts of the Group for the year ended 30 September 2020. However, the economic impact of the Covid pandemic 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 2021.

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, 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 environment the granting of Covid 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-related relief does not, of itself, indicate an SICR, but has carefully considered internal credit and customer data to determine whether there might be any accounts with SICR not otherwise identified by the process.

Where accounts have received secondary periods of relief beyond the initial three month period, this has generally been considered to be strongly indicative of underlying problems and such accounts have been identified as having an SICR. Furthermore, adjustments to correct probabilities of default in models will also have a consequent result of identifying more SICRs.

More information on the definition of SICR adopted is given in note 11.

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SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2021 (Unaudited)

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 (which might include 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, its economic effect on customers and the forms of the reliefs given to ameliorate that impact. These may both change the underlying data and impact on the derivation of metrics normally used to monitor credit performance.

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

In order to provide forward looking economic inputs to the modelling of the ECL, the Group must derive a set of scenarios which are internally coherent. The Group addresses these requirements using four distinct economic scenarios chosen to represent the range of possible outcomes. These scenarios at 31 March 2021 have been derived in light of the Covid situation, modelling a variety of possible outcomes as described in note 11. It should be noted, however, that there is currently a wide range of opinions amongst economists about the longer-term prospects for the UK and this is likely to remain the case until the country's path out of lockdown and beyond becomes clearer.

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 economic scenarios described above and their impact on the overall provision are set out in that note, which also includes sensitivity analysis on that impact.

(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. The likely future cash flows have been assessed by the management on the basis of available performance data and customer contacts.

No evidence has so far been identified which would require the further adjustment of EIR income for the Group's products as a result of Covid in the six months ended 31 March 2021.

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 £11.6m (30 September 2020: £7.7m), while an increase of the assumed asset lives of such assets by three months would increase balance sheet assets by £11.8m (30 September 2020: £7.9m)
- An increase of 50% in the number of five year fixed rate buy-to-let loan assets assumed to redeem before the end of the fixed rate period, generating additional early redemption charges would increase balance sheet assets by £11.0m (30 September 2020: £6.2m)
- A reduction (or increase) in estimated cash flows from purchased loan assets of 5% would reduce (or increase) balance sheet assets by £8.1m (30 September 2020: £8.8m)

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 validated by use of an impairment test based on the projected cash flows for the CGU, 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 is the type of event which would demand such retesting and the progress of the pandemic and UK Government response to it since September 2020 caused to Group to revisit its testing at 31 March 2021, 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 CGU is able to achieve in practice. The impact of Covid 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.

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31. GOING CONCERN BASIS

The condensed financial information for the half year has been prepared on the going concern basis.

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

Particular focus is given to the Group's financial forecasts for this period to ensure the adequacy of resources available for the Group to meet its business objectives on both a short term and strategic 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 8 to 59. The principal risks and uncertainties affecting the Group in the forthcoming six months are described on pages 157 to 161.

Note 54 to the 2020 Group Accounts includes an analysis of the Group's regulatory and working capital position and policies, while notes 55 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 63 and 64 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.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2021 (Unaudited)

31. GOING CONCERN BASIS (CONTINUED)

In compiling the most recent forecast, for the period commencing 1 April 2021, particular attention was paid to the potential consequences of Covid 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, based on updated external projections. Future business activity was reforecast at this time, reflecting current expectations and projected market conditions.

The forecast was based on the best available information at the time of its approval, but the uncertainties surrounding the ongoing impact of Covid 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.

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

- An increase of 20% in buy-to-let volumes. This examined the impact of volumes on profitability and illustrated the extent to which capital resources and liquidity would be stretched due to the higher cash and capital requirements
- Higher funding costs – 25bps higher cost on all new savings deposits throughout. This scenario illustrates the impact of a significant prolonged margin squeeze on profitability and whether this would cause significant impacts on any capital, liquidity or encumbrance ratios
- A 50% reduction in the growth of development finance portfolio coupled with a 50bp reduction in margins. Development finance is the highest yielding product and this scenario illustrates the effect of product mix on contribution and other ratios
- A doubling of redemption rates for buy-to-let mortgages reaching the end of their fixed rate period. This illustrates the potential risk inherent in the five-year fixed rate business which will mature in 2022 and beyond
- Increased economic stress on customers - as well as modelling the impact of each of the economic scenarios set out in note 11 across the forecast horizon, the January 2021 Bank of England stress test assumptions were also modelled. To ensure this represented a worst-case scenario all other assumptions were held steady, although in reality adjustments to new business appetite and other factors would be made

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.

