paragon

Paragon Banking Group PLC

Annual Report 2022

For the year ended 30 September 2022

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

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

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

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

Contents

Five year performance summary

	2018 £m	2019 £m	2020 £m	2021 £m	**2022 £m**
Underlying profit before taxation	156.5	164.4	120.0	194.2	**221.4**
Profit before taxation	181.5	159.0	118.4	213.7	**417.9**
Profit after taxation	145.8	127.4	91.3	164.5	**313.6**
Total loans to customers	12,127.8	12,186.1	12,631.4	13,402.7	**14,210.3**
Shareholders' funds	1,095.9	1,108.4	1,156.0	1,241.9	**1,417.3**

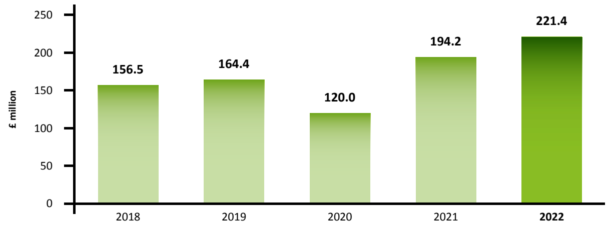
	2018	2019	2020	2021	**2022**
Return on tangible equity	16.1%	14.1%	9.7%	16.2%	**27.2%**
Earnings per share					
- basic	55.9p	49.4p	36.0p	65.2p	**129.2p**
- diluted	54.2p	48.2p	35.6p	63.0p	**125.9p**
Dividend per ordinary share	19.4p	21.2p	14.4p	26.1p	**28.6p**

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

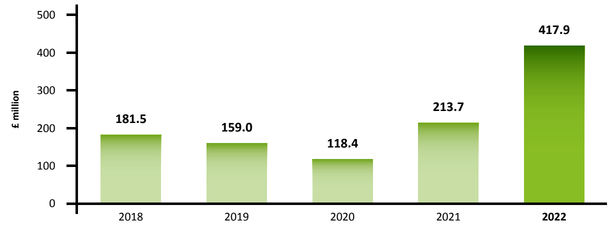
The calculation of return on tangible equity is shown in note 59b. The derivation of underlying profit before taxation and other underlying measures is described in Appendix A.

Financial highlights

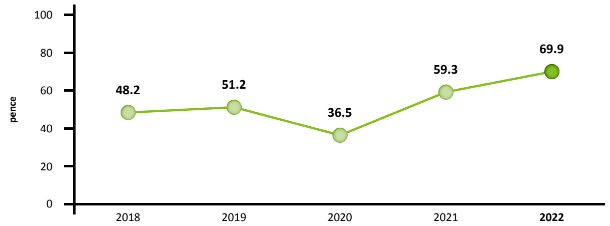
Underlying profit before tax
£221.4 million 14.0% higher (2021: £194.2 million)



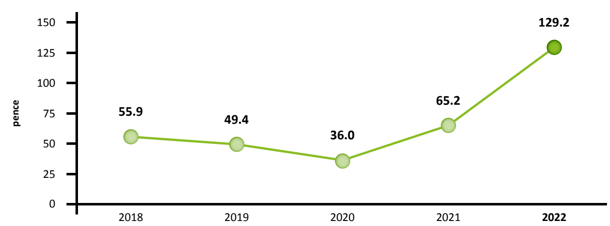
Profit before tax
£417.9 million 91.5% higher (2021: £218.2 million)



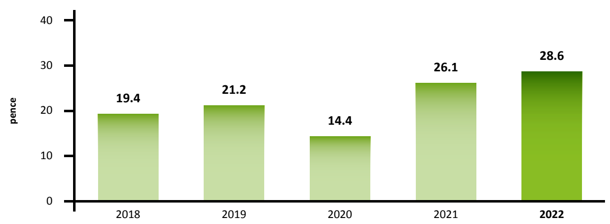
Underlying basic earnings per share
69.9 pence 17.9% higher (2021: 59.3 pence)



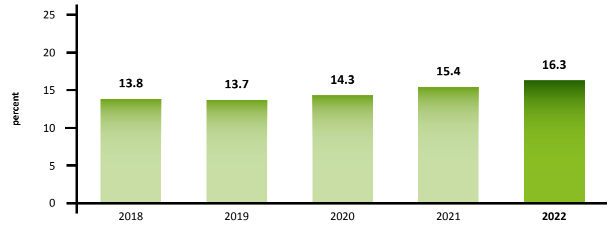
Basic earnings per share
129.2 pence 98.2% higher (2021: 65.2 pence)



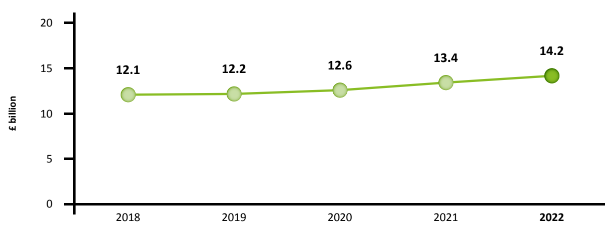
Dividend per share
28.6 pence 9.6% higher (2021: 26.1 pence)



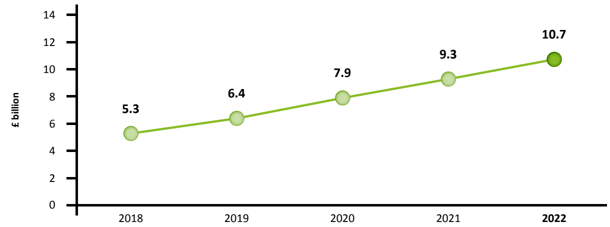
Capital – CET1 Ratio
16.3% Strengthened in the year (2021: 15.4%)



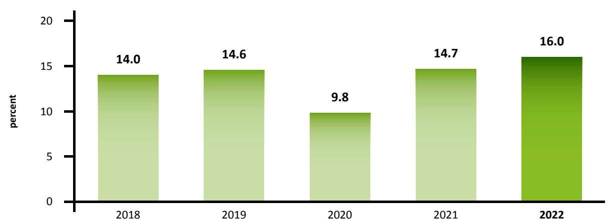
Total loans to customers
£14.2 billion 6.0% higher (2021: £13.4 billion)



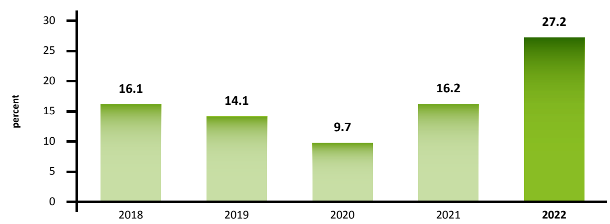
Retail deposits
£10.7 billion 14.7% higher (2021: £9.3 billion)



Underlying return on tangible equity
16.0% (2021: 14.7%)



Return on tangible equity (‘RoTE’)
27.2% (2021: 16.2%)



A.

Strategic Report

The business and its performance in the year

FAIRNESS

To work together to ensure fair outcomes for all our customers

> **Whether we're working with customers or colleagues, it's important to be fair. If we see a customer is facing difficulties, we don't pre-judge what might be happening. Instead, we make sure that we listen, show empathy and understanding, and explore a range of different ways to move forward.**

Darrel, Collections

> **The Group's strategic approach has helped to guide it through the recent periods of turbulence and will continue to deliver positive results for our stakeholders into the future.**
>
> **Robert East,** Chair of the Board

A1. Chair of the Board's introduction

Dear Shareholder

It gives me great pleasure to write to you for the first time as Chair at the end of a year which has seen material changes and challenges for the Group and for the UK economy. While the impacts of the Covid pandemic have receded, new challenges have emerged, including a sharp rise in energy prices and inflation, and consequent increases in interest rates after a long period of stability. These have been coupled with the effects of uncertainty around UK fiscal policy and the geopolitical impacts of the conflict in Ukraine.

Throughout this the Group has remained focussed on delivering its strategy and purpose.

This annual report sets out how the Group has responded to these challenges, how it has incorporated learnings from the pandemic into its business model and its positioning as it continues to develop its businesses. I hope that you, and other stakeholders, will find the report useful in understanding the Group's story for this eventful year.

The business and its purpose

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

We have reviewed our reporting structure in the year, and we will describe the business through two lending divisions, Mortgage Lending and Commercial Lending. Given the ongoing reduction in the size of the former Idem Capital division, it is no longer helpful to report this separately. Each of the divisions offers a range of specialist lending propositions, all principally funded through our retail deposit base, supplemented with wholesale and central bank borrowings.

This specialist focus means that the Group is well placed to both understand the impacts of the developing national situation on its customers and to work with them to ensure the best possible outcomes, whatever the future may bring.

Digitalisation is key to the Group's strategy, and I am pleased to note that the ongoing programmes of system and process improvement across the Group have continued through the year with important enhancements being delivered, benefitting customers, business introducers and our own operational effectiveness.

The Group's strategic approach has helped to guide it through the recent periods of turbulence and will continue to deliver positive results for our stakeholders into the future.

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

Results

We are pleased with our results for the year. New lending was £3.2 billion, a significant increase from the £2.6 billion recorded in 2021, with lending in the early part of the preceding year constrained by the impact of Covid. The savings deposit base exceeded £10 billion for the first time, reaching £10.7 billion at the year end, increased from £9.3 billion a year earlier. Wholesale funding remained stable in the year and the Group's credit rating was increased to BBB+ by Fitch in March.

Underlying profit for the year, at £221.4 million, exceeded £200 million for the first time, despite maintaining a conservative approach towards expected loss as the economic and political situation in the UK evolved (2021: £194.2 million). Earnings per share on the underlying basis increased to 69.9 pence (2021: 59.3 pence) and the underlying return on equity at 16.0% continued to strengthen (2021: 14.7%).

Profit before tax on the statutory basis, which also includes fair value accounting gains recorded on hedging, was substantially higher than underlying profit at £417.9 million (2021: £213.7 million). Statutory EPS increased to 129.2 pence (2021: 65.2 pence) and RoTE on the statutory basis was 27.2% (2021: 16.2%). The level of these measures was driven by the magnitude of interest rate movements in the year affecting the Group's derivative positions, which are used to hedge interest rate risk on its new business pipeline of fixed rate mortgages. These do not reflect the underlying performance of the business and will reverse over the lives of the related hedges.

Regulatory capital has remained strong during the period, with the year end Core Equity Tier 1 ('CET1') ratio reaching 16.3% (2021: 15.4%) even allowing for asset growth and distributions. Group liquidity was also maintained at a healthy level.

The financial results and operational performance are reviewed in Sections A3 and A4

Stakeholders

As I have progressed through my induction programme with the Group, I have been impressed with how seriously the Group takes its responsibility to all stakeholders and its duties as a corporate citizen.

During the year the Group's people policies were endorsed with the upgrading of its Investors in People ('IiP') status to the Platinum level, with only 5% of all assessments being graded this highly. The Group's Equality, Diversity and Inclusion ('EDI') network also continued to develop and has provided useful inputs across the year.

The Group's Sustainability Committee, established in the previous year, continued its work coordinating a holistic approach to ESG impacting issues across the Group. There has been a particular focus on issues relating to climate change and this resulted in the Group joining UK Bankers for Net Zero. More details on climate impacts are included in Section A6.3 where the Group's position is described in accordance with the recommendations of the Taskforce on Climate-related Financial Disclosure ('TCFD'), as required by the new listing rule.

Readers interested in sustainability issues will also find the Group's 'Responsible Business Report' useful. The second edition of this report is being published during December 2022.

Sustainability, social responsibility and citizenship issues are discussed in Section A6

Governance

The Group continues to operate under the UK Corporate Governance Code, complying with its provisions in the year. I joined the Board on 1 September 2022, in place of Fiona Clutterbuck, who had served more than nine years on the Board. I would like to thank Fiona on behalf of my colleagues for her skill in chairing the Board since 2018 and the wisdom of her counsel through the succeeding periods of uncertainty over Brexit, the impact of Covid and the evolution of the cost of living crisis. On a personal note I would like to thank her for her help in ensuring a smooth handover and supporting my induction.

Tanvi Davda, a new non-executive director, also joined the Board in September. This represents an expansion of the Board as we respond to growing regulatory and stakeholder expectations. Tanvi's appointment also broadens the range of skills and experience available to the Board. Gender and ethnic diversity will continue to be a key area of focus for the year ahead and the Board and Nomination Committee have taken material steps towards ensuring timely compliance with all regulatory targets, including the new Listing Rule requirements, by 30 September 2023.

Several of my colleagues on the Board spent a significant period of time towards the end of the year meeting with shareholders to develop a revised directors' remuneration policy, which also reflects the latest regulatory requirements. This has been considered carefully by the Board and we hope that shareholders and other stakeholders will consider that it appropriately balances all relevant factors.

Corporate governance is discussed in Sections B3 and B4

Risk

The Group continues to develop its systems and processes to manage risk. In common with other banks, the resilience self-assessment required by the regulator was completed in the year, with satisfactory results. In addition, significant work was undertaken to ensure that the FCA expectations for the new consumer duty can be met when this comes into force. This will be an area of continued focus into the new financial year as the implementation deadlines approach.

The Risk Management report is set out in Section B8

Shareholder returns

The Group has the strategic objective of providing a strong and sustainable return to investors while maintaining a prudent capital position, and due to the strength of its reserves has been able to announce share buy-backs of £75.0 million during the year, in addition to the declaration of an interim dividend.

Following its year-end review of the Group's capital position, the Board concluded that a final dividend for the year of 19.2 pence per share can be declared, subject to shareholder approval, giving a total dividend for the year of 28.6 pence per share, and thereby achieving a dividend cover of 2.5 times of earnings excluding fair value gains, broadly in line with policy. It also authorised a further share buy back of up to £50.0 million. We would like to thank our shareholders for their continuing support during the year.

Conclusion

My first months with the business make me confident that the Group's strategy and culture are such that it is well positioned for the future. Results for the year have been good and the Group has the capital strength and the people and processes which will enable it to respond effectively to the challenges arising from the current economic situation, as well as to grasp the opportunities which will inevitably arise as a result.

Finally I would like to thank all of my Paragon colleagues for all of their hard work in the year, and the welcome they have afforded me. I look forward to working with them and all of our other stakeholders towards the Group's continuing success.

Robert East

Chair of the Board

6 December 2022

A2. Business overview

At a glance

Paragon is a specialist banking group. We offer a range of savings products and provide finance for landlords, small businesses and residential property developers in the UK. Founded in 1985 and listed on the London Stock Exchange, we are a FTSE 250 company, headquartered in Solihull, employing 1,500 people.

> Our purpose is to support the **ambitions** of the **people** and **businesses** of the UK by delivering **specialist financial services**

Paragon's purpose provides the foundation for everything we do and today we are helping more than 340,000 customers to achieve their ambitions.

We have helped the UK to develop a thriving Private Rented Sector ('PRS') for more than 25 years, supporting landlords up and down the country to invest in and build valuable businesses that deliver flexibility and choice for those who choose to rent.

In addition to this, we help residential property developers turn unused sites into new housing, addressing the continuing housing shortage in the UK, and we offer finance to small and medium sized businesses operating across a wide range of different sectors, helping them to innovate, develop and grow.

We also support savers to reach personal goals – providing them with better returns on their savings.

As a specialist bank, we focus on lending to customers who require specialist products in markets typically underserved by larger high street banks.

This approach requires us to be experts in these areas, and we seek to know more than our competitors about our customers and the markets in which we operate, the products and services we offer, and the risks we incur. We see specialisation as what makes us different and as our competitive advantage, and it runs through our business model and strategy.

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

Our values

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

FAIRNESS

PROFESSIONALISM

INTEGRITY

COMMITMENT

TEAMWORK

RESPECT

HUMOUR

CREATIVITY

Our operations

Our operations are organised into two lending divisions, with new lending funded principally by savings deposits.

Mortgage Lending

We offer **buy-to-let mortgages** to landlords operating in the UK's Private Rented Sector. A pioneer in buy-to-let lending, we have originated over £27.3 billion of buy-to-let mortgages since the mid-1990s.

Our customers

We provide finance to landlords operating in the UK's Private Rented Sector, with a focus on professional landlords who have a portfolio of four or more properties, as well as those investing in more complex property types and via corporate structures.

Why we stand out

Our long-standing expertise in property valuation and risk assessment, together with our prudent approach to underwriting and surveying expertise make us a trusted partner in the professional landlord community and an authoritative voice in discussions about the future direction of the sector.

Key facts

50,000+ landlords
30 September 2022

£1.9 billion new lending (+17.2%)
12 months ended 30 September 2022

£12.3 billion loan assets (+4.2%)
30 September 2022

Commercial Lending

Since the introduction of our first **commercial lending** products for small and medium sized business in 2014, carefully targeted expansion in this area has been a key strategic focus for the Group. We focus on specialised assets and underserved markets in four main areas.

SME lending

We offer finance to business customers to fund assets and investment, helping them to innovate, adapt and grow. Supporting customers across construction, agriculture, transport, technology, manufacturing and professional services, our products include hire purchase, lease purchase, invoice finance and commercial loans.

Development finance

We support experienced small and medium sized property developers with competitive and flexible finance to bring their development plans to life. As well as residential development loans, we provide pre-let commercial development funding and finance for purpose-built student accommodation, along with bridging and pre-planning finance and marketing period loans.

Structured lending

Our structured lending team provide finance to non-bank specialist lenders, structured through secured and committed revolving credit facilities.

Motor finance

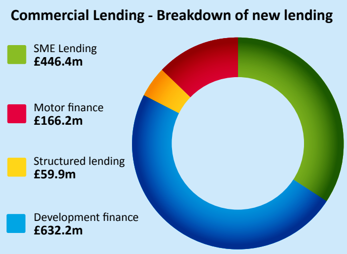
Our motor finance team provides finance through approved intermediaries and dealers for cars, light commercial vehicles, motorhomes and caravans.

Key facts

37,000+ customers
30 September 2022

£1.3 billion new lending (+34.3%)
12 months ended 30 September 2022

£1.9 billion loan assets (+19.6%)
30 September 2022



Funding

Our principal source of **funding** for our lending activities is our range of savings products offered to UK households. Other funding for lending is derived from the efficient use of the Bank of England funding schemes, while securitisation continues to fund elements of the book and is used tactically. Central funding is provided through corporate and retail bonds.

Savings

We offer a range of safe, simple and transparent Easy Access, Notice and Fixed Term savings accounts, including ISAs.

Our regular customer surveys show a consistently high level of satisfaction with our application process and customer service representatives.

Our online and postal application channels, are supplemented by digital banking and wealth management platform relationships.

Key facts

225,000+ direct savings customers
30 September 2022

£30,200 direct customer average deposit
30 September 2022

£10.7 billion total volume of savings deposits
30 September 2022

4.2/5 Feefo customer service rating*

*Based on 1,097 reviews in the 12 months to 30 September 2022

Our business model

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

What we do

A broad funding base

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

- **Retail deposits**
- **Securitisation**
- **Bond issuance**
- **Central bank funding**

Using our core strengths

Customer expertise

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

610 million +
Items of customer data analysed each month

Risk management

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

Impairment provision
£14.0 million

Technology

We are utilising digital technology to improve productivity, enhance service to customers and access new markets.

LetsConnect

Our new digital community gathering actionable insight from buy-to-let landlords and intermediaries.

Management expertise

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

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

To deliver value to all our stakeholders

Our section 172 statement can be found on pages 100 to 108.

Shareholders

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

Dividend per share
28.6p

Employees

Helping all our people develop their career and reach their potential. See page 59

Average training per employee in 2022*
5.2 days

Society

Helping the UK economy grow and supporting the communities in which we operate. See page 76

286
paid volunteer days supporting charities and local community groups

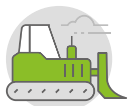
*Empoyer skills survey, UK average 3.6 days

Lending on diversified loan assets

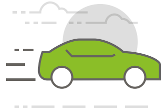
We focus on building our asset base by originating new loans, developing new products and diversifying into new markets.

Buy-to-let mortgages

Residential development loans



SME lending



Motor finance

Cost control

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

Underlying cost: income ratio

39.4%

Our people

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

Platinum Investors in People accreditation

Culture

Our core values underpin the way we do business and how we interact with our customers and other stakeholders, with a focus on delivering good customer outcomes.

New Code of Conduct introduced across the Group

Strong financial foundations

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

CET1 ratio

16.3%

Customers

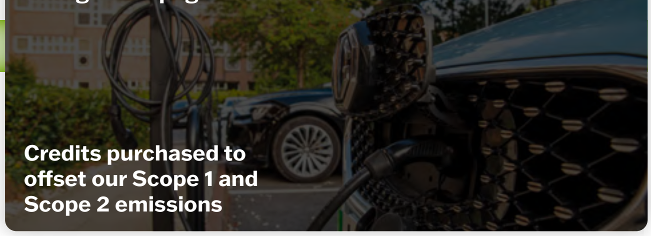
Providing tailored lending and savings products, expertise and working with intermediaries to help our customers achieve their ambitions. **See page 57**

+59

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

Environment

Continually reducing our environmental impact and designing products that support positive environmental change. **See page 64**



Credits purchased to offset our Scope 1 and Scope 2 emissions

Our markets

Adapting to evolving trends

Our success is dependent upon on our ability to optimise the products and support we offer to customers in our specialist markets, which is determined by our expertise in these markets and our capability to adapt to evolving trends. The overall economic landscape, the pace of digitalisation in product distribution and customer service, and the requirement to respond to climate change are critical factors impacting our customers and our approach. During the period, we have made considerable progress in each of these areas as we digitalise at pace, which is providing us with increased capability and capacity to support our customers in an uncertain and more challenging economic environment.

Buy-to-let mortgages

The Private Rented Sector ('PRS') is an essential component of the UK's housing market, providing affordable and stable homes for people who need flexibility to move for education and employment or as an alternative to house purchase. Economic, social and demographic changes have driven considerable expansion of the PRS since the early 2000s and today it comprises 4.4 million households in England, accounting for 19% of all homes[1]. It is the second most popular tenure after owner-occupation.

Market trends

UK buy-to-let mortgage lending totalled £292.9 billion at 30 September 2022, following a 15% increase in new lending to £53.3 billion during the 12 months to 30 September 2022. Remortgaging increased from 58% to 66% of new lending as stamp duty relief on house purchases introduced during the pandemic ended and the first wave of five-year fixed rate mortgages, which became more popular with landlords in 2017, approached the end of their initial term[2].

Tenant demand for PRS housing continues to grow[3] and the sector is expected to expand as housing provision increases across all tenures to meet the projected housing requirement for 1.8 million additional households across the UK over the next decade[4]. While purpose built, build-to-rent accommodation will meet some of this demand, with less than 240,000 such homes in planning, under construction or completed, it is likely to remain a modest proportion of the total[5].

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

Buy-to-let mortgage finance helps to fund an estimated

46%

of properties in the PRS[6].

[1]English Housing Survey, Headline Report, 2020-21. [2]UK Finance. [3]UK Residential Market Survey, RICS, September 2022 and Housing Insight Report, Propertymark, September 2022. [4]Challenges and opportunities for the private rented sector, Capital Economics, February 2022. [5]Build to Rent Q2 2022, prepared by Savills for the British Property Federation, July 2022. [6]Estimated from English Housing Survey, Headline Report, 2020-21 and UK Finance data.

Residential property development finance

The UK residential property market and rate of housebuilding drive the opportunities for development finance. UK Government targets for new homes and planning considerations influence activity in the residential development sector, alongside interest rates and lifestyle choices.

Market trends

The demand for housing in the UK continues to exceed supply, driven by population growth and new household formation. Government forecasts suggest 300,000 net new homes are needed each year, and with less than 175,000 delivered in 2021-2022[7], there is significant opportunity for residential developers looking to expand in the UK.

Despite strong demand for new homes, residential developments are taking slightly longer to gain planning approval and reach completion. This is partly a result of longer lead times to obtain planning approval, including extra responses to the introduction of new biodiversity requirements, and partly the result of an increase in material costs and skilled labour shortages since emerging from the pandemic. Uncertainty over the future direction of house prices and concern over funding costs are also making developers more cautious.

The Government is preparing a new Future Homes and Building Standard which will complement new Building Regulations introduced in June 2022. Taken together, it is expected that these measures will ensure that new homes built from 2025 produce 75-80% less carbon emissions than homes delivered under the old regulations and are net zero ready, enabling them to transition without the need for retrofitting.

[7]Housing supply: indicators of new supply, June 2022, Department for Levelling Up, Housing and Communities.

SME lending

The asset-backed SME finance market is broad and Paragon is focussed on specific asset classes. The general economic conditions influence activity in these areas, together with other key drivers, including: supply issues and manufacturing delays caused by the pandemic; the rate of new work in industries such as construction; Government regulations and trading restrictions; advances in technology and SME growth, and a growing focus on climate and sustainability.

Market trends

In the 12 months to 30 September, the overall asset finance market grew by 2% to £30.8 billion. Within this, the plant and machinery sub-segment expanded by 8% to reach £7.6 billion, commercial vehicles and business equipment grew 2% to £8.6 billion and £1.9 billion, and the IT sub-segment fell back by 23% to £1.5 billion[8].

While businesses started the year with an optimistic outlook and an appetite to boost investment, caution increased over the second half as the conflict in Ukraine pushed up energy prices and other input costs.

2 out of 5

SMEs view going green as a competitive advantage

Research undertaken by Paragon confirmed a high level of interest in green investment amongst SMEs, with 80% saying that sustainability is a priority and only 5% indicating resistance to change. However, businesses also said that cost concerns and lack of certainty around government legislation were barriers to change[9].

One area where there is relative certainty is in the vehicle market, where the sale of new petrol and diesel vehicles will be phased out by 2030, with a further government commitment to phase out fossil fuel HGVs by 2040. Between January and September 2022, all-electric and hybrid fuel vehicles grew to 51% of new registrations[10].

[8]Finance and Leasing Association. [9]SME Green Finance, Paragon. [10]SMMT.

Savings

While the UK savings market remains dominated by the large high street banks, competition from new banks continues to be supported by the grant of new licenses, the strength of the FSCS guarantee and the development of new technology. This benefits savers by giving them access to a wider range of savings providers and accounts which offer more competitive interest rates.

Market trends

The UK household savings market, estimated at £1.4 trillion, grew by 4%[11]. Paragon's share of this market now stands at 0.76%, a small increase from 0.69% last year, with huge potential to develop further to fund future growth in our lending as required.

The Bank of England began a series of Base Rate rises in December 2021 in response to inflation and, as a result, deposit rates began to lift across the market, giving savers more incentive to consider switching.

The pandemic has accelerated the take up of online banking. Familiarity with online banking increases confidence in online savings providers like Paragon and, building upon this, the development and implementation of API and Open Finance technology will make it easier for customers to move their money from low interest rate savings and current accounts to more attractive competitors.

During the pandemic, the proportion of savings held in variable rate easy access accounts increased from 63% to 69%[11], with fixed rate savings accounts and ISAs taking a lower share of the total than before. As interest rates rise, savers may be encouraged to return to these products.

[11]Bank of England.

Our strategy

Our strategy is driven by our purpose and helps us achieve our vision to become the UK's leading technology-enabled specialist bank and an organisation of which our employees are proud. We focus on specialist customers and aim to deliver long-term sustainable growth and shareholder returns through a low risk and robust model. We have five clear strategic priorities that help us deliver our strategy, underpinned by three strategic pillars.

Our strategic priorities	Strategic progress
Growth Read more on pages 18 and 19	**Delivering consistent growth in new lending, loan assets and funding by focusing our expertise in specialist lending markets and building an award-winning retail savings franchise.**
Diversification Read more on pages 20 and 21	**Developing resilience by diversifying into commercial lending alongside our traditional stronghold in buy-to-let and reducing our reliance on wholesale funding.**
Digitalisation Read more on pages 22 and 23	**Transforming all aspects of our business using digital, cloud-based technology to enhance customer service, productivity and growth.**
Capital management Read more on pages 24 and 25	**Building and maintaining strong levels of core capital to support customers through the economic cycle, provide capacity for growth and shareholder returns.**
Sustainability Read more on pages 26 and 27	**Moving towards net zero, building skills and capability to support long term growth and maintaining strong stewardship.**

Our strategic pillars

A customer focused culture

Expert knowledge and experience, supported by proprietary insight, data and analytics to deliver deep understanding and good outcomes for all our customers.

A dedicated team

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

Principal risks

We have identified a number of principal risks, arising from both the environment in which we operate and our business model, which could impact our ability to achieve our strategic priorities. We have an Enterprise Risk Management Framework ('ERMF') in place to ensure that these risks are monitored and managed in accordance with the Group's risk appetite.

These risks and the steps the Group takes to safeguard against them are discussed in more detail in Section B8

Capital
Insufficient capital to operate effectively and meet minimum requirements.

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

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

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

Our strategic priorities are simple, fully integrated and work hand-in-glove with each other in pursuit of the Group’s overall purpose.

Nigel Terrington, Chief Executive

Find out more about the progress we’re making on each of our strategic priorities on pages 18 to 27

11.6%
five year compound average growth in new lending

6.0%
net loan book growth during 2021/22

40.6%
of new lending now Commercial Lending

72.7%
savings as a proportion of total funding

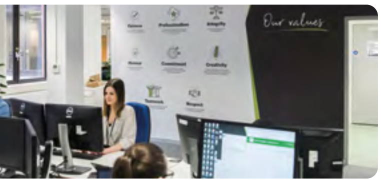
Digital transformation underway across the Group
new customer-facing applications and capability
enhanced operational infrastructure

£1,221.8 million
Tier 1 equity

16.0%
underlying return on tangible equity

Commitment to net zero operationally by 2030

Investors in People Platinum status achieved



Strong financial foundations

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

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

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

Strategic
The corporate plan does not fully align to and support strategic priorities or is not executed effectively.

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

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

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

Strategy in action | **Growth**

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

"The specialist markets in which we operate are witnessing good underlying growth levels and we have also achieved market share gains aided by additional product launches and improved engagement with our distribution channels. Alongside origination, we have also focused on customer retention, improving service to encourage repeat business and extend customer lifetime.

Nigel Terrington, Chief Executive

Consistent progress

New lending and loan book growth achieved in the latest reporting period builds upon a long track record of strong and consistent growth over many years.

£3.2 billion
New lending
12 months ended
30 September 2022

11.6%
CAGR
2017 – 2022

£14.2 billion
Total loans and
advances to customers
at 30 September 2022

5.0%
CAGR
2017 – 2022

Fresh approach to customer retention

With a record £1.8 billion of buy-to-let mortgages reaching the end of their initial, five-year fixed rate period during the year, we introduced a re-engineered, technology-driven switch and further advance process to make it quick and easy for mortgage customers and intermediaries to review and renew their mortgage finance with Paragon.

Based on in-depth customer and mortgage intermediary research, three key improvements were introduced.

1. Switching was offered six months prior to maturity instead of three months.
2. The further advance process was streamlined to speed up underwriting and valuation.
3. End-to-end customer support was introduced from one dedicated team.

"**Switching is easy. Extended and switched to a new mortgage term in literally five minutes through the online service whereas with other companies it has taken weeks of form-filling and being on the phone. Great service!**

Trustpilot

Focus on specialist markets

Through our targeted approach, focused on lending in specialist markets, we help a diverse range of customers to achieve their ambitions. We continually evolve our products and service in response to changing dynamics in the markets we serve, enabling us to optimise our return on capital.

Helping landlords to grow

Landlords with portfolios of four or more properties and complex property types comprise the fastest growing segment of the buy-to-let market and we have delivered a consistent stream of product and service developments to meet their needs.

£5 to £10 million
increase in amount landlords can borrow across their portfolio

£2 to £4 million
increase in maximum loan size

Portfolio expansion

By doubling the amount landlords can borrow and increasing the maximum loan available on a single property, we've provided more headroom for landlords to grow their portfolios, as well as helping them to pivot to meet rising demand for more and better quality space to support higher levels of home working following the pandemic.

Supporting residential property developers

Since expanding our property development finance capability in 2018 through the acquisition of Titlestone, we have extended support to more residential property developers across the UK and introduced new products to target a broader customer base.

43%
of lending to residential property developers is now outside of London and the South East

Building out across the UK

Over the last five years, we have doubled our team of Relationship Directors and Portfolio Managers to 40 specialists, extending our reach across the UK. Building from our stronghold in the South East, we have achieved good growth in the East and West Midlands and the South West.

Standing up for British business

Our SME lending team has deep and specialist knowledge in the sectors and industries in which it operates, offering steadfast support to British businesses throughout the pandemic and beyond with a mix of direct and broker distribution.

2030
new petrol and diesel vans to be phased out

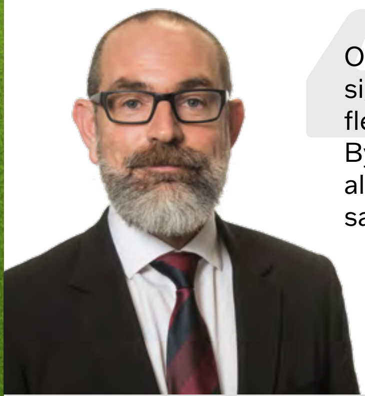
2040
commitment to phase out fossil fuel HGVs

A champion of change

The acceleration in online shopping during the pandemic has increased demand for commercial vehicles, with tighter environmental standards on the horizon boosting interest in new more sustainable vehicles. To help meet this demand, our transport and logistics team have deepened relationships with commercial vehicle dealerships to offer their customers an alternative to manufacturer funding.

Strategy in action | # Diversification

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



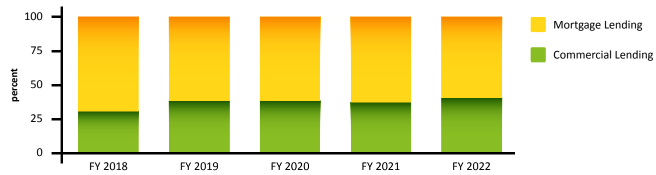
Our journey from monoline lender to diversified specialist bank has significantly accelerated our growth, whilst enabling us to respond with flexibility and stay resilient in the face of changing market conditions. By adding capability in specialist commercial lending markets alongside our core buy-to-let expertise and introducing a successful savings franchise, we are now reaching out to a much broader customer base than ever before from a stronger funding platform.

Michael Helsby, Managing Director – Strategic Development and Savings

Lending diversification

As a result of the success of our diversification strategy, the Commercial Lending division's share of new lending has grown to 40.6% of total lending and its income contribution is now £88.6 million compared with £19.9 million five years ago.

Product division's share of originations



Steady build up in commercial lending capability

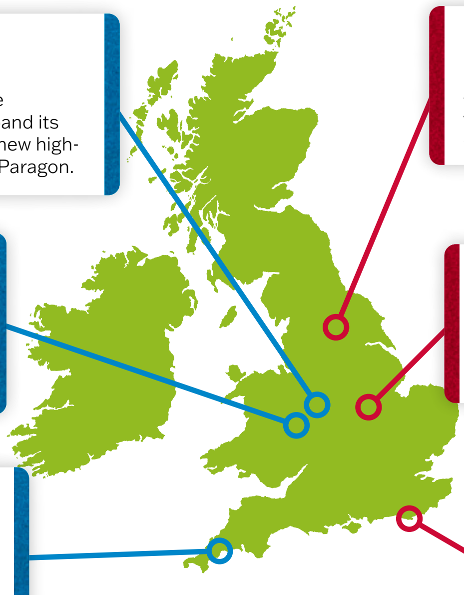
Our diversification into carefully targeted commercial lending markets has been achieved through a mix of acquisition and organic growth, resulting in good coverage across a wide range of industry sectors and a steady build-up of our loan book. Our Commercial Lending customers are spread across the UK. SME lending customers span a wide range of industry sectors and our development finance clients include a mix of new build and conversion projects.

3D Tooling Technologies
Sector: Manufacturing
This product and component prototype development specialist was able to expand its operations following the acquisition of new high-performance machine tools funded by Paragon.

Urbanite
Purpose-built student homes
A £14.8 million finance facility for a 457-bed development of cutting-edge, student accommodation in Leeds.

Textek
Sector: Recycling
Recycling plant, combined with fire suppression and dust extraction systems funded by Paragon mean this recycling pioneer can divert one million mattress away from landfill each year.

Barry Howard Homes
New build development
Funding to support the development of 28 new-build homes close to Weedon in Northamptonshire.



Exeter City Council
Sector: Refuse collection
The first electric Refuse Collection Vehicles ('RCV') provided by Paragon fleet management company, SFS, began work, giving Exeter residents cleaner air and reduced noise.

239 Kingsway Hove Ltd
Luxury apartment scheme
An £18 million finance package to assist with the acquisition of land and development costs for 37 two and three-bedroom seafront apartments in Hove.

SME lending

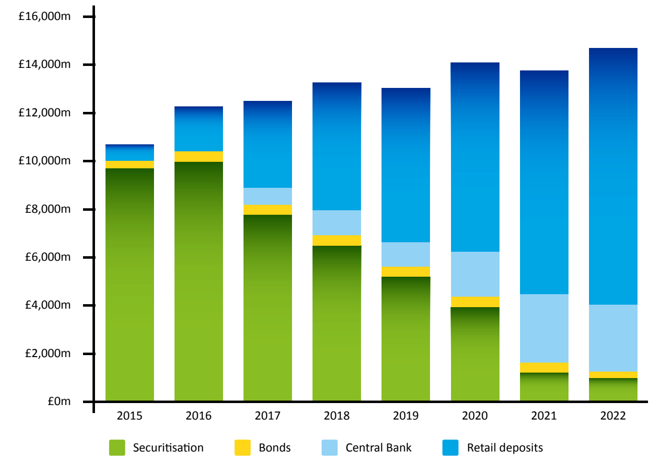
Development finance

Funding diversification

Funding diversification is also a crucial value driver. This year savings deposits passed the £10 billion milestone, with securitised funding at 7% of the Group's total debt compared to 99% ten years ago.