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

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2021 (Unaudited)

31. GOING CONCERN BASIS (CONTINUED)

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

The Group started the period with a strong capital surplus and has continued to build its liquidity buffer during the period, as described below, which should 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.

Availability of funding and liquidity

The availability of funding and liquidity is a key consideration, including retail deposit, wholesale funding, central bank and other contingent liquidity options.

The Group's retail deposits of £8,631.2m (note 14) are repayable within five years, with 74.6% (£6,435.4m) 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 2021, Paragon Bank held £1,817.3m of balance sheet assets for liquidity purposes, all of which comprised central bank deposits (note 9). A further £150.0m of liquidity was provided by the long/short repo arrangement described in the Group's 2020 Annual Report and Accounts. This brings the total available to £1,967.3m.

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 £1,929.2m of further drawings. Holdings of the Group's own externally rated mortgage backed loan notes can also be used to access the Bank of England's liquidity facilities or other funding arrangements. At 31 March 2021 the Group had £471.3m (30 September 2020: £1,063.5m) of such notes available for use, of which £215.7m were rated AAA (30 September 2020: £872.9m). The available AAA notes would give access to £175.2m (30 September 2020: £502.5m) if used to support drawings on Bank of England facilities.

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 are financed through retail deposits and may be refinanced through securitisation where this is appropriate and cost-effective. While the Group has not accessed the public securitisation market in the year, the market has remained active throughout the Covid crisis and remains a potential funding source.

The earliest maturity of any of the Group's working capital debt is in January 2022, when a retail bond issue of £125.0m matures. The Group's remaining TFS borrowings of £219.4m also fall due within twelve months.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2021 (Unaudited)

31. GOING CONCERN BASIS (CONTINUED)

The Group's access to debt is also enhanced by its corporate BBB rating affirmed by Fitch Ratings in March 2021 and its status as an issuer is evidenced by the BB+ rating of its £150.0m Tier-2 Bonds. It has regularly accessed the capital markets for warehouse funding and corporate and retail bonds over recent years and continues to be able to access these markets.

The Group'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.

As described in note 26, the Group's capital base is subject to consolidated supervision by the PRA. Its capital at 31 March 2021 was in excess of regulatory requirements and group forecasts show this continuing to be the case.

Going Concern assessment

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 2021, the Group's analysis of its potential exposure to impacts of the Covid 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.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
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32. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

The Group had no financial assets or liabilities in the period ended 31 March 2021 or the year ended 30 September 2020 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.

(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 2021 £m	31 March 2020 £m	30 September 2020 £m
Financial assets				
Derivative financial assets	12	180.7	538.1	463.3
		180.7	538.1	463.3
Financial liabilities				
Derivative financial liabilities	12	76.2	94.6	132.4
Contingent consideration	16	11.5	19.5	13.5
		87.7	114.1	145.9

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 2021 (Unaudited)

32. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

Contingent consideration

The value of the contingent considerations shown in note 16 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 2021		31 March 2020		30 September 2020	
	Carrying amount	Fair value	Carrying amount	Fair value	Carrying amount	Fair value
	£m	£m	£m	£m	£m	£m
Financial assets						
Cash	2,103.0	2,103.0	1,206.8	1,206.8	1,925.0	1,925.0
Loans to customers	12,816.3	12,854.9	12,506.1	12,706.0	12,631.4	12,856.1
Sundry financial assets	86.0	86.0	105.2	105.2	125.3	125.3
	15,005.3	15,043.9	13,818.1	14,018.0	14,681.7	14,906.4
Financial liabilities						
Short term bank borrowings	0.1	0.1	0.2	0.2	0.4	0.4
Asset backed loan notes	2,011.3	2,011.3	3,887.3	3,887.3	3,270.5	3,270.5
Secured bank borrowings	755.7	755.7	879.2	879.2	657.8	657.8
Retail deposits	8,631.2	8,676.6	6,911.9	6,938.1	7,856.6	7,900.6
Corporate and retail bonds	405.3	428.3	446.3	473.4	446.6	455.7
Other financial liabilities	72.3	72.3	80.6	80.6	74.6	74.6
	11,875.9	11,944.3	12,205.5	12,258.8	12,306.5	12,359.6

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.

Sundry assets and liabilities

Fair values of financial assets and liabilities disclosed as sundry assets and sundry liabilities are not considered to be materially different to their carrying values.

These assets and liabilities are of relatively low value and may be settled at their carrying value at the balance sheet date or shortly thereafter.

ADDITIONAL FINANCIAL INFORMATION (APPENDICES)

For the six months ended 31 March 2021 (not covered by the Independent Review Report)

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.

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 2021 £m	31 March 2020 £m	30 September 2020 £m
Profit on ordinary activities before tax	96.4	57.1	118.4
Add back: Fair value adjustments	(13.5)	0.1	1.6
Underlying profit	82.9	57.2	120.0

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

	31 March 2021 £m	31 March 2020 £m	30 September 2020 £m
Underlying profit	82.9	57.2	120.0
Tax at effective rate (note 7)	(19.1)	(12.6)	(27.5)
Underlying earnings	63.8	44.6	92.5
Basic weighted average number of shares (note 8)	253.3	253.2	253.6
Underlying earnings per share	25.2p	17.6p	36.5p

ADDITIONAL FINANCIAL INFORMATION (APPENDICES)

For the six months ended 31 March 2021 (not covered by the Independent Review Report)

A. UNDERLYING PROFIT (CONTINUED)

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

	Six months to 31 March 2021 £m	Six months to 31 March 2020 £m	Year to 30 September 2020 £m
Underlying earnings	63.8	44.6	92.5
Amortisation of intangible assets	1.0	1.0	2.0
Adjusted underlying earnings	64.8	45.6	94.5
Average tangible equity (note 26(b))	1,009.6	944.4	961.6
Underlying RoTE (annualised)	12.8%	9.7%	9.8%

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 shown.

Six months to 31 March 2021

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Total £m
Opening loans to customers (note 10)	10,819.5	1,514.8	297.1	12,631.4
Closing loans to customers (note 10)	11,130.6	1,427.1	258.6	12,816.3
Average loans to customers	10,975.0	1,471.0	277.9	12,723.9
Net interest	103.1	46.5	10.8	147.5
NIM (annualised)	1.88%	6.32%	7.77%	2.32%
Impairment provision	4.9	1.3	(0.2)	6.0
Cost of risk (annualised)	0.09%	0.18%	(0.14)%	0.09%

ADDITIONAL FINANCIAL INFORMATION (APPENDICES)

For the six months ended 31 March 2021 (not covered by the Independent Review Report)

B. INCOME STATEMENT RATIOS (Continued)

Six months to 31 March 2020

	Mortgage Lending £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 (annualised)	1.82%	5.25%	7.28%	2.29%
Impairment provision	13.8	15.5	0.7	30.0
Cost of risk (annualised)	0.26%	2.10%	0.39%	0.49%

Year to 30 September 2020

	Mortgage Lending £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)	10,819.5	1,514.8	297.1	12,631.4
Average loans to customers	10,581.8	1,483.4	343.5	12,408.7
Net interest	190.0	82.1	26.1	278.1
NIM	1.80%	5.53%	7.60%	2.24%
Impairment provision	25.8	21.7	0.8	48.3
Cost of risk	0.24%	1.46%	0.23%	0.39%

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

ADDITIONAL FINANCIAL INFORMATION (APPENDICES)

For the six months ended 31 March 2021 (not covered by the Independent Review Report)

C. COST:INCOME RATIO

Cost:income ratio is derived as follows:

	31 March 2021	31 March 2020	30 September 2020
Operating expenses (£m)	65.8	62.5	126.8
Total operating income (£m)	154.7	149.7	295.1
Cost / Income	42.5%	41.8%	43.0%

D. NET ASSET VALUE

	Note	31 March 2021	31 March 2020	30 September 2020
Total equity (£m)		1,203.8	1,122.0	1,156.0
Outstanding issued shares (m)	18	262.0	261.7	261.8
Treasury shares (m)	20	(5.2)	(5.2)	(5.2)
Shares held by ESOP schemes (m)	20	(3.1)	(2.2)	(3.6)
		253.7	254.3	253.0
Net asset value per £1 ordinary share		£4.74	£4.41	£4.57
Tangible equity (£m)	26	1,033.3	951.5	985.9
Tangible net asset value per £1 ordinary share		£4.07	£3.74	£3.90

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. The uncertainties around the longer-term impacts of the pandemic continue to be identified and assessed but overall in the opinion of the directors these have not changed materially from those described in Section A2.2 of the Annual Report and Accounts of the Group for the year ended 30 September 2020.