Funding by type

(30 September 2015 –2022)

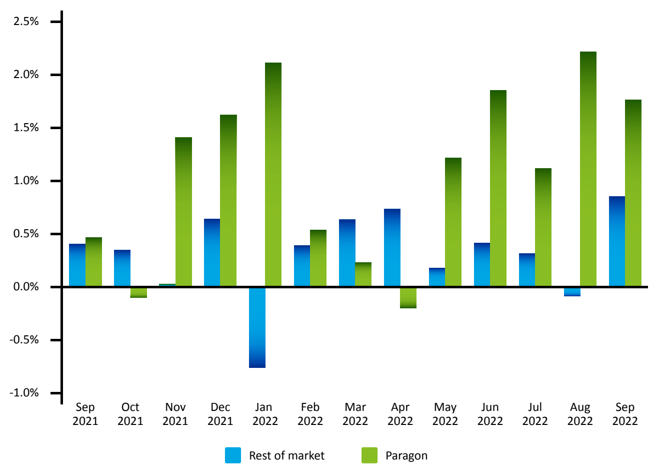


Competitive interest rates for savers

The rates we offer to our customers are carefully balanced to ensure that we provide good customer outcomes and value while gathering the appropriate level of deposits needed to fund our lending needs. In calibrating our rates we make sure to benefit both existing and new customers by remaining competitive in a fast moving environment. While average interest rates on our deposits have increased over the year, giving customers a better return, we have moved our average rate from above to below the SONIA reference rate.

Paragon vs Rest of market monthly stock growth

(Source: Bank of England)



Savings deposits pass £10 billion

Since the introduction of our first online saving accounts in 2014, Paragon has emerged as an award-winning savings provider in the UK and, this year, total deposits passed £10 billion. Our growth has consistently outperformed the industry average, shown by Bank of England data. From September 2021 to September 2022, Paragon's savings deposits grew by 14.7%. This compares to total market growth of 3.8% over the same period.

Scoring highly with savings customers

Feedback shows customers rate us highly. We measure customer satisfaction at three different points – when customers open an account with us, when their fixed rate account matures and when they close an account with us.

Satisfaction score		Net Promotor Score	
74%	75%	+59	+52
Account opening	Fixed rate account maturing	Account opening	Fixed rate account maturing

Strategy in action | Digitalisation

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

> We are undergoing a multi-year, multi-business line cloud-based re-platforming programme which will transform the way we engage with both the intermediary market and also new and existing customers. Our new systems will make extensive use of API and Open Banking technologies which will help to enhance our customer propositions on an increasingly cost-effective basis.
>
> **Pam Rowland**, Chief Operating Officer

Transforming our capability

The pandemic has accelerated the implementation and adoption of digital technology across the economy. Having already embarked upon our digital journey, we are now moving further and faster to leverage the benefits digitalisation can bring.

Broader reach and better service
Digital technology gives us access to a broader range of customers and speeds up our response time and service capability.

Operational leverage
Greater automation adds capacity to take on new business at a faster rate, accelerating scale benefits.

Better decision making
More comprehensive data capture and performance monitoring provides the basis for enhanced decision making.

Deeper insight
Online communities give us real-time access to customers, speeding up the time between insight and action.

Improved efficiency and future focus
Fewer manual interventions mean more expertise to support new product development and future growth.

More flexible learning
Digital technology enriches our learning, helping our people add new skills faster than ever before.

Enhancing performance throughout the business

Since embarking on our digital transformation, we have delivered a steady stream of focused developments across the business. Over 80% of our systems are now cloud-based and, as we move progressively through our current investment programme, further developments will continue to come on stream.

Digitalisation developments delivered to date

2019

Moving mortgage applications online
Enabling intermediary partners to submit buy-to-let mortgage applications via a new online portal, with the benefit of enhanced product search, pre-application mortgage illustrations, document upload and real-time case tracking.

2020-2021

Reaching out to new savings customers
Expanding our distribution capability, by building links to online current account providers and deposit platforms, such as Monzo and Hargreaves Lansdown, enabling their customers to save with us.

2020-2021

Re-imagining our learning
Enhancing employee learning with a new e-learning portal. Since implementation, employees have completed over 9,000 hours of learning on a wide range of topics.

2021

Accelerating SME lending growth
Speeding up the loan application process for SME lending intermediaries with the introduction of a new online portal providing 24/7 access from all devices and featuring autofill capability, links to third party data sources, drag and drop document upload, real-time case tracking, auto-generation of finance documents and e-signature.

> **Digital lending is a key opportunity for competitive differentiation. This is not just about speed of decisioning and fulfilment (the important basics) but also about delivering personalised customer journeys on a scale never seen before.**
>
> Why digital lending is the future for banks and SMEs, EY Global SME survey, July 2022

66% of SMEs are interested in access to faster credit

55% of SMEs would like to be funded within seven days

2021-2022

Re-engineering essential support systems
Boosting operational resilience and efficiency with the introduction of a single payment platform and a cloud-based financial ledger

2022

Simplifying the mortgage switch and further advance process
see page 18 for more

7 out of 10

landlord customers want digital communications rather than paper

(Source: Lets Connect member survey, 21-30 September 2022)

2022

Improving integration for development finance
Supporting future growth through the implementation of a new end-to-end loan management system for development finance, enabling the team to add and manage new business more effectively from initial enquiry all the way through to repayment.

2022

Connecting to online communities
Learning more and learning faster about the issues and service features that matter to our mortgage customers and intermediaries as we take our first steps into online research communities with Lets Connect.

Buy-to-let, end-to-end service enhancement underway

Building on these developments, we are currently working on an end-to-end service enhancement project which will transform the business origination and account servicing experience for mortgage customers and intermediaries. Informed by four important principles, this will help us to automate routine tasks and free up expertise to focus on growth, while improving speed, consistency and transparency.

1. Streamlined information capture
2. Easy to use
3. Automated workflow
4. Enhanced tracking

The new origination aspect of this project is scheduled for delivery towards the end of 2023, with account servicing following one year later.

Strategy in action

Capital management

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

"Our balance sheet is a source of great strength. We have always sought to operate with a cautious risk appetite, both operationally and prudentially, helping us to support our customers through challenging times, invest for growth and offer strong and consistent returns.

Richard Woodman, Chief Financial Officer

Strong core capital

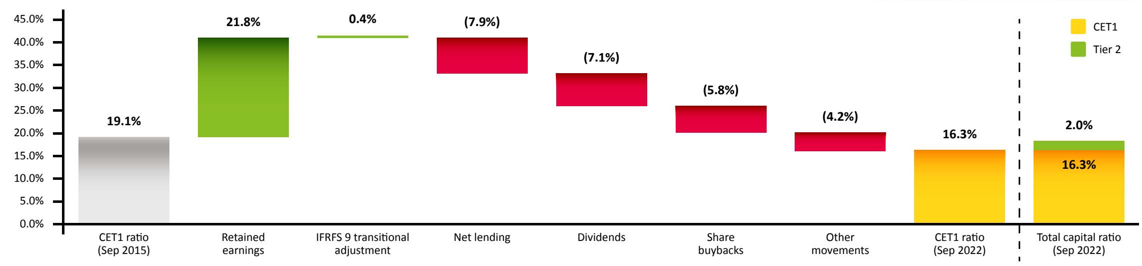
Paragon enjoys strong levels of core capital and high levels of internally generated capital. Since 2015, we have generated significant Core Tier 1 Equity ('CET1') before investing in future growth and making distributions to shareholders.

Our Core Tier 1 Equity ratio and our Total Capital ratio at 30 September were both comfortably in excess of the 8.8% regulatory minimum mandated for us by the banking regulator, the PRA, in 2021.

18.3%
Total Capital Ratio
30 September 2022

16.3%
Core Tier 1 Equity Ratio
30 September 2022

Movements in capital since 2015



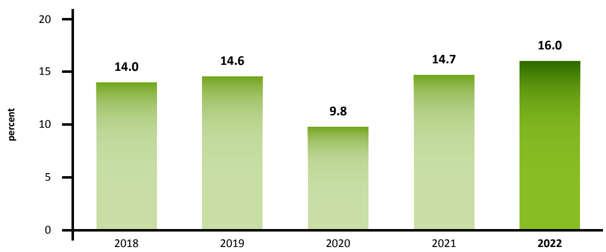
Supporting our customers

Our strong capital position gives us capacity to support our customers through challenging times while maintaining the soundness and stability of the bank. During the Covid pandemic, for example, our capital strength meant we were able to support affected customers, representing 22,000 accounts, with payment holidays and other relief measures until they were able to get themselves back on a sound financial footing.

Underpinning our growth ambitions

We always treat capital as a scarce resource and maintain a disciplined approach to its employment, prioritising the optimisation of the returns we can achieve. We have now achieved a return on tangible equity above our target of 15% and we believe this level is sustainable.

Underlying return on tangible equity



Delivering returns to shareholders

We have delivered significant lending growth while making consistent and significant returns to our shareholders over many years. The dividend pay-out ratio of 40% has seen £384.3 million paid to shareholders since 2015 and this has been supplemented by buy-back programmes totalling £322.2 million. Combined, this amounts to £706.5 million of capital being repatriated to shareholders since 2015, representing over 75% of our market capitalisation at the year end.

£384.3 million

Total dividends paid to shareholders since 2015

£322.2 million

Total capital returned to shareholders through share buy-backs since 2015

Making progress towards IRB accreditation

We are seeking accreditation to adopt an Internal Ratings Based ('IRB') approach when setting and managing our risk-weighted capital requirements. We submitted our buy-to-let Phase 2 IRB application to the PRA in 2021. Engagement with the PRA has been constructive and we continue to make good progress.

Why IRB matters?

As a conservative lender, with a proven through-the-cycle track record, IRB offers a number of advantages over a standardised approach to setting risk-weighted capital. In particular, it will:

1. **Enable us to tailor our capital requirements more closely to the credit risks we face**
2. **Make us more competitive in the market**
3. **Allow us to price for risk**
4. **Free up capital to support growth**

Data analytics and technology have been used extensively in our buy-to-let business throughout our history and help to support our IRB application.

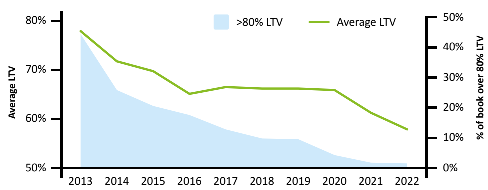
Low risk and proven resilience

Our buy-to-let credit performance has always outperformed the sector and this remains the case today. Support extended during the pandemic has been repaid and arrears stand at 15 basis points, less than half of the industry average. The asset backing of the buy-to-let portfolio is incredibly strong, with an average loan-to-value of 57.9% and only 1.4% of the loan book at greater than 80%.

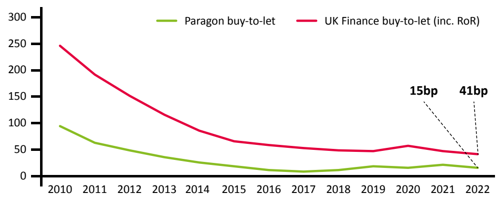
OVER 99%

of Group lending is secured, largely on property

Buy-to-let average loan to value



Buy-to-let arrears rate – 3 months+



Enterprise Risk Management Framework

We are further strengthening our strategic and operational risk management approach with the introduction of an Enterprise Risk Management Framework ('ERMF'), making sure that all risks across the Group are prioritised and managed in a similar way.

On track for completion in 2023, key developments in 2022 included:

- Completion of the ERMF
- Updating policies to strengthen protection against risks
- Refreshing the terms of reference for each of the Group's risk committees
- Group-wide, e-learning on risk management and the ERMF

Strategy in action | # Sustainability

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

We published our second Responsible Business Report in December 2022, which sets out our progress on the main ESG issues for our business and our stakeholders. We have divided our responsibilities into the following areas and more details on each can be found in our report.

44%
year-on-year reduction in market-based emissions over the last three years

Electrification of our company car fleet; all cars to be EV or PHEV by **2031**

Minimising our footprint

As we operate in mortgage, consumer and commercial finance markets, the overall environmental impact of our operations is low. However, we are continually looking at ways to improve the environmental performance of our sites and are committed to reducing our operational footprint to net zero by 2030. We have also offset our carbon emissions from 2022 through the purchase of certified carbon offsets.

Full £150m
allocation of our Tier 2 Green Bond

Sustainable finance

As a diversified bank providing products and services across multiple sectors, we have a responsibility to help our customers reduce their environmental impact and have developed a range of sustainable products across our business. To plot a clear pathway to net zero, we also need to fully understand the emissions we enable through our lending.

A range of **green mortgage products** and further advances launched

Updated our credit policy to allow applicants to apply for properties with **solar panels**

Helping our customers

We are committed to supporting the ambitions of the people and businesses of the UK by providing specialist financial services. This means using our expertise to develop products and support to meet the needs of our customers. We are committed to delivering good customer outcomes in line with our values and understand that at times customers may need extra support.

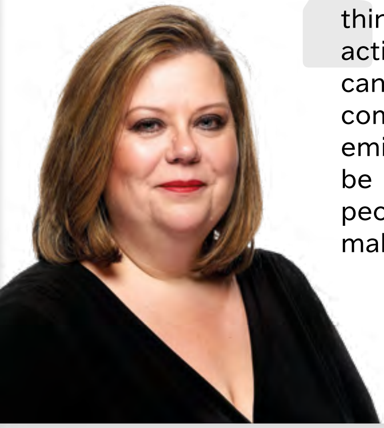
feefo

4.2/5 Feefo review score from savings customers

20,298
customers surveyed during 2022 by our dedicated customer insight team to augment customer understanding and improve customer experience

88%
of savers would consider taking out another savings product with Paragon

97%
of savers achieved what they set out to do in their recent interaction



> We are focused on doing the right things for all our stakeholders, taking action in areas where we believe we can have the greatest impact, from a commitment to reduce greenhouse gas emissions and helping our customers be more sustainable, to supporting our people to achieve their potential and making a difference in our communities.

Deborah Bateman, External Relations Director and Chair of the Sustainability Committee

Building a strong team

We employ 1,500 people based across the UK who work together to help our customers achieve their ambitions. The future of our business depends on those people – they drive Paragon's success. That's why we continue to work hard to attract, develop and retain a diverse workforce, where everyone feels supported, confident and able to reach their full potential. We are exceptionally proud of our culture which underpins how we do things at Paragon and helps us recruit and retain the best people for our business.

In 2022, we were named as a Platinum employer by Investors in People, joining just 5% of UK companies who have been assessed to hold this prestigious status. The accreditation is recognition of our commitment towards high performance through excellent employee connection, engagement, wellbeing and organisational culture.

Women in Finance Charter • Women in Finance Charter • Women in Finance Charter •

Women in Finance Charter target of 35% female representation in senior management positions exceeded

New High Potential Programme launched for our rising stars in specialist roles

Progress Together

Founding member of Progress Together, an independent body created to drive socio-economic diversity at senior levels across UK financial services

Contributing to our communities

For several years we've been involved with community volunteering and charitable partnerships to positively impact the communities in which we operate, but 2022 saw Paragon step up to deliver more support than ever before.

50+ different charitable organisations supported

through donations and volunteering

286 volunteering days achieved in 2022

through our community volunteer scheme which offers every employee one paid day off each year to help make a difference (2021: 49)

£75,000+ charitable contributions and money raised in 2022

including £31,000 raised by our dedicated Charity Committee (2021: £73,000+)

Doing business responsibly

Being a responsible business and doing the right thing is engrained throughout Paragon. We actively promote good practice on a range of important issues and expect the same from our suppliers and other business partners. We work hard to make sure we always do business the right way and this requires honest and proper conduct by our people, strong and fair relationships with our stakeholders and a robust governance structure.

13

mandatory learning courses launched for our people in 2022

Employee Code of Conduct launched in 2022, setting out the high standards of behaviour we expect from our people.

Signatory to the UK's Prompt Payment Code, administered by the Office of the Small Business Commissioner, to ensure suppliers are treated fairly in respect of payment terms and receive payment on time.

Prompt Payment Code

> Our business model has been designed, using extensive through-the-cycle experience, to be resilient in challenging environments.

Nigel Terrington, Chief Executive Officer

A3. Chief Executive's review

Strategic Report

Introduction

The Group has maintained the progress seen in 2021 into 2022, delivering strong results which reflect its strategic positioning, strong operational performance, robust operating platform and the commitment and professionalism of its people.

Our business model has been designed, using extensive through-the-cycle experience, to be resilient in challenging environments. Further, our diversification strategy and balance sheet structuring are designed to deliver stable funding, generate improved returns over time and also benefit in periods of higher interest rates.

The 2022 outturns demonstrate the effectiveness of this strategy, with the net loan book growing by 6.0%, margins widening by 30 basis points, cost efficiency improving and the underlying return on tangible equity rising to 16.0%. Statutory tangible net asset value per share increased by 22.8% to £5.33 per share (2021: £4.34).

The Group maintains close relationships with its customers, intermediaries and other business partners which have been particularly important with both the increase in the cost of living, and then interest rates rising sharply during the year.

Alongside this strong financial and operational delivery, we have continued to implement our digitalisation plans, with a number of front and back-office developments being delivered during the year, making immediate tangible improvements to customer journeys and operational efficiency.

Financial performance

Trading has been strong across the Group in the year. A combination of strong loan growth, widening net interest margins and tight cost control have resulted in profits before fair value items increasing by 16.4% to £226.0 million (2021: £194.2 million).

We have updated the Multiple Economic Scenarios ('MES') used for our impairment assessments, particularly in light of recent instability arising from the end of the pandemic, the war in Ukraine, rising inflation and interest rates and the policy responses to this backdrop. The scenario changes are illustrated below by comparing the weighted average forecast levels of key variables for the quarter ending 30 September 2023 in the current forecast to those for the same period in the forecast used at the previous year end.

Forecast for the quarter ended 30 September 2023

	2022 MES	2021 MES
GDP	**(1.1)%**	2.9%
CPI	**11.9%**	1.9%
Unemployment	**5.3%**	5.9%
House prices	**(8.2)%**	(0.7)%

In addition to a harsher suite of assumptions, given the extreme volatility seen, particularly in the final quarter of the year, the Group has adjusted its downside / severe weighting mix from 35% / 15% in 2021 to 30% / 20% in the current year. We have also released the remaining Covid overlays, but have added £15.0 million of judgmental adjustments to reflect the lack of observed data (notably in respect of inflation data) in the model build.

The Group has always operated a cautious hedging strategy, designed to minimise interest rate risk. This hedging takes place for both completed loans and the pipeline, and the Group has strategically increased its level of pipeline hedging in the year to enhance the protection of future margins. Derivatives hedging the pipeline only qualify for hedge accounting when the loan actually completes and are measured on a fair value basis until that point. Taking swaps out early in the process has, in a rapidly rising rate environment, created a material (£191.9 million) fair value gain for 2022. Whilst this will reverse over the coming years, it evidences the value that would have been lost to the Group had the pipeline loans only been hedged when they actually converted.

Basic earnings per share rose 17.9% to 69.9 pence on an underlying basis (removing the after tax impact of the fair value gains). Including the gains, reported basic EPS rose by 98.2% to 129.2 pence per share.

The total dividend for the year of 28.6 pence per share represents around 40% of the underlying earnings per share, with the effects of fair value movements removed.

Trading performance

Aggregate new business levels rose by 23.6% from 2021's level to £3.2 billion in 2022. As well as new front-end systems in the Commercial Lending division, the Group also benefitted from system and processing enhancements in its buy-to-let business, most notably in its product maturity management.

Mortgage Lending new advances increased by 17.2% to £1.91 billion (2021: £1.63 billion). The focus continues to be on complex properties and professional landlords, with simple business comprising just 2.1% of completions (2021: 3.2%). Five-year fixed rate loans, which increased in popularity in 2017, started to reach product maturity in 2022. The Group has been particularly successful in retaining these customers, having developed an online portal to facilitate the maturity process, and over 70% of our maturing specialist landlord customers chose to refinance with the Group at product maturity. The credit performance of the buy-to-let mortgage portfolio remains strong, with indexed loan to values falling to 57.9% at September 2022 (2021: 61.2%) and with only 1.4% of the book having an indexed LTV above 80%. Three month plus arrears on the portfolio were 15 basis points at 30 September 2022 (2021: 21 basis points).

Commercial Lending also had a strong year, with our new advances increasing by 34.3% to £1.30 billion, with each of the four sub-divisions seeing year-on-year growth. A complete end-to-end replatforming was delivered in development finance and a new digital broker portal launched in SME Lending during the year, the latter having an immediate impact on our processing times and business flows, which saw a rise of 40.9% in the final quarter of the year compared to the third quarter. Further digital enhancements will be delivered in the next financial year.

Capital and funding

Savings deposits remain the prime funding source for the Group, with balances increasing by 14.7% in the year, to £10.7 billion. The pricing profile of these deposits also changed during the period. Whilst comparing very favourably to the rates paid by the larger banks, the price of the administered rate portfolio moved from a premium of 37 basis points above SONIA at September 2021 to a discount of 64 basis points at September 2022. Further, for much of the second half of the year, equivalent swap rates exceeded the price of the Group's fixed rate bonds, also generating post-hedging funding below SONIA on this portion of the deposit book.

The move to a retail, rather than wholesale funded basis, has benefitted the Group greatly during the year and is the main driver in the outperformance of its net interest margin against both initial guidance and expectations. This optionality provides significant benefit and is a reflection of the Group's diversification strategy.

The Group completed £64.2 million of its £75.0 million share buy-back in the year. However having given an irrevocable instruction to Peel Hunt to complete the buy-back, the full value has been deducted from equity. The buy-back was subsequently completed on 7 November 2022. At 30 September 2022, our CET1 and TCR ratios stood at 16.3% and 18.3% respectively (2021: 15.4% and 17.6% respectively).

The level of capital resources substantially exceeds the regulatory minimum, which stands at 8.8% at the CET1 level, recognising the Group has no AT1 issuance.

Following the year end the Bank of England published their Consultation Paper regarding the process for the implementation of the Basel 3.1 standards in the UK. These largely followed the core Basel proposals and, as such, were materially in line with expectations. The Consultation Paper also highlighted enhancements to the IRB accreditation process and an increase in the Bank's threshold for Strong and Simple treatment to £20 billion of assets, each of which would have a favourable impact on the Group if retained in the ultimate supervisory statement.

The Group's IRB accreditation process continues. Although it has taken longer than initially anticipated, we now have good engagement with the PRA team. Non-binding feedback has been received in respect of the modelling aspects covered in Phase 2 of the process, with subsequent analysis and model remediation underway to meet the PRA's expectations.

Business model developments

The Group's multi-business line digitalisation programme continued at pace during the year. In addition to the development finance and SME systems noted above there were further notable developments, including the maturity management portal in buy-to-let and the movement of our general ledger to a cloud-based solution. An extensive change programme remains in place, with further developments scheduled to go live across the current and subsequent years. The general approach to accounting for these developments is to expense the bulk of expenditure, with the value of capitalised computer software standing at only £3.9 million at the year end.

People

The strong results for the year would not have been possible without the continued hard work, dedication and performance of our people. During the year we were awarded Platinum status by Investors in People ('IiP'), reflecting the Group's strong training and development approach and importantly the demonstration of behaviours that clearly reflect our values and culture. This status has only been attained by 5% of firms accredited by IiP.

We are committed to demonstrating a diverse and inclusive workplace, with the activities of our Equality, Diversity and Inclusion ('EDI') network materially expanding during the year, together with regular board engagement. Our initial HM Treasury Women in Finance targets, set in 2017, have been substantially met.

We have been particularly aware of the challenges our people were facing given the rapid increase in living costs in the year, and we gave each employee below senior management level a £500 one-off payment in the summer, together with a £500 advance on the 2022 profit related pay ('PRP') payment. Given the record level of profit reported in 2022, the final element of the 2022 PRP award will also be strong – further supporting our people.

Sustainability

In its first full year of operation the Group's Sustainability Committee has made much progress in fostering a holistic approach to a range of environmental and social issues and the related risks and opportunities. A particular area of focus has been climate change, where we are aware of the level of interest from stakeholders and regulators.

Policies have continued to develop in this area, while the year also saw the first offsetting of operational emissions, the continued greening of the Group's office estate and significant developments in lending on battery electric vehicles and energy efficient properties. The Group has also joined Bankers for Net Zero.

More widely the Group was pleased to publish its first Code of Conduct, outlining for all stakeholders the principles which guide its relationships with employees, customers, business introducers, suppliers and the wider community.

Outlook

The recent economic backdrop has created a volatile operating environment, with cost of living increases and rising interest rates creating uncertainties which impact demand, affordability and will potentially increase impairment levels. The Group's funding structure allows for a swift reaction to the changing environment and close contact with our customers allows us to help those who face difficulties as a result of changing rates and inflationary pressures.

We recognise that this environment will present challenges for the UK, its consumers and its businesses and, as an organisation built on relationships, we stand ready to support our customers through this difficult period.

We enter 2023 with strong margins, high quality loan books, robust pipelines, strong capital, cautious provisioning and well-developed franchises in each of our operating divisions. Our digitalisation process is expected to deliver further efficiencies and improvements for our customers and supporting intermediaries, and together with our agile and dedicated people, the Group is well placed to respond to the challenges in the year ahead. The strength of our business ensures we are well positioned to react positively to the opportunities which will inevitably emerge.

Nigel Terrington

Chief Executive Officer

6 December 2022

A4. Review of the year

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

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

Strategic Report

A4.1 Business review

The Group reports its results analysed between two segments, Mortgage Lending and Commercial Lending, based on types of customers, products and the internal management structure. This analysis was adopted in the year, following a review of segmental reporting. The former Idem Capital segment is no longer presented, and the remaining assets reanalysed. Comparative information has been restated in line with the new reporting structure.

New business advances in the year and year end loan balances are summarised below, analysed by segment:

	Advances in the year		Net loan balances at the year end	
	2022	2021	**2022**	2021
	£m	£m	**£m**	£m
Mortgage Lending	**1,910.0**	1,630.0	**12,328.7**	11,829.6
Commercial Lending	**1,304.7**	971.5	**1,881.6**	1,573.1
	3,214.7	2,601.5	**14,210.3**	13,402.7

The Group's total loan balance increased by 6.0% in the year following a 6.1% increase in the preceding twelve months. The Group continued to pursue its strategy of focussed growth as its markets continued to recover from the impacts of the Covid pandemic. This growth was despite the sale of £78.9 million of unsecured loan balances as the Group exited that market in the year.

Total advances increased 23.6% year-on-year, although the pattern varied across the Group's specialist markets, as a result of the differing impacts of the complex movements in the UK economic situation as it developed through the year.

A4.1.1 Mortgage Lending

The Group's Mortgage Lending division principally provides buy-to-let mortgages secured on UK residential property to specialist landlords. The Group has been active in this market for over a quarter of a century, through a wide range of economic environments. This gives the Group deep data and an unparalleled understanding of this form of mortgage and the landlord customer base it targets.

During the period the Group also offered a limited volume of loans to non-specialist landlords and owner-occupied first charge mortgages secured on residential property. Owner-occupied lending is carefully managed to ensure that only lending with appropriate risks which provides an acceptable return on capital is undertaken. The segment also includes legacy assets from discontinued product lines, including second charge mortgage loans formerly included in the Idem Capital segment.

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

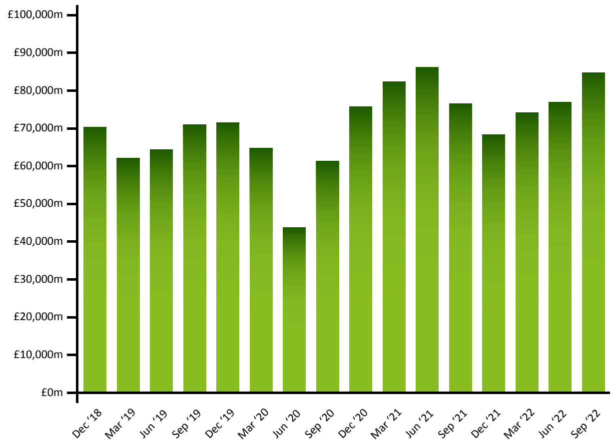
Housing and mortgage market

Activity in the UK housing market reduced year-on-year, although this is partly attributable to the artificially high volume of transactions in 2021, which included transactions delayed from the previous year due to Covid restrictions, and was stimulated by stamp duty reliefs. Transactions for the year reported by HMRC, at 1,223,000, were 21.3% lower than the 1,554,000 in the previous year. In their September 2022 Residential Market Survey, RICS noted a further slowing in market activity, attributable to the outlook on interest rates and more general economic uncertainty.

House prices saw strong growth in the year, contrary to some expert projections, with the Nationwide House Price Index recording a year-on-year increase of 9.5% to September 2022 (2021: 10.0%), although the rate of increase had slowed considerably towards the end of the period. Nationwide predict further slowing into the new financial year, due to the impact of affordability pressures, with RICS forecasting house price falls over a twelve month horizon.

New mortgage lending in the market remained strong in the year, with the Bank of England reporting new approvals of £304.3 billion in the year ended 30 September 2022. This was a decrease of only 3.6% on the record £315.9 billion reported for the previous financial year, which had been driven by the stamp duty holiday which ended on 30 September 2021. However, this total included an 18.0% fall in loans for house purchase, generally in line with the fall in transactions and greater re-mortgage activity.

Quarterly Bank of England UK mortgage approval data for the last four financial years is set out below, where the impacts of Covid waves and UK Government interventions on overall trends can be clearly seen.



At 30 September 2022 the UK Finance ('UKF') survey of mortgage market arrears and possessions reported a largely benign position with arrears levels holding steady or slightly falling and possessions rising, but remaining far below the pre-Covid levels of early 2020.

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

The Group's target customers in the buy-to-let sector are specialist landlords. Such landlords will typically let out four or more properties, or operate with more complex properties, and will generally run their portfolio as a business and have both a strong understanding of their local lettings market and a high level of personal day-to-day involvement. The Group is amongst a small number of specialist lenders addressing this sector, which is underserved by many of the larger lenders.

The Group's experience over the past year is that some smaller amateur landlords are leaving the market in the face of economic pressures and regulatory changes, while its specialist customers remain committed to the sector.

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.

The PRS continues to provide homes for around 19% of UK households. With supply and pricing issues impacting first-time buyers and the potential for incomes to become more constrained, the sector will continue to be crucial in national housing provision.

The Group has commissioned research on the future of the sector with the Social Market Foundation. This exercise found that, contrary to some widely held beliefs, most people renting their home in the private rented sector are happy with both their property and their landlord, and value the flexibility renting offers to them.

The research also concluded that the attention of policy makers, the media and society more generally, focuses on the minority of PRS tenants who have had particularly bad experiences with renting. However, 81% of private renters expressed their contentment with their current property, and 85% said they were satisfied with their landlord.

The full report on this research – ***Where Next for the Private Rented Sector?*** – is available on the Group's website at www.paragonbankinggroup.co.uk.

In contrast to the wider mortgage market, new buy-to-let advances reported by UKF, at £53.3 billion for the year ended 30 September 2022, were 14.6% higher than for the previous year (2021: £46.5 billion). However, this was mostly driven by remortgage activity, which increased by 23.4% while the value of new buy-to-let mortgages for house purchase fell by 10.6%.

In the lettings market RICS' September 2022 UK Residential Market Survey reported continuing strong tenant demand coupled with a dearth of supply, which was pushing rents upwards, with an expectation of a strong growth in rental prices in the short term. Research published by Zoopla supported these conclusions.

This is borne out by the Group's own independently commissioned research for the quarter ended 30 September 2022 which showed 65% of landlords were experiencing increased tenant demand, with 39% reporting significant increases. Upward movements in rents were also reported. This continuing demand will benefit affordability and cash flows for the Group's landlord customers. Despite their positive view of the current situation, however, landlord confidence had declined significantly in the last quarter of the financial year across all metrics measured, covering their own business, the sector and the UK economy more generally.

The UKF analysis of arrears and possessions also provided analysis of buy-to let cases, showing a similar position to the wider mortgage market, with arrears levels largely stable.

These factors indicate that the buy-to-let mortgage market remains strong, even in the face of economic pressures, and underpins the strength of the Group's proposition.

Mortgage Lending activity

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

	2022	2021
	£m	£m
Originated assets		
Specialist buy-to-let	**1,869.5**	1,562.2
Non-specialist buy-to-let	**39.5**	52.2
Total buy-to-let	**1,909.0**	1,614.4
Owner-occupied	**1.0**	1.5
Second charge	**-**	14.1
	1,910.0	1,630.0

Total mortgage originations in the Group increased by 17.2%, as the housing market continued to recover from the Covid pandemic. The Group's focus within the mortgage sector remained tightly on the specialist buy-to-let product, lending to larger landlords, those operating through corporate structures and those with complex properties, with other products ancillary to this activity.

New lending on specialist buy-to-let mortgages increased by 19.7% as this part of the PRS remained strong. These specialist completions, at £1,869.5 million formed 97.9% of the Group's new mortgage business. Restrictions in lending imposed during the pandemic were all reversed in the first half of the year, with further developments introduced, helping to drive volumes. Non-specialist buy-to-let lending remains modest in comparison, with advances continuing to decline.

The majority of the Group's mortgage lending products offer fixed rates for an initial period, with many customers choosing a new product, either with the Group or elsewhere, at the end of this fixed period. A market shift in 2017 saw five-year fixes become the dominant product and the initial tranche of that lending reached the end of the five-year period in the latter part of the year. The Group has well-established retention procedures to address accounts as their fixed rates expire and over 70% of the specialist landlord customers whose products matured in the year chose to refinance with the Group. This contact programme has also helped expand the pipeline of prospective new business.

The new business pipeline, being the loans passing through the underwriting process, stood at a record £1,256.0 million at the year-end, 24.6% higher than a year earlier (2021: £1,008.1 million), providing a strong platform for growth into the 2023 financial year. While the majority of this pipeline comprises fixed rate loans, with rates set by reference to market expectations at the time of offer, the Group's policy of pipeline hedging means that loans may be completed in a rising rate environment with limited impact on margins.

The Group sources the majority of its new buy-to-let lending through specialist intermediaries, and it continues to invest to ensure the service offered to them is excellent. During the year the Group's regular surveys of its intermediaries showed 89% were satisfied with the ease of obtaining a response from the Group (2021: 91%), delivering an NPS at offer stage of +40 (2021: +43). Two thirds (67%) of intermediaries dealing with the Group rated its service as good or better than that provided by other lenders (2021: 66%). Paragon Mortgages was also named as Best Professional Buy-to-let Lender at the 2022 Your Mortgage awards.

The Group's long-term programme of reengineering its mortgage business continued through the year. All systems and operational processes are being thoroughly reviewed and refined to align them with the Group's strategy for the division and the overarching plan of digitalising the business. As part of this reengineering, the capacity of the underwriting function has been significantly increased, ensuring that service standards and turnaround times remain excellent.

Initially, particular focus has been on those areas which can deliver immediate impact, such as customer retention, and on enhancing service to mortgage brokers. Improvements which went live in the period are already playing an important role in managing retention risk as five-year fixed rate mortgages start to mature and have made the process of requesting a further advance much more streamlined for the Group's customers.

Environmental impacts

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.

As part of its response to climate change the Group offers a range of green buy-to-let mortgages on all properties within the Group's lending criteria. These products offer lower interest rates for energy efficient properties with EPC ratings of C or higher.

The UK Government has identified the provision of more energy efficient housing as a prime objective in its response to climate change, with EPC levels being set as one of the principal benchmarks to be used. It also announced a target of upgrading as many homes as possible in the PRS to an EPC rating of C or higher.

The Group, together with other UK banking entities, has been working with the UK Government to develop a more consistent approach to the definition of green activities in the housing market and the housing finance sectors and is hopeful of progressing these discussions further in the forthcoming year.

The Group's new lending volumes on green buy-to-let products, which have increased by 44.1% in the year, are set out below.

	2022	2021
	£m	£m
EPC rated A or B	**169.0**	134.3
EPC rated C	**663.2**	443.4
Total rated A to C	**832.2**	577.7
Percentage with available data (England and Wales)	**99.6%**	92.6%

The increasing proportion of new accounts relating to energy-efficient properties is important in achieving the Group's downstream emissions aspirations and is generating a gradual improvement for the buy-to-let loan book as a whole.

The Group's latest analysis identified EPC grades for 92.8% by value of its mortgage book in England and Wales at 30 September 2022 (2021: 88.3%). Of these 98.9% were graded E or higher (2021: 98.4%) with 39.3% rated A, B or C (2021: 37.6%). The year-on-year movements are principally a result of the balance of new business, with 45.1% of advances in the year (2021: 39.7%) having one of the top three grades.

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

The Group also monitors the potential physical risks to security values arising from climate change. This includes assessing a property's flood risk as part of the underwriting process. At 30 September 2022, approximately 2.6% by number of properties securing the Group's buy-to-let mortgages in England and Wales for which information was available were considered to be at medium or high risk of flooding from the sea or rivers, based on data from the Environment Agency (2021: 2.5%).