The pandemic impacts Group's assessment of its exposure under almost all the categories within its risk management framework. The effects 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 principal risks are summarised below.

Category	Risk	Description
Capital risk	Capital	The risk that there is, or will be, insufficient capital to operate effectively including meeting minimum regulatory requirements, operating within board-approved risk appetite and supporting the Group's strategic goals
Liquidity and funding risk The risk that the Group has insufficient financial resources to enable it to meet its obligations as they fall due, cannot raise or maintain sufficient funds to finance its future plans, or can only secure such resources at excessive cost, and / or encumbrance	Funding concentration	Risk due to concentration of funding in particular products, delivery channels, markets and terms
	Funding tenor	Risk to the maturity structure of the Group's funding due to external, internal or contractual events
Market risk The risk of changes in the net value of, or net income arising from, the Group's assets and liabilities from adverse movements in market prices. The Group does not have a trading book, but the risk arises in the banking book	Duration	Arises from assets and liabilities being linked to the same interest rate indices, but re-pricing at different dates
	Basis	Arises from assets and liabilities linked to different rate indices which do not move in tandem
	Optionality	Arises as the settlement of assets and liabilities is sometimes different from originally forecast
	Foreign exchange	Risk that changes in the relative value of currencies could result in financial loss

PRINCIPAL RISKS AND UNCERTAINTIES

Credit risk The risk of financial loss arising from a borrower or counterparty failing to meet their financial obligations to the Group when they fall due	Customer	The risk that the Group is exposed to unexpected material losses from the failure to screen potential borrowers, underwrite new business, and manage repayments effectively
	Concentration	The risk of loss that might occur from higher proportions of exposure within any area of lending or operation. The Group monitors and controls concentrations of loans, to amongst others, business lines, geographic regions, groups of customers and types of collateral
	Collateral	The risk of financial loss occurring as the result of property or assets secured against debt owed to the Group reducing in value
	Wholesale counterparty	The risk of failure of an institution holding the Group's investments or providing hedging facilities for risk mitigation which could expose the bank to loss or liquidity issues
	Outsourcer default	The risk that, as a result of the Group outsourcing material activities to a third-party supplier, the Group is exposed to financial loss on the failure of that provider
Model risk The risk that the Group may make incorrect decisions based on the on the output of internal models, due to errors in the development, implementation or use of such models resulting in a loss or misreporting within financial statements	Assumptions	The risk of an error in assumptions made anywhere in the model lifecycle, covering scope, data sourcing, development, testing, validation, implementation and maintenance which results in incorrect decisioning
	Operation	The risk a model which has been scoped, developed, implemented and executed as expected, may produce incorrect reporting, if its use is not controlled, or it is not operated in a safe, reliable and controlled environment
Pension obligation risk	Pension obligation	There is a risk that the Group's commitments under its defined benefit scheme are insufficient to meet its liabilities, either due to adverse investment performance or inaccurate assumptions, including future inflation levels, members' salaries or mortality rates