In addition, a more detailed analysis was carried out in the period, using data which was more location specific, and also included risk of flooding from surface water. This showed 3.0% of properties securing buy-to-let mortgages, where data was available, were at 'higher' risk.

The Group's mortgage business is currently working to develop products to support its existing customers in making their properties more energy efficient. Given that the majority of properties in the PRS require some form of upgrade to meet the Government targets, this kind of support will be vital to achieving the UK's net zero target.

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

Performance

The outstanding loan balances in the segment are set out below, analysed by business line. Legacy second charge mortgage assets and other consumer loans were previously disclosed within the Idem Capital segment.

	30 September 2022	30 September 2021
	£m	£m
Post-2010 assets		
First charge buy-to-let	**8,536.4**	7,379.0
First charge owner-occupied	**28.0**	35.6
Second charge	**104.4**	148.1
	8,668.8	7,562.7
Legacy and acquired assets		
First charge buy-to-let	**3,549.6**	4,034.2
First charge owner-occupied	**8.4**	11.8
Second charge	**101.9**	133.6
Other consumer lending	**-**	87.3
	12,328.7	11,829.6

At 30 September 2022, the total net mortgage portfolio was 4.2% higher than at the start of the financial year, reflecting strong lending and retention performance. The balance of post-2010 buy-to-let lending grew by 15.7% and it now represents 69.2% of the division's total loan assets (2021: 62.4%).

The Group's residual unsecured consumer lending book, shown as 'other consumer lending' in the above table was disposed of in the year, realising a gain of £4.6 million, as part of the Group's exit strategy for this part of the lending market.

The annualised redemption rate on buy-to-let mortgage assets, at 9.8% (2021: 6.9%), has continued at a relatively low level, with the increase representing a reversion closer to pre-Covid levels. This is despite increasing numbers of five-year fixed rate loans reaching the end of their fixed period. As described above, the Group has adopted a number of strategic initiatives to retain customers whose mortgage accounts reach the end of their fixed rate period.

Arrears on the buy-to-let book reduced in the year to 0.15% (2021: 0.21%), with the payment performance of the Group's customers remaining strong, despite the growing economic pressures in the UK. Arrears on post-2010 lending were at 0.09% (2021: 0.09%). These arrears remain very low compared to the national buy-to-let market, with UKF reporting arrears of 0.41% across the buy-to-let sector at 30 September 2022 (2021: 0.47%). However, as noted above, landlord's expectations for their businesses appear more pessimistic than this performance data would suggest.

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

The loan-to-value coverage in the Group's buy-to-let loan book, at 57.9% (2021: 61.2%) represents significant security, enhanced over the year by the generally rising levels of house prices. Levels of interest cover and stressed affordability in the portfolio remain substantial, leaving customers well placed to develop their businesses going forward, indeed, on a simple weighted average basis, the Group's landlord customers now have over £10.0 billion of equity in their mortgaged properties.

Second charge arrears from post-2010 lending increased to 1.88% from 1.18% in the year, reflecting the increased seasoning and size of the portfolio. For legacy assets arrears rose to 26.7% (2021: 24.3%). These arrears levels remain higher than the average for the sector, but this reflects the seasoning of the balances, while the continuing upward trend reflects the redemption of performing accounts. This book contains a significant number of accounts which are currently making full monthly payments but which had missed payments at some point in the past, inflating the arrears rate. Average arrears for secured lending of 7.5% at 30 September 2022 were reported by the Finance and Leasing Association ('FLA') (2021: 8.6%). The Group enjoys substantial security on its second charge mortgage assets, with an average loan-to-value ratio on such cases of 50.6% (2021: 56.1%) providing a significant mitigant to credit risk.

In terms of the Group's impairments procedures, 16.4% of the segment's gross balances were considered as having a significant increase in credit risk ('SICR') (2021: 12.4%) including 1.1% which were credit impaired (2021: 2.2%). This was a result of the impact of the worsening economic outlook on probabilities of default. However, the impact of security values meant that provision coverage was stable, at 31 basis points (2021: 32 basis points), although coverage on fully performing accounts had increased from 2 basis points at 30 September 2021 to 6 basis points at the year end.

The Group's receiver of rent process for buy-to-let assets helps to reduce the level of losses by giving direct access to the rental flows from the underlying properties, while allowing tenants to stay in their homes. At the year end, 475 properties were managed by a receiver on the customer's behalf, a reduction of 14.1% over the year (2021: 553 properties), as cases were resolved, with generally successful results, considerably mitigating the original potential loss. Almost all these cases currently relate to pre-2010 lending, with cases being addressed on a long-term basis. There were relatively low numbers of new receivership cases in the year.

Outlook

While the increase in market interest rates has dampened the demand for new product, the Group's mortgage lending business is well placed as it enters the new financial year. Its investment in systems, which will continue going forward, enables it to provide an effective and responsive service to brokers and customers, whichever direction the UK economy takes, while its underwriting standards, the strong current performance and low loan-to-value ratio of the portfolio, and the hedging of the fixed rate pipeline bring strong defensive qualities to the balance sheet.

A4.1.2 Commercial Lending

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

The four business lines address:

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

Each of these businesses is led by a managing director, supported by a specialist team with a strong understanding of their market. The principal competitors for each are small banks and non-bank lenders. The Group operates principally in markets where the largest lenders have little presence, creating both a credit availability issue for customers and significant opportunities for the Group.

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

Commercial Lending activity

The Commercial Lending segment saw a 34.3% increase in new business during the year as UK economic activity continued to recover from the effects of Covid, with each sub-segment showing year-on-year growth.

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

	2022	2021
	£m	£m
Development finance	**632.2**	510.4
SME lending	**446.4**	336.9
Structured lending	**59.9**	24.0
Motor finance	**166.2**	100.2
	1,304.7	971.5

The impact of this new lending has been to increase the Group's overall Commercial Lending exposure by 19.6% in the year to £1,881.6 million (2021: £1,573.1 million).

Development finance

The Group's development finance business performed strongly in the year with new lending increasing by 23.9% to £632.2 million (2021: £510.4 million). While the volume of projects funded increased as the UK emerged from Covid, some developers continued to experience supply chain issues, although not to the extent where ultimate project viability was threatened, and some project timescales were extended. Towards the end of the year the volume of enquiries reduced somewhat, with developers reacting to the uncertain economic outlook by taking a cautious approach to initiating new projects. This resulted in undrawn amounts on live facilities at 30 September 2022, at £556.0 million, being 11.1% higher than at the previous year end (2021: £500.4 million), while the post-offer pipeline fell to £136.8 million (2021: £298.6 million).

During the year the business launched its first major green finance option. Projects to develop energy-efficient properties, those with an EPC A grade, can receive beneficial funding terms. By 30 September 2022, £64.5 million of new lending facilities had been agreed under the green initiative, with drawings reaching £11.9 million by the year end. This type of project will be an area of focus for the Group going forward, as developers increasingly factor these discounts into their project planning.

The regional spread of the Group's lending has broadened, with the proportion of the portfolio located in London and the South-East of England falling to 56.8% from 63.6% at 30 September 2021. Activity increased particularly in both the East Midlands and West Midlands, with funding provided for a number of flagship projects. The business has also increased the range of specialist developments it has funded, including a heightened focus on the later living sector. However, the vast majority of lending relates to standard residential property.

The Group's investment in systems for this business has continued through this period, with a major upgrade to loan servicing capabilities delivered in the year as well as a stream of enhancements being delivered on a regular basis through the year to improve process efficiency and customer service. This drive towards digitalisation will continue, providing a solid platform for the growth of the business and supporting the transition to an IRB approach to capital management.

The business also saw a leadership change, with Robert Orr, who had led the operation since the Group's acquisition of the Titlestone development finance business in 2018 stepping back, to be succeeded as Managing Director by Neal Moy, who joined the Group with wide experience in the property finance sector. Other appointments were also made to enhance the relationship team.

Despite an uncertain economic outlook and potential supply chain disruptions the underlying business proposition for developers remains fundamentally unchanged. The UK is still failing to meet its targets for the development of new housing and demand continues to increase. The current state of the UK house building market gives a significant opportunity for smaller developers to expand, if they can access reliable sources of funding for projects. The Group's proposition is strong and attractive and continues to provide healthy returns for the capital invested and opportunities for growth as it moves forward with new systems and leadership to face the challenges ahead.

SME lending

The Group's SME lending business is primarily focussed on financing core business assets for SMEs. The core assets financed included wheeled construction plant, such as excavators, and other commercial vehicles. These customers are therefore sensitive to sentiment around capital investment in the UK, which has become more negative towards the latter part of the year, resulting in a slowing of growth in the SME asset finance market reported for the FLA, where in the early part of the year a stronger post-pandemic recovery was seen.

Against this background the Group's SME asset leasing business saw volumes increase by 39.7% year-on-year to £276.9 million, excluding government-backed balances (2021: £198.2 million), far higher than the average of 9% reported by the FLA for the SME sector. Investment in operating leases has also continued with £14.5 million of assets acquired in the period (2021: £13.0 million).

Much of this success is attributable to investment made in systems and processes, including the introduction of a new broker portal at the start of the year. This has increased efficiency and responsiveness in the underwriting process, as well as enhancing the Group's ability to handle smaller value propositions cost-effectively. This has also enabled record numbers of applications to be handled and improved conversion rates. Advances in the second half were over 45% higher than those in the first six months of the year, reflecting the roll out of the new portal. The reduced average loan size is also beneficial in spreading credit risk.

These service enhancements have improved the standing of the business in the finance broker community. 88% of brokers surveyed by the Group in the year said that they considered that their experience with the Group was as good or better than with other lenders and 81% stated that they were likely to provide further business.

Following the major upgrade, the programme of investment in system improvements to create efficiency gains has continued throughout the year. Agile and modular delivery enables individual improvements to go into the live system as they are completed, providing incremental enhancements.

The Group continued to advance loans under the UK Government-sponsored Recovery Loan Scheme, ('RLS') until the second phase of that scheme closed for new applications in June 2022. The Group's application to take part in the third phase of that scheme is being processed. RLS loans have the benefit of an 80% government guarantee (after the proceeds of any business assets are applied for leasing balances) for pre-January 2022 advances and a 70% guarantee for applications received between January and June 2022. The Group's lending on these products primarily focussed on its existing customers, and the majority of RLS lending has been on asset-secured products.

During the year £32.2 million was advanced under schemes backed by a government guarantee (2021: £64.2 million), of which £31.5 million was asset leasing business. This reduction was in line with expectations, given that these loans were initially introduced as a response to the Covid pandemic. The Group continues to closely monitor the portfolio for any adverse indications.

Short-term lending to professional services firms outside government supported schemes more than doubled to £125.8 million (2021: £62.0 million). These loans are often used to spread the impact of tax payments, and the availability of tax deferrals, together with the availability of loans under the Coronavirus Business Interruption Loan Scheme ('CBILS') and similar arrangements amongst this customer group had seriously depressed demand. However, the underlying requirement for this form of finance remains for the longer-term, and performance has continued to move back towards pre-Covid levels.

The division has seen an increased level of green lending propositions over recent months, with many SME businesses in the transportation field and beyond seeking to reduce their carbon footprints. The division also has a strong presence in waste management, supporting local authorities as they transition to greener refuse collection activities, including funding new all-electric refuse collection vehicles for the City of Exeter, and providing funding for the development of recycling plants. It is a strategic priority of the Group to support UK SMEs, whose journey towards net zero may require significant capital investment over time, and these types of initiatives are expected to increase going forward.

UK SMEs are potentially facing a difficult period as interest rates and inflation rise and the labour market remains tight. The FLA outlook survey for September reports significantly negative expectations across the leasing market for business investment and the economy more generally. In the Group's own independently conducted research of over 1,000 SMEs, the majority acknowledged the seriousness of the economic situation, particularly the potential impact of inflation and costs, but were cautiously optimistic of managing their way successfully through it. In this environment opportunities for the Group's SME business are likely to be restricted, but it will leverage its customer relationships and account management experience to protect its franchise and optimise customer outcomes, whichever direction the UK economy moves in.

Structured lending

The Group's structured lending exposure has seen an increased level of activity in the year, with several new facilities agreed and older balances repaid, diversifying the business' exposures and increasing the overall balance outstanding by 50.3%. Total facilities also increased by 18.9% to £220.5 million (2021: £185.5 million).

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

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

Motor finance

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

During the year the Group also began funding static caravans, which provide good yields and fit comfortably with the Group's focus on specialist products.

Lending in the year grew 65.9% to £166.2 million (2021: £100.2 million), although the business was significantly affected by the Covid pandemic in the first part of the 2021 financial year and the current year's business represents a return to a more normal level.

The Group also launched its first products for financing battery-powered electric vehicles ('BEVs'). £6.0 million of new loans were made, reflecting the recent growth in the availability of these vehicles, with BEVs representing 11.8% of new vehicle registrations in the year, as reported by the Society of Motor Manufacturers and Traders. The offering was extended in the second half of the year to cover light commercial BEVs. The Group is well placed to support the green aspirations of its customers, as electric vehicles become a more widely viable and popular option.

Performance

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

	2022 £m	2021 £m
Asset leasing	**532.5**	468.7
Professions finance	**60.9**	33.1
CBILS, BBLS and RLS	**88.0**	83.8
Invoice finance	**25.7**	20.9
Unsecured business lending	**14.6**	10.3
Total SME lending	**721.7**	616.8
Development finance	**719.9**	608.2
Structured lending	**178.7**	118.9
Motor finance	**261.3**	229.2
	1,881.6	1,573.1

Despite the building pressures in the UK economy credit performance in the development finance book has been good, and the overall performance of the projects has been generally in line with expectations. Accounts are regularly monitored and graded on a case-by-case basis by the Credit Risk function. At 30 September 2022 only one account had been identified as being at risk of loss, a long standing legacy case.

The average loan to gross development value for the portfolio at the year end, a measure of security cover, was 62.1% (2021: 61.7%), which gives the Group a substantial buffer if any project encounters problems. No new serious credit issues arose during the financial year.

Credit performance in the division's originated finance leasing portfolios has been generally good, with improving arrears measures in both asset leasing at 0.08% and motor finance at 1.58% (2021: 0.27% and 2.30% respectively), however there have been a small number of cases where serious credit issues have been identified and the sector is expected to display more volatile credit performance as government support initiatives unwind.

For UK Government guaranteed loans credit performance remained strong. Despite widespread coverage of fraudulent loan applications across the sector the Group's total claims made up to 30 September 2022 were £2.4 million, with £2.2 million of this balance already recovered from the Government.

In the structured lending business, the Group carefully monitors the performance of the underlying asset pool on a monthly basis, to ensure its security remains adequate. The Group relies on its data monitoring and verification processes to ensure that these reviews are able to detect any credit issues. Performance in the year has been in line with expectations, with generally improved metrics across the book, and all accounts classified in IFRS 9 Stage 1 at the year end.

In terms of the Group's impairments procedures, 4.7% of the segment's gross balances were considered as having an SICR (2021: 6.0%) including 0.7% which were credit impaired (2021: 1.9%). Provision coverage had reduced in line with the shift towards performing accounts, at 134 basis points (2021: 174 basis points) although coverage on fully performing accounts had increased from 86 basis points at 30 September 2021 to 108 basis points at the year end as a result of management's evaluation of the probability of potential problem cases not registering through the normal SICR identification procedures in the current economic environment.

Outlook

The evident headwinds in the UK economy are likely to reduce the scope for near-term new business volume growth across the division's markets. However, the franchise remains strong and the efficient and effective processes which have been rolled out through the Group's digitalisation programme, coupled with strong customer relationship management and the high standards of credit management applied over time, will both protect the value in the businesses and allow them to gain market share, should their broader markets see a slowdown.

A4.2 Funding

The Group is principally funded by retail deposits, but also accesses a variety of other funding sources. This creates an adaptable and sustainable funding position which can flex with developments in the business, its operating environment and the economic landscape. The Group is therefore able to access cost-effective funding, as well as raising funding for strategic initiatives on a timely basis.

During the year the Group's requirements for additional funding were satisfied through the retail deposit market. Demand for deposit products remained strong, with nervousness amongst consumers over impending cost of living issues motivating customers to save, at least in the short term.

The Group's funding at 30 September 2022 is summarised as follows:

	2022 £m	2021 £m	2020 £m
Retail deposit balances	**10,669.2**	9,300.4	7,856.6
Securitised and warehouse funding	**995.3**	1,246.0	3,928.3
Central bank facilities	**2,750.0**	2,819.0	1,854.4
Tier 2 and retail bonds	**261.5**	386.1	446.6
Total on balance sheet funding	**14,676.0**	13,751.5	14,085.9
Off balance sheet liquidity facilities	**150.0**	150.0	150.0
	14,826.0	13,901.5	14,235.9

The Group's retail deposit balance grew by 14.7% in the year to £10,669.2 million (2021: £9,300.4 million), exceeding £10 billion for the first time and representing 72.7% of balance sheet funding (2021: 67.6%), with wholesale borrowings continuing to reduce over the year.

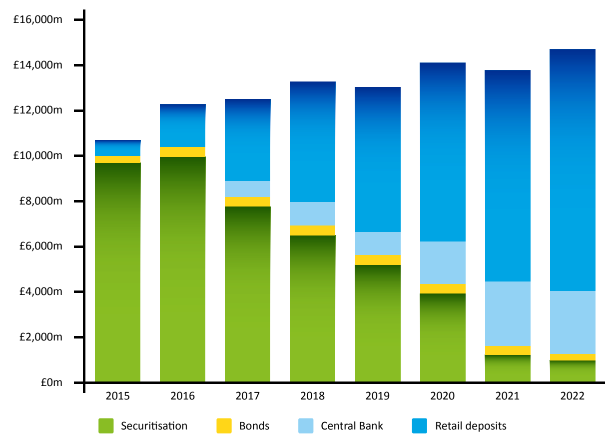
At 30 September 2022 the proportion of easy access deposits, which are repayable on demand, was 27.0% of total on-balance sheet funding (2021: 24.1%). This increase is partly a result of market sentiment, with savers reluctant to commit funds to term deposits in the anticipation of future interest rate rises, and partly as a result of the Group's maturing liquidity policy. This percentage remains low compared to the rest of the banking sector and can be expected to rise going forward.

With the generally uncertain economic outlook, the Group has maintained a cautious approach to liquidity in the period. Some loosening of policy took place in the period in response to the gradual opening up of the UK economy, but at the end of the year the Group still had £1,689.1 million of cash available for liquidity and other purposes (2021: £1,236.5 million). The Group's contingent liquidity policy will be kept under review as the ultimate outcome of the Covid crisis becomes clearer and longer-term trends become more evident, but the Group intends to maintain a conservative approach.

The Group's long-term funding strategy, following the granting of its banking licence in 2014, has been to move to using retail deposits as its primary funding source, using the debt markets on an opportunistic basis for additional funding requirements. The Group's progress towards this goal is illustrated by the chart below which shows, at each of the financial year ends since 2015, the outstanding funding balance by type.

Funding by type

(30 September 2015 –2022)



The Group's programme to transition away from the use of the London Interbank Offered Rate ('LIBOR') as a reference rate was completed during the year, in time for the withdrawal of that rate in December 2021. This formed the culmination of a multi-year programme to transition to other benchmarks, notably the Sterling Overnight Index Average ('SONIA') for both wholesale funding and retail lending and saving products.

The Group engages in fixed rate lending and accepts fixed term deposits. It is therefore exposed to interest rate risk, and it manages this position through hedging with interest rate derivatives. Where interest rates are moving this can lead to substantial fair value movements, but the Group has established policies and procedures to ensure that only economically appropriate transactions which hedge normal trading activities are entered into.

A4.2.1 Retail funding

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

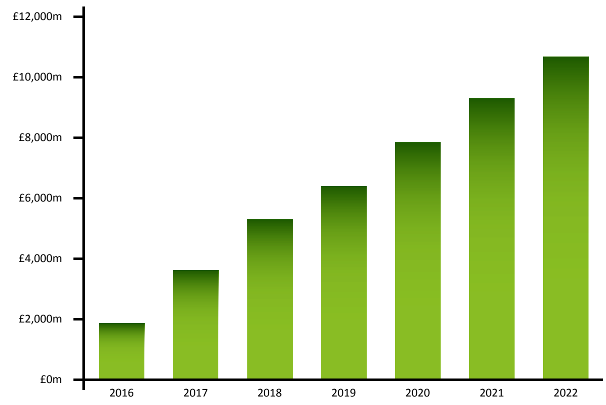
The Group offers a variety of savings products, including term deposits, ISAs and easy access accounts and the business accesses the market through a variety of in-house and external channels. The proposition is based on competitive rates and value for money, combined with the Group's strong customer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

The retail deposit market in the UK is large, deep and well developed. During the year, savings balances of UK individuals reported by the Bank of England continued to increase, despite increasing pressures on living costs, with balances at 30 September 2022 reaching £1,402.3 billion (2021: £1,351.6 billion), an increase of 3.8% in the year. Some of this increase may be reversed as the cost of living increases, but as a small participant the Group is less likely to be affected by this than larger banks and building societies.

The Group's retail deposit franchise performed well in the year and was able to deliver the required funding base at attractive cost compared to wholesale alternatives. The growth of the retail funding balance over recent years is set out below.

Retail deposits

(At 30 September 2016 – 2022)



Savings accounts at the financial year end are analysed below.

	Average interest rate		Proportion of deposits	
	2022	2021	**2022**	2021
	%	%	**%**	%
Fixed rate deposits	**1.74%**	1.25%	**58.1%**	58.8%
Variable rate deposits	**1.55%**	0.42%	**41.9%**	41.2%
All balances	**1.66%**	0.91%	**100.0%**	100.0%

The average initial term of fixed rate deposits was 22 months (2021: 26 months). Market savings rates in the year have begun to increase from their historically low levels as the UK bank base rate has moved upwards, particularly towards the end of the year. The Bank of England has reported average interest rates at 30 September 2022 for new 2-year fixed rate deposits at 2.67% (2021: 0.46%), at 0.6% for instant access balances (2021: 0.10%) and similar rises across product types. This rising rate environment has impacted on the Group's absolute funding cost, as shown above.

It is notable that the SONIA market interest benchmark had increased from 0.05% at the start of the year to 2.19% by its close, meaning that the average variable rate paid by the Group represented a 64 basis point discount to SONIA whereas the opening position had been a 37 basis point premium.

The Group has continued to increase volumes through its direct channel and through an expansion of the number and volume of accounts opened through third party digital banking and wealth management platforms. The use of these third parties increases options to manage inflows and allows the Group to access a wider base of customers. The Group now operates through eight channels, including new relationships which commenced in the year. These channels now represent around 13% of the total deposit base and the Group's infrastructure offers opportunities to expand this further.

The Group regards the quality of its customer service as a vital component of its savings market strategy and conducts insight surveys throughout the customer journey. In this research 88% of customers opening a savings account with the Group in the year who provided data, stated that they would 'probably' or 'definitely' take a second product (2021: 88%). The NPS in the same survey was +59, similar to that in the previous year (2021: +58).

When customers with maturing savings balances in the year were surveyed, 87% stated that they would 'probably' or 'definitely' consider taking out a replacement product with the Group (2021: 89%) with an NPS at maturity of +52, the same level as in the 2021 financial year (2021: +52).

This level of customer satisfaction is also demonstrated by the Group's continuing success in industry awards. During the year awards won included 'Best Fixed Term Savings Account Provider' at the 2022 YourMoney awards, 'Best Fixed Rate Cash ISA Provider' at the 2022 Moneynet awards and 'Most Consistent Best Buy Savings Provider' in the MoneyComms 2022 Top Performers list.

The Group's direct and third party channels are both supported by reliable and scalable infrastructure, and it continues to invest in systems and processes to enable the business to develop. This delivers a retail deposit stream where volumes and rates can be effectively managed to support the Group's requirements.

The operation will continue to develop, expanding offerings, addressing wider customer groups and accessing new channels while monitoring the emerging impact of the cost of living and rising interest rates on the consumer savings market. The Group's profiling of its target customers suggests they may be more resilient than average in the event of future economic stresses, but the developing situation will remain under close review.

A4.2.2 Central bank facilities

The Bank of England Term Funding scheme for SMEs ('TFSME') continued to be available through the early part of the year to support lenders in providing credit to SME customers through the Covid pandemic. The Group refinanced its borrowings under the scheme before it closed to manage its maturity dates.

During the year the amount drawn under TFSME was £2,750.0 million (2021: £2,750.0 million). As TFSME provides funding at or very close to base rate, in a low base rate environment it forms a particularly cost-effective form of borrowing for lenders which, like the Group, wished to support their SME customers through the economic uncertainties of the pandemic. The relative cost-effectiveness of these borrowings as base rates begin to rise is being kept under review.

The Group's remaining drawings under the Bank of England's original Term Funding Scheme ('TFS') were repaid in the year. The Group retains access to other Bank of England funding channels and utilised these to make drawings under the Indexed Long-Term Repo Scheme ('ILTR') during the period. None of these drawings remained outstanding at the year end.

The Group expects to continue to make use of these central bank 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 at 30 September 2022 of up to £1,776.0 million (2021: £1,424.2 million).

A4.2.3 Wholesale funding

The Group's wholesale funding includes securitisation funding, warehouse bank debt and retail and Tier 2 corporate bonds, which are each accessed from time to time as appropriate. The Group's Long-Term Issuer Default Rating was increased to BBB+ by Fitch in March 2022, with a stable outlook, enhancing the Group's funding capacity.

For much of the year the capital markets remained active, with activity in most areas of funding. The securitisation markets remained open, but with very few transactions coming to market. Towards the end of the year the levels of uncertainty in the markets effectively prevented any new deals being launched.

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

The Group renegotiated its £400.0 million warehouse funding facility during the period, increasing the facility size to £450.0 million and transitioning the interest rate from 0.60% above LIBOR to 0.50% over SONIA. 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 Group's retail bond issued in January 2015 was repaid at maturity in January 2022. The Group also entered into sale and repurchase transactions from time to time, to ensure it retains access to this channel for liquidity purposes.

The Group's wholesale funding position is stable, mostly long-dated and cost effective. It retains the infrastructure to access all appropriate wholesale funding sources whenever appropriate. This wholesale funding strategy is effective and adaptable, and the Group will continue to access all these funding sources on a strategic and opportunistic basis as appropriate.

A4.2.4 Funding outlook

The year ended 30 September 2022 saw the continuing growth of the Group's savings proposition, with total balances exceeding £10.0 billion for the first time. The wholesale part of the funding base continued to reduce while remaining stable, with little requiring refinancing in the short term, providing some protection against any developing issues in the UK economy.

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

Further information on all the above borrowings is given in notes 33 to 37.

A4.3 Capital review

The Group manages its capital to maintain the strength of its balance sheet, ensure that its regulatory capital and liquidity positions are sufficient to safeguard depositors and provide capacity to meet its strategic objectives and other opportunities going forward.

With the increasing levels of uncertainty in the UK economy over the year and the upward movement in interest rates and inflation towards the end of the year, the Group focussed on ensuring that its capital strength remains sufficient to withstand the potential pressures.

For regulatory purposes the Group's capital comprises shareholders' equity and its Tier-2 green bond. It has no outstanding Additional Tier 1 ('AT1') issuance, but has the capacity to issue such securities, if considered appropriate, under an authority granted by shareholders at the 2022 Annual General Meeting ('AGM'), which will be proposed for renewal at the 2023 meeting.

A4.3.1 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 a Total Capital Requirement ('TCR') setting an amount of regulatory capital, defined under the international Basel III rules, currently implemented through the EU Capital Requirements Regulation and Directive regime ('CRD IV'), which was transposed to the PRA Rulebook as part of the Brexit arrangements.

The TCR includes elements determined based on the Group's total risk exposure together with fixed elements, and is held in order to safeguard depositors in the event of severe losses being incurred by the Group. The TCR is specific to the Group and is set on the basis of periodic supervisory reviews carried out by the regulator, most recently in 2021.

The Group's TCR at 30 September 2022 was 8.8% (2021: 8.8%), compared to the minimum TCR allowed under the Basel III framework of 8.0%. This low level gives the Group advantages in capital management and reflects the regulator's view of the maturity of the Group's systems for the management of capital and risk.

As a matter of strategy, the Group maintains strong capital and leverage ratios. It was granted transitional relief on the adoption of IFRS 9, along with most other banks, with additional relief granted in 2020 for the impact on capital of provisions created in response to the Covid pandemic. This relief is being phased out, year-by-year, while any reversal of Covid-related provisions will generate a corresponding reduction in relief.

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. As the value of reliefs will taper over time, the difference between measures on the regulatory and fully loaded bases will narrow and eventually converge. The Group's principal capital measures, CET1 and Total Regulatory Capital ('TRC') are set out below on both bases.

	Regulatory basis		**Fully loaded basis**	
	2022	2021	**2022**	2021
	£m	£m	**£m**	£m
Capital				
CET1 capital	**1,221.8**	1,055.8	**1,196.0**	1,026.1
Total Regulatory Capital ('TRC')	**1,371.8**	1,205.8	**1,346.0**	1,176.1
Requirement				
TCR	**660.6**	604.2	**658.4**	601.8

The Group's CET1 capital comprises its equity shareholders' funds, adjusted as required by Regulatory Capital Rules of the PRA and can be used for all capital purposes. TRC, in addition, includes tier-2 capital in the form of the Group's green bond. This tier-2 capital can be used to meet up to 25% of the Group's TCR.

The increase in capital over the year has been generated by the profits earned in the year, offset, to some extent, by the impact of dividends and buy-backs. The capital positions set out above include gains made on fair value accounting, which will reverse over time. The increase in TCR on both the regulatory and fully loaded bases shown above has arisen principally as a result of balance sheet growth in the year.

CET1 capital must also cover the buffers required by the 'Capital Buffers' part of the PRA Rulebook, the Counter-Cyclical ('CCyB') and Capital Conservation ('CCoB') buffers. These apply to all firms and are based on a percentage of total risk exposure. The CCoB remained at 2.5%, its long-term rate, throughout the year (2021: 2.5%), while the UK CCyB remained at 0.0% (2021: 0.0%), having been reduced from 1.0% during 2020 as a regulatory response to the pandemic. However, it has been announced by the Financial Policy Committee of the Bank of England that the CCyB will increase to 1.0% from December 2022 and 2.0%, its expected long-term standard level, in July 2023 and this requirement for additional capital in the future has been factored into the Group's capital planning.

CET1 capital required to cover CCoB and CCyB buffers increased to £187.9 million at the year end on the regulatory basis (2021: £170.9 million), mostly as a result of balance sheet growth.

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

The Group's capital ratios, after allowing for the proposed dividend for the year and its irrevocable buy-back commitments, are set out below.

	Basic		**Fully loaded**	
	2022	2021	**2022**	2021
CET1 ratio	**16.3%**	15.4%	**16.0%**	15.1%
Total capital ratio	**18.3%**	17.6%	**18.0%**	17.3%
UK leverage ratio	**7.9%**	7.5%	**7.8%**	7.3%

All the Group's capital ratios show strong improvement over the period. This reflects the trading profits, including those relating to fair values and the extinguishing of the pension scheme liability. As the IFRS 9 reliefs are phased out the fully loaded and regulatory bases will automatically converge.

The Basel Committee on Banking Supervision ('BCBS') had set the implementation date for its revisions to the Basel 3 framework, sometimes referred to as Basel 3.1, as 1 January 2023. This is, however, subject to those revisions being enacted in the relevant jurisdiction, which was delayed by the Covid pandemic. In the UK these rules will be enacted through the PRA Rulebook and the PRA has announced that it intends that these changes will become effective in the UK from 1 January 2025, following a consultation on the detailed requirements which was published in November 2022.

The PRA has also launched a more extensive consultation on a 'strong and simple' approach to regulating non-systemically important banks without international activities. While its initial proposals address the smallest banks, it has indicated that this is a first step and that all non-systemic banks will be considered. The Group is monitoring these developments and will respond through its capital planning as appropriate.

The Group submitted the second stage of its application for the accreditation of its IRB approach to buy-to-let credit risk for capital adequacy purposes to the PRA in March 2021 and is currently responding to PRA feedback on various elements of this phase, ahead of a formal PRA panel assessment. The project continues to progress to plan, and work continues into the new financial year on both the buy-to-let portfolio and development finance lending, which represents the next step in the Group's IRB roadmap.

A4.3.2 Liquidity

It is Group policy to hold sufficient liquidity in the business to meet cash requirements in the short and long term, as well as to provide a buffer under stress. There is also a regulatory requirement to hold liquidity in Paragon Bank. This policy has a consequent effect on the Group's operational capital and funding requirements.

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

The LCR measures short-term resilience and compares available highly liquid assets to forecast short-term outflows, calculated according to a prescribed formula, with a 30 day horizon. The monthly average of the Bank's LCR for the period was 146.2% compared to 165.6% during the 2021 financial year. These figures, however, reflect the reduction of liquidity being held as Covid receded in the early part of the year followed by a tightening in the latter part of the year as the economic situation deteriorated.

The NSFR is a longer-term measure of liquidity with a one year horizon, supporting the management of balance sheet maturities. At 30 September 2022 the Bank's NSFR stood at 122.3% (30 September 2021: 119.6%), reflecting the strengthening of the overall funding and capital position over the year.

A4.3.3 Dividends and distribution policy

The Group's distribution policy over recent years has been based on the objective of enhancing shareholder returns on a sustainable basis, while protecting the capital base. In order to achieve this, its stated policy has been to distribute 40% of consolidated earnings to shareholders in ordinary circumstances, achieving a dividend cover ratio of approximately 2.5 times.

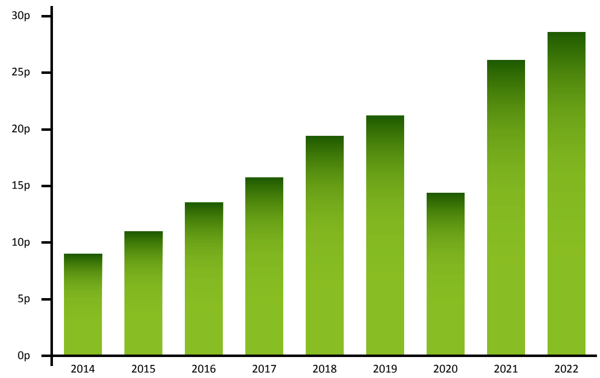
It has also undertaken buy-backs of shares in the market from time to time as part of its management of overall capital, where these enhance shareholder value and excess capital is available, balancing the expectations and requirements of different investor groups.

An interim dividend for the year of 9.4 pence per share (2021: 7.2 pence per share) was paid in July 2022 and the Board is proposing, subject to approval at the AGM on 1 March 2023, a final dividend for the year of 19.2 pence per share (2021: 18.9 pence per share). This would give a total dividend of 28.6 pence per share (2021: 26.1 pence per share). Given the magnitude of the fair value gains recorded in the year, the Board considered whether they should be included in the calculation of the distribution. As these gains are considered to be essentially timing differences it was decided to exclude them. The dividend proposed therefore represents approximately 40% of the adjusted profit, giving a dividend cover on the adjusted basis of 2.50 times (2021: 2.50 times) (Appendix D).

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

Dividend for the year

(In respect of the years 2014 –2022)



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

During the year the Board authorised the completion of the remainder of the buy-back programme which had been suspended at the 2021 year end. It also authorised a buy-back programme for the year of £50.0 million, which was subsequently extended to £75.0 million. £66.9 million, including costs, was expended during the year (Note 45). An irrevocable instruction for the completion of the remaining £10.8 million was given to the Group's brokers before the year end. This was accrued for at the year end and was completed on 7 November 2022.

As part of the review of capital management described above the Board decided that it was appropriate to authorise a further buy-back programme of up to £50.0 million for the 2023 financial year. This will commence shortly after the announcement of the Group's 2022 year end results.

The Group has the general authority to make such purchases, granted at the AGM on 2 March 2022. Any purchases made under these programmes will be announced through the Regulatory News Service ('RNS') of the London Stock Exchange and the shares will be initially held in treasury.

The Board has affirmed the existing dividend policy going forward, subject to an assessment of prevailing conditions at the time, including future capital requirements, business strategy and external economic risks.

A4.3.4 Capital outlook

The Group keeps its current and forecast capital position under review in the light of economic, strategic and business requirements and proposed or forecast changes in the capital regime. The capital position strengthened in the year, although part of this increase relates to fair value gains which do not form part of underlying results.

The Group is well capitalised as it enters 2023, even after providing for an appropriate level of dividends and share buy-backs, the planned increases in the CCyB and the phasing out of IFRS 9 relief. Even in light of potential worsening in the UK's economic position this capital strength is prudent and sustainable and supports the overall viability of the business for the benefit of all stakeholders.

A4.4 Financial results

The delivery of the Group's strategy through a year of economic turbulence in the UK saw underlying profit (Appendix A), which excludes fair value gains and the profit arising on the sale of a loan book, continuing to grow in the year, reaching £221.4 million, an increase of 14.0% (2021: £194.2 million). This drove growth in underlying earnings per share, which rose by 17.9%, reaching 69.9 pence per share (2021: 59.3 pence per share).

The Group's statutory results for the year were significantly inflated by the accounting treatment required for pipeline hedging. It is the Group's policy to hedge a substantial part of its lending pipeline with interest rate derivatives and these can lead to substantial fair value gains being recorded in a rapidly changing interest rate environment before the relevant loans complete. The actual cash flows from hedging will impact on net margin through the subsequent life of the loan and the fair value gains will unwind. The level of such gains recorded in the period increased profit before tax on the statutory basis to £417.9 million (2021: £213.7 million), with earnings per share at 129.2 pence per share (2021: 65.2 pence per share).

The Group has consistently excluded these fair value items from underlying results as the timing of their recognition does not reflect that of their economic impact on the business.

A4.4.1 Consolidated results

Consolidated results
For the year ended 30 September 2022

	2022	2021
	£m	£m
Interest receivable	**545.7**	443.5
Interest payable and similar charges	**(174.5)**	(133.0)
Net interest income	**371.2**	310.5
Net leasing income	**4.6**	3.5
Gain on disposal of loan assets	**4.6**	-
Other income	**12.6**	10.9
Total operating income	**393.0**	324.9
Operating expenses	**(153.0)**	(135.4)
Provisions for losses	**(14.0)**	4.7
	226.0	194.2
Fair value net gains	**191.9**	19.5
Operating profit being profit on ordinary activities before taxation	**417.9**	213.7
Tax charge on profit on ordinary activities	**(104.3)**	(49.2)
Profit on ordinary activities after taxation	**313.6**	164.5

	2022	2021
Dividend – rate per share for the year	**28.6p**	26.1p
Basic earnings per share	**129.2p**	65.2p
Diluted earnings per share	**125.9p**	63.0p

Income

The Group's total operating income increased by 21.0% in the year, reaching £393.0 million. This included a one-off gain of £4.6 million on the disposal of the residual unsecured consumer lending book, which is excluded from underlying metrics.

The principal component of operating income continues to be net interest on the Group's lending assets. This increased from £310.5 million in 2021 to £371.2 million in 2022, a growth rate of 19.5%. This arises both from net growth in the loan book, with average balances increasing by 6.1% to £13,806.5 million (2021: £13,017.0 million) (Appendix B), and from an improvement in net interest margin ('NIM'), in both of its divisions. This is despite the sale of higher yielding unsecured consumer assets in the year.

The progression of the Group's NIM over the past five years is set out below.

	Total
	Basis points
Year ended 30 September	
2022	**269**
2021	239
2020	224
2019	229
2018	219

The Group's other operating income (excluding the one-off gain) increased by 19.4% to £17.2 million from £14.4 million in the previous year, representing generally higher activity across all elements of the business.

Costs

The Group's cost base for the year increased by 13.0% in the year to £153.0 million (2021: £135.4 million). The largest item within costs continues to be employment costs, forming 67.7% of the total at £103.6 million (2021: £87.9 million). The increase of 17.9% in the year is partly attributable to an increase in staff numbers, with average headcount increasing by 5.0% to 1,498, but also the increase in the number of higher skilled, and therefore higher paid positions as the business develops. The Group has also been impacted by the level of UK wage inflation, which has been particularly severe in professional and technology positions.

Costs not related to employment, at £49.4 million were only marginally increased from those in the previous year (2021: £47.5 million), despite the impact of Covid restrictions on expenditure in 2021. The Group continues to channel significant resources into its digitalisation programme, with systems and enhancements delivered across the business in the period. These developments are fundamental to the Group's strategy going forward.

Costs continue to be incurred on the Group's IRB programme, which is expected to deliver significant benefits to the Group's capital position in the longer term.

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

	Underlying %	Statutory %
Year ended 30 September		
2022	**39.4**	**38.9**
2021	41.7	41.7
2020	43.0	43.0
2019	42.1	40.7
2018	40.6	37.8

Cost:income continued to reduce slowly in the year with margins on income widening. Cost control is a strategic priority of the Group, but it recognises that the cost base must also adapt to deliver its strategic priorities and to meet regulatory expectations. Therefore the aim of a sustainably lower cost:income ratio is a long-term aspiration, rather than a short term priority.

Impairment provisions

The Group's recognition of credit losses is governed by the accounting standard IFRS 9, which requires the directors to take a view on the future performance of the Group's loan assets and to base provisioning on expected credit losses ('ECL'). It is unfortunate that since the standard was introduced in 2018 the UK has encountered a series of unprecedented economic, political and social disruptions, which have made the prediction of future asset behaviour, and therefore the operation of the standard very complex.

Based on the evaluation of ECL in the year, the Group has made a charge for impairment of £14.0 million (2021: release of £4.7 million). This mostly results from a balancing of the reduced likelihood of Covid impacts on the Group's portfolios against emerging economic and political issues such as the cost of living and doing business in the UK, the potential impacts on the global economy of the conflict in Ukraine and uncertainties over the future direction of UK Government policy, both generally and on issues which may affect the Group and its customers directly. None of these issues have direct precedents and therefore a significant exercise of judgment is required to evaluate how these should be reflected in ECL.

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

	Write offs £m	Charge / (release) £m	Cost of risk %
Year ended 30 September			
2022	**16.5**	**14.0**	**0.10**
2021	13.3	(4.7)	(0.04)
2020	9.9	48.3	0.39
2019	17.0	8.0	0.07

The fluctuations shown above show the impact of these uncertainties over time as they appear and then resolve. The high charge in 2020 represented the initial onset of the Covid pandemic, in 2021 the position appeared to have become a little more stable, while 2022 has seen new challenges arising, which have significantly reduced the level of clarity on the overall direction of the UK economy heading into the 2023 financial year.

The application of provisions in writing off accounts has remained more stable across the period, although the 2022 result was inflated by a large one-off case in asset finance. This highlights both the Group's careful approach to provisioning and the resilient nature of its assets.

Multiple economic scenarios and impacts

In order to support management's estimation of ECLs the Group has developed models to project losses in its largest books based on customer performance to the reporting date and anticipated future economic conditions. The use of these models therefore requires the use of a range of forward-looking economic scenarios which are each evaluated and then weighted to form an overall projection.

For portfolios where detailed models cannot be used the Group will also consider the potential impact of these economic scenarios where this might be significant.

Economic forecasting at the reporting date has become more difficult than at the half year, with the levels of uncertainty in the UK political environment significantly heightened at September 2022, increasing the risk of inaccurate forecasts.

Generally the consensus of forecasters is for a worse outlook overall than at the previous year end and the March half year, with the magnitude of change in key economic metrics likely to be larger than seen in some considerable time. The levels of uncertainty also mean that the range of opinions amongst reputable forecasters is considerable.

In the face of these uncertainties the Group has constructed the scenarios for its ECL modelling based on a number of forecasts from public and private bodies, synthesised to produce internally coherent sets of data. The central scenario is that used for the Group's planning process, while upside and downside scenarios have been derived from these. To allow for the wider range of economic possibilities to be covered, the downside scenario has been set further below the base case than has previously been the case.

As in previous years, the severe downside scenario is based on the Bank of England stress testing scenario published in 2022, adjusted to allow a harsher impact on house prices. This scenario is included to represent the range of highly stressed outcomes for the UK and the Group's customers.

Overall the forecasts represent an environment of increased interest rate expectations, a more subdued housing market, especially in the short term and inflation at very high levels compared to recent history.

Given the increased range of potential outcomes, the Group has reviewed the weightings attributable to each scenario in its modelling. It has determined that it is appropriate to increase the weighting applied to the severe scenario by 5% to 20% and make a corresponding reduction in the weighting of the downside scenario, representing the growth in the number of plausible severe outturns for the UK.

The forecast economic assumptions within each scenario, and the weightings applied, are set out in more detail in note 23.

The impairment provision levels generated by the Group's provisioning procedures and the scenarios described above are set out below. In order to demonstrate the impact of the scenarios used, the provisions have also been calculated on a single scenario basis for the central and severe scenarios.

	2022		2021	
	Unadjusted provision	**Cover ratio**	Unadjusted provision	Cover ratio
	£m		£m	
Weighted average	**48.5**	**0.34%**	46.0	0.34%
Central scenario	**38.3**	**0.27%**	33.3	0.25%
Severe scenario	**85.3**	**0.60%**	86.7	0.64%

The increase in the provisions calculated represents a more normal economic environment, with a reversion to longer term relationships between customer behaviour and eventual loss, reducing the need for other judgements to some extent. However, observation does not suggest that this linkage is fully re-established as yet.

The distribution of gross balances by IFRS 9 stage produced by the Group's impairment methodology at the two most recent year ends is set out below.

	2022	2021
Stage 1	**85.2%**	88.4%
Stage 2	**13.7%**	9.5%
Stage 3	**0.9%**	1.2%
POCI	**0.2%**	0.9%
Total	**100.0%**	100.0%

This demonstrates the resolution of non-performing cases, the disposal of the POCI cases in the unsecured loan business and the increased identification of Stage 2 cases by provision models in response to a more normal economic framework.

Judgemental adjustments

The fundamental requirement of any provisioning methodology is that the accounts present fairly the assets of the business. Therefore it is a vital part of the process that all mechanical outputs are challenged based on management's understanding of the business to ensure that the provision is consistent with all available information at the year end, qualitative or quantitative and whether it can be input into the modelling process or not. While the Group would ideally like its mechanical provisioning procedures to allow for as much of this information as possible, it acknowledges that this can never entirely be the case.

This is particularly true where predicted economic conditions are not represented in the data used to develop the model, where the inherent modelling uncertainty will increase. There is also information which may only be relevant in certain situations, or more qualitative data, such as internal and external feedback, which it would be difficult to incorporate into a statistical modelling framework.

Management use their understanding of any model limitations, coupled with the wider ongoing and ad hoc management information about the Group's portfolios to determine whether any judgemental adjustments to provisioning are required.

At 30 September 2022, the absolute magnitude of economic indicators such as bank base rates and inflation lay significantly outside recent historical levels, as did their rate of change, which may decrease model reliability. The Group's loan books were generally performing well, with historically low arrears figures in the principal portfolios. However, customer and market feedback suggests that the overall effect of these may be masking a higher ECL than that predicted.

This is particularly so in the Group's SME lending operations where SME businesses are known to be holding excess cash balances, partly resulting from government-supported lending schemes, which may be being used to delay the impact of potential business issues.

It is also clear that some customer groups in the SME business, such as those related to the construction industry, might be impacted more specifically by the economic situation and any potential governmental response to it, which might also have an impact on the recoverable value of security assets.

To allow for these additional uncertainties the Group has applied judgemental overlays to its SME leasing portfolio and to its buy-to-let mortgage book.

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

	2022	2021
	£m	£m
Mortgage Lending	**5.0**	9.2
Commercial Lending	**10.0**	10.2
	15.0	19.4

The reduction in the overlay in Mortgage Lending reflects the receding threat of Covid generated losses, compared to 2021. There is also some transfer from overlays to the modelled provision as a more normal linkage between customer metrics and future performance returns. However, it is clear that there are new concerns in the UK economy, including those arising from living costs which are not being fully recognised in the modelling.

In the SME lending book, it is unclear whether the long-term damage to customer businesses from Covid shutdowns has yet fully manifested itself. Bureau data shows that the cash balances which had built up in the SME sector as Covid-related funds were drawn down has still not normalised and this may be delaying these impacts. There is also likely to be an extent to which businesses weakened by Covid impacts are less able to withstand the forecast economic headwinds than might ordinarily be expected. For these reasons management determined that the level of overlay in this part of the portfolio should be broadly maintained in response to those concerns.

Management then considered whether there were any customer groups (such as industries or geographies) where the risk was particularly greater than others. No such significant groups have yet been identified so the judgemental uplifts were applied across all performing cases.

The application of these judgemental adjustments is considered to align the accounting provision levels with current loss expectations in the business, taking into account all relevant internal information and allowing for inherent economic uncertainties. The Group will continue to monitor the appropriateness and scale of these overlays going forward and consider the extent to which any of the elements giving rise to them can or should be incorporated into models and standard processes.

Ratios and trends

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

	2022	2021	2020
	£m	£m	£m
Calculated provision	**48.5**	46.0	62.0
Judgemental adjustments	**15.0**	19.4	19.8
Total	**63.5**	65.4	81.8
Cover ratio			
Mortgage Lending	**0.31%**	0.32%	0.48%
Commercial Lending	**1.34%**	1.74%	1.83%
Total	**0.44%**	0.49%	0.64%

The trend of the ratios above is back towards a more normal measure of coverage, as the UK economic situation continues to evolve, although without returning to the 0.34% coverage ratio seen pre-pandemic at 30 September 2019. The downward trend was also influenced by the resolution of some significant legacy positions, and by the increasing levels of security coverage generated by house price inflation in the period, with the average loan to value in the buy-to-let mortgage portfolio falling to 57.9% (2021: 61.2%). The future levels of coverage will be dependent on the performance of the UK economy and its impact on the Group's customers and their markets, where applicable.

Fair value movements

The fair value line in the Group's profit and loss account primarily reports fair value movements arising from the Group's interest rate hedging arrangements. These are put in place to protect the Group's margins when offering fixed interest rate products in either its savings or lending markets while continuing to honour offers to customers in the event of significant interest rate movements. The Group maintains a cautious approach to interest rate risk and considers its exposures to be appropriately economically hedged. The Group does not engage in any form of speculative derivative trading and all fair value movements relate to banking book exposures.

The accounting entries included in this balance are primarily non-cash items and will reverse over the life of the hedging arrangement, although period to period movements are mostly influenced by volatility in market interest rates.

Where derivatives are hedging active loan or savings balances the accounting entries should broadly cancel each other out, although this effect can be distorted in periods of greater interest rate volatility, such as the financial year just ended.

Where derivatives are hedging the lending pipeline such offsets are not available, and the full fair value movement will be shown on this line. Where future interest rate expectations increase significantly between the point at which the pipeline loans were hedged and the point at which the loans complete, then a substantial fair value movement will have been posted to the balance sheet by this time. However, through the life of the loan product the derivative will provide inflows of cash to support the income from the loan, compensating for the difference between the fixed rate already agreed and the fixed rates available in the market at the time of completion.

For this reason the Group regards these movements as essentially the anticipation of gains belonging economically to later accounting periods and excludes them from underlying results.

The particularly high levels of these movements in the 2022 financial year, where a gain of £191.9 million was recorded (2021: £19.5 million) result primarily from the levels of volatility in UK benchmark interest rate expectations in the year, the Group's approach to pipeline hedging and the retention strategy applying to maturing five-year fixed loans, which meant that the pipeline was larger and of longer duration (and hence more exposed to movements in rates) than in earlier periods.

The Group has a net derivative position of £1,201.0 million at 30 September 2022, which is unmatched for hedge accounting, although forming part of the economic hedging position. These derivatives must be carried at a fair value based on expected cash flows over their contractual lives. As a substantial proportion of this balance has a lifetime of two to five years, volatility in the interest rate markets can generate substantial month to month fluctuations in this valuation which have to be included in the Group's profit.

The table below shows the movements in unmatched exposures over the last three years alongside the maximum and minimum five year swap rates in the year as a measure of volatility.

		2022	2021	2020
		£m	£m	£m
Opening	Loan	**681.6**	567.7	315.4
	Deposit	**683.5**	935.0	562.0
	Net	**(1.9)**	(367.3)	(246.6)
Closing	Loan	**1,578.1**	681.6	567.7
	Deposit	**377.1**	683.5	935.0
	Net	**1,201.0**	(1.9)	(367.3)
Average		**599.6**	(184.6)	(307.0)
Swap rate	High	**5.39%**	1.09%	0.66%
	Low	**1.11%**	(0.05)%	(0.08)%
	Range	**4.28%**	1.14%	0.74%

This clearly shows a quadrupling of the interest rate range, the doubling of the loan pipeline hedge and a reduction in the deposit pipeline hedge which would have provided an offset. These factors have driven the gain from pipeline hedging recorded in the year.

As a result of these accounting transactions the Group is carrying a net fair value hedging asset on its balance sheet of £216.7 million (2021: £8.8 million) which will revert to zero over the lives of the related instruments.

Tax

Accounting standards require that a company should account for tax in its year end accounts at the rates of tax enshrined in legislation at the reporting date, regardless of any indications of future tax policy given by governments. This means that these accounts are prepared on the assumption that the UK Government increases the rate of corporation tax from 19% to 25% from April 2023 and reduces the bank surcharge from 8% to 3%, from the same date. Any deviation from this position will be accounted for in future periods.

The effective tax rate applied to the Group's profits has increased from 23.0% in 2021 to 25.0% during 2022. The main cause of this has been the recognition of the deferred tax liability on fair value gains which are calculated on the basis of the higher tax rates legislated for in future years. The bank surcharge represented 313 basis points of the effective rate in the year (2021: 496 basis points), meaning that it represented over half the difference between the basic and effective rates.

As the bulk of the fair value gain arose in Paragon Bank it is subject to a higher rate of tax than the overall effective rate for the Group. This meant that the effective tax rate on underlying profit was 23.4%. In previous periods the effective tax rate on underlying profit had been materially similar to the overall effective tax rate.

Results

The year's profit before tax was 95.6% higher than in 2021 at £417.9 million (2021: £213.7 million), with much of the increase related to fair value items. Profit after tax increased 90.6% to £313.6 million (2021: £164.5 million).

Basic earnings per share increased to 129.2 pence (2021: 65.2 pence) and the diluted measure was 125.9 pence per share (2021: 63.0 pence), both inflated by the fair value accounting adjustments.

This result increased consolidated equity to £1,417.3 million (2021: £1,241.9 million), representing a tangible net asset value of £5.33 per share (2021: £4.34 per share) and a net asset value on the statutory basis of £6.06 per share (2021: £5.03 per share) (Appendix E).

A4.4.2 Assets and liabilities

Summary balance sheet
30 September 2022

	2022	2021	2020
	£m	£m	£m
Investment in customer loans			
Mortgage Lending	**12,328.7**	11,829.6	11,101.1
Commercial Lending	**1,881.6**	1,573.1	1,530.3
	14,210.3	13,402.7	12,631.4
Hedging adjustments	**(559.9)**	5.5	109.7
Derivative financial assets	**779.0**	44.2	463.3
Cash	**1,930.9**	1,360.1	1,925.0
Intangible assets	**170.2**	170.5	170.1
Pension surplus	**7.1**	-	-
Other assets	**116.0**	154.0	206.0
Total assets	**16,653.6**	15,137.0	15,505.5
Equity	**1,417.3**	1,241.9	1,156.0
Retail deposits	**10,669.2**	9,300.4	7,856.6
Hedging adjustments	**(99.7)**	(3.0)	10.4
Other borrowings	**4,007.2**	4,451.4	6,229.7
Derivative financial liabilities	**102.1**	43.9	132.4
Pension deficit	-	10.3	20.4
Other liabilities	**557.5**	92.1	100.0
Total equity and liabilities	**16,653.6**	15,137.0	15,505.5

The Group's loan portfolio grew by 6.0% during 2022, with growth in both Mortgage Lending and Commercial Lending, despite the disposal of its unsecured consumer lending book. More detail on these movements is given in Section A4.1. This increase, together with the Group's liquidity and capital policy, determines its funding requirements and hence the level of its liabilities.

Funding structure and cash resources

The Group's funding balance increased by 6.7% during the year, marginally faster than the growth in the loan book as cash balances increased. The proportion represented by retail deposits increased to 72.7% in accordance with the Group's long-term funding strategy (2021: 67.6%), with wholesale borrowings paid down. Movements in funding balances are discussed in more detail in Section A4.2.

Derivatives and hedging

The Group's derivative assets shown in the table above relate almost entirely to the hedging of interest rate risk in the lending and deposit portfolios. Driven by interest rate volatility the balances of both the derivative assets and liabilities, and the related hedging adjustments on loans and deposits, have risen sharply as the volume of the Group's fixed rate products where the rate significantly differs from market fixed rate positions has grown, as market rates have increased during the year. All these items will ultimately effectively flow to the profit and loss account as fair value movements.

Pension obligations

The valuation of the Group's defined benefit pension scheme under International Accounting Standard ('IAS') 19 moved from a deficit of £10.3 million at the start of the year to a surplus of £7.1 million at 30 September 2022. This valuation is driven by inputs based on market-derived interest rates and the volatility in the period produced significant fluctuations. These inputs must be based on point-in-time observations at the year end, and market disruption around the end of September 2022 has therefore impacted the valuation.

The principal change in inputs was the increase in the discount rate used in evaluating scheme liabilities, which is based on long-term corporate bond yields, from 2.00% to 5.00%, while the assumed rate of RPI inflation, which is based on gilt yields and would normally counteract the impact of rising discount rates only increased from 3.40% to 3.55%. These movements led to a pre-tax valuation gain of £15.3 million being booked in other comprehensive income.

While the valuation under IAS 19 is that which is required to be disclosed in the accounts, pension trustees generally use the technical provisions basis as provided in the Pensions Act 2004 to measure scheme liabilities. On this basis, the deficit at 30 September 2022 was estimated at £1.4 million, an increase of £0.4 million in the period (2021: deficit of £1.0 million), representing a 98.7% funding level (2021: 99.4%). However, the position was subject to significant fluctuation around the year end date due to market conditions.

Other assets and liabilities

Sundry assets fell from £154.0 million to £116.0 million in the year, largely a result of movements in collateral balances generated by the movements in derivatives described above, which reduced by £36.6 million.

Sundry liabilities grew from £92.1 million to £557.5 million, also principally driven by derivative movements, with collateral liabilities increasing by £388.4 million and a deferred tax balance of £44.4 million being recognised, largely due to fair value accounting adjustments. The increasing interest rate environment also generated increases in accrued interest payable of £23.5 million.

A4.4.3 Segmental results

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

	2022	2021
	£m	£m
Segmental profit		
Mortgage Lending	**239.9**	230.2
Commercial Lending	**88.6**	76.4
	328.5	306.6
Unallocated central costs and other one-off items	**(102.5)**	(112.4)
	226.0	194.2

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

Mortgage Lending

The Group's Mortgage Lending division, which now includes second mortgage assets formerly reported in the Idem Capital segment, continued to perform strongly and grow its NIM. Net interest grew by 9.6% in the year to £261.5 million (2021: £238.7 million) with average net assets growing by 5.4% to £12,079.2 million (2021: £11,465.3 million) as NIM increased to 216 basis points (2021: 208 basis points).

Credit performance in the period was good with a provision of £4.6 million in the year (2021: release of £7.6 million) and a cost of risk of 4 basis points. IFRS 9 Stage 3 cases reduced from £145.3 million to £119.3 million as the Group continued to resolve legacy cases which had been managed on a long-term basis.

Commercial Lending

In the Commercial Lending division average balances grew by 11.3% to £1,727.3 million (2021: £1,551.7 million), leading to an increase of 18.8% in net interest to £113.1 million (2021: £95.2 million). NIM grew from 614 basis points to 655 basis points, due to the continuing focus on higher margin business, and with lower-margin government backed lending forming a smaller part of new business than in the previous year.

While credit performance in the period remained largely stable, with low arrears and relatively few defaulted cases in the portfolio, potential adverse headwinds evolved in their nature but remained a threat. Stage 3 gross balances comprised only 0.3% of the segment's total gross portfolio at 30 September 2022 (2021: 1.2%). However, the uncertain outlook for the UK economy meant that the provision charge in the segment increased from £2.9 million in 2021 to £9.4 million in 2022, to ensure these risks are adequately provided against.

A4.5 Operations

At the heart of the Group's strategy is its vision to become a leading technology-enabled specialist bank. This relies on the strength of its people, systems and controls and the continuing development of these alongside the evolution of its business is an ongoing focus at senior management levels. The Covid pandemic demonstrated the Group's agility and flexibility in resource deployment, which are fundamental to the execution of this strategy and the Group's ability to demonstrate its resilience to its regulators also confirms the strength of this position.

It was very pleasing that the Group's commitment to its people was recognised by the award of Platinum Investors in People ('IiP') status, the highest level available, achieved by only 5% of employers assessed.

During the year the Group's operational journey away from Covid restrictions continued and a permanent commitment to hybrid working was made. The evolution of these hybrid models in different business areas continues to be a major area of focus. At the same time IT and process developments continued to progress, supporting the Group's digitalised vision of its future operating model, while the Enterprise Risk Management Framework has further evolved to ensure that the business remains robust.

All these activities combine to give the Group an evolving operational structure on which it can rely to deliver its business strategy in the future.

A4.5.1 Operations

The Group workforce has now exceeded 1,500 people, and they have seen a major shift in working patterns over recent years, which has continued through the most recent year. A hybrid working model was adopted on an ongoing basis, following trials and building on experience of the Covid pandemic. The majority of employees are attached to one of the Group's locations, with a proportion of their time spent working from home.

In order for the Group to provide the best possible service to customers and remain successful, individual business areas have taken different approaches to implementing the flexibility this offers their people. The optimisation of these arrangements has been an area of significant operational focus in the period and this process continues into the new financial year. The evaluation of the potential consequences of these changes on the Group's social, physical and IT infrastructure will remain a priority moving forward.

The Group's success in continuing to progress the development of new systems, processes and products during the Covid pandemic meant that it entered the year well positioned to deliver enhancements in the period, and a significant number of technological, operational and regulatory developments were completed or progressed.

Long-term projects to provide better technology for the development finance, SME lending and mortgage lending operations continued in the period, with enhancements becoming available to support customers and intermediaries. During the year major projects upgrading the Group's payment and treasury systems came on line, alongside additional cyber-security capabilities. Shorter-term projects provided enhancements to accounting systems, surveyors' administration, video conferencing and interactions with customers in vulnerable circumstances.

These developments are already contributing to the success of the Group's operations, delivering benefits to brokers and applicants for new SME lending products and to buy-to-let mortgage customers reaching the end of a fixed term on their products, as already described in Section A4.1 above.

The Group considers that its office locations remain valuable as part of its hybrid working model. Physical proximity can play a significant role in fostering collaboration, collegiality, creativity and the growth of the Group's culture and identity. The Group continues to review its locations to ensure they are optimised for new working methods and to manage their energy efficiency. As part of that process the Group's SME lending hub was relocated within the Southampton area, to a more suitable building with a better environmental impact. The Group's premises in Cardiff and Poole were also replaced with more appropriate facilities.

The Group has maintained its focus on high quality customer service throughout the period and is currently working to embed the new FCA Consumer Duty requirements in its systems and processes. This is a significant transformation in the way that the regulator approaches firm's responsibilities and a major project is taking place to ensure that the business will be able to comply within the deadlines set by the FCA.

On the Group's termination of its unsecured lending activities and the sale of its residual loan assets it was a particular focus to ensure that customers, especially those with vulnerabilities or potential vulnerabilities, were not adversely impacted by the process. The Group focusses on complaints data as a high level satisfaction metric, and incident levels remained low throughout the period.

The operational resilience of the business remains an important area of focus for the Group. During the period the formal self-assessment required by regulators was successfully completed, endorsing the Group's investment of time and resources in this area over recent periods.

A4.5.2 Governance

Throughout the year ended 30 September 2022, the Group continued to comply with the principles and provisions of the UK Corporate Governance Code (the 'Code') and more detail on the application of the Code principles by the Group is set out in section B of this Annual Report and Accounts. The Group adopted the 'comply and explain' approach under Provision 19 of the Code to extend the tenure of Fiona Clutterbuck as Chair past nine years for succession planning purposes and to ensure the appointment of a suitable replacement Chair. Fiona stepped down from the Board on 1 September 2022 on the appointment of the new Chair, Robert East.

The appointment of the new Chair of the Board in September 2022 has also resulted in the Company adopting a 'comply and explain' approach to Provision 21 of the Code, which requires a Board to undertake a formal and rigorous annual evaluation of the performance of the Board, its committees, the Chair and individual directors. Given the appointment of a new Chair, the decision was taken to defer the 2022 evaluation until 2023 to allow the new Chair sufficient time in post to make the evaluation more relevant, meaningful and useful. The board evaluation in 2023 will be externally facilitated.

Board of Directors

On 1 September Robert East was appointed as Chair of the Board in place of Fiona Clutterbuck who stepped down from the Board on that day. Robert has over 40 years' experience in UK financial services, including at board level, as CEO and Chair. During his executive career he held senior roles at Barclays. He was also CEO of Cattles, where he led the restructuring and wind down of its operations from 2010 to 2016. He has held positions as Chair of Vanquis Bank, Skipton Building Society and Hampshire Trust Bank. He has previously served as a non-executive director on the boards of Provident Financial Group, Skipton and Hampshire Trust Bank, where he was also Chair of the Risk Committee.

On the same day Tanvi Davda was appointed as an additional independent non-executive director of the Group. She brings a diverse range of skills and knowledge to the Board following an executive career of more than 25 years. Her career began at Credit Suisse as a derivatives trader. She then went on to work with IBM as a management consultant before joining ABN AMRO and then Barclays Wealth, where she was Managing Director of Global Research and Investments. In 2015, Tanvi co-founded Saranac Partners, a boutique wealth manager, where she was Managing Partner until 2021. She continued to sit on the Saranac Partners board as a non-executive director until the end of November 2022. She has also held non-executive roles on the boards of Ofqual, the qualifications and examinations regulator, and the Student Loans Company.

Following these changes the Board consists of nine directors, three of whom are female (33.3%).

Remuneration policy

The PRA remuneration rules applicable to the Group were changed with effect from the current financial year as it qualified as a Proportionality Level 2 ('Level 2') bank, bringing it within the scope of more onerous rules. This is a result of both the reduction in the asset threshold defining a Level 2 bank from £15 billion to £13 billion, announced by the PRA in December 2020, and of the development of the rules themselves. Affected employees have been determined and the changes required identified. All variable pay awards in respect of the current period have been made in accordance with relevant regulatory remuneration rules. The principal changes relate to the delivery mechanisms for the provision of variable remuneration to such people and the duration of deferral, for parts of that variable remuneration, which they are now subject to.

The Group's triennial review of its Directors' Remuneration policy commenced in the second half of the year, with consultations taking place with shareholders, investor bodies and other stakeholder groups. The proposed policy developed in this process will be presented to the 2023 AGM for approval by shareholders. We would like to thank all stakeholders who took part in the process for their input.

A4.5.3 Management and people

The Group employs just over 1,500 people and during the year headcount has grown by 4.3% (2021: 3.6%), largely driven by the creation of new roles in mortgage underwriting and customer support functions.

People and development

During the period the Group's priority has continued to be the wellbeing of employees, ensuring they were provided with the necessary support to return to the office environment safely as the restrictions from the pandemic came to an end. This included a number of trials, managed across the Group's different business areas, to identify the optimum way of working in a hybrid way, providing flexibility for employees whilst maintaining the high standards of delivering good outcomes for the Group's customers. In March 2022, an announcement was made to all employees to confirm hybrid working was being adopted on a permanent basis following the success of the trials.

The Group's Wellbeing team continues to play an important role in helping employees with their mental, physical, financial and emotional wellbeing. The Group's introduction of The Vitality Health programme during the year gave all employees access allowing them to obtain personalised health reviews, discounts and rewards through Vitality's partner brands and Vitality Wellbeing Coaches.

In May 2022 the Group was proud to announce the re-accreditation of its IiP status, being recognised for the first time as a Platinum employer. This recognition is the first for a Solihull based employer and it means the Group is one of just 5% of assessed organisations who have achieved this recognition.

The attrition rate of employees has increased during the period due to an increase in the number of retirees and a buoyant marketplace. The overall shortage of labour in the UK economy has put pressure on attracting trained and effective resource and the Group has experienced some of the effects of this. Whilst the voluntary attrition rate has increased to 12.2% from 8.6% in 2021, this level is not significantly above pre-Covid levels, and the Group continues to track below the national average of 18.6% for the banking and finance sector in 2022, published by Reward Gateway. Strong levels of retention remain a key feature of the Group's employee base with 55% of employees achieving over 5 years' service, 12% achieving over 20 years and 4% achieving over 30 years' service.

Employees continued to show flexibility during the year with many undertaking secondments and transfers to different areas of the business to ensure the Group continued to meet the needs of its customers. Although the decision was made to exit the unsecured consumer loans market in the year, of the 43 employees affected, over 50% were offered similar or alternate roles within the Group, with a number deciding to take voluntary redundancy in August.

The Group maintains its UK Living Wage Foundation accreditation and minimum pay exceeds the levels set by the Foundation. In July 2022, the Group made an exceptional payment of £1,000 to all employees below senior leader level, including a £500 advance of profit related pay for the current year, to assist with the cost-of-living pressures.

Holiday entitlement was enhanced during the year, with an additional day's leave given for an employee's birthday and, following a proposal from the Group's People Forum, it was agreed to extend the half day for Christmas Eve and New Year's Eve to a full day's leave for each date. All full time employees now enjoy at least 28 days paid leave, rising to 33 days after five years. This is in addition to public holidays.

Learning and development

The Group continues to provide employees with a range of training and development opportunities. During the period this has included a range of technology focused training to support the delivery of the IT roadmap and permanent move to hybrid working, alongside extensive leadership and management training. Additionally, a new development programme for high performing employees working in specialist, non-managerial roles was launched to support the career progression of technical experts. This training is complemented by other development opportunities such as apprenticeships, coaching and mentoring.

Equality and diversity

The Group made significant progress on its equality, diversity and inclusion ('EDI') strategy during the year. Richard Rowntree, Managing Director – Mortgages, continues in the role of Executive Sponsor for EDI and sponsors the Group's EDI Network which continued to develop through the year. The Network has had a positive impact on the development of the business and has been involved in several initiatives, including promoting the importance of diversity data collection (as at 30 September 2022 the Group had achieved 73% disclosure rate (2021: 63%)) and arranging Listening Circles where members of the Executive Committee meet with employees from minority groups to discuss their experiences of working at Paragon, often resulting in a reverse mentoring experience.

In May 2022 the Group became a founding member of 'Progress Together', the City of London's Socio-Economic Diversity Membership Body. The Group is committed to improving socio-economic diversity across the financial services sector and is working on several initiatives to widen the talent pools it is accessing.

The Group is pleased to report that it continues to achieve each of its targets set under the Women in Finance Charter in 2017, which focussed on female and ethnic minority representation in the workforce and management. The Group has committed to achieve 40% female representation in senior management by 31 December 2025, compared to the current 38.1%.

To support its efforts to improve gender equality the Group has continued to participate in Mission Gender Equity, a cross-company mentoring programme run by Moving Ahead. This opportunity has proven popular with both mentors and mentees, with 97% of mentees being retained, 30% securing a new role within the Group and 17% being promoted. Nicki Breen, Learning and Development Business Partner, was also recognised as a runner-up in Moving Ahead's 'Most Dedicated Programme Partner of the Year' award. The Group is pleased to be participating in a similar scheme, Mission INCLUDE, for employees from ethnic minorities over the coming year.

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

A4.5.4 Sustainability

Sustainability, including resilience in the face of climate change risks, is core to the Group's strategy: to focus on specialist 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 and savings through the design of products offered and the choices of sectors in which to operate

The Group has a Sustainability Committee which coordinates its overall response to climate change and other sustainability issues and reports directly to the Executive Committee. This provides a forum for sharing information on initiatives within business areas and helps to develop the Group's proactive approach. Since its formation in 2021 it has increased the profile of sustainability-related risks and opportunities within the Group and driven improved reporting and understanding of these matters.

The Group published its first sustainability report, the Responsible Business Report, in December 2021 and has used feedback from that exercise in the development of its 2022 report. This reporting provides more detailed information on its sustainability initiatives and demonstrates how sustainability is embedded throughout the Group. It is available on the Group's corporate website at www.paragonbankinggroup.co.uk.

Climate change

Climate change is designated as a principal risk within the Group's Enterprise Risk Management Framework. As a result 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 recognises the importance of reducing the impact that its own operations have on the environment. As a financial services provider the Group's overall environmental footprint across its principal operations is low. The Group is, however, committed to identifying, measuring and managing the impact of its operations on the environment and to find ways to mitigate any negative impacts. During the year key initiatives included:

- Inclusion of conditions related to climate targets in the Group's long-term variable pay arrangements
- Establishing a target to reduce operational footprint to net zero by 2030 and purchasing carbon credits to offset operational emissions in the year
- Relocating the Group's Southampton, Cardiff and Poole operations to more energy efficient premises
- Installing electric vehicle charging points at the several of the Group's buildings for use by employees
- Updating the company car policy so that only hybrid or electric vehicles will be provided on new leases, eliminating diesel and petrol vehicles from the company fleet by 2025. The Group's target is for a completely electric-only fleet by 2031
- Continuing the rollout of LED lighting across the Group's principal sites

The Group has also joined Bankers for Net Zero.

Green product initiatives have been developed across all the Group's main sectors and continue to evolve. These are discussed in the relevant business reviews in Section A4.1.

The Group continues to develop its reporting to manage both its risk management processes and its reporting under the principles set out by the Taskforce on Climate-Related Financial Disclosure ('TCFD'). As required by the UK Listing Rules the Group has reported on climate change risk and exposures under the TCFD framework in its 2022 year end accounts, building on the disclosures introduced in 2021.

The Group takes climate change very seriously and will only make commitments which it objectively believes are achievable and will deliver real benefits on climate change.

Social engagement

The Group's Charity Committee raised almost £43,000 for the Alzheimer's Society, the employee's chosen charity for 2021, an outstanding result, given the restrictions imposed on normal fundraising activities by the pandemic. For the nine months ended 30 September 2022, £31,000 was raised for Mind and employees have now selected Newlife, a disabled children's charity, as the beneficiary of fund raising efforts for the 2023 financial year.

Employees are also using their entitlement to an annual paid volunteering day, particularly as more opportunities become available with the loosening of Covid restrictions, with days used increasing from 49 in 2021 to 286. Employees took part in projects in the fields of homelessness, education and the environment, with the Group promoting a wider take-up for the coming year.