PRINCIPAL RISKS AND UNCERTAINTIES

Reputational risk The risk of negative consequences arising from a failure to meet the expectations and standards of the Group's customers, investors, regulators or other counterparties whilst undertaking business activities	Brand	The risk of deterioration in the inherent value of the Group's brand equity through adverse publicity which may result in an adverse impact on share price or loss of competitive advantage
	Corporate responsibility	The risk that the Group's corporate responsibility approach does not promote commitment to practice environmental and social sustainability in the environmental and social landscapes in which it operates therefore creating negative consequences to the perception of the Group
Strategic risk The risk that changes to the business model or macroeconomic, geopolitical, regulatory, competitive or other factors may lead to an inappropriate or obsolete business model, strategy or strategic plan	Business	The risk that the Group is adversely exposed to factors either externally and / or by lack of innovation and overambitious targets that lower its profits or cause it to fail
	Political	The risk that political decisions, economic action / inaction, events, or conditions significantly affect the Group or its market sectors, profitability or value
	Acquisition	The failure to target appropriate acquisitions or manage the transition effectively and implementation risks resulting from material corporate acquisitions which may impact adversely on the Group's performance
Climate Change risk The risk of climate changes impacting the Group either directly or indirectly through its third-party relationships. This includes the transitional risk to Paragon's strategy and profile through moving to a low carbon environment and any physical risks arising from changes to the natural environment	Physical	The risk to the Group, its market sectors and supply chain of business disruption and loss caused by more frequent or severe man-made weather events such as flooding, droughts and storms
	Transitional	The risk that the speed of transition towards a greener economy may have a significantly adverse effect on the Group's asset values and / or the cost of doing business
Conduct risk The risk that the Group's culture drives poor behaviours or decision making in the execution of its business activities which leads to failure to achieve fair outcomes for customers and /or the ability to demonstrate the Group is acting with integrity in the market	Customer fair outcomes	The risk that the Group fails to put customers at the centre of how the business is run, culturally, strategically and operationally, failing to meet their needs and potentially leading to detrimental outcomes

PRINCIPAL RISKS AND UNCERTAINTIES

Operational risk The risk of financial and non- financial detriment resulting from inadequate or failed internal procedures, people and systems or from external events	People	Failure of the Group to recruit, retain, develop and effectively lead / manage its people
	Health and safety	Non-adherence to legislation and regulation in order to ensure the health, safety and welfare of employees, contractors, visitors and members of the public
	Property	Property owned or occupied by the Group is subject to unauthorised access, physical damage or loss of services adversely affecting the effective operation of the business
	Third party	Risk associated with the selection, procurement and delivery of goods and services from third party suppliers to the Group, and ensuring their ongoing management is in line with the Group's legal, regulatory and commercial obligations
	Information technology and security	The Group's IT structure and systems are unable to support its operational needs, including failure to adequately protect against the threat of cyber-crime
	Change	Poor implementation of business change including projects and programmes delivering new or amended processes, products or IT systems
	Transaction processing	Poorly executed regular business transactions resulting in customer detriment and / or financial loss
	Regulatory compliance	Failure to adhere to the legislation, regulations and guidelines relevant to the Group leading to regulatory censure, fines, legal recourse and the inability to carry out business-as-usual
	Legal	Failure to act according to the law, meet contractual obligations, and manage disputes as a Group or with its customers or third parties
	Data protection	The Group fails to comply with its data protection obligations with respect to confidentiality, integrity and availability leading to large fines and significant reputational damage

PRINCIPAL RISKS AND UNCERTAINTIES

	Financial crime	Failure to detect and / or prevent the Group from falling victim to offences of fraud, theft and money laundering across establishments, products and services. Failure to fulfil regulatory and legal obligations on all aspects of financial crime legislation and to prevent any form of potential bribery, corruption or terrorist fundraising through normal business activity
	Corporate governance	Failure of the processes and structures by which the Group is directed and controlled by its Board of Directors, executive management, business units and support functions. This results in inappropriate management information to enable effective decision making
	Financial control and reporting	Incorrect accounting, reporting and financial management resulting in financial misstatement, poor decision making and associated losses for the Group

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. This includes the discussion of:

- the impact on the Group's markets and customers, including factors likely to affect lending volumes, in the Business Review (Section 1)
- the impact on credit risk and the consequential impacts on impairment and profitability, in the 'Impairment' section of the Financial Review (Section 4)
- 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, in Section 5.5 of the Operational Review
- the response of the Group's risk management framework to the crisis, in the Operational Review (Section 5.5)

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

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

These factors include, but are not limited to: material impacts related to foreign exchange fluctuations; macro-economic activity; the impact of outbreaks, epidemics or pandemics, such as the Covid pandemic and ongoing challenges and uncertainties posed by the Covid pandemic for businesses and governments around the world, including the duration, spread and any recurrence of the Covid pandemic and the extent of the impact of the Covid pandemic on overall demand for our services and products; 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 outbreak); actions by the Group's competitors; the UK's exit from the EU, unstable economic conditions and market volatility, including currency fluctuations; the risk of a global economic downturn; technological changes and risks to the security of IT and operational infrastructure, systems, data and information resulting from increased threat of cyber and other attacks; general changes in government policy that may significantly influence investor decisions; 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.