A4.5.5 Risk

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

Risk environment

Whilst the two previous reporting years have largely been dominated by the response to the Covid pandemic the Group now faces new economic and geopolitical challenges which require it to remain agile and resilient in its risk management capability. It is recognised that the wider pandemic is still a global challenge, and the possibility of further waves may pose additional issues. The Group's ability in successfully navigating the unprecedented situation posed by Covid in 2020 and 2021, means that it is well-placed to address any future operational challenges this may bring.

It is clear that the risk environment has significantly changed due to Covid and wider global issues which have, and will require the Group to ensure it continues to closely monitor impacts on its operations and risk profile. The Group's risk management framework will continue to provide a robust mechanism to ensure that new risks are promptly identified, assessed, managed, and appropriately overseen from a risk governance perspective.

There are a number of strategic issues that have been prominent in the risk landscape during the year and are expected to continue to pose challenges for the foreseeable future:

- The "cost of living" crisis has escalated over recent months and remains a dominant theme in the political and economic agenda. The implications of increasing inflationary pressures are far-reaching and the Group continues to monitor how this may impact its customers and employees
    - o In an environment of rising interest rates and cost pressures for both new and existing borrowers, the Group continues to ensure that high standards of prudent lending are maintained. The Group takes a forward-looking, as well as current view of affordability, and has adjusted credit policy to ensure loan repayments are sustainable for customers and will continue to do so. The Group takes its responsibilities in respect of customers in vulnerable circumstances extremely seriously and continues to ensure where appropriate forbearance solutions are necessary these are tailored to individual customer circumstances and aligned to regulatory guidance and expectation
    - o The Group remains committed to supporting its employees in the face of economic challenges. Various financial and wellbeing initiatives have been instigated to ensure that employees have access to information and resources to assist in navigating cost of living challenges. The welfare of its employees is a key priority of the Group, and it will continue to look at innovative ways of ensuring that individuals feel fully supported during the current uncertainty

  The Group continues to closely monitor how changes in political leadership and associated priorities, policies or interventions may influence the broader economic landscape.

- Following the outbreak of conflict between Russia and Ukraine the Group identified and ringfenced any potential exposures to Russian, Belorussian or Ukrainian customers and suppliers. Close oversight continues to be maintained through ongoing customer due diligence and risk assessment processes. In addition, the Group is committed to ongoing investment in its cyber controls, given heightened threat assessments posed by the geopolitical situation

- The embedding of the Group's operational resilience capability continued, given its proven criticality in the handling of the pandemic, and the incorporation of lessons learned into the overarching framework. The Group continues to build out its resilience capability having identified ongoing enhancements as a result of its initial self-assessment undertaken in March 2022. As regulatory and industry practice evolve following this sector-wide exercise, the Group is well-positioned to respond accordingly. Robust operational resilience capability is deemed to be critical as the Group undertakes its programme of strategic transformation across a number of legacy platforms and processes

- Prioritising focus on climate change given the associated risks, remains an ever-present challenge. The UK Government has confirmed its goal of net zero carbon by 2050 and the Group, and the rest of the financial services industry, have a vital role to play in that commitment. The Group considers the impacts of climate change risk through both its operations and its lending activities, and continues to evolve its approach to measure and mitigate the transition and physical risks potentially caused by climate change

These issues are expected to continue to dominate the risk landscape moving into 2023, particularly with the overall levels of economic uncertainty in the UK and the prospect of levels of inflation and interest rates not seen for many years. The Group will carefully monitor the emerging impacts on both credit risk and the wider risk landscape as the situation develops.

Risk management

Given the spectrum of risks the Group has faced, and continues to face, the maintenance of a robust risk management framework, allowing it to promptly identify and assess risk exposures and develop appropriate mitigants, remains imperative. It therefore remains committed to further evolution and embedding of its risk practices with significant progress having been made in the year in further enhancing its ability to manage all categories of risk through the ERMF.

The recruitment of experienced resource in 2021 within the second line of defence has enabled considerable enhancement of core risk processes during the year. This ensures that the risk framework continues to support the strategic aspirations of the Group in an effective and proportionate way. Good progress has been made in refining the suite of policies that underpin the management of each of the Group's identified principal risks. This, in turn, has resulted in refinement of associated risk appetites and better articulation of the control environment for each risk type. These activities have been accompanied by a comprehensive programme of education aimed at bolstering the Group's risk culture, and ensuring that individual accountabilities and responsibilities in respect of risk are fully understood.

A detailed roadmap supports the development of the framework, with regular reporting against these commitments provided to the Risk and Compliance Committee. Strong progress was made through the year with the focus for 2023 onwards directed to ongoing embedding and validating the success of this through a programme of risk maturity assessments.

Despite the wider strategic challenges, the Group has identified, focussed and delivered on a number of risk issues including:

- **LIBOR transition** – Successfully transitioning all customers with LIBOR-linked products to alternative rates prior to the withdrawal of LIBOR in December 2021, while ensuring that all strategic, operational and conduct-related risk implications of the changes in product design, funding and operation were fully met
- **Financial crime** – Enhancing further the Group's financial crime systems and controls. Such systems have been an area of regulatory focus across the sector and the Group has made significant investment in both technology and resources to support its comprehensive anti-money laundering programme
- **FCA Consumer Duty** – Mobilising a comprehensive programme of work to assess the impact of the new FCA Consumer Duty on the products and services offered across the Group, ensuring that its culture is driving good outcomes for its customers
- **IRB** – Continuing to develop IRB model methodologies for the buy-to-let and development finance portfolios, while embedding the overarching model risk framework to enhance credit risk management and support the Group's IRB application process. Following submission to the PRA of Phase 2 of the buy-to-let application in March 2021, initial agreed refinement points are in the process of being addressed. Phase 3 documentation for buy-to-let, and Phase 2 documentation for development finance, are nearing completion and waiting for PRA submission invitation prior to concluding final internal governance steps

The Group has also continued to develop its management of third-party outsourcing risks, climate change risk, cyber security and data risk and stress testing, while embedding the results of the resilience self-assessment referred to above.

The long-term impact of the UK's exit from the EU continues to emerge. Whilst the Group does not have operations outside the UK it has continued to review the capital, liquidity and operational implications of the stresses which might be caused by the process. In particular, it has continued to monitor the issues related to the supply of essential goods which are causing shortages in a number of sectors. Whilst the Group is not directly affected by these issues at present the Board is keeping the situation under ongoing review as supply issues in areas such as building materials and IT equipment could impact the Group's operations or those of its customers.

The Group also continues to monitor the wider challenges around energy supplies given the potential threats of power shortages and energy rationing. This is subject to ongoing analysis and stress testing and the Group has undertaken detailed contingency planning in the event that such a scenario occurs. Currently the Group is comfortable that it has access to adequate alternative energy sources, however, this continues to be assessed as the implications and likelihood of energy shortages becomes clearer.

Risk outlook

The principal challenges in the risk environment faced by the Group as it moves forward into its 2023 financial year and beyond include:

- Risks associated with the wider economic landscape and the impact this will inevitably have on individual living standards, particularly expected increases in energy costs. Whilst the level and duration of government intervention is yet unclear given the changing political leadership there will be a need to ensure appropriate treatment of ongoing arrears and the position of affected customers. Key to this will be ensuring that the treatment of customers is fair and conduct principles remain at the forefront of all interactions
- Addressing an increasing level of regulatory compliance standards, where the Group is committed to ensuring it remains compliant in all areas of its business. Particular focus in the Group is on addressing the regulatory requirements in respect of the new FCA Consumer Duty rules and ensuring that it continues to meet regulatory expectations in respect of its anti-money laundering and wider financial crime control frameworks
- Risks associated with climate change, where the UK Government confirmed its goal of net zero carbon by 2050 in November 2020, giving the Group, and the rest of the financial services industry, a vital role to play in that commitment. As global strategies continue to be refined the Group will ensure that both its operational footprint and the impact of its lending activities, explicitly consider climate change risks as a core strategic driver

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

A4.5.5 Regulation

Paragon Bank is authorised by the PRA and regulated by the PRA and the FCA. The Group is subject to consolidated supervision by the PRA and a number of its subsidiaries are authorised and regulated by the FCA. As a result, current and projected regulatory changes continue to pose a significant risk for the Group. The impact and pace of change necessitated through the ongoing programme of revisions to the Basel supervisory regime continues to pose a particular challenge for the Group. These together with other potential regulatory changes to the business are closely monitored through the comprehensive governance and control structures in place.

During the year all relevant regulatory publications have been considered by the Group, any implications identified and required changes implemented within an appropriate timeframe. The volume of requests for information from the FCA has increased during the year and this trend is anticipated to continue, focussing on exercising forbearance for customers as the cost of living crisis develops. The Group responds to such requests in a timely fashion, and maintains robust controls to support the delivery of fair customer outcomes.

The following developments currently in progress have the greatest potential impact on the Group:

- **Consumer Duty** – In July 2022, the FCA issued its final rules and guidance on "A new Consumer Duty", which seeks to set higher expectations for the standard of support provided to customers, and challenges firms to evidence the customer outcomes that they are delivering. As implementation of the new rules is staged (with the requirement for existing products to be in compliance by July 2023, and closed products by July 2024), previous project plans have been revised to ensure appropriate focus and prioritisation. This activity is being championed by the Board, with a non-executive director having specifically been assigned responsibility for oversight of the programme

- **MREL** – The Bank of England published a Consultation Paper ('CP') setting out proposed changes to the Minimum Requirement for Own Funds and Eligible Liabilities ('MREL') on 22 July 2021. On 3 December 2021 the Bank of England published a Statement of Policy based upon this consultation, which took effect from 1 January 2022. Although the Group is not subject to MREL requirements currently, given its potential for growth it may be required to issue MREL eligible instruments at some point in the future and therefore continues to closely monitor developments and potential impacts

- **Basel 3.1** – The PRA published a Consultation Paper on Basel 3.1 implementation in November 2022. This follows delays driven by a need to respond to the Covid pandemic. The PRA's current intention is to consult on the proposals then implement on 1 January 2025. The Group actively monitors and manages its capital, assessing the implications of a range of different impacts including the implementation of any new requirements

- **Regulatory framework** – In 2021 the PRA published Discussion Paper 1/21, which explored options for developing a 'strong and simple' prudential framework for banks and building societies that are considered by the PRA to be neither systemically important nor internationally active, such as the Group. The PRA published a Consultation Paper 5/22 in April 2022 that focused on a proposed approach for the smallest firms, which would not impact on the Group based on the total assets threshold (£15 billion). However, the regulator has indicated that larger institutions will be addressed in the future. The Group continues to monitor developments and potential implications for its operations

- **Customers in vulnerable circumstances** – The treatment of customers in vulnerable circumstances continues to be a strong focus for the FCA, demonstrated in its business plan and three-year strategy released in April 2022. The Group continues to take its responsibilities in this regard very seriously. Significant work continues to be undertaken to revise existing procedures, controls and training provisions to meet regulatory and industry expectations

- **Operational resilience** – Following the publication of the final rules and guidance on 'building operational resilience in financial services' in 2021 by the FCA, PRA and Bank of England, the Group successfully met the March 2022 policy implementation deadline. This included setting of impact tolerances for important business services, embedding a scenario testing approach and undertaking a self-assessment against the regulatory framework. The 2022 self-assessment set clear objectives for further refining the Group's approach to resilience

  The Group is committed to a programme of continuous improvement in its resilience capability. Important business services are mapped and tested using severe but plausible scenarios to push the boundaries on the ability of the infrastructure, key dependencies and third parties to recover from disruption. This approach should ensure the Group can meet the regulatory deadline of 2025 where it will need to demonstrate the ability to stay consistently within impact tolerances

- **Climate change** – The Group continues to embed its approach to managing climate-related financial risks, described on a basis consistent with TCFD recommendations in Section A6.4. The Sustainability Committee, alongside the existing executive level risk committees, ensures comprehensive consideration across all aspects of the business and ensures the Group is well-positioned to address the emerging challenges

  Managing the impacts of climate change is seen as a key strategic priority for the Group and a detailed plan of work has been developed which reflects regulatory and wider requirements. This will continue to be refined as new thinking emerges

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

The Financial Services and Markets Bill, which sets out how the UK financial sector will be regulated post-Brexit, was published in July 2022 with the aim that it will obtain Royal Assent by May 2023. The Bill will implement the outcomes of the Future Regulatory Framework ('FRF') Review, revoking retained EU law relating to financial services and enabling HM Treasury and the financial services regulators to replace it with legislation designed specifically for UK markets, in a way that builds on the UK's existing approach to financial services regulation. The Bill covers a wide range of areas, but key elements include the introduction of a new secondary objective for both the PRA and the FCA for medium to long-term growth and international competitiveness in the financial services sector, an enhancement to regulatory powers over critical third parties and increased powers for HM Treasury over the Bank of England and PRA on existing and new rules. The Group continues its close monitoring of developments in this area and the emerging implications of Brexit more widely, and how these may ultimately impact the specific regulatory frameworks under which the Group operates.

The governance and risk management framework within the Group continues to be developed to ensure that the impacts of all new regulatory requirements are clearly understood and mitigated as far as possible. Regular reports on key regulatory developments are received at both executive and board risk committees.

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

A5. Future prospects

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

- Explain how they have assessed the prospects of the Group and whether, on this basis, they have a reasonable expectation that the Group will be able to continue in operation (the 'viability statement')
- State whether they consider it is appropriate for the Group to adopt the going concern basis of accounting in the preparation of the financial statements presented in Section D (the 'going concern statement')

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

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

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

Note 59 to the accounts includes an analysis of the Group's working and regulatory capital position and policies, while notes 61 to 63 include a detailed description of its funding structures, its use of financial instruments, its financial risk management objectives and policies and its exposure to credit, interest rate and liquidity risk. Critical accounting judgements and estimates affecting the results and financial position disclosed in this annual report are discussed in notes 66 and 67.

Financial forecasts

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

The plans for the period commencing on 1 October 2022 have been approved by the Board and have been compiled taking into consideration the Group's cash flow, dividend cover, encumbrance, liquidity and capital requirements as well as other key financial ratios throughout the period.

Current economic and market conditions are reflected at the start of the plan with consideration given to how these will evolve over the plan period and affect the business model. The economic assumptions used are consistent with the economic scenarios considered for determining impairment provisions.

The plan is compiled by consolidating separate forecasts for each business segment to form the top-level projection for the Group. This allows full visibility of the basis of compilation and enables detailed variance analysis to identify anomalies or unrealistic movements. Cost forecasts and new business volumes are agreed with the heads of the various business areas to ensure that targets are realistic and operationally viable. Forecast loan impairment levels reflect the economic scenarios and weightings used in the Group's provisioning at 30 September 2022.

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

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

- Higher buy-to-let volumes – This scenario allows the Board to see what impact higher buy-to-let volumes at a reduced yield has on the profitability of the business. The higher volumes also allow the Board to determine whether capital resources and liquidity would be stretched due to the higher cash and capital requirements
- Higher funding costs – This scenario allows the Board to see the impact of a significant prolonged margin squeeze on profitability and whether this would cause significant impacts on any capital, liquidity or encumbrance ratios
- Lower development finance volume and yield – This scenario replicates a significant increase in competition within the sector (potentially from market shrinkage), reducing yields and impacting market share. Since development finance is the highest yielding product, its reduction shows the Board the impact of a lower mix on the contribution to costs and what other ratios may be affected from such a drop in volume
- Higher buy-to-let redemptions – This scenario highlights to the Board the potential risk that is inherent in the currently held EIR buy-to-let debtor and invites discussion as to what mitigating action could be taken to avoid such an impact
- Bad debt stress – This scenario simulates a significant short-term capital and profitability shock with prolonged house price deflation across the plan horizon. To ensure that it is a worst-case stress point and also to avoid replicating the ICAAP process, only bad debt rates are altered in these scenarios – all new business and other assumptions remain with no management actions included
- Combined downside stress – This presents a plausible set of adverse factors to the business model that allows the Board to see how this impacts the strategy across the five-year horizon

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

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

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

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

In addition, the directors held 'deep dive' sessions into key areas of risk focus including the impact of rising interest rates, rising inflation and broader consequences of the cost of living crisis while continuing with focussed reviews of key risk areas including credit risk, capital risk, liquidity and market risk, climate change risk, conduct risk and across the different categories of operational risk. The output from these sessions was fed back into the Group's risk management process.

The directors also continued to monitor the potential impact of the UK Brexit process as the economic and regulatory implications of the UK's exit from the EU continue to crystallise, and the emerging long-term effects of the Covid pandemic.

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

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

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

Risk assessment

During the year the Board discussed, reviewed and approved the principal risks identified for the Group. This process included debate and challenge regarding the most material areas for focus on an ongoing basis. No material changes were proposed to the principal risks.

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

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

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

The Board has spent considerable time in the year monitoring the emerging economic situation in the UK, in particular the impact on its customers of rising prices, rising interest rates and reducing confidence more generally. In particular the impact on the Group's operations of increasing customer vulnerability and potential pressure on affordability was an important focus area. The results of these considerations have fed into the Group's forecasting and risk assessment.

Availability of funding and liquidity

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

The Group's retail deposits of £10,669.2 million (note 32), raised through Paragon Bank, are repayable within five years, with 80.8% of this balance (£8,620.5 million) payable within twelve months of the balance sheet date. The liquidity exposure represented by these deposits is closely monitored; a process supervised by the Asset and Liability Committee. The Group is required to hold liquid assets in Paragon Bank to mitigate this liquidity risk. At 30 September 2022 Paragon Bank held £1,505.5 million of balance sheet assets for liquidity purposes, in the form of central bank deposits (note 62). A further £150.0 million of liquidity was provided by an off balance sheet swap arrangement (note 62), bringing the total to £1,655.5 million.

Paragon Bank manages its liquidity in line with the Board's risk appetite and the requirements of the PRA, which are formally documented in the Board's approved ILAAP, updated annually. The bank maintains a liquidity framework that includes a short to medium term cash flow requirement analysis, a longer-term funding plan and access to the Bank of England's liquidity insurance facilities, where pre-positioned assets would support drawings of £1,776.0 million.

Holdings of the Group's own externally rated mortgage backed loan notes can also be used to access the Bank of England's liquidity facilities or other funding arrangements. At 30 September 2022 the Group had £455.2 million of such notes available for use, of which £213.0 million were rated AAA. The available AAA notes would give access to £171.6 million if used to support drawings on Bank of England facilities.

The Group's securitisation funding structures, described in note 62, provide match funding for part of the asset base. Repayment of the securitisation borrowings is restricted to funds generated by the underlying assets and there is limited recourse to the Group's general funds. Recent and current loan originations are financed through retail deposits and may be refinanced through securitisation where this is appropriate and cost-effective. While the Group has not accessed the public securitisation market in the year, the market remains active with strong levels of demand, and the Group maintains the infrastructure required to access it.

The earliest maturity of any of the Group's bond debt is the £112.5 million retail bond, due August 2024. Central bank debt under the TFSME is not repayable until 2025.

The Group's access to debt is enhanced by its corporate rating, which was upgraded to BBB+ by Fitch Ratings in March 2022, and its status as an issuer is evidenced by the BB+ rating of its £150.0 million Tier-2 bond. It has regularly accessed the capital markets for warehouse funding and corporate and retail bonds, over recent years and continues to be able to access these markets. The Group has access to the short-term repo market for liquidity purposes which it uses from time to time.

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

As described in note 59 the Group's capital base is subject to consolidated supervision by the PRA. The most recent review of the Group's capital position and management systems during the year ended 30 September 2021, resulted in a reduction of the minimum capital level. Its capital at 30 September 2022 was in excess of regulatory requirements and its forecasts indicate this will continue to be the case.

Viability statement

In making the viability statement the directors considered the three-year period commencing on 1 October 2022. This aligns with the horizons used for the risk evaluation exercise which is performed annually and facilitated by the CRO.

The directors considered:

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

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

On this basis, the directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the three-year period commencing on 1 October 2022.

While this statement is given in respect of the three-year period specified above, it should be noted that its risk evaluation exercise also includes a high-level view extending to September 2027 and the directors have no reason to believe that the Group will not be viable over the longer term. However, given the inherent uncertainties involved in forecasting over longer periods, the shorter period has been adopted for the purposes of this viability statement.

Going concern statement

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

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

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

A6. Citizenship and sustainability

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

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

In order to ensure that an overall strategic focus on sustainability issues is maintained, the Group has a sustainability committee, comprised of relevant ExCo members and other responsible senior managers. The Committee meets regularly and is chaired by Deborah Bateman, the External Relations Director.

Further information on the Group's sustainability profile and agenda is given in the annual Responsible Business Report, published each December and available on the Group's website at www.paragonbankinggroup.co.uk.

A6.1 Non-Financial Information Statement

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

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

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

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

Sustainability analysts frequently request detail of significant fines or penalties incurred by companies for ESG related incidents, or confirmation that there were no such incidents. The Group has incurred no such fines greater than US$ 100.0 million in the year (2021: none). Information on penalties and disciplinary incidents relating to sustainability issues is given below in each section, where relevant.

A6.2 Customers

During the year the Group has maintained its focus on providing high quality customer service, and it is currently working to embed the new FCA Consumer Duty requirements in its systems and processes.

The Group's strategic objective is to be a prudent, risk-focussed, specialist bank with a closely controlled, cost-efficient operating model. Customers are at the heart of the Group's business which, as a specialist bank, uses its expertise to provide financial products and support to help them achieve their ambitions. The Group is committed to treating customers fairly, offering extra support when they need it and listening to their feedback.

The fair treatment of customers and the delivery of fair outcomes to them is central to the achievement of the Group's strategic business objectives and it has no appetite for any material failure to deliver fair outcomes for customers.

Customers can be confident that the Group will always consider their needs and act fairly and responsibly in its dealings with them. To ensure this, a number of customer focused management groups are dedicated to improving customer journeys and supporting customers on an ongoing basis.

In particular, a cross-functional working group addresses the needs of customers in vulnerable circumstances, considering their needs and any additional support that they require, while ensuring that the Group's people, processes and products are able to meet these needs. Deliverables over the last twelve months have been focused on identifying the drivers of vulnerability, enhancing training for employees and enhancing IT systems to facilitate improved identification of, and engagement with such customers.

While the Group strives to provide excellent service at all times, it is inevitable that issues will arise from time to time. The Group regards these as opportunities to improve and consequently management teams meet monthly to discuss customer feedback and complaints to understand how the levels of service that customers, and potential customers, demand and expect can be maintained and enhanced.

Customer support and understanding are also two of the key outcomes that align to the core delivery requirements of the FCA's new Consumer Duty. The Group has a well-defined and structured project in place that focuses, where they are applicable, on the implementation of the new principle, cross cutting rules and consumer outcomes, thereby ensuring that the milestones for implementation in 2023 and 2024 are achieved.

The desire to achieve good outcomes for our customers is an important commercial differentiator which has helped the Group build strong relationships over many years. Its ongoing and planned activity across its business units is aimed at ensuring that all customers can be confident that:

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

This pro-active approach accords with the FCA's Principles for Business, particularly with regard to ensuring good customer outcomes, preventing customer harm and ensuring that all communications are clear, fair and not misleading. Performance in respect of these requirements is monitored and procedures regularly adjusted to deliver better customer solutions.

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

Complaints

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

Handling

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

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

Monitoring

In order to ensure the delivery of consistent and good customer outcomes, the Group has established complaint reporting forums in all business areas, which enable the effective discussion of complaint volumes, trends and root cause analysis. This ensures that all business lines effectively resolve customer complaints, learn from the issues raised and address any underlying causes of those complaints.

The effectiveness of this activity is regularly assessed through independent first line outcomes testing, ensuring ongoing competence in the identification and resolution of complaints. The reporting of this activity flows to the Customer and Conduct Committee ('CCC'), ensuring complaint visibility is provided at the highest levels of the business.

The Group actively seeks feedback on its complaint handling process using an automated survey, where customers are regularly invited to provide feedback on the way in which they feel their complaints have been dealt with. The results, where appropriate, are used to share best practice, improve agent education, and identify potential process improvements.

There is an active Complaints Community group that meets regularly, where all business areas are represented. Its purpose is to ensure complaints are handled consistently and that industry updates, knowledge and best practice are all shared with all business units concerned with complaint handling.

The Group focusses on FOS complaints data as a high-level satisfaction metric, with levels of customer escalation in the period remaining low. Consolidated information for the two Group companies required to report to FOS, for the four most recent FOS reporting periods, is set out below.

	Six months ended			
	30 June 2022	31 December 2021	30 June 2021	31 December 2020
Cases reported	**46**	35	50	60
Uphold rate	**34.4%**	34.2%	34.0%	43.3%

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

The Group routinely assesses its complaints performance against the FCA bi-annual complaints submissions, comparing complaint metrics to our peers and against the industry as a whole.

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

A6.3 People

The Group employs just over 1,500 people, the majority under hybrid working arrangements where part of their time is spent working at home and part in one of the Group's office locations. The largest number are attached to the Group's Solihull head office, with other significant hubs in Southampton and London.

During the past year the Group has seen a 4% growth in its headcount, predominately driven by the creation of new roles in mortgage underwriting and customer support functions. This investment in resource has helped the Group to serve its customers and achieve its strategic priorities.

Investors in People

In May 2022, the Group was re-accredited as an Investors in People ('IiP') employer and achieved Platinum status for the first time. This recognition is the first for a Solihull employer and has been attained by only 5% of employers assessed by IiP. The IiP re-accreditation process included an all-employee survey where 73% of employees provided feedback on their experiences working at Paragon (2019: 64% of employees responded), as well as 10% of employees being interviewed by the IiP assessors. The results showed a significant improvement across all performance indicators since the previous triennial accreditation in 2019; with the consistency of management and leadership behaviours, and the Group's strong culture, shaped by its values, particularly commended.

Employment conditions

All the Group's employees are based in the UK and the Group is committed to upholding all aspects of UK employment law, including legislation addressing terms of service, working conditions, equality and taxation.

The Group continues to minimise its use of short-term and temporary staff. As of 30 September 2022, employees on temporary or short-term contracts accounted for 2.0% of the workforce (2021: 2.3%) and no use was made of zero-hours contracts. The Group usually only employs persons over the age of 18, except in connection with apprenticeships or other training arrangements.

Like all UK businesses, the Group has felt the impact of the 'great resignation' and has seen an increase in voluntary employee turnover during the period to 12.2% (2021: 8.7%). Whilst this represents an increase, much of this is explained by a reversion to pre-Covid levels, with the attrition values for the 2019 and 2020 financial years being 10.4% and 11.5% respectively. The Group's attrition rate remains lower than the average rate in the banking and finance sector in 2022 of 18.6%, published by Reward Gateway and the 2021 figure for the financial services sector of 13.7% published by XpertHR in 2021.

The Group benefits from the extensive through-the-cycle experience of a significant number of long serving employees at all levels. 29.4% of the workforce at 30 September 2022 had served for over ten years with 12.0% having been with the Group for over twenty years.

In March 2022, the Group announced its adoption of a hybrid working model on a permanent basis. This followed the success of several pilots and the analysis of feedback received from employees as the UK emerged from the Covid pandemic. Today over 40% of staff are typically working from home at any point. Flexible working is actively encouraged across all areas, to promote a healthy work-life balance for employees and to ensure that the Group retains the skills and experience of its people. Formal flexible working arrangements are in place for 22.6% of employees (2021: 24%), with 74.0% of these working part-time (2021: 73.6%). The Group monitors working practices to ensure that it complies with the Working Time Regulations.

As part of its ongoing commitment to employee wellbeing and recognising the importance of a healthy work-life balance, the Group provides a minimum holiday entitlement for its employees of 25 days per year for full time employees. This is in addition to public holidays and significantly in excess of legal requirements. In addition, all employees are now also granted an additional day's leave for their birthday, as well as a full day's leave for Christmas Eve and New Year's Eve; this means that all full time employees have a minimum of 28 days paid leave each year, in addition to public holidays.

In recognition of the increased cost of living that is impacting many of the Group's employees, a payment of £500 was made to all employees below senior management in July. Additionally, the 86% of employees who are eligible for the Group's profit related pay scheme were also given an advance payment of £500 in July.

The Group's remuneration packages remain compliant with the UK's national minimum wage rates, and in addition, the Group has maintained its Living Wage employer accreditation since June 2016. As a Living Wage employer, the Group pays at least the Real Living Wage (£9.90 per hour at 30 September 2022) to all employees and also ensures that wages paid by contractors and suppliers meet the same threshold. From 1 October 2022 the Group will pay a minimum of £21,255 to all full-time employees, equivalent to £10.90 per hour.

The Group seeks to avoid compulsory redundancies wherever possible, aiming to redeploy affected employees elsewhere in the business. On the disposal of the Group's unsecured loan portfolio in the year (Section A4.1.1) over 50% of the 43 employees affected were offered alternative roles, although some of these elected to take voluntary redundancy.

The Group runs a Worksave defined contribution pension scheme and complies with the Government's auto-enrolment requirements; 85% of employees are members of this scheme. A legacy defined benefit pension scheme is also in place for long-serving employees. Combined, the Group is contributing towards the retirement provision of 95% of its employees.

Culture

The Group launched its employee Code of Conduct during the period. The code provides additional guidance to employees on the behaviours expected of them when dealing with each other, our customers, and other stakeholders, and is a central component of continuing to build and embed a strong risk culture. Employees are expected to attest that they understand the expectations set out in the code and as at 30 September 100% of employees had done so.

The Code of Conduct is published on the Group's website at www.paragonbankinggroup.co.uk.

Equality, diversity and inclusion

The Group is committed to creating a diverse workforce and an inclusive culture. It promotes equality amongst all its employees through its policies, procedures and practices. Every employee is entitled to a working environment that promotes dignity, equality and respect for all. The Group will not tolerate any acts of unlawful or unfair discrimination (including harassment) committed against an employee, contractor, job applicant or visitor because of a protected characteristic:

- sex
- gender reassignment
- marriage and civil partnership
- pregnancy and maternity
- race (including ethnic origin, colour, nationality and national origin)

- disability
- sexual orientation
- religion and or belief
- age

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

The Board believes the achievement of a balanced workforce at all levels delivers the best culture, behaviours, customer outcomes, profitability and productivity and therefore supports the success of the Group's business. The Nomination Committee provides board-level oversight on all inclusivity matters affecting the Group's people.

The Group's Equality, Diversity and Inclusion ('EDI') Network continues to shape the Group's EDI plans and is sponsored at executive level by Richard Rowntree, Managing Director – Mortgages. The Network has continued to lead on communication activities during the period with significant communication and education campaigns being run for Black History Month, Disability History Month, International Women's Day, and Pride at Paragon.

For all these high-profile campaigns, members of the Executive Committee have attended employee listening circles, which have provided them with the opportunity to meet with employees from minority groups to gain an understanding of their experiences working at Paragon. These sessions have provided Executive Committee members with reverse mentoring opportunities as well as providing the EDI Network with valuable feedback that is shaping the Group's future plans.

During the year over 78% of managers attended a half-day Inclusive Leadership training course delivered by the Group's learning and development team. The course, along with a second 'Inclusive Workplace' programme that was offered to all employees, received outstanding feedback. 100% of employees completed their annual mandatory Equality, Diversity and Inclusion eLearning during the period.

Collecting diversity monitoring data

In September 2021 the Group began asking employees to complete diversity monitoring profiles in CoreHR, the central HR system. Data was requested about their gender identity, sexual orientation, ethnicity and race, religion, socio-economic background, disabilities and caring responsibilities outside of work. As at 30 September 2022 over 73.1% of employees had completed their profile. This data has provided the Group with a better understanding of the composition of the workforce and allowed Human Resources to analyse and monitor whether all employees have the same access to training, development and job opportunities.

Socio-economic diversity

The Group recognises the importance of improving socio-economic diversity at senior levels across the UK financial services industry and is proud be one of the Founding Members of 'Progress Together', the City of London's socio-economic diversity membership body. Richard Rowntree, Managing Director – Mortgages, is also an active member of the City of London's taskforce to improve socio-economic diversity across the sector, and has spoken at numerous industry events on this subject.

During the year, the Group has formed working relationships with inner-city colleges as a means of attracting talent from more diverse backgrounds and is continually monitoring data to ensure that it is not creating barriers for employees from lower socio-economic backgrounds.

The Group has also been involved in the Smart Futures Programme during the period. This is a ten month programme for year 12 students from low-income backgrounds and includes work experience, mentoring and interactive training, helping them gain useful skills for future employment.

Race at Work Charter

The Group is a signatory of the Race at Work Charter and has taken several steps during the year to meet the charter's requirements. These include the development of 'Mission INCLUDE', a mentoring scheme for employees from underrepresented groups.

The programme provides high potential employees from these groups with a mentor from another organisation who is a member of an underrepresented group or an ally. It was piloted during the period and a full cohort of employees are enrolled to start the programme from September 2022.

An internal development programme, 'Ignite' is also being introduced, following feedback gathered through listening circles. This will focus on providing greater career support to employees in underrepresented groups and addressing personal development needs such as making an impact, building your brand and networking.

Disability Confident

Employees identifying as having a disability comprise 4.7% of those completing their diversity profile. The Group remains Disability Confident Committed under the UK Government's Disability Confident scheme. As well as continuing to provide paid employment to people with disabilities, as a Disability Confident Committed organisation, the Group continues to meet the five Disability Confident core commitments:

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

During the year the Group was accredited to level 2 of the scheme, following the completion of a self-assessment process and the provision of evidence that all core commitments were being met, including the agreement of an action plan.

Several communications and engagement campaigns throughout the year have focused on raising awareness about disability, including neurodiversity; this included the EDI Network hosting a Webex with Alex Manners, an Asperger's champion to talk about his own experiences.

The Group makes every effort to retrain and support employees who suffer from disabilities during their employment, including the provision of flexible working to assist their return to work, and to ensure all its people with disabilities have the opportunity to fulfil their potential.

Women in Finance

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

In January 2017 the Group's first set of internal targets under the charter was published on its website. They included a target of 35% female representation in senior management roles by January 2022, increasing from 26% at the time the targets were set.

The Group's results against these targets at the January 2022 end date of the first phase of the project are set out below:

Measure	Target	Result	Status
Female representation in senior management	35%	39%	Achieved
Females in workforce	50%	52%	Achieved
Females as a percentage of employees receiving management career development and leadership training	50%	47%	Partially achieved*
Managers from an ethnic minority background	10%	11%	Achieved
Workforce on flexible working	10%	24%	Achieved
Flexible working on a part-time basis	50%	78%	Achieved

*During the 2022 calendar year all managers attended a series of online leadership workshops designed to support the new hybrid working model, which restricted opportunities for other forms of training.

At 30 September 2022, the Group had achieved 38.1% female representation in senior management (2021: 38.7%). For the next phase of its charter journey the Group has committed to achieve 40% female representation in senior management by 31 December 2025.

The definition of senior management used in the Group's 'Women in Finance' targets is the same as that used by the FTSE Women Leaders initiative. When that review published its most recent report in February 2022, the Group's level of female representation in senior management was third highest out of the twelve banks and similar FTSE-350 institutions covered by the initiative.

Gender Pay

As required by legislation, the Group has calculated its gender pay gap as at April 2022. The results will be published on the UK Government website and on the Group's own website and are summarised below.

	April 2022	April 2021
Median gender pay gap	32.5%	36.6%
Mean gender pay gap	36.3%	38.4%
Median bonus pay gap	1.9%	3.4%
Mean bonus pay gap	84.4%	76.5%

This year's gender pay measures, although improved, are similar to those for 2021 and remain larger than the Group would like. The Group has continued to monitor these differences and found them to be predominately due to the seniority and nature of roles that men and women are undertaking in the organisation. The marginal increase in the number of women in the upper quartile is contributing towards the small improvement in the Group's pay gap.

The results are broadly in line with those for the financial services sector reported by the Office of National Statistics in their 2022 Annual Survey of Hours and Earnings ('ASHE') which showed a median pay gap of 36.6% (2021: 36.5%) and a mean pay gap of 30.8% (2021: 33.2%).

Roles in the lower pay quartiles are typically operational and processing positions, predominantly filled by female employees. These roles lend themselves particularly well to part-time working arrangements. Throughout the organisation females account for most part-time working arrangements and, due to the nature of the gender pay gap calculation taking no account of the hours worked by employees in calculating averages, this further increases the size of the gender pay gap.

The vast majority (86%) of the Group's employees are eligible for a bonus under the Profit Related Pay ('PRP') scheme. As all qualifying employees receive the same bonus on an FTE basis, these awards lead to the small median bonus pay gap. 19% of employees are eligible for the Group's discretionary bonus scheme (36% of the scheme's participants are women), and 8% of employees are also eligible for share based awards, of which 28% of recipients are female. This means that discretionary and share based bonus schemes are disproportionately awarded to men, and the large mean bonus gap is further driven by the bonuses awarded to the most senior executives, the majority of whom are men.

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

Composition of the workforce

During the year the workforce has grown by 4.3% to 1,503 employees (2021: 1,441). Information on the composition of the workforce at the year end is summarised below:

	2022 Females	2022 Males	2021 Females	2021 Males
Employees				
Number	764	739	757	684
Percentage	50.8%	49.2%	52.5%	47.5%
Managers				
Number	126	176	128	171
Percentage	41.7%	58.3%	42.8%	57.2%
Senior managers				
Number	9	36	8	34
Percentage	20.0%	80.0%	19.0%	81.0%
Directors				
Number	3	6	3	5
Percentage	33.3%	66.7%	37.5%	62.5%

During the year the Group amended its internal metrics to monitor 'managers' rather than 'management level employees', which included senior professional and technical personnel. The numbers shown above for 2021 have been restated in line with the new definition.

The definition of 'senior manager' used in the table above is that required by the Companies Act 2006 (Strategic Report and Directors Report) Regulations 2013 which differs from that used by the FTSE Women Leaders Initiative.

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

- 19.4% of employees (2021: 17.2%)
- 13.0% of managers (2021: 13.4%)
- 12.2% of senior managers (2021: 4.7%)

This is based on the 68% of employees who declared their ethnicity (2021: 58%). For the purposes of this analysis, ethnic minority employees comprise all those not identifying as 'White British'.

Health and wellbeing

The Group has continued to focus on supporting the wellbeing of employees throughout the year, providing support with emotional, physical, financial, and social wellbeing issues. During the period Anne Barnett, Chief People Officer, took on the role of Executive Sponsor for Wellbeing.

Given the cost-of-living challenges facing employees, there has been additional focus on financial wellbeing this year with numerous campaigns and avenues of support being made available to employees. These include providing access to free will writing services, support with budgeting and debt management, as well as pensions advice.

The Group also remains committed to providing employees with access to trained mental health first aiders. Four members of the Wellbeing team have undertaken mental health training in the period and nine team members received training on grief and bereavement from external specialists. As well as the Wellbeing team being available to provide support to employees, employees have access to a dedicated Wellbeing Hub where specialist support services such as those who help with domestic violence or bereavement are signposted, as well as numerous resources to help with a wide range of wellbeing issues.

In April 2022 the Group introduced The Vitality Health programme giving all employees access to a range of physical wellbeing products, including personalised health reviews, online GP services, discounts and rewards through Vitality's partner brands and Vitality Wellbeing Coaches. Free exercise classes, suspended during Covid, were also reintroduced as part of the Group's ongoing commitment to improving employees' physical wellbeing as more time begins to be spent in the office.

Training and development

The Group has continued to focus on providing employees with quality opportunities to develop, whether in person or virtually. On average employees received 5.2 days training each in the year (2021: 4.6 days). This continues to place the Group significantly higher than the average figure of 3.6 days per person reported by the 2019 Employer Skills Survey, published by the UK Department for Education in 2020, the most recent national survey of training provision. This included online training undertaken by all employees on various topics including regulatory requirements.

The technical training team have played a key role in ensuring that major transformation projects undertaken by the Group are introduced effectively and well supported through easily accessible development. They have also provided a rich variety of support through the means of video creation, online sessions and classroom learning to ensure that the learning available is both fit-for-purpose but still engaging. They have also continued to ensure that employees are able to maximise the benefit of working remotely by using all systems available to their full potential.

Another continued area of focus has been ensuring all employees understand how to support those of the Group's customers in vulnerable circumstances. An interactive e-learning solution was rolled out to all employees, supplemented with bespoke courses for all customer-facing employees.

All employees and line managers are encouraged to regularly talk about their performance through monitoring objectives during the year as part of frequent and timely conversations about performance. This not only supports individual performance and personal development, but also helps the Group to effectively manage rising talent and fulfil its succession planning objectives.

The Group's Senior Leadership Development Programme continued the development of its third cohort throughout this financial year, with a further nine individuals undertaking bespoke development plans. Graduates from the earlier cohorts continued to advance in the year with several moving to more senior roles or taking on significantly increased responsibilities.

Wider management and leadership programmes have also continued through virtual delivery, including a suite of leadership modules called 'Leadership for the Future'. These have been delivered virtually, bringing together all layers of the Group's management structure to share best-practice through networking and learning together.

The Group has continued to focus on developing female talent during the year to support our Women in Finance Charter commitments. 48% of employees receiving management development are female, and the Group continues to support the 30% Club Mission Gender Equity cross-company mentoring programme run by Moving Ahead. Feedback from both mentors and mentees participating in the programme continues to be favourable, and 28% of participants have progressed their careers within the Group since participating in the programme, despite the challenge of all meetings taking place virtually. In comparison, research conducted for the 30% Club showed an average promotion rate of 10% for female managers. The fifth cohort of employees started their programme just before the year end.

The Group has recently joined the '5% Club', which promotes the provision of early careers roles such as apprenticeship, graduate positions and student placements. As part of this commitment it, has set a target that such early careers roles will comprise at least 5% of its workforce by September 2027. At 30 September 2022 the Group had 74 such employees, comprising 4.9% of the workforce.

The Group has continued to draw down Apprenticeship Levy funds to support its development objectives. The number of apprenticeships has been steadily increasing over the last 12 months, with the Group having 44 apprentices (2021: 37), 2.9% of employees (2021: 2.3%) registered under the levy scheme at the year end. These apprenticeships cover a range of specialist and operational roles including IT, audit, customer services and management. The Group's utilisation of its available levy funds over the year has reduced to 31% (2021: 42.6%), despite the increased participation, as a result of increased overall payroll costs, which determine the levy payable.

There are currently 101 individuals completing professional qualifications across the Group (2021: 101), including 40 undertaking their CeMap mortgage qualification (2021: 44). Of these 55% are female (2021: 57%) contributing towards the Women in Finance agenda.

Recruitment

Headcount continued to grow during the period, with over 200 new hires commencing employment, most of which were within Mortgages and Customer Servicing. As experienced by all businesses, recruitment has been challenging during the period, particularly in specialist roles, although recruitment volumes stabilised over the final quarter of the period.

The Group also runs a successful 'refer a friend' scheme whereby employees receive a referral fee if an individual they refer passes probation. This year 28 individuals were successfully recruited through this scheme (2021: 26).

Employees' involvement

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

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

During the period non-executive directors and Fiona Clutterbuck, the former Chair, attended three People Forum meetings and discussed topics such as the role of the Board and the Group's strategic priorities, including the focus on organic growth. The new Chair, Robert East, and new non-executive director, Tanvi Davda, will meet with the Forum in the early part of the new financial year as part of their induction programmes.

Executive directors also provide biannual updates on business progress to the entire workforce which continue to be delivered through video messages. Executive Committee members also use the Group's intranet to deliver updates on important initiatives within the business from time to time.

The Forum also made a recommendation to grant additional leave for employee birthdays, which took effect from March 2022. Discussions have also been held on how to assist employees with cost-of-living pressures, and ideas including the provision of free sanitary products, have been implemented.

To involve employees in the Group's performance, the Company operates a ShareSave share option scheme and a profit-sharing scheme, both of which enable eligible employees to benefit from the performance of the business. At 30 September 2022, 63.9% of the Group's employees were members of one or more ShareSave scheme and 85.6% were eligible for profit related pay in respect of the 2022 financial year.

Health and Safety

Throughout the year, the Group has remained compliant with all applicable health and safety legal requirements and applied best practice management standards across its businesses. This is combined with a commitment to providing a healthy and safe working environment for all employees, contractors and visitors to its premises, and those impacted by its operations in public areas. While the Group's primary source of health and safety related risk remains with the vehicle maintenance operations of Specialist Fleet Services Limited ('SFS'), the health, safety and wellbeing of all employees is a key focus of the Group's people policies.

The key safety and wellbeing initiative during the period has centred on the development of the Group's hybrid working model as pandemic restrictions lifted and people returned to the Group's offices on a more regular basis, while retaining an element of offsite working. To enable employees to work effectively and safely in a hybrid environment, access to appropriate equipment has been reviewed and procedures, such as remote workstation assessments, have been developed to address the additional issues of maintaining a healthy working environment under this model.

The Group's head office is located in the centre of Solihull, in proximity to properties that could indirectly impact on it. An annual testing programme addresses fire evacuation and network grid failures as a minimum. The focus of the programme ensures the key controls required to mitigate any disruption are simulated to confirm that our processes remain resilient, with sufficient resource available to manage a potential incident, should one occur. This is scaled accordingly throughout all Group locations.

Periodic hazard reviews are carried out across the Group's premises both to identify specific issues and to highlight any trends. In addition to actioning each individual hazard, trend analysis allows focus on safety interventions with particular topics at each site. This may include targeted safety training or safety communications.

During the year all employees have undertaken e-learning modules covering health and safety and fire awareness. These have been upgraded during the year as a result of a focussed review of health and safety training. Additionally, employees have been provided with intranet communications on topics including fire evacuation, driving for work, personal emergency evacuation plans, electrical visual inspections of IT equipment and employee's individual health and safety responsibilities. Together with information provided through Group policies, these provide employees with appropriate levels of information, instruction, training and supervision, to empower them to take ownership of their individual responsibility for a healthy and safe environment.

SFS employees in automotive workshop roles additionally receive a minimum of 40 hours of continuous training to ensure awareness of the specific issues inherent in their duties and working environment to mitigate the inherent heightened risk.

Employees, wherever they are based, are encouraged to report any concerns in line with the Group's stated health and safety objectives. They are provided with further opportunities to raise concerns through engagement with People Forum representatives and to shape future initiatives to enhance health, safety and wellbeing.

Management and systems

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

The Group (excluding SFS) was re-certified to ISO45001:2018 in April 2022 and its Occupational Health and Safety Management System ('OHSMS') continues to be audited for compliance bi-annually by a UKAS accredited auditor. The OHSMS provides the central governance framework for sites outside the OHSMS scope to ensure the Group remains compliant with all applicable health and safety legal requirements.

SFS has its own health and safety manager and ISO45001:2018 certified OHSMS, which is audited for compliance annually by a UKAS accredited auditor. Incidents are investigated using specialist local resource with access to Group support as required.

Resources within the health and safety function were reviewed during the period and were sufficient to ensure that appropriate standards of health and safety management have been maintained throughout the year.

Performance

Health and safety performance continues to be good with the number of incidents remaining at a low level. During the financial year ended 30 September 2022 there were no prosecutions or any enforcement action from visits by the authorities for non-compliance in respect of health and safety matters (2021: None).

The Group's office premises continue to comply with all health and safety regulations, with the number of fire marshals, first aiders and other qualified personnel continuing to be appropriate at all times. This continues to be regularly monitored across all sites, based on the number of occupants, as the hybrid working model develops.

During the year, the Group reported 20 minor incidents classified as relating to work activity or the building environment (2021: 9). There was one lost-time incident which was notifiable under the Reporting of Incidents, Disease and Dangerous Occurrences Regulations 2013 ('RIDDOR') (2021: nil). The incident was minor and resulted in eight lost days.

Reported 'near-miss' incidents remained at low levels, with only 28 events in the course of the year (2021: 18). The year-on-year increase was attributable to enhanced reporting procedures.

All accidents and incidents are investigated with the co-operation of employees to identify the root cause of the incident including any workplace / work activity hazards, systems or behavioural errors. Corrective and preventative actions are then implemented.

A6.4 Environmental impact

Climate change is one of the biggest challenges faced by the world today and to ensure the Group is taking an active role in the transition, it recently became a member of Bankers for Net Zero ('B4NZ'). This year, the Group has made a commitment to achieve net zero by 2050 but, in doing so, it recognises that net zero cannot be achieved in isolation and that its net zero commitment may not be achieved without significant and continued support from important government policy and broader industry initiatives. As a member of B4NZ the Group can continue to support the wider efforts of the financial services industry and aims to minimise the impact it has on climate change.

The Group's aspirations for its journey to net zero are set out below.

Year	Achievement / aspirations
2020	• Climate change designated as a principal risk
2021	• Sustainability Committee established to monitor progress on climate focus areas • Financed emissions of the mortgage portfolio reported for the first time
2022	• Became a member of B4NZ • Began offsetting operational footprint • 2019 year end operational footprint emissions set as the baseline to track 2030 net zero commitment
2030	• Net zero across the operational footprint
2050	• The Group has committed to net zero across all emission scopes in support of UK Government net zero commitment

Impacts of climate change

The Group's environmental impacts can be considered under two headings, its operational (or internal) impacts and the impact of its lending activities (the external or downstream impacts). The Group continues to find ways to reduce its operational impacts and this year the Group set out its ambition to reduce its operational footprint to net zero by 2030.

The operational footprint is defined as the Group's Scope 1 (direct) emissions, Scope 2 (indirect energy) emissions and those Scope 3 (other) emissions related to power, waste, water and business travel. It therefore excludes downstream or other upstream emissions from our value chain. Net zero is defined as a reduction in these emissions to zero, or to a residual level that is consistent with reaching net zero emissions at the global or sector level in eligible 1.5°C aligned pathways.

The Group has offset its operational footprint for the financial year ended 30 September 2022 through the purchase of Gold Standard or VCS (Verified Carbon Standard) certified offsets. More detail on the Group's approach to managing the environmental impact of its own activities is provided under '(f) Operational impacts' below. Throughout the year the Group's approach to managing the environmental impacts associated with its financing activities have been enhanced through improved governance, risk management and the delivery of a climate change scenario analysis module as part of the 2022 ICAAP capital adequacy assessment.

The Group's external, or downstream, impacts arise from the use to which its customers put the funds loaned to them. Most directly, for asset-backed lending it relates to the impacts of the asset being financed and its use by the customer.

The uses to which customers put the funds advanced to them by the Group give rise to two related groups of risks:

- **Physical risks** – Climate change and other environmental factors may, of themselves, increase financial risks. As an example, increased flooding risk might have an adverse impact on security asset valuations
- **Transitional risks** – Policy, legal, technology and market changes aimed at mitigating the impacts of climate change could pose financial or reputational risks to lenders, amongst other businesses. Such changes and pressures might impact the ability to realise a security or continue business lines

The Group uses these classifications to categorise the financial risks of climate change and is working to further embed the consideration of both forms of risk across all its lending. Risks in each of these categories may impact over the short-term (zero to five years), medium-term (five to ten years) or long-term (over ten years). These timelines go beyond a typical planning horizon of five years to appropriately consider climate change risks which may materialise over a longer period of time.

Reporting on climate change

The UK Listing Rule 9.8.6(8) requires the Group to disclose whether it has included climate-related financial disclosures consistent with the Taskforce on Climate-related Financial Disclosures ('TCFD') recommendations and explain any areas of non-consistency. The Group's climate-related disclosures set out below are consistent with the recommendations of the TCFD and the expectations set out in the Listing Rules.

In preparing the disclosures set out below, consideration has been given to the 2021 TCFD Implementing Guidance and the Supplemental Guidance for Banks, the FRC Thematic Review of TCFD disclosures and the FCA Review of TCFD-aligned disclosures by premium listed companies. The disclosures articulate the current status of the Group's climate related activities and highlight those areas for future development, at an appropriate level to enable users to assess the Group's exposure to, and approach to addressing, climate-related risks.

The following table sets out the sections of this part of the annual report in which material relevant to each TCFD pillar may be found.

Governance

Disclose the organisation's governance around climate-related risks and opportunities		Section
a) Describe the Board's oversight of climate-related risks and opportunities	• The Board has designated climate change as a principal risk within the Group's ERMF • The CFO has been designated as the director responsible for climate change matters • The Board has reviewed and approved the Group's offsetting approach and medium-term operational footprint targets • The Board is updated on sustainability through a monthly CEO report and the Risk and Compliance Committee is engaged on a quarterly basis through the CRO's Report	**(a) Governance** – Board oversight – Sustainability Committee and climate change working groups
b) Describe management's role in assessing and managing climate-related risks and opportunities	• The Sustainability Committee is a dedicated sustainability governance forum with a broad Environmental, Social and Governance ('ESG') perspective and reports to ExCo and the Board • The terms of reference of key executive risk sub-committees have been updated to incorporate the consideration of climate change	**(a) Governance** – Board oversight – Embedding climate change within the organisation's governance structure

Strategy

Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning where such information is material		Section
a) Describe the climate-related risks and opportunities the organisation has identified over the short, medium, and long term	As part of the 2022 ICAAP the following have been delivered: • a quantitative scenario analysis assessment on the most significant segment of the balance sheet, buy-to-let mortgages • a qualitative climate change risk assessment across both Mortgage Lending and Commercial Lending, considering the key climate related risk drivers The expectation is that as scenario analysis matures it will become an integral part of the process for identifying climate-related risks and opportunities	**(b) Strategy** – Climate related opportunities – Use of scenario analysis **(c) Risk management** – Potential risks identified over the short, medium and long term
b) Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning	• Group has committed to net zero across its operational footprint by 2030. The expectation is that performance against net zero will be tracked by the Sustainability Committee and reported up to the Board • Following the outcomes of the ESG focused session at the Board strategy day, the Group released a series of sustainable lending products • The delivery of the climate change scenario analysis module in the Board approved 2022 ICAAP enhanced the Group's process for embedding climate change within planning and strategy • The Group continues to improve the efficiency of its supply chain and invest in internal initiatives to reduce its impact on climate change	**(a) Governance** – Board oversight **(b) Strategy** – Climate related opportunities – Use of Scenario analysis **(f) Operational impact** – Supply chain and procurement – Environmental initiatives

		Section
c) Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario	• Throughout the year, a climate change scenario analysis exercise was delivered as part of the 2022 ICAAP. The approach aligned with the Bank of England's Climate Biennial Exploratory Scenario ('CBES') and did not identify any significant vulnerabilities	**(b) Strategy** – Use of scenario analysis **(g) Future developments**

Risk Management

Disclose how the organisation identifies, assesses, and manages climate-related risks		**Section**
a) Describe the organisation's processes for identifying and assessing climate-related risks	• The Group's activity has focused on incorporating climate risk considerations within the ERMF and improving risk governance • The Sustainability Committee and the Credit Committee track the EPC ratings of new mortgage completions on a monthly basis • Improved governance and increased climate change reporting into the Sustainability Committee, and the executive risk sub-committees has enhanced the approach for identifying and managing climate related risks • In-depth risk reviews were held with business areas ahead of the scenario analysis exercise to identify key drivers of climate change risk	**(a) Governance** – Embedding climate change within the organisation's governance structure – Governance structure chart **(b) Strategy** – Use of scenario analysis **(g) Future developments**
b) Describe the organisation's processes for managing climate-related risks	• The underwriting processes consider climate risk factors. For mortgages and development finance this includes flood, subsidence, coastal erosion and the EPC of the property or development • On a regular basis the Sustainability Committee is provided with updates on the Group's key sustainability focus areas as well as any wider industry and regulatory developments on sustainability and climate related issues	**(c) Risk management** – Assessment at underwriting – Quantifying our climate exposure **(b) Strategy** – Climate related opportunities **(d) Metrics and targets**
c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organisation's overall risk management	• The governance structure has been updated to include the Sustainability Committee which allows for climate change updates and monitoring to be escalated as appropriate • The climate change risk policy is under development and will ultimately be approved by The Risk and Compliance Committee. The policy development will support the formalisation of climate change risk governance within the ERMF • The governance structure and the development of the climate change risk policy are clear stepping stones in the development of risk appetite and further embedding of climate change risk into the Group's ERMF • More detail on the Group's ERMF and approach to climate change as a principal risk is outlined in sections B8.4 and B8.5	**(a) Governance** – Sustainability Committee and climate change working group – Embedding climate change within the organisation's governance structure **(c) Risk management** – Assessment at underwriting – Quantifying our climate exposure **(g) Future developments**

Metrics and Targets

Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material		Section
a) Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process	• Across the Group's mortgage portfolio energy efficiency, flood risk and ground instability have been qualitatively and quantitatively reviewed during risk driver assessments • Across SME lending Standard Industrial Classification ('SIC') codes have been used to identify those operating in high carbon intensive industries • Throughout the year the amount of lending on our green mortgage range has increased • During the 2022 ICAAP the alignment of the mortgage portfolio's projected emissions with a well-below 2°C scenario was assessed	**(c) Risk management** – Quantifying our climate exposure **(d) Metrics and targets** **(b) Strategy** – Use of scenario analysis
b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks	• Scope 3 financed emissions across the mortgage portfolio are disclosed below • The process for measuring the carbon emissions from the Group's operations has been independently verified and continues to be enhanced. Disclosures have been included for the Group's operational footprint (Scope 1,2 and 3 emissions)	**(e) Financed emissions** – Scope 3 mortgage emissions **(f) Operational impact** – Performance indicators – Emissions across the value chain
c) Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets	• The Group has become a member of B4NZ • In March 2021 the Company issued a £150 million Green Tier-2 Bond which as of August 2022 achieved full allocation of £150 million of EPC A / B buy-to-let loans • The Group has offset its operational footprint for the 2022 financial year and committed to reduce these emissions to net zero by 2030	**(b) Strategy** – Climate related opportunities **(f) Operational impact** – Performance indicators

(a) Governance

Board oversight

In 2020, the Board designated climate change as a principal risk within the ERMF. This means information and measures on climate change risks are considered at board level and are tabled at Risk and Compliance Committee meetings throughout the year as part of the wider report from the CRO. The CFO has been designated as the director responsible for climate change matters and has an individual performance target to understand and assess the financial risks from climate change and oversee these risks within the firm's overall business strategy and risk appetite. Actual performance on this target is assessed annually and impacts the bonus or incentive received (see Section B7).

The Board is engaged on a regular basis through a monthly CEO report which provides oversight of sustainability and climate-related matters and how they impact strategy. The focus continues to be on improving the Board's understanding of climate change and its associated risks and opportunities as well as developing the Group's internal approach and strategy.

Engagement throughout the year included:

- As part of a broader ESG presentation, an update on climate change maturity was presented to the Board. The presentation gave an update on progress in delivering regulatory expectations whilst also outlining key deliverables and ambitions over the short term planning horizon.
- A climate change scenario analysis module was delivered to the Board as part of the 2022 ICAAP. This quantitatively and qualitatively reviewed the Group's exposure to climate change risk and additionally assessed the net zero pathway for the mortgage portfolio.
- A presentation was given to the Board at its annual offsite strategy event proposing an offsetting approach and the setting of medium-term operational footprint targets. Performance against these goals and ambitions will be tracked by the Sustainability Committee and reported up to the Board.

Sustainability Committee and climate change working groups

The Group has established a Sustainability Committee, chaired by Deborah Bateman, the External Relations Director. This committee is a dedicated sustainability governance forum with a broad ESG perspective, including climate change, and reports to the Performance ExCo and the Board on a regular basis. On a regular basis the Sustainability Committee is provided with updates on the Group's key sustainability focus areas, progress within business areas and any wider industry and regulatory developments on sustainability and climate-related issues. The Sustainability Committee has oversight of monthly climate change management information for the mortgage portfolio which includes concentrations of monthly advances, pre and post offer pipeline and the financed emissions of the portfolio.

The Group has established a series of working groups which report directly into the Sustainability Committee, and include personnel from across the business. This ensures that the broad scope of climate change related risks are appropriately identified and managed with oversight from the appropriate channels.

Throughout the year, with the support of the climate change working groups and the Sustainability Committee, the Group has:

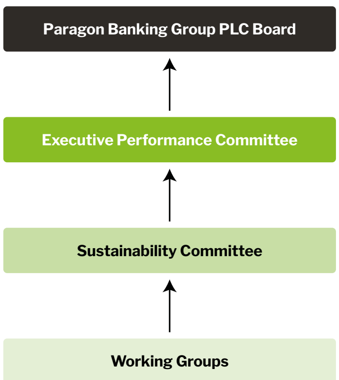
- Delivered new green products to encourage our customers to take up lower carbon technology or help them transition to a lower carbon economy
- Delivered teach-ins on three sustainability focus areas to key stakeholders – financed emissions, the operational footprint and social and governance matters
- Developed an approach to extrapolate the EPC and emissions of mortgages loans where an EPC was not matched. This was utilised within the scenario analysis exercise
- Developed the Group's internal approach and principles for offsetting
- Reviewed the Group's climate change maturity against supervisory expectations and re-established short-term deliverables and ambitions
- Delivered a climate change scenario analysis exercise for inclusion in the 2022 ICAAP
- Delivered the operational footprint baseline
- Provided insight into UK Finance and the Climate Financial Risk Forum ('CFRF') Scenario Analysis industry Working Group ('SAWG') to leverage experience and develop the Group's understanding whilst also providing a voice on future policy and processes

Embedding climate change within the governance structure

Throughout the last year, climate change continued to be further embedded within the Group's governance structure and culture. The Group continues to align its approach to managing climate change risk to its ERMF to ensure a consistent and comprehensive approach is taken across the business. The terms of reference of key risk committees have been updated to reflect their responsibilities to identify and manage the wider impacts and transmission channels of climate related risks.

Climate and sustainability governance structure chart

The Governance structure outlines how climate and sustainability related matters are escalated throughout the Group and upwards to the Board. In addition to this reporting structure, the Sustainability Committee and its working groups support and provide relevant reports to the ERC and its sub-committees where appropriate. The Group's overall governance structure is described more fully in section B.



The process for identifying and managing climate-related risks and opportunities has been enhanced in the year through improved governance and increased climate-related reporting into the Sustainability Committee and executive risk sub-committees.

(b) Strategy

As set out above, the Group has made a commitment to achieve net zero for all operational and attributable lending and investment emissions by 2050. The Group aims to support the UK Government's decarbonisation goals however recognises the scale of the challenge ahead and understands that without the support from industry and policy makers no business can achieve net zero. The Group has joined B4NZ acknowledging the importance of a unified approach across the financial services industry to achieve net zero.

As part of the Group's commitment for net zero, the Group offset the Scope 1, 2 and 3 emissions associated with its operational footprint for the year ended 30 September 2022. The Group understands that offsetting is not a long term solution, and its offsetting commitment is supported by an ambition to achieve net zero across these emissions by 2030. The commitment to offset the Group's operational footprint formulates a carbon price which will be used internally to drive future decision-making and investment into internal emission reductions.

Climate related opportunities

Climate change related opportunities have been, and continue to be, considered as part of the Group's strategy and it aims to support its customers in their transition to a low carbon economy.

In March 2021 the Group became the first bank in the UK to issue a green Tier-2 capital instrument. The Bond set out the Group's ambition to finance £150.0 million of newly originated EPC A / B buy-to-let loans. The Green Bond Investor report, which is available on the Group's website, outlines the progress made up to 31 March 2022, and by August 2022 the full targeted allocation had been reached.

Following the outcomes of the ESG focused session at the Board strategy event the Group's lending businesses have released a series of green products during the year. These have included:

- Expanding the green mortgage range to offer a green alternative on preferential terms to every mortgage product for any customers applying with an EPC rating of C or higher, supporting the green bond allocation
- Commencing lending on battery electric vehicles in the Group's motor finance operation
- Launching the green homes initiative within the development finance business in November 2021, offering a financial incentive to developments constructing EPC A-rated homes

The Group understands the importance of sustainable finance as a mechanism to drive the transition to a low-carbon economy. Other ways in which the Group aims to enable the transition are through education and engagement with customers, brokers, stakeholders and other industry initiatives.

Use of scenario analysis

During the year a climate chance scenario analysis exercise was delivered as part of the 2022 ICAAP. The analysis built on previous risk driver assessments, which had identified the areas most significant to the Group. The focus of the quantitative assessment was on the mortgage portfolio due to the relative size of the portfolio and the availability of climate related data.

The approach aligned with the Bank of England's Climate Biennial Exploratory Scenario ('CBES') to provide a comparable and consistent outcome. The analysis considered the potential impact that transitioning to net zero and the damages from flooding could have on property values and credit exposure. Details of the forecasting approaches are outlined below. The scope of this exercise, and the approach adopted, will be enhanced in future iterations. The outcomes were presented to and approved by the Board.

Transition risk	Using the CBES's expanded assumptions on transmission channels, the cost to transition through retrofits was projected based on the EPC data available across the mortgage portfolio, with extrapolated proxies used to fill data gaps.
Transition risk	Using internal EPC data and the Partnership for Carbon Accounting Financial ('PCAF') Standard, current and projected financed emissions were calculated across the portfolio out to 2050. The projected portfolio emissions were then compared to a portfolio decarbonisation pathway. The scenario highlighted the importance of the electrification of heat and the decarbonisation of the National Grid. This emphasised the importance of UK Government policy which is targeting 600,000 heat pump installations per year by 2028 and the decarbonisation of electricity by 2035. These are both key to the decarbonisation of buildings in the UK.
Physical risk	The flood risk across the mortgage portfolio was projected out to 2080 in line with the CBES 'no additional action' scenario and to 2050 in line with the CBES 'Early Action' ('EA') and 'Late Action' ('LA') scenarios. The analysis focused on identifying the percentage of the portfolio exposed to high flood risk and the percentage that would fall into a 1-in-100 year flood risk event zone. In addition, the analysis considered the currently projected annualised cost of repairs out to 2050 to model the losses caused by physical risk.

The analysis indicated that only a very small proportion of properties across the mortgage portfolio have high transition risk and/or high flood risk. The assessment also indicated that potential losses are highest across properties with lower energy efficiency ratings and / or properties located in higher flood risk zones. Overall the results of the assessment did not identify any significant vulnerabilities across the Group and confirmed that current processes are fit for purpose. Insight from this scenario analysis was shared with the in-house surveyor team which conducted follow-up assessments on a sample basis. These assessments determined that the properties were not considered at risk from flood, and that underwriting controls focused on mitigating the assessed risks were appropriate and robust.

In addition, a qualitative review of the Group's exposure to climate change risk by business area was performed to enable a broader view of the risks and how they are mitigated. The qualitative assessment summarises the main risk drivers associated with each asset class and identifies mitigants that are currently in place or are being developed. This analysis was performed to help size the potential risks from climate change within Paragon and the levers available to mitigate future risk build up.

Overall, the adoption of climate change scenario analysis has improved the Group's understanding of the key climate change risk drivers, the potential impact they could have on the Group and the mitigating options available. As the Group integrates the learnings from the SAWG, the climate change scenario analysis process will continue to mature and become an integral process for identifying climate-related risks and opportunities.

The outcomes of the climate change scenario analysis suggest that currently there is not a significant and quantifiable link to asset value or impairments due to climate-related factors. As the Group's approach to climate change scenario analysis continues to develop, climate factors and their link to asset values, impairments and future strategy will continue to be analysed.

(c) Risk management

Climate change continues to be further embedded within the Group's ERMF which is designed to align and embed risk management practices across the organisation. The ERMF provides a framework for identifying, escalating and monitoring climate-related risks across the Group. More detail on the ERMF and the Group's approach to climate change as a principal risk are outlined in Sections B8.4 and B8.5.

Potential risks identified over the short, medium and long term

Although the impacts of climate change are current, there is still significant uncertainty around the channels and timings through which the related financial and non-financial risks might materialise. The table below outlines examples of risk drivers considered to be significant to the Group's business and strategy, and the timeframes over which they might impact. The interaction of these with the traditional risk types is an area for future development as climate change risk is embedded within the risk management structure.

Climate change risk	Source	Risk driver examples	Timeframe
Transition risk	Current and emerging regulation	Continued tightening of energy efficiency regulations in the private rented sector, which could risk creating mortgage prisoners or impact asset values.	Short, medium and long-term
	Technology	Transition to low carbon technologies, such as electric vehicles, which could impact asset values and infrastructure requirements. This also includes the risk that such new, low-carbon technologies may prove ineffective.	Short and medium-term
	Market	Change in consumer preferences, such as a shift to lower emissions assets, such as energy efficient homes or low emission vehicles.	Medium and long-term
	Reputation	Increased stakeholder, shareholder and regulatory scrutiny if there is perceived to be a lack of action to mitigate climate change.	Short and medium-term
Physical risk	Acute	Damage to property or assets, business disruption and higher insurance costs from climate driven events such as flooding.	Short, medium and long-term
	Chronic	Alterations in weather patterns and stability of local ecosystems affecting sea levels, flood and subsidence, ultimately impacting productivity and asset values.	Long-term

Assessment at underwriting

Assessment of current environmental risks and forward-looking climate change risks are factored into the Group's business processes. When assessing the appropriateness of a property as security on a buy-to-let mortgage, factors such as the EPC rating of the property, flood risk, risk of coastal erosion and ground stability are considered.

The valuation report prepared by surveyors includes an assessment of coastal erosion, ground stability and flood risk based on the surveyor's expert knowledge of the local area, historic events and information from insurers. As part of the conservative approach taken, these risks are assessed on a property-by-property basis. Additionally it is essential for the Group to ensure that a property is and remains insurable, including for both subsidence and flood risk, providing cover across the mortgage book.

Since 2018 all properties accepted as a security have been required to have a minimum EPC rating of E at the time of offer unless valid exemptions are in place. EPC data is of increasing importance with regulations and government policy tightening, with the aim of decarbonising the building stock. The Group's data capture process has been enhanced to improve the current understanding of the exposure, but also for use in longer term climate scenario analysis.

Although UK Government policy in the private rented sector currently requires EPC ratings of E or better, the tightening of these standards to a minimum EPC rating of C is expected in the short to medium term; and will likely continue to tighten throughout the UK's pathway to net zero by 2050. The challenge of decarbonising UK residential real estate is shared by lenders and mortgage customers and will continue out to 2050, with a variety of technological and regulatory challenges. The risks caused from the decarbonisation of UK building stock are not idiosyncratic to the Group, or its customers, and are industry wide. The Group will continue to support the transition, leveraging its strong balance sheet and robust credit standards.

Quantifying climate exposure

EPC levels and the associated regulation have been identified as having the potential to impact the Group's exposure to credit risk. In response, the Credit Committee and the credit team have an ongoing programme to analyse the potential linkage between EPC and loan performance. In addition the EPC risk assessment led to the launch of the green product range and the enhancement of underwriting processes to support climate considerations. The Sustainability Committee and the Credit Committee monitor the energy performance of mortgaged properties to ensure that an excessive build-up in concentration of less efficient properties is avoided.

Since the launch of the green product range, new inflows of mortgages with EPC ratings of C and above have exceeded concentrations in the extant portfolio and the Group is actively working towards developing retrofit options to support our customers with lower rated properties as they transition.

Support is also provided to customers through engagement and education. The Group has posted educational articles and blogs explaining the regulations, outlining who they affect and how they are enforced. Customers who have been identified as having higher risk properties have been contacted directly, to explain the regulations, highlight their implications and set out the options available to them.

(d) Metrics and targets

Mortgage Lending

The tables below summarise the principal metrics for the Group's mortgage lending exposure in England and Wales. Coverage levels are shown as a percentage of accounts with properties in England or Wales, which represent 97.6% of the portfolio. Work is ongoing to source comparable data for the Group's Scottish and Northern Irish exposures.

Indicator	Measure	2022	Coverage	2021	Coverage
EPC	Grading A or B	8.2%	92.8%	8.1%	88.3%
	Grading C	31.1%	92.8%	29.5%	88.3%
	Grading A to C	39.3%	92.8%	37.6%	88.3%
	Grading D or E	59.6%	92.8%	60.8%	88.3%
	Grading F or G	1.1%	92.8%	1.6%	88.3%
Flood risk	High risk properties	0.9%	99.6%	0.7%	99.6%
	Medium risk properties	1.7%	99.6%	1.8%	99.6%
	High or medium risk properties	2.6%	99.6%	2.5%	99.6%

Flood risk in the above table is based on exposure to flooding from rivers and seas only, whereas in the underwriting process flood risk from other sources is also considered. This analysis used postcode level data and indicated that only a small proportion of properties were located within a medium or high-risk zone.

As part of the 2022 scenario analysis risk assessment, the Group acquired further, more detailed flood risk data which was more location specific, addressed a wider range of flood risks, and covered the whole of the UK. This assessment included flood risk from rivers, surface water and coastal flooding, and generated the results set out below.

Indicator	Measure	2022	Coverage	2021	Coverage
Flood risk	Very high risk	0.1%	93.4%	0.1%	93.9%
	High risk	2.9%	93.4%	3.1%	93.9%
	High or very high risk	3.0%	93.4%	3.2%	93.9%

These results indicate that only a small balance of the Group's mortgages are at higher risk. The Group is yet to experience any loss attributable to flood or ground instability.

As well as addressing the current flood risk, the assessment also included a projection of the potential future flood risk out to 2080 under various climate scenarios. The analysis was used to evaluate whether there was likely to be any build-up of medium to long term risk if the underwriting process was to remain unchanged. Although an increase in risk was projected over the period, the findings were discussed by internal property and credit risk experts and the marginal increase was not considered to be substantial.

New mortgage lending, for properties with EPC grades of A to C increased by 44.1% in the year to £832.2 million (2021: £577.7 million). For new buy-to-let mortgages in England and Wales advanced during the year ended 30 September 2022, the distribution of EPC grades was:

Indicator	Measure	2022	Coverage	2021	Coverage
EPC	Grading A to B	9.2%	99.6%	9.3%	92.5%
	Grading C	36.0%	99.6%	31.0%	92.5%
	Grading A to C	45.2%	99.6%	40.3%	92.5%
	Grading D or E	54.6%	99.6%	59.2%	92.5%
	Grading A to E	99.8%	99.6%	99.5%	92.5%
	Grading F or G	0.3%	99.6%	0.5%	92.5%

The Group's completions continue to have a higher average EPC grade than the total portfolio stock, shifting the overall mix towards more energy efficient properties, a trend which will be accelerated by the green mortgage range. However, a focus by banks on green advances alone will not deliver the desired changes in the housing stock, and initiatives to decarbonise the existing stock will be needed.

Commercial Lending

In the Group's SME lending business, limited company customers have been broadly analysed by SIC codes to identify those operating in high carbon intensive industries. The results are set out below:

Indicator	Measure	2022	Coverage	2021	Coverage
Sector	Water, sewerage and waste	4.15%	100%	4.53%	100%
	Extractive industries	1.82%	100%	2.35%	100%
	Power generation	0.10%	100%	0.01%	100%
Total carbon intensive industries		6.01%	100%	6.89%	100%

This demonstrates that the Group's SME lending customer base is not disproportionately exposed to those industries considered to have the highest environmental impacts.

Measures addressing other risk elements including those in other business streams, such as the classification of the environmental impacts of business assets and motor vehicles financed, and classification of development finance projects by environmental rating, are under development and continue to evolve.

(e) Financed emissions

Financed emissions, which are considered as Scope 3 emissions, are emissions generated by the Group's customers which are facilitated by the financing provided. As set out above, the Group has made a commitment to net zero by 2050 and in doing so has an ambition to reduce the financed emissions associated with its lending portfolio.

Given the relative size of the Group's lending portfolios, the current focus is on the buy-to-let mortgage portfolio, however the Financed Emissions working group, which reports to the Sustainability Committee, continues to develop methods to monitor the emissions across the Commercial Lending division.

Initial estimates for development finance lending have been calculated using Royal Institute of British Architects ('RIBA') estimates on embodied carbon in the construction of residential and commercial buildings. For financed emissions from vehicles funded by the Group's motor finance and asset finance operations, emissions have been estimated through vehicle registration details and vehicle mileage where data is available.

These financed emission disclosures will be developed further, adopting methodologies to increase the balance sheet coverage as well as emission reductions. Linking up with external initiatives such as the PCAF will allow for the development of an emissions framework across the balance sheet. The Group's financed emissions are a significant contributor to our value chain emissions and are key to monitoring the decarbonisation of our business.

Scope 3 Mortgage emissions

Absolute financed emissions have been calculated across the buy-to-let mortgage portfolio, in accordance with the PCAF standard. Under this approach a lender, such as the Group, is considered to be responsible for a proportion of the emissions based on an 'attribution factor'.

For buy-to-let mortgage loans the annual emissions relating to the financed property are attributed to the mortgage provider on a loan-to-value basis.

PCAF Scope 3 financed emissions

Scope 3 Annual buy-to-let mortgage emissions	2022	2021
Balance of mortgage lending (£m)	**12,015.6**	11,311.9
Balance of mortgage lending with EPC emissions data (£m)	**10,858.3**	10,171.7
Absolute Financed Emissions from properties with EPCs (kilotonnes CO_2e)	**208.5**	208.2
Physical Emissions Intensity of properties with EPCs (kgCO_2e per m^2)	**46.6**	47.1
Economic Emissions Intensity of properties with valid EPCs (tonnesCO_2e per £ million balance)	**19.2**	20.5

The Group has restated its 2021 financed emissions due to improvements in historical EPC data quality and EPC matching made in the year. The restatement allows for a more informative comparison of the financed emissions across the two periods.

This metric is the one most often disclosed by UK lenders on property in their climate reporting.

Notes on calculation methods

1. The financed emission attribution factor uses outstanding balance and original valuation to calculate the (unindexed) loan-to-value factor – this is aligned with the PCAF guidelines.
2. The data contained in the EPC has not been altered or updated.
3. The data score calculated in accordance with the PCAF guidelines was 3 as all the data above relates to properties with available EPCs.
4. The calculation of physical emissions intensity used the sum of attributed floor area using loan-to-value ratios.

(f) Operational impact

The Group is mainly engaged in mortgage, consumer and commercial finance and therefore the overall environmental impact of its operations is considered to be low.

A group company, Specialist Fleet Services ('SFS'), leases refuse collection vehicles to local authorities throughout the UK and undertakes additional aftersales activities that include servicing, maintenance and breakdown support, hence has the most significant potential environmental impacts.

The main environmental impacts of the Group's other operations are limited to universal environmental issues such as resource use, procurement in offices and business travel.

Policy

The Group complies with all applicable laws and regulations relating to the environment and includes these within its legal compliance framework. In support of the climate change principal risk policy, the Group is developing an operational sustainability risk strategy which will outline its environmental commitments. It will also further embed the consideration of climate-related operational risks within the ERMF.

Groupwide recycling and awareness campaigns are run with employees to reduce various forms of waste such as food, consumables and energy.

Risk management

The environmental risk inherent in the Group's operations is managed by the Group Property function and is within the remit of the Chief Operating Officer. It is monitored within the Group's operational risk management framework by the second line Operational Risk team and the Operational Risk Committee.

Energy and waste data is collated by Group Property, the division responsible for managing the Group's premises. Consumption figures for all locations occupied, whether directly owned or tenanted, are actively monitored. This is reported upwards to board level.

SFS operates from several workshops around the UK and has exposure to several waste streams (oils, vehicle parts etc) generated in the normal course of its workshop activities. These are effectively managed under an environmental management system that is certificated to an International Standard – ISO14001:2015. A dedicated health and safety manager has direct responsibility for environmental issues at all SFS sites.

The Group complies with the Energy Savings and Opportunities Scheme ('ESOS'). This is a UK Government initiative and requires the Group to identify and reduce its energy consumption. The Group last submitted its ESOS compliance notification to the Environment Agency in December 2019. The next submission is due in 2023.

Supply chain and procurement

The principal suppliers of the Group comprise its outsourced savings administrator, legal and professional services providers, building lessors and IT service providers. They therefore are exposed to similar operational environmental risks to those of the Group.

The Group remains committed to identifying, targeting and addressing inefficiencies within its supply chain. The procurement function works with key suppliers to identify solutions to reduce the environmental impacts of our business activities, whether direct or indirectly.

All pre-printed stationery items used by the Group are from renewable sources certified by FSC.

86.4% (2021: 81.5%) of the purchased electricity in the year was obtained from sources certified as renewable by the Office of Gas and Electricity Markets ('OFGEM').

Environmental initiatives

All the general waste produced at the Group's principal sites, excluding SFS locations, was disposed of through an approved waste contractor using Waste to Energy initiatives, resulting in no waste from these locations being disposed at landfill.

During the year the Group's Southampton and Poole operations were relocated to newly refurbished premises with energy ratings of B and C respectively. These new premises have reduced the Group's operational footprint and increased energy efficiency.

The Group's environmental initiatives in the period include:

- Offsetting the operational footprint through the purchase of carbon credits
- Energy efficient intelligently controlled lighting is being installed at the Solihull head office. This project was 52% complete at the year end with an expected completion date in the second quarter of 2023. Internal maintenance resource is being used for this project with waste generated being segregated and disposed of responsibly via an approved third-party contractor. Following completion of the upgrade the building's EPC will be reassessed, with a rating of C anticipated
- Electric vehicle charging points have been installed at the Group's two sites in Solihull and the Southampton office is also equipped with charging facilities. Usage by the Group's employees is currently at 68% of capacity
- Continuation of the programme upgrading washroom facilities at the head office building. This employs touchless energy and resource-saving technology. All construction wastes are segregated and disposed of responsibly by the appointed contractor
- Progress towards implementing a Sustainability Management System to accord with best practice measures from ISO14001:2015 and ISO50001:2018 and drive support for the management of environmental and energy performance
- From January 2022 employees entitled to a company car were restricted to ordering either a hybrid or full electric vehicle

Performance indicators

The environmental key performance indicators for the Group, have been determined having regard to the Reporting Guidelines published by the Department of Business, Energy and Industrial Strategy ('BEIS') and the Department for Environment, Food and Rural Affairs ('DEFRA') in March 2019, and are set out below.

The Group does not consider itself to have significant environmental impacts or risks under the headings 'Resource Efficiency and Materials', 'Emissions to Land, Air and Water' or 'Biodiversity and Ecosystem Services' set out in the Guidelines, due to the nature of its business activities.

This information is presented for the twelve months ended 30 September in each year and includes all entities consolidated in the Group's financial statements. Normalised data is based on total operating income less gains on sale of £388.4 million (2021: £324.9 million). The data for 2019 is presented as during the year this was designated as the operational footprint baseline against which the Group will measure its progress.

Greenhouse gas ('GHG') emissions

	2022	2021	2019
	Tonnes CO_2e	Tonnes CO_2e	Baseline Tonnes CO_2e
Scope 1 (Direct emissions)			
Combustion of fuel:			
Operation of gas heating boilers	**507**	450	519
Petrol and diesel used by company cars	**401**	353	679
Operation of facilities:			
Air conditioning systems	**33**	33	24
	941	836	1,222
Scope 2 (Energy indirect emissions)			
Directly purchased electricity *(Location-based)*	**540**	641	995
Directly purchased electricity (Market-based)	***81***	*637*	*990*
Total scopes 1 and 2 *(Location-based)*	**1,481**	1,477	2,217
Total scopes 1 and 2 (Market-based)	***1,022***	*1,473*	*2,212*
Normalised tonnes - Scope 1 and 2 CO_2e per £m income *(Location-based)*	**3.8**	4.5	7.5
Normalised tonnes - Scope 1 and 2 CO_2e per £m income (Market-based)	***2.6***	*4.5*	*7.4*
Scope 3 (Other indirect emissions)			
Fuel and energy related activities not included in scope 1 or 2	**441**	426	542
Water consumption	**4**	4	14
Waste generated in operations	**136**	60	88
Total scope 3	**581**	490	644
Total scopes 1, 2 and 3 *(Location-based)*	**2,062**	1,967	2,861
Total scopes 1, 2 and 3 (Market-based)	***1,603***	*1,963*	*2,856*
Normalised tonnes Scope 1,2 and 3 CO_2e per £m income *(Location-based)*	**5.3**	6.1	9.6
Normalised tonnes Scope 1,2 and 3 CO_2e per £m income (Market-based)	***4.1***	*6.0*	*9.6*

CO_2 equivalent ('CO_2e') values above, other than for market-based Scope 2 elements, are calculated based on the BEIS / DEFRA guidelines published on 22 June 2022. Market-based emissions have been calculated in accordance with GHG Protocol guidelines. Where the Group's data does not meet the Scope 2 Quality criteria the emissions are estimated utilising the UK grid DEFRA conversion factor since a UK residual mix is not currently available.

This year the Group's 2022 operational footprint has been offset and independently verified to provide a higher level of assurance over the emissions being offset. This verification was undertaken by EcoAct, an independent carbon management company, and was aligned with the ISO 14064-3: 2019 standard with specification and guidance for the verification and validation of greenhouse gas statements. EcoAct's opinion was that nothing had come to their attention which indicated that the location-based and market-based emissions totals set out above were not fairly stated and free from material error.

Offsetting has been achieved through the purchase of carbon credits certified under the Verified Carbon Standard ('VCS') programme or the Gold Standard programme, two of the most widely accepted international certification systems.

The amounts shown above for location-based total Scope 1 and Scope 2 emissions are those required to be reported under the Companies Act (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018. Other Scope 3 emissions from operations not reported above are not considered to be significant in this context. All these emissions relate to activities in the UK and its offshore area. These emissions define the scope of the Group's target to achieve net zero across the operational footprint by 2030.

The reduction in emissions from the 2019 baseline continues to be principally driven by the shift to hybrid working. There has been a slight increase in location-based emissions compared to 2021 due to increased office occupancy. Emissions attributable to employees working from home are not, at present, included within the scope of the regulations.

The majority of emissions included above relate to the provision of heat, light and power to the Group's premises. The reduction across market-based emissions is primarily driven from a change in electricity supplier across the Group's main sites to one which sources zero carbon electricity and has improved data availability. The market-based method for electricity used reflects specifically the emissions from the electricity that the Group has purchased and derives emission factors from contracts with suppliers and related data, where data is available. This differs from the location-based method, which reflects average emissions for electricity supplied through the UK grid, based on figures published by the UK Government.

The Group has not been involved in any prosecutions, accidents or similar non-compliances in respect of environmental matters, nor incurred any fines in respect of such matters.

Power usage

The Group uses mains electricity and natural gas from the UK grid to provide heat, light and power to its office buildings. It also uses fuel in company vehicles, which is included in Scope 1 above and through business travel of employees, which is included in Scope 3. The amount of power used in the year ended 30 September 2022 is shown below.

	2022	2021	2019
	MWh	MWh	MWh
Renewable electricity	**2,409.3**	2,458.6	3,123.5
Other electricity	**380.7**	558.9	768.1
Electricity	**2,790.0**	3,017.5	3,891.6
Natural gas	**2,780.2**	2,454.9	2,817.1
Motor fuel	**1,877.7**	1,551.7	3,099.9
	7,447.9	7,024.1	9,808.6
Normalised MWh per £m income	**19.2**	21.6	33.0

Consumption levels have seen a small increase from 2021 linked to increased office occupancy and increased in travel across our SFS division and the Group. However, consumption still remains lower than the 2019 baseline.

Gas and electricity usage are based on consumption recorded on purchase invoices. Vehicle fuel usage is based upon expense claims and recorded mileage. Renewable energy is supplied through the grid with OFGEM accreditation received from the suppliers.

Water usage

The Group's water usage is limited to the consumption of piped water in the UK and no water is extracted directly. Water usage in the year ended 30 September 2022 was 10,202m^3 (2021: 8,500m^3), based upon consumption recorded on purchase invoices, a normalised amount of 26.3m^3 per £m income (2021: 26.1m^3 per £m income). The increase in usage is a result of increasing office occupancy as the Group shifts from the lower Covid -era levels of occupancy to the new hybrid working occupancy levels.

Waste

SFS is the Group's primary producer of waste. Its vehicle servicing activities generate a variety of different waste streams, including various grades of oil, and a range of metals and plastics. These wastes are managed responsibly in accordance with an ISO14001:2015 certificated management system. Waste streams generated by SFS are disposed of in accordance with the waste hierarchy before being consigned to approved waste transfer stations under contract and Waste Transfer Notes obtained.

The Group's waste output excluding SFS consists of a mixture of general office waste types, principally paper and cardboard with some wood, plastic and metals. The Group provides facilities in its offices for recycling paper, cardboard, newspapers, glass, plastics, and aluminium and steel cans. Batteries and printer and photocopier cartridges are collected and sent for recycling. The largest part of the Group's recycled outputs relates to waste paper.

All the Group's waste is either recycled, used in waste-to-energy initiatives or sent to landfill. Amounts of waste generated in the year ended 30 September 2022 together with the methods of disposal are shown below.

	2022 Tonnes	2021 Tonnes	2019 Tonnes
Recycled	**123**	87	122
Waste-to-Energy Initiatives	**21**	17	-
Landfill	**287**	125	187
	431	229	309
Normalised tonnes per £m income	**1.11**	0.70	0.75

Waste generation data is based upon volumes reported on disposal invoices.

The increase in waste throughout the period was driven by both increased activity in the workshops of the SFS division and better quality reporting of waste across all of the Group's locations. Various office moves also took place in the year which led to higher waste volumes as sites were cleared.

The Group's long-term strategy is to increase the percentage of waste which is either recycled or used in Waste-to-Energy initiatives.

Travel and commuting

As part of the Group's ongoing ESG commitments, new principles were introduced into the Company Car Policy during the year to support the Group's efforts to decarbonise. The Group has made the commitment that there will be no diesel vehicles in its fleet by 31 December 2025. To meet this target the following steps have been agreed:

- Ordering of diesel and petrol vehicles ceased in January 2022
- CO_2 emissions for the Group's fleet have been restricted to 75g/km with annual reviews set each April to ensure continuing alignment with the objectives.
- New orders will be restricted to electric-only vehicles, from 1 October 2026, subject to the progress of the UK Government's decarbonisation plan.
- All non-electric cars will be removed from the Group's fleet by 30 September 2031.

In March 2022 the Group installed electric vehicle charging points at its Solihull Head Office. This is in addition to the charging points at the Southampton site, and plans are underway to install points at other sites. The aim is to reduce emissions from employees commuting and business travel.

In June 2022 the Group introduced a Green Car salary sacrifice scheme, offering all employees a tax efficient way to purchase an electric or plug-in hybrid vehicle via salary exchange. The Group also expanded its cycle to work scheme to run year-round, with more employees signing up each month.

(g) Future developments

In addition to the actions already taken and reported above, the Group's climate change programme going forward also includes:

- Embedding the climate change risk policy which clearly documents the Group's approach to managing climate change risk within the ERMF. The policy documents how the understanding and management of climate risk is distributed across the business whilst articulating clear roles and responsibilities across the three lines of defence for managing and monitoring of climate change risk across the business
- Development of formal climate-related risk appetites and a full suite of Key Risk Indicators and Key Performance Indicators. These will be further developed into short-term and long-term climate related targets or ambitions for the Group
- Continued development of climate change scenario analysis leveraging industry good practice to determine the resilience of the Group's strategy under different climate-related scenarios. This includes further assessing the impacts of climate-related issues on asset values and financial performance
- Development of products and initiatives to support and educate customers through their transition to a lower carbon economy
- Continue to work towards reducing the Group's operational footprint to net zero by 2030 and to offset in the intervening period
- Enhancing reporting of emissions data to include more elements of the value chain, as described below

Emissions across the value chain

There are significant challenges in data collection and accurate calculation for Scope 3 emissions however the Group is committed to disclosing its Scope 3 emissions where significant and relevant to our stakeholders. The table below outlines the key emissions from Scopes 1 to 3 across our value chain and their current reporting status. The Group's current focus remains on its operational footprint and financed emissions where it is able to have a more direct influence on the outcomes. However it is intended that as the Group's understanding broadens more action will be taken to reduce these emissions.

Scope	Emissions source	Approach	Commitments
Scope 1	Operating gas heating boilers	Included within '(f) Operational impact' above	Offset from 2022 Commitment to net zero by 2030
	Petrol and diesel used by company cars		
	Air conditioning systems		
Scope 2	Purchased electricity, heat and steam	Included within '(f) Operational impact' above	Offset from 2022 Commitment to net zero by 2030
Scope 3	Fuel and energy related activities not in Scope 1 or 2	Included within '(f) Operational impact' above	Offset from 2022 Commitment to net zero by 2030
	Waste generated in operations		
	Water consumption		
Scope 3	Working from home emissions	Under development	As set out above, in support of the UK government goal of net zero by 2050 the Group has made a commitment to achieve net zero by 2050
Scope 3	Employee commuting	Not yet started	
Scope 3	Supply chain emissions	Preliminary development work done	
Scope 3	Financed emissions -Mortgages	Reported in '(e) Financed emissions' above	
Scope 3	Financed emissions – Commercial lending	Under development	

A6.5 Social and community

The Group's activities are based wholly within the United Kingdom. It operates within the legal and regulatory framework of the UK, acknowledging the importance of corporate responsibility and citizenship, striving to go beyond what is required in its relationships with its customers, the wider community and other stakeholders.

The Group operates as a specialist lender providing funding for business propositions in the development finance and SME lending markets which might struggle to attract interest from larger lenders, helping to support the SMEs which are crucial to the UK economy.

Where possible, the Group uses its lending relationships to promote good practice. The buy-to-let mortgage division demands minimum standards from its landlord customers in the properties it funds, helping to drive up standards in the PRS for tenants and potential tenants.

Looking forward, the Group is developing products which encourage customers to reduce their environmental impacts, helping to drive action on climate change.

Industry initiatives

Through its activity within trade organisations in the UK, the Group is helping to formulate public policy and share experience on best practice to drive forward better financial provision. The Group has been particularly active in initiatives to enable the PRS to serve the UK housing market more effectively. The Group also regularly engages directly with Government to help inform departments on how market trends are impacting landlords, their sentiment and behaviours. The Group's CEO is a member of both HM Treasury's Home Finance Forum and the Bank of England Residential Property Forum which provide input to policy at the highest levels.

Membership of bodies such as UKF and the FLA enables the Group to be part of shaping the future provision of financial services to the benefit of the whole community. The Group plays an active role in these bodies, with representatives on working groups covering a range of topics. In 2021, this was enhanced through work by the Mortgage Lending business, carried out in conjunction with the Green Finance Institute, on the potential for providing green products to the buy-to-let mortgage market. The business has also worked with the Coalition for Energy Efficient Buildings formed by the Institute.

As part of the development of its sustainability strategy the Group has joined the Bankers for Net Zero initiative. As an active member the Group will continue to support UK industry in mobilising SMEs to take action on climate change while providing input to the shaping of policy at a national level.

The Group contributes to registered charities providing debt advice to support its vulnerable customers. Contributions of £642,000 (2021: £912,000) were made by the Group during the year to the work of the Foundation for Credit Counselling, which operates the StepChange Debt Charity. This ensures that such customers are able to receive free, independent advice on their finances from qualified counsellors. The reduction in the year was principally a result of the Group's exit from the unsecured personal finance market as fewer of the Group's customers made use of the charity's services.

Supporting charity

The Group supports charity initiatives as part of its commitment to corporate citizenship, both by making direct donations and also by supporting the fundraising activities of Paragon's Charity Committee. During the year a designated member of ExCo, Deborah Bateman, the External Relations Director, was appointed to oversee the Group's strategy in this area.

For direct donations the Group focusses on organisations serving the communities in which it operates and supports the fundraising efforts of individual employees. It also operates a Give as You Earn Scheme through payroll. Contributions made in the year totalled £50,100 (2021: £39,600).

Charities which benefitted from the Group's donations included local schools, sports clubs, hospitals and hospices, The Downs Syndrome Association, UK Sepsis Trust, Prostate Cancer UK, Happy Days Children's Charity, and many others. During Pride month the Group encouraged fundraising for LGBTQ+ affiliated charities with one of the beneficiaries being Mind.

The Group also supports Paragon's Charity Committee, consisting of employees who give up their own time to organise a variety of fundraising activities throughout the year. Each year all employees are given the opportunity to nominate a charity, and a vote is carried out amongst the employees to select the charity to benefit from the following year's fundraising activities.

During the year the fundraising period was aligned to the Group's financial year rather than the calendar year, resulting in a nine month campaign ending in September 2022 on behalf of Mind which raised £31,000. In the twelve months ended 31 December 2021 £43,000 was raised for The Alzheimer's Society. The employees' chosen charity for the year ending 30 September 2023 is Newlife, the charity for disabled children, and the process of planning events is already under way.

Community volunteering

Employees are offered one paid volunteering day each year to support volunteering projects as part of our corporate responsibility strategy. As a specialist lender, the Group is conscious of the potential impact it may have on society and the environment. Therefore, community volunteering projects have focussed on:

- Poverty
  - supporting people who are experiencing poverty
  - developing a better environment for individuals experiencing poverty
  - offering support to help people get out of poverty
- Education
  - strengthening the education of school children (reading and financial awareness skills)
  - supporting children to successfully transition into the world of work (interview skills, work experience projects, careers advice and apprenticeship events)
- Environment
  - improving the local environment (litter-picking in parks and along canals and rivers, school garden maintenance and hostel refurbishment)

As pandemic restrictions receded in the year, employees welcomed the opportunity to return to face-to-face volunteering, and a number of initiatives to raise the profile of the programme have taken place. The number of volunteer days completed in the financial year totalled 286 (2021: 49), bringing the total number of volunteering hours accumulated since October 2021 to over 2,000.

Some examples of projects supported are highlighted below.

Poverty

SIFA Fireside based in central Birmingham provides a range of ever-evolving responsive services to ensure the essential needs of Birmingham's homeless communities are met. This year 19 employees volunteered their services to help prepare food at the drop-in centre and lend a friendly ear to its users.

St Basils works with young people aged 16-25 who are homeless or at risk of homelessness, helping almost 4,000 young people per year across the West Midlands region. This year, 178 individuals worked on decorating and gardening projects to help improve the environment for these people.

At the outbreak of the war in Ukraine, employees co-ordinated a food and basic supplies delivery to Poland, to support refugees flooding across the border. Two vans were filled with donations including food, nappies, baby milk and other basic supplies.

For Christmas 2021, the annual donations of food and luxury items by employees for Christians Against Poverty continued. 51 hampers for families in need across the West Midlands were delivered.

Other local projects supported include the Walsall Black Sisters Collective, Manchester Sikh Society, and Naomi House and Jacksplace hospices in Hampshire.

Education

In total 56 employees supported careers fairs and work experience events, including interview skills preparation, at schools in close proximity to the Group's head office such as St Peter's School, Arden School, Tudor Grange, Alderbrook School and Solihull College.

There has also been support for projects to help improve the school environment for two primary schools struggling with securing funding.

The Group has also begun participation in the SMART Futures programme by working closely with the EY Foundation, an independent charity which supports young people from low-income backgrounds to get paid work experience, employability skills training and mentoring.

This year the Group supported four students with placements and mentoring. These are Year 12 students who have been eligible for free school meals and/or have a household income of under £24,421 and who are interested in careers in banking.

Environment

The Canal and River Trust care for a 2,000 mile long, 200-year-old network of canals, rivers and reservoirs. Its vision is to have living waterways that transform places, enrich lives and bring wellbeing opportunities to millions. Two project teams completed clear-up projects on sections of the waterways.

LoveSolihull supports several litter-picking projects in Solihull to improve the quality of local parks and walkways.

Volunteers from the Group's Southampton office supported beach cleans and caring for animals at Marwell Zoo.

Taxation policy and payments

Materially all the Group's taxable income arises in the UK and therefore it has no presence in jurisdictions considered to enable tax base erosion and profit shifting.

The Group's tax strategy is to comply with all relevant tax obligations whilst co-operating fully with the tax authorities. The Group recognises that in generating profits which can be distributed to shareholders it benefits from resources provided by government and the payment of tax is a contribution towards the cost of those resources. The Group will only undertake tax planning that supports commercial activities and, in the UK context, is not contrary to the intention of Parliament.

As a group containing a bank, the Group is subject to The Code of Practice on Taxation for Banks (the 'Bank Tax Code') published by His Majesty's Revenue and Customs ('HMRC') in March 2013. The Group has previously confirmed to HMRC that it was unconditionally committed to complying with the Bank Tax Code, and formally re-approved the Group's tax governance policies and the tax strategy outlined above.

During each financial year since 2018 the Group has published a tax strategy document for that year, approved by the Board of Directors, on its website, in accordance with the Finance Act 2016. These documents address the following matters:

- the approach of the Group to risk management and governance arrangements in relation to UK taxation
- the attitude of the Group towards tax planning (so far as affecting UK taxation)
- the level of risk in relation to UK taxation that the Group is prepared to accept
- the approach of the Group towards its dealings with HMRC

The most recent such statement was published during the year and can be found in the Investor Relations section of the Group's website in 'Results, reports and presentations'.

The published tax strategy is owned by the Board collectively in accordance with HMRC's published expectations. The CFO has been designated as the Senior Accounting Officer for tax purposes and, as such, reviews compliance with the Group's policies each year and certifies the appropriateness of its tax accounting arrangements to HMRC.

The Group has an open and positive relationship with HMRC, meeting with their representatives on a regular basis, and is committed to full disclosure and transparency in all matters.

The Group is resident and operates in the UK and generates revenues for the UK authorities both through corporation tax and other taxes directly borne, but also through substantial payroll taxes.

Taxes borne include UK corporation tax on its profits, including the Banking Surcharge, and payroll-based taxes, including employers National Insurance ('NI') contributions and Apprenticeship Levy payments. In addition, as a financial institution, it is unable to recover the majority of the VAT charged by suppliers and this represents a cost to the Group.

Taxes collected on behalf of HMRC include payroll deductions from employees, in the form of PAYE and employees NI contributions and VAT relating to certain income from customers.

The amounts borne and collected during the period were as follows.

	2022	**2022**	2021	2021
	£m	**£m**	£m	£m
Taxes borne				
UK Taxation				
Corporation tax	**56.5**		48.3	
Employers' payroll taxes	**11.6**		8.1	
Irrecoverable VAT and other indirect taxes	**8.2**		5.1	
Stamp duty	**0.3**		0.2	
Total UK national taxation		**76.6**		61.7
Local taxation				
Business rates		**1.4**		1.3
		78.0		63.0
Taxes collected				
Employees' payroll taxes	**23.8**		20.6	
VAT	**0.7**		3.8	
		24.5		24.4
		102.5		87.4

Overall, the tax borne by the Group and collected by it on behalf of the UK Government demonstrates its economic activity, its contribution to the UK economy and state and the value it adds to society more broadly.

A6.6 Human rights

The Group respects all human rights and in conducting its business regards those rights relating to non-discrimination, fair treatment and respect for privacy to be the most relevant and to have the greatest potential impact on its key stakeholder groups of customers, employees and suppliers.

The Group's commitment to supporting its people's employment rights is described in Section A6.3.

The Group operates exclusively in the UK and, as such, is subject to the UK Human Rights Act 1998, which incorporates the European Convention on Human Rights into UK law. The Group has systems in place to ensure its policies and procedures are compatible with all legal requirements applicable to it and to identify any new or emerging requirements.

The Board and the CEO have overall responsibility for ensuring that all areas within the Group uphold and promote respect for human rights. The Group seeks to anticipate, prevent and mitigate any potential negative human rights impacts as well as enhance positive impacts through its policies and procedures and, in particular, through its policies regarding employment, equality and diversity, treating customers fairly and information security.

The Group's policies seek to ensure that employees and business partners comply with the relevant legislation and regulations in place in the UK and to promote good practice. The Group's policies are formulated and kept up-to-date by the relevant business areas, authorised in accordance with the Group's governance procedures and are communicated to all employees.

The Group's compliance with human rights regulation falls within its overall compliance regime, and any breaches or potential breaches would be investigated and addressed through the Group's risk management framework and, if appropriate, its disciplinary procedures.

The Group complies with and supports the objective of the Modern Slavery Act 2015, in raising awareness of modern slavery and human trafficking.

It is committed to ensuring there is no modern slavery or human trafficking in its supply chains or in any part of the business and to acting ethically and with integrity in all business relationships. It actively engages with suppliers to ensure compliance with Modern Slavery legislation is achieved. This commitment is reflected in the Group's policies and its Supplier Code of Conduct.

The Group publishes an annual Modern Slavery Statement, describing policies for achieving this, which can be found on the Group's website: www.paragonbankinggroup.co.uk.

The Group undertakes extensive monitoring of the implementation of all its policies and is not aware of any incident in which the organisation's activities resulted in an abuse of human rights or a breach of Modern Slavery legislation. No fines or prosecutions in respect of non-compliance with human rights legislation, including Modern Slavery legislation, have been incurred in the financial year (2021: none).

A6.7 Business practices

The Group's approach to doing business is set out in its Code of Conduct, which draws together a framework of detailed policies. All employees are expected to read and attest to the code on an annual basis, and training is provided to ensure the code is fully understood.

The code covers obligations to colleagues and customers and compliance with the legal, regulatory and ethical aspects of the way people discharge their individual roles within the organisation. The Code of Conduct is publicly available on the Group's website at www.paragonbankinggroup.co.uk.

Business partners

The Group's business model relies on maintaining good relationships with its principal business partners, primarily financial intermediaries, such as mortgage brokers, and purchase ledger suppliers, including those for establishment costs and professional services.

The Group is committed to the fair treatment of all suppliers. In return, it expects suppliers to help to deliver a high standard of service to our customers and act responsibly.

The Group has a Supplier Code of Conduct, available on its website (www.paragonbankinggroup.co.uk), which sets out its overall approach to supplier engagement and corporate responsibility and, importantly, the standards of behaviour expected from suppliers. As part of the Group's focus on the enhancement of positive supplier relationships, a supplier satisfaction survey was conducted during the year. This survey sought to further the Group's understanding of suppliers' experiences in dealing with it and the findings will support the onward development of its approach.

The Supplier Code of Conduct also includes the Group's conduct commitments and its expectations of business partners in relation to bribery and corruption, data protection and modern slavery. It also contains important information concerning the Group's employment practices, approach to health and safety, community matters and environmental policies.

When outsourcing activities, the Group retains responsibility for those services and the associated risks. The Group remains focused on its most critical suppliers to meet enhanced regulatory requirements under the PRA Supervisory Statement (SS2/21) on Outsourcing and Third Party Risk Management which, inter alia, incorporates the European Banking Authority's Guidelines on outsourcing into UK regulation. The Group's alignment to these requirements strengthens resilience across its supply chain.

The Group aims to pay all its suppliers within 30 days of receiving a valid invoice, where correct procedures are followed and actively engages with suppliers where issues arise. It is a signatory to the UK's Prompt Payment Code ('PPC'), administered by the Office of the Small Business Commissioner and as such commits to paying invoices within 60 days, unless there is good reason for non-payment. The PPC also aims to ensure all invoices from suppliers it defines as small businesses, are paid within 30 days unless under query.

The Group's central administration company, Paragon Finance PLC, reports its payment performance semi-annually under the 'Reporting on Payment Practices and Performance Regulations 2017'. Data for the most recent reporting periods up to the six months ended 30 September 2022, calculated on the basis set out in the regulations, is shown below.

	Six months ended		
	30 September 2022	31 March 2022	30 September 2021
Average time to pay invoices (days)	**22**	21	22
Invoices paid within 60 days	**94%**	95%	95%

Anti-corruption

The Group carries out its business fairly, honestly and openly. It has a comprehensive anti-bribery and anti-corruption policy, endorsed by the directors, forming part of its Code of Conduct. These policies cover all employees and are operated throughout the business. The Group will not make or accept bribes, nor will it condone the offering or receiving of bribes on its behalf. The Group will always avoid doing business with those who do not accept its values and who may harm its reputation.

The Group carries out an annual risk assessment as required by the Bribery Act 2010 and continues to conclude that it is not a company with a high risk of bribery. The Group conducts all its business within the UK and its only significant outsourcing arrangement relates to the administration of its savings operations by the outsourcing arm of a major UK building society. The UK is not considered a jurisdiction with a high incidence of corrupt practices, ranking eleventh safest in the Corruption Perceptions Index for 2022, out of 180 countries and territories. However, the Group takes its responsibilities seriously and will not tolerate bribery in any form, on any scale and therefore keeps its policies and procedures under regular review. The Group will self-report any identified serious incident of bribery or corruption.

The Group's policies cover the conduct of its business, its interaction with suppliers and contractors and the giving or receiving of gifts and corporate hospitality. They prohibit facilitation payments. Before new suppliers are approved, the Group's procedure requires that they must be assessed against the requirements of the anti-bribery and corruption policy standard, which is a key document under the Group's suite of risk policies. This policy standard is updated, and a risk assessment conducted, on an annual basis.

All employees are required to read the Group's anti-bribery and corruption policy standard and undertake annual on-line training to assess their understanding. The anti-bribery culture forms part of the induction course for all new employees and is reinforced at subsequent training sessions. Any employee found to be in breach of these policies will be subject to disciplinary action. No such disciplinary action has taken place in the year ended 30 September 2022.

The CRO, in conjunction with the Head of Financial Crime Risk, who also holds the Money Laundering Reporting Officer ('MLRO') responsibility for the Group, are jointly responsible for ensuring the Bribery Act risk assessment and resulting policies and procedures are in place and reviewed on a regular basis. Both these roles are part of the 'second line' Risk and Compliance function. They are also responsible for ensuring any changes in the law are noted and applied to the Group's policies and procedures, where appropriate. In the last year there have been no material changes in legislation or guidance in the UK.

The Group has not been involved in any incidents resulting in prosecutions, fines, or penalties or in similar incidents of non-compliance in respect of bribery, corruption or other illegal business practices (2021: none).

Anti-money laundering

As a financial services entity, the Group also has procedures in place to ensure it cannot be used to facilitate money laundering, sanctions abuse or other forms of financial crime. These are consistently reviewed to ensure they remain robust. Following the FCA "Dear CEO" letter in 2021 regarding financial crime systems and controls, a comprehensive gap analysis was undertaken. In parallel, the Group continues to monitor the increasing complexity of financial crime threats and any potential or actual changes to the legislative framework to manage the emerging threats. Any resultant actions from these activities have already, or are in the process of, being addressed as a priority. During the financial year considerable investment has been made in both resources and technology to ensure that the Group's anti-money laundering and financial crime infrastructure and processes continue to operate rigorously.

Employees receive regular annual training in these areas, with their understanding being tested and levels of completion monitored through the governance framework and reported to regulators.

Management responsibility

The Group's senior legal officer is the General Counsel, who is a member of the Executive Committee and attends meetings of the Board. The CRO has overall responsibility for the risk and compliance functions. He is also a member of the Executive Committee and reports directly to the Risk and Compliance Committee of the Board (see Section B8).

All business heads are responsible for having the appropriate controls in place to ensure that employees adhere to the Group's anti-money laundering, anti-bribery and anti-corruption policies and procedures and other policies relating to business practices at all times. This is monitored as part of the Group's risk management process and reviewed, as appropriate, by the Internal Audit function.

Whistleblowing

A whistleblowing hotline, run by an independent third party, Protect, is available to employees who have concerns over any aspects of the Group's business practices. This is described further in Section B4.5.

A7. Approval of Strategic Report

Section A of this Annual Report comprises a Strategic Report for the Group. The information on how the directors have discharged their duties under s172 of the Companies Act 2006 included in Section B4.3 of the corporate governance report is also included in this strategic report by reference.

This Strategic Report has been drawn up and presented in accordance with, and in reliance upon, applicable English company law, in particular Chapter 4A of the Companies Act 2006, and the liabilities of the directors in connection with this report shall be subject to the limitations and restrictions provided by such law.

It should be noted that the Strategic Report has been prepared for the Group as a whole, and therefore gives greater emphasis to those matters which are significant to the Company and its subsidiaries when viewed as a whole.

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

Ciara Murphy

Company Secretary

6 December 2022

B.

Corporate Governance

How the Group is run and how risk is managed

PROFESSIONALISM

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

“Professionalism is highly valued at Paragon and there’s lots of positive reinforcement around its importance. It’s about putting care into what you do. If you care about your actions, you’ll pass that care on to customers and get better results for everyone.

Josh, Climate and ESG Risk Management

B1. Chair's statement on corporate governance

> **As the new Chair I am pleased with the Group's commitment to strong corporate governance as a foundation for strategic success and with the seriousness with which my new colleagues take their responsibilities under the UK Corporate Governance Code.**

Robert East, Chair of the Board

Dear Shareholder

In this section of the Annual Report the Group presents disclosures which describe its governance processes and outline how the Board and its Committees addressed the important issues facing the Group during the year.

As the new Chair I am pleased with the Group's commitment to strong corporate governance as a foundation for strategic success and with the seriousness with which my new colleagues take their responsibilities under the UK Corporate Governance Code (the 'Code'). As a board we understand the importance of a robust governance structure and an effective risk management framework in delivering sustainable growth and shareholder returns and in protecting the interests of all stakeholders.

We continue to monitor the outputs of the BEIS review of corporate governance, which has continued to proceed during the year, albeit slowly, and we look forward to receiving more clarity on the direction of policy in the coming year, both from BEIS and from the FRC, who propose to consult on an updated Corporate Governance Code, so that we can incorporate this into our forward planning.

During the year the governance structure continued to mature. The Board was expanded, the Sustainability Committee completed its first full year of operation and the Board's first champion for the FCA Consumer Duty was appointed.

Stakeholder engagement

As the restrictions of the Covid pandemic relaxed, the Group's programmes of stakeholder engagement began to normalise and develop further.

During the latter part of the year the previous Chair, Fiona Clutterbuck, together with Hugo Tudor, the Senior Independent Director and Chair of the Remuneration Committee, met with representatives of shareholders and proxy advisers. Given the requirement for the approval of the directors' remuneration policy at the next AGM in March 2023, these discussions centred on the Group's approach to executive remuneration and potential amendments to the policy, but also covered other governance and broader sustainability issues. These discussions, which are reported back to the Board are both constructive and useful. I look forward to taking part in the next round of engagements and would urge all our principal shareholders to participate.

The Board's primary channel of engagement with the workforce continues to be through the Group's People Forum. This forum meets regularly and provides the Board with insight into the views of the employees. The Chief People Officer updates the Nomination Committee on the outcome of these meetings and has a comprehensive action plan to ensure that the key themes captured are fed back into the Board's decision-making process and that these decisions are subsequently reported back to employees, both through the Forum and through group-wide communications.

During the year the previous Chair, and several non-executive directors attended meetings of the Forum and have told me how useful they found those interactions, and of how valuable they found employee insights as the Group's approach to hybrid working was developed. I look forward to meeting with the Forum in the near future as part of my induction.

The Board was also interested to receive the results of the Investors in People assessment carried out in March. This included the results of detailed independent surveys of the workforce and an assessment of face-to-face interviews with employees, giving insight into the way the Group's people relate to it and how they feel the Group relates to them.

I, and my Board colleagues, have had the opportunity of meeting with the representatives of various regulators in the year. We value these interactions, and take the views of our regulators very seriously in considering policy and strategy.

At the end of the year the Group also launched its first code of conduct, which sets out the principles that all its people should apply in dealing with customers, suppliers and each other. This is publicly available on the Group's website, and I believe will play a valuable role in codifying the principles by which we have always sought to operate.

Diversity and inclusion

The Group's focus on diversity and inclusion has continued to grow in prominence in the year. The EDI Network is becoming an established part of the Group's structures and during the year I was proud that Paragon has become a founding partner of Progress Together, an organisation to promote socio-economic diversity at senior levels in the financial services industry, sponsored by the City of London.

The Group continued to meet its targets for gender diversity at board and senior management level under the FTSE Women Leaders initiative and the Board now complies with the Parker guidance on ethnic diversity on boards.

The Board continues to monitor the Group's diversity policies and their outcomes carefully, and I look forward to building on the work done by my predecessor as Chair, Fiona Clutterbuck, who rightly made this a particular priority.

Board effectiveness

As I was not appointed until the end of the financial year, the annual review of board effectiveness was delayed and will take place when I have had more opportunity to familiarise myself with the people and processes involved and to form my own views on priorities for the review. It will be an externally facilitated review and I look forward to sharing the results with you next year.

Board changes

I took office as Chair on 1 September 2022 following a detailed search and selection process, regulatory approval and a full handover from Fiona Clutterbuck, my predecessor. Fiona stepped down both as Chair of the Board and as a director on my appointment. I, and my fellow directors, would like to thank her for her wise stewardship of the Board over the past few years and particularly for her leadership through the Covid pandemic, which posed particular practical difficulties for non-executive directors.

I am currently going through a detailed induction process, meeting with people at all levels of the Group so I can familiarise myself with its structure and operations. I am finding the process most enlightening and would like to thank the people I have met so far for their openness and engagement.

As I joined the Board, one of my first duties was to welcome Tanvi Davda as an additional non-executive director. Tanvi's experience in business leadership, wealth management and derivatives gives her a distinctly different perspective on the financial services industry and I look forward to her contributions to the Board's deliberations.

The Group's next AGM will be held on 1 March 2023 in London, and I look forward to welcoming as many shareholders as possible in person.

Robert East
Chair of the Board
6 December 2022

B2. Corporate Governance Statement

The Board is committed to the principles of corporate governance contained in the UK Corporate Governance Code issued by the FRC in July 2018 (the 'Code'). Throughout the year ended 30 September 2022, the Company complied with the principles and provisions of the Code.

During the year under review, and as permitted under the Code, the Company adopted the 'comply and explain' approach under Provision 19 of the Code to extend the Chair of the Board's tenure past nine years to allow for the appointment of a suitable replacement Chair.

After a rigorous selection process, and following regulatory approval from the FCA and PRA, Robert East was appointed as Chair with effect from 1 September 2022. Former Chair, Fiona Clutterbuck, whose term on the Board reached nine years in September 2021, remained in post until Robert's appointment became effective. The Board believes that this limited extension ensured a smooth transition of duties from Fiona to Robert. The membership of the Board was further enhanced by the appointment of Tanvi Davda on 1 September 2022. The search processes to recruit Robert and Tanvi are discussed further in the report of the Nomination Committee in Section B5.

The appointment of the new Chair of the Board in September 2022 has also resulted in the Company adopting a 'comply and explain' approach to Provision 21 of the Code, which requires a Board to undertake a formal and rigorous annual evaluation of the performance of the Board, its committees, the Chair and individual directors. Given the appointment of a new Chair in the year, the decision was taken to defer the 2022 evaluation until 2023 to allow Robert sufficient time in post to make the evaluation more relevant and meaningful. The Board evaluation in 2023 will be externally facilitated. This decision is discussed further in Section B4.4.

The table below references the individual Code Principles to the sections of this report which provide supporting information explaining how they have been applied.

Section 1: Board Leadership and Company Purpose	**Section**
A. The Company is led by an effective and entrepreneurial board, who promote the long-term sustainable success of the Company, generating shareholder value and contributing to wider society.	B3
B. The Company's purpose, values and strategy, which align with its culture, have been established and are promoted by the Board.	B1
C. The Board ensures that necessary resources are in place for the Company to meet its objectives and measure performance and has established a framework of effective controls, which enables risk to be assessed and managed.	B8
D. The Board ensures effective engagement with stakeholders and encourages their participation.	B4.3
E. The Board ensures that workforce policies and practices are consistent with the Company's values and support its long-term sustainable success. The workforce should be able to raise any matters of concern.	B4.3

Section 2: Division of Responsibilities	**Section**
F. The Chair is objective and leads the Board effectively, facilitating constructive relations and effective contribution from non-executive directors.	B4.1
G. The Board includes an appropriate combination of executive and non-executive directors, with a clear division of responsibilities.	B4.1
H. Non-executive directors have sufficient time to meet their board responsibilities. They provide constructive challenge, strategic guidance, offer specialist advice and hold management to account.	B4.1
I. The Board, supported by the Company Secretary, has the policies, processes, information, time and resources required to function effectively and efficiently.	B4.1

Section 3: Composition, Succession and Evaluation	Section
J. Appointments to the Board are subject to a formal, rigorous and transparent procedure, and an effective succession plan is in place for Board and senior management. Appointments and succession plans are based on merit and objective criteria and promote diversity.	B5
K. There is an appropriate mix of skills, experience and knowledge. Tenure and membership of the Board and its committees are regularly reviewed.	B4.4
L. The annual board evaluation provides an opportunity for the directors to consider their collective and individual effectiveness and decide where there are areas for improvement.	B4.4

Section 4: Audit, Risk and Internal Control	Section
M. The policies and procedures, established by the Board, ensure the independence and effectiveness of internal and external audit functions. The Board has satisfied itself of the integrity of financial and narrative statements.	B6
N. The Board presents a fair, balanced and understandable assessment of the Company's position and prospects.	B6
O. The Board has established procedures to manage risk, oversee the internal control framework and determine the principal risks the Company is willing to take in order to achieve its long-term strategic objectives.	B8

Section 5: Remuneration	Section
P. Remuneration policies and practices support strategy and promote long-term sustainable success. Executive remuneration is aligned to the Company's purpose, values and successful delivery of long-term strategy.	B7
Q. A formal and transparent procedure has been established to develop policy and determine director and senior management remuneration. No director is involved in deciding their own remuneration outcome.	B7
R. The directors exercise independent judgement and discretion over remuneration outcomes, taking account of company and individual performance and wider circumstances.	B7

B3. Board of Directors and Senior Management

B3.1 The Board of Directors

Members of the Board of Directors at the date of approval of the Annual Report are set out below.

Robert D East

Chair of the Board (Age 62)

Appointed to the Board as independent non-executive Chair of the Board on 1 September 2022.

Experience

Robert has over 40 years' experience in UK financial services, including at board level, as CEO and Chair.

During his executive career he held senior roles at Barclays. He was also CEO of Cattles, where he led the restructuring and wind down of its operations from 2010 to 2016.

He has held positions as Chair of Vanquis Bank, Skipton Building Society and Hampshire Trust Bank. He has previously served as a non-executive director on the boards of Provident Financial Group, Skipton Building Society and Hampshire Trust Bank, where he was also Chair of the Risk Committee.

Robert holds a diploma in Financial Studies (DipFS) from the London Institute of Banking and Finance and is an associate of the Chartered Institute of Bankers ('CIB').

Specific areas of expertise*

- Strong retail and commercial banking expertise
- Detailed knowledge of the financial services sector
- Leadership of transformational change

Committee membership

Chair: Nomination Committee

Member: Remuneration and Risk and Compliance Committees

Current external appointments

Director of RCWJ Limited

Nigel S Terrington

Chief Executive (Age 62)

Appointed to the Board as Treasury Director in 1990, and became Finance Director in 1992 and CEO in 1995.

Experience and expertise

Nigel Terrington's early career began in investment banking, which included working for UBS where he trained as a credit analyst and ran its Financial Institutions Group. He joined the Group in 1987, becoming Treasurer shortly thereafter, before being appointed as Finance Director and then Chief Executive.

He is a member of the Board of UK Finance and is the Chair of UK Finance's Specialist Bank Advisory Committee. Previously he was the Chair of the Council of Mortgage Lenders ('CML'), Chair of the Intermediary Mortgage Lenders Association ('IMLA'), Chair of the Finance and Leasing Association ('FLA') Consumer Finance Division and a board member of the FLA.

He is an associate of the CIB and in 2017 received an Honorary Doctorate from Birmingham City University for services to the finance industry.

Specific areas of expertise*

Overall, Nigel has expertise gained from long term, through-the-cycle, strategic and detailed understanding of the Group, its markets, its operations and its people. He saw the Group through both the 1992 and 2007 financial crises and has led the diversification of the Group from a monoline buy-to-let lender to its current broadly-based specialist banking group.

Committee membership

Member: Disclosure Committee

Current external appointments

Board member of UK Finance

Chair of UK Finance's Specialist Banks Advisory Committee

Member of HM Treasury's Home Finance Forum

Member of Bank of England's Residential Property Forum

Richard J Woodman

Chief Financial Officer (Age 57)

Appointed to the Board as Director of Corporate Development in 2012 and became CFO in June 2014.

Experience and expertise

Richard Woodman joined the Group in 1989 and has held various senior strategic and financial roles, including Director of Business Analysis and Planning and Managing Director of Idem Capital.

He has taken a lead role in the Group's strategic development and, in particular, in the loan portfolio acquisition programme through Idem Capital and the Group's Mergers and Acquisitions ('M&A') programme.

He is a member of the Chartered Institute of Management Accountants.

Specific areas of expertise*

Richard has broad expertise gained from long term, through-the-cycle, knowledge and understanding of the Group, its markets and its operations, in particular its financial management controls, liquidity, stress testing and capital management.

Committee membership

Member: Disclosure Committee

Current external appointments

Director of Woodman Portfolio Holdings Limited

Director of Rose Wine Limited

*All directors have broad knowledge of all areas of the Group's business, but the 'areas of expertise' highlight specific areas in relation to an individual's contribution to the Group's long-term sustainable success.

Fiona J Clutterbuck stepped down as Chair of the Board and as a director on 1 September 2022.

Hugo R Tudor

Non-executive director (Age 59)

Appointed in 2014 – eight years served.

Became Senior Independent Director in July 2020.

Experience

Hugo Tudor spent 26 years in the fund management industry, originally with Schroders and most recently with BlackRock, covering a wide range of UK equities.

He is a Chartered Financial Analyst and a Chartered Accountant.

Specific areas of expertise*

- Detailed knowledge of the investor perspective
- A strong understanding of the executive remuneration market

Committee membership

Chair: Remuneration Committee

Member: Audit, Nomination and Risk and Compliance Committees

Current external appointments

Director of Damus Capital Limited

Director of Porthcothan Property Limited

Director of Vitec Global Limited, Vitec Air Systems Limited and Vitec Aspida Limited

Peter A Hill

Non-executive director (Age 61)

Appointed in 2020 – two years served.

Experience

Peter Hill's career in financial services has spanned over 40 years, including eight years as CEO of Leeds Building Society between 2011 and 2019, where he previously held the role of Operations Director.

Chair of Mortgage Brain Holdings Limited.

He was a non-executive director and Chair of the Risk Committee at Pure Retirement from 2019 to 2022.

He was chair of the CML for three years and was a member of the Board of UK Finance.

Peter is a fellow of the Royal Society of Arts and an associate of the CIB.

Specific areas of expertise*

- Specialist retail banking and mortgage lending expertise
- Detailed knowledge of the financial services sector

Committee membership

Chair: Risk and Compliance Committee

Member: Audit Committee

Current external appointments

Chair of Mortgage Brain Holdings Limited

Director, Trustee and Chair of the Finance & Governance Committee of Leeds Rugby Foundation

Alison C M Morris

Non-executive director (Age 63)

Appointed in 2020 - three years served.

Experience

Alison is a chartered accountant and was a partner in PwC's financial services audit practice until the end of 2019.

She joined PwC in 1982 and spent her career with the organisation in a range of internal and external audit roles across asset and wealth management, as well as banking and capital markets.

She led audit projects for a range of banking clients, as well as other companies across the FTSE 100 and FTSE 250 and held a number of leadership roles within PwC, including sitting on the executive management team which led their audit practice.

Specific areas of expertise*

- Recent and relevant experience of the financial services sector
- Detailed and specialist knowledge of accounting and auditing practice as well as of the audit market and accounting regulations

Committee membership

Chair: Audit Committee

Member: Remuneration and Risk and Compliance Committees

Current external appointments

Non-executive director of M&G Group Limited, M&G Investment Management Limited and M&G Alternatives Investment Management Limited, all part of the M&G plc group

Non-executive director of Sabre Insurance Group PLC and Sabre Insurance Company Limited

Chair of the Audit Committee at M&G Group and Sabre Insurance Group

Barbara A Ridpath

Non-executive director (Age 66)

Appointed in 2017 – five years served.

Experience

Barbara Ridpath has worked in finance for most of her career, in New York, London and Paris at the Federal Reserve Bank of New York, Standard & Poor's and JPMorgan.

She was instrumental in the development of UK mortgage securitisation in the late 1980s and went on to lead the Standard & Poor's Ratings Group in Europe, the Middle East and Africa.

Barbara is currently a non-executive director of ORX in Switzerland, a trade association for non-financial operating risk professionals (including cyber risk), and a director of ORX UK Limited.

Specific areas of expertise*

- Strong knowledge of the operation and implementation of operational risk management systems
- Detailed knowledge of the securitisation market

Committee membership

Member: Audit, Nomination and Risk and Compliance Committees

Current external appointments

Non-executive director of ORX in Switzerland and director of ORX UK Limited

Chair of the Ethical Investment Advisory Group of the Church of England

Non-executive director of Open Banking Limited and Change Banking Limited

Member of the International Advisory Council of the Institute of Business Ethics

Member of the UKF Conduct and Culture Forum

Graeme H Yorston

Non-executive director (Age 65)

Appointed in 2017 – five years served.

Experience

Graeme Yorston was Group Chief Executive of Principality Building Society, the 6th largest mutual in the UK. He has over 48 years' experience in financial services having carried out a number of senior roles in Abbey National (now Santander) including IT Director for the Retail Bank, Regional Director and running a number of significant change programmes.

Graeme has served on the CBI Council for Wales, the Board of Business in the Community in Wales and was HRH Prince Charles, Ambassador for BITC in Wales for two years.

He was awarded Director of the Year in Wales by the Institute of Directors in 2016.

Graeme is a Fellow of the CIB, holds an MBA from Warwick Business School and was awarded an Honorary Doctorate in Business Administration by Cardiff Metropolitan University in 2017.

Specific areas of expertise*

- Strong retail banking sector knowledge and experience particularly in marketing, communications and customer service
- Detailed experience of overseeing Business Change and IT systems

Committee membership

Member: Nomination, Remuneration and Risk and Compliance Committees

Current external appointments

None

Tanvi P Davda

Non-executive director (Age 50)

Appointed on 1 September 2022 – less than a year served.

Experience

Tanvi brings a diverse range of skills and knowledge to the Board. With an executive career of more than 25 years, Tanvi began her career at Credit Suisse as a derivatives trader, then went on to work with IBM as a management consultant before joining ABN AMRO, and then Barclays Wealth where she was Managing Director of Global Research and Investments.

In 2015, Tanvi co-founded the wealth management firm, Saranac Partners, where she was CEO until 2021, and was a non-executive director until 2022.

Tanvi's non-executive career has also included roles on the Board of Ofqual, the qualifications and examinations regulator, and the Student Loans Company.

Specific areas of expertise*

- Strong finance, advisory and regulatory experience

Committee membership

Member: Remuneration and Risk and Compliance Committees

Current external appointments

Director of Ashrah Advisory Limited

Director of CLC Services Limited

Trustee for Cheltenham Ladies College

B3.2 Executive Committee

The members of the Group's Executive Committee are set out below, with their tenure in their current role.

Nigel Terrington
Chief Executive Officer ('CEO')
Since 1995

Richard Woodman
Chief Financial Officer ('CFO')
Since 2014

Richard Rowntree
Managing Director – Mortgages
Since 2020

Dave Newcombe
Managing Director – Commercial Lending
Since 2019

Michael Helsby
Strategic Development Director
Since 2018

Pam Rowland
Chief Operating Officer ('COO')
Since 2014

Peter Shorthouse
Treasury and Structured Finance Director
Since 2010

Deborah Bateman
External Relations Director
Since 2009

Anne Barnett
Chief People Officer ('CPO')
Since 2009

Marius van Niekerk
General Counsel
Since 2019

Ben Whibley
Chief Risk Officer ('CRO')
Since 2019

All members sit on both the Executive Performance Committee ('Performance ExCo') and the ERC. The Internal Audit Director, Sarah Mayne, attends meetings of both committees as an observer.

B3.3 The Board's activities in the year

Matters considered by the Board

During the year, the Board undertook a range of activities, in addition to its regular discussions of performance and strategy. These included:

- Considering the impact of interest rate volatility, inflation and other macro-economic uncertainties on the Group
- Assessing the Group's operational resilience
- Further developing the Group's climate change commitments
- Monitoring the impact of new ways of working following the Covid pandemic

In addition, the Board regularly receives and reviews reports prior to its meetings covering such matters as strategy, business performance and results in each of the Group's business areas. The Board also receives updates on legal and governance matters, treasury and funding, the work of its committees and investor relations and shareholder feedback.

Other significant matters overseen by the Board are set out below by theme:

Topic	Meeting
Business strategy	
Training / insight session exploring the outlook for the UK economy and housing market. The session was facilitated by an economic research consultancy.	Oct 2021
Approval of the corporate plan for the financial years ending 2022 to 2026. More detail on the Group's strategy can be found in sections A3 and A4.	Dec 2021
A deep dive review into Commercial Lending operations, which included an overview of the division's strategy and priorities, delivered by the managing director of the business.	Jan 2022
Market update on the financial services sector provided by an investment bank.	Feb 2022
Insight session on project prioritisation, delivered by the Operations, Change and IT teams.	Apr 2022
Approval of the sale of the Group's residual unsecured personal loan portfolio for £78.9 million and the consequent cessation of unsecured loan administration activities.	May 2022
Deep dive review of the Group's SME lending business provided by senior management from the area.	July 2022
Update on the Group's change programme and on progress on the digitalisation strategy.	July 2022
Risk and regulation	
Update on model risk.	Oct 2021
Training on financial crime and regulatory expectations of firms on Anti-Money Laundering.	Oct 2021
Consideration and approval of the 2021 ILAAP.	Oct 2021
Update on regulatory reporting which included an overview of the Group's regulatory reporting assurance framework.	Oct 2021
Training on the ICAAP stress testing framework.	Jan 2022
Insight session on developments made to the SME lending origination process and associated benefits.	Jan 2022
Update on the ICAAP and Recovery Plan.	Jan 2022
Review and approval of the Group's Liquidity and Funding and Market Risk Appetites.	Feb 2022
Training on the Group's enterprise risk management framework, delivered by in-house experts.	Mar 2022
Training on interest rate risk in the banking book ('IRRBB').	Mar 2022
Consideration and approval of the 2022 ICAAP.	Apr 2022

Topic	Meeting
Risk and regulation	
Approval of the 2022 Recovery Plan.	May 2022
Training on, and approval of, the 2022 ILAAP.	July 2022
Insight session on the Group Insurance function.	July 2022
Approval of revisions to the Group's principal risk categories.	July 2022
Legal and regulatory training, which covered topics such as UK MAR and directors' duties.	July 2022
Annual review and approval of Anti-Bribery and Corruption and Whistleblowing Policies.	Sept 2022
Cyber security / operational resilience	
Training / insight session on cyber security, presented by in-house experts.	Oct 2021
Deep dive into operational resilience, delivered by specialists from the Operations, IT and Cyber Security teams.	Oct 2021
Approval of the Group's operational resilience self-assessment.	Mar 2022
Insight session on the use of Cloud services for IT solutions, and risk and resilience implications.	Jul 2022
Corporate governance	
Consideration of succession planning for the Board and senior management in conjunction with the Nomination Committee.	Jan, Feb, July and Sept 2022
Annual review of the Corporate Governance Policy Framework.	Feb 2022
Consideration of the annual whistleblowing report, which provided the Board with the assurance of the integrity of the Whistleblowing Policy, independence of the process and details of disclosures and developing trends identified during the reporting period.	Mar 2022
Approval of the Modern Slavery Statement and Policy following an annual review.	Mar 2022
Annual review of tax strategy and compliance, and approval of policy statement.	Mar 2022
Annual review of the Group's purpose, to confirm that it remained relevant and was fit for purpose for the next twelve months. When making this assessment the Board considered the Code requirement that the Group's purpose should align with its culture.	Apr 2022
Recommendation of the declaration of a final dividend of 18.9 pence per share in respect of the financial year ended 30 September 2021 and of a share buy-back programme for 2022 (with £50 million announced with the preliminary results in addition to the remaining £2.2 million from the 2021 buy-back).	Dec 2021
Approval of the declaration of an interim dividend of 9.4 pence per share and an agreement to increase the total amount of the share buy-back programme from £50 million to £75 million as part of the half year consideration of the Group's capital position.	Jun 2022
Sustainability	
Deep dive into climate change and sustainability, and their impacts on the Group's strategy and risk profile.	Oct 2021
Consideration of shareholder feedback following the full year results announcement.	Dec 2021
Update on sustainability and the Group's inaugural (2021) Responsible Business Report.	Dec 2021
Training on the new FCA Consumer Duty, which included an overview of next steps for the Group in advance of implementation of the Duty.	Jan 2022

Topic	Meeting
Sustainability	
Update on employee feedback through the Nomination Committee. This was obtained through surveys, the People Forum and the IiP triennial reassessment, amongst other channels.	Feb and July 2022
Update on investor relations delivered by the External Relations Director, which covered matters including share price development, an overview of the Group's share register and movements over the preceding twelve months and asset management trends.	Jun 2022
Insight session on the Group's climate change exposures, strategy and commitments.	Jun 2022
Annual review and approval of the Group's Equality, Diversity and Inclusion Policy.	July 2022
Consideration of shareholder feedback following the half year results announcement.	July 2022
Approval of the Group's Code of Conduct. The Code of Conduct is discussed further in section A6.	Sept 2022
Update on the Group's Carbon Neutral Offsetting Proposal, which is discussed further in Section A6.4.	Sept 2022

Corporate Governance

The way in which the Board discharged its duty to consider the interests of all stakeholders in these discussions is discussed in Section B4.3. Contributors to board papers are required to consider and highlight any potential principal stakeholder impacts of any proposal as a matter of course.

Board and committee attendance

The attendance of individual directors at the regular meetings of the Board and its main committees in the year is set out below, with the number of meetings each was eligible to attend shown in parentheses. Directors who are unable to attend meetings still receive the relevant papers and any comments / questions from them are reported to the meeting via the Chair. Directors have attended a number of ad hoc meetings, workshops and training sessions during the year and have contributed to discussions outside of the meeting calendar.

Board and committee attendance

Director	Board	Audit Committee	Risk and Compliance Committee	Remuneration Committee	Nomination Committee
Robert D East	1 (1)	-	0 (0)	1 (1)	1 (1)
Fiona J Clutterbuck	9 (9)	-	5 (5)	4 (4)	2 (2)
Nigel S Terrington	10 (10)	-	-	-	-
Richard J Woodman	10 (10)	-	-	-	-
Tanvi P Davda	1 (1)	-	0 (0)	1 (1)	-
Peter A Hill	10 (10)	5 (5)	5 (5)	-	-
Alison C M Morris	10 (10)	5 (5)	5 (5)	5 (5)	-
Hugo R Tudor	10 (10)	5 (5)	5 (5)	5 (5)	3 (3)
Barbara A Ridpath	10 (10)	5 (5)	5 (5)	-	3 (3)
Graeme H Yorston	10 (10)	-	5 (5)	5 (5)	3 (3)

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

B4. Governance Framework

This section describes how Corporate Governance operates within the Group, setting out:

B4.1	B4.2	B4.3	B4.4	B4.5
Board and committee structure – the forums through which corporate governance operates and how they relate to each other	Elements of the governance framework – how the framework operates	Board and stakeholders – how the Board discharges its duty to promote the success of the Group having regard to stakeholder interests	Board evaluation and development – how the Board ensures the framework is, and will remain, fit for purpose	Whistleblowing – how concerns may be raised and the action that is taken

B4.1 Board and committee structures

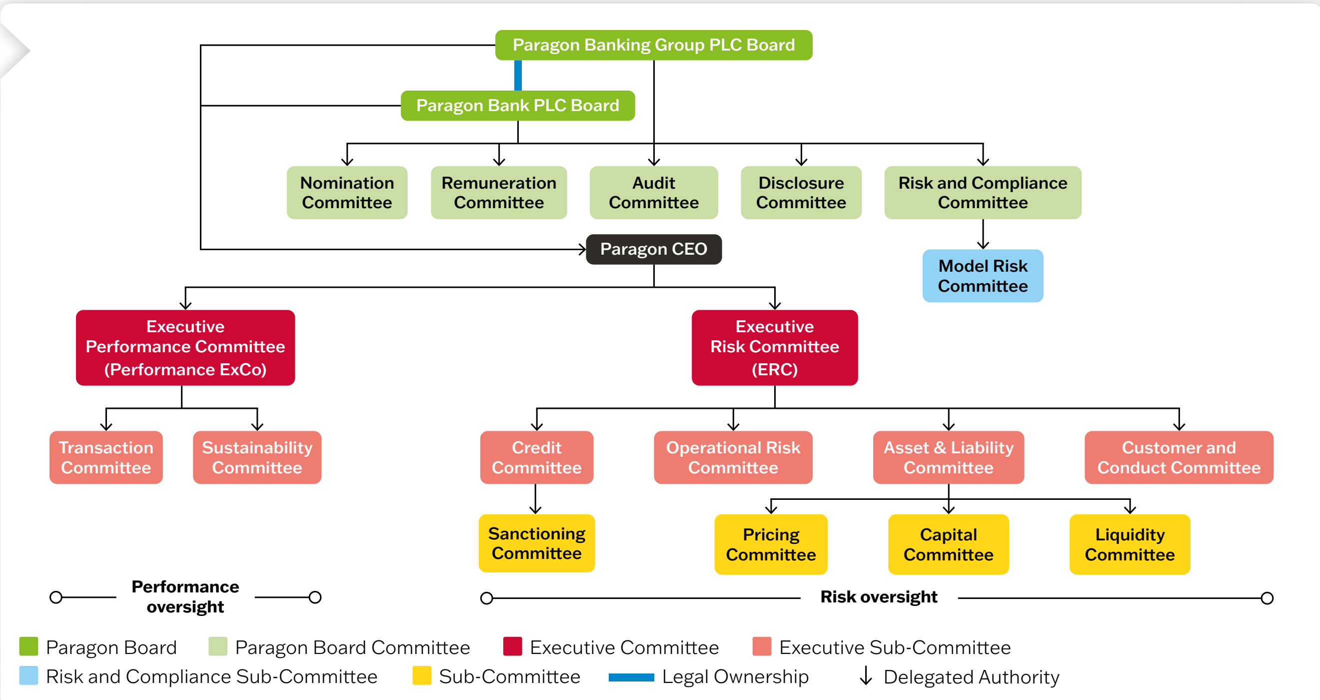
Board leadership, group purpose and the Group Corporate Governance Policy Framework

The Board of Directors is responsible for promoting the long-term, sustainable success of the Group, generating value for shareholders and contributing to wider society. It establishes the Group's overall purpose, values and strategy and ensures that these and the Group's culture are aligned. The Board is also responsible for delivery of these within a robust corporate governance framework. Purpose, values and strategy are described in Section A2 and the corporate governance framework is described in the following pages.

The Board of the Company and its subsidiaries are supported by the Group Corporate Governance Policy Framework (the 'Framework'). The Framework provides key components of how the Board and its committees govern the business of the Company. Application of the Framework is within the context of other requirements, such as applicable laws, the regulatory regime for deposit taking banks, the Listing Rules, the Articles of Association of the Company and the Disclosure Guidance and Transparency Rules. On appointment, directors are briefed on their duties and responsibilities as a director of a listed company.

Board and committee structure and membership

The Board operates through a number of sub-committees covering a range of matters, set out below.



Summarised information on each of the board committees is set out below.

Committee	Audit	Remuneration	Risk and Compliance	Nomination
Chair	A C M Morris	H R Tudor	P A Hill	R D East*
Minimum number of meetings	4	3	4	2
Further information	Section B6	Section B7	Section B8	Section B5

*F J Clutterbuck until 1 September 2022

Members	Independent non-executive	Audit	Remuneration	Risk and Compliance	Nomination
R D East	Chair*	No	From 1 September 2022	From 1 September 2022	From 1 September 2022
F J Clutterbuck	Until 10 May 2018*	No	Until 1 September 2022	Until 1 September 2022	Until 1 September 2022
T P Davda	Yes	No	From 1 September 2022	From 1 September 2022	No
P A Hill	Yes	Yes	No	Yes	No
A C M Morris	Yes	Yes	Yes	Yes	No
H R Tudor	Yes	Yes	Yes	Yes	Yes
B A Ridpath	Yes	Yes	No	Yes	Yes
G H Yorston	Yes	No	Yes	Yes	Yes

*Robert East was considered independent on appointment as Chair of the Board of Directors on 1 September 2022 and Fiona Clutterbuck was considered independent on her appointment as Chair on 10 May 2018.

In addition to the memberships above, Hugo Tudor attends Model Risk Committee meetings, representing the non-executive directors.

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

The non-executive directors also met with senior managers from the IT and Change functions in February and August 2022 as part of an ongoing programme of meetings to increase their understanding of current issues and developments in these areas.

Executive committee structures

The Group's executive management sit on two executive committees, the Performance ExCo and the ERC.

The Performance ExCo provides support to the CEO in the day-to-day running and management of the Group and, where appropriate, items discussed at the Performance ExCo are escalated to the Board for further discussion and for decision.

The ERC supports the CEO with monitoring adherence to risk appetite statements and identifying, assessing and controlling the principal risks within the Group and reporting on these to the Board. The ERC also supervises the evolution and further embedding of the Group's risk management framework and reviews and considers emerging risks facing the Group.

Sub-committees

Performance ExCo sub-committees

The Sustainability Committee reports directly to the Performance ExCo. Its members are the External Relations Director, who chairs the committee, the Balance Sheet Risk Director, Director of Treasury and Structured Finance, Managing Director – Commercial Lending, Managing Director – Mortgages, COO, Savings Director, Chief People Officer and Enterprise Risk Director. The Committee's purpose is to deliver a coordinated, transparent approach to ESG matters, including climate change, considering strategy, commercial implications, disclosure, engagement and insight.

The Transaction Committee, which reports directly to the Performance ExCo, consists of the CEO, the CFO, the Director of Treasury and Structured Finance and the CRO, any two of which can form a quorum, but that quorum should include either the CEO or CFO. The Committee meets to consider potential acquisitions or disposals of assets, where these are not large enough to require consideration by the Board as a whole.

ERC sub-committees

Four principal executive risk sub-committees, with membership consisting of executive directors and appropriate senior employees, report to the ERC. All of these committees are described further in the Risk Management Section, B8. The governance structure also includes further sub-committees which provide focus on specific risk elements, and report to the principal sub-committees.

All sub-committees, which report to either the ERC or Performance ExCo, are reviewed annually to determine whether further enhancements can be introduced, whilst maintaining rigorous oversight and control. All sub-committees operate within defined terms of reference and sufficient resources are made available to them to undertake their duties.

B4.2 Elements of the Governance Framework

Culture

The Group is proud of its culture and was accredited with Platinum Investors in People ('IiP') status in May 2022 (see Section A6.3). The Board considered the Group's culture as part of the annual review of the Group's purpose in April 2022.

To assess and promote the Group's culture, non-executive directors have attended People Forum meetings as part of the Board's commitment to engage directly with the workforce. Further detail can be found at B5.3. In addition, the Group ran an employee survey in October 2021 and employees were also invited to complete an anonymous survey as part of the IiP triennial assessment in March 2022, which included specific questions on the Group's culture. Results from these surveys, together with feedback received via the People Forum, were reviewed by the Nomination Committee on behalf of the Board. The strong employee engagement and employee attestations, including that the employees lived the Company's values and behaviours, were noted.

Matters Reserved for the Board

The schedule of matters reserved for the Board is reviewed annually and made available on the Group website. The document details key matters which are required to be or, in the interests of the Company and its stakeholders, should only be decided by the Board as a whole. Whilst a number of matters are reserved for the Board, the Board delegates certain responsibilities and authorities to the CEO and Board committees.

Division of Responsibilities between the Chair, CEO and Senior Independent Director

There is a clear division of responsibilities between the running of the Board and the executive responsibility for the day-to-day running of the business of the Group. The Chair leads the Board and is responsible for its overall effectiveness thereby promoting the high standard of corporate governance to which the Company subscribes. The CEO leads the day-to-day executive management of the business and provides regular reporting to the Board through the Chair.

The respective responsibilities of the Chair of the Board, the CEO and the Senior Independent Director are set out in the division of responsibilities statement, which is reviewed by the Board annually and made available on the Group's website.

The Chair's other business commitments are set out in the biographical details section (Section B3.1).

Role of independent non-executive directors

Throughout the year the independent non-executive directors have formed the majority of the Board, providing effective balance and challenge.

In addition to the general legal and regulatory responsibilities of all directors, non-executive directors' more specific responsibilities include providing independent oversight, and non-executive directors who are also members of the Remuneration Committee determine appropriate levels of remuneration for executive directors. Non-executive directors also take into account the views of shareholders and other stakeholders, and certain directors attended People Forum meetings during the year, which provided an opportunity for engagement with the Group's people. More detail on these interactions can be found in section A4.6.3.

During the year Hugo Tudor attended the MRC on behalf of the independent non-executive directors. On 27 October 2022, Graeme Yorston was appointed as the Consumer Duty Board Champion, as part of the Group's implementation of the new FCA Consumer Duty rules. Non-executive directors also meet with the change and IT functions to increase their awareness of these areas and provide counsel.

All non-executive directors are appointed for fixed terms and must ensure they have sufficient time available to discharge their responsibilities and regularly update their knowledge and familiarity with the Group's business. The Chair of the Board was considered independent on appointment on 1 September 2022. The previous Chair was considered independent at her appointment, having previously served as a non-executive director. The non-executive directors meet with the Chair, from time to time, without the executive directors being present.

At the AGM, the Chair of the Board will confirm to shareholders, when proposing the re-election of any non-executive director that, following formal performance evaluation, the individual's performance continues to be effective and demonstrates commitment to the role. The letters of appointment of the non-executive directors will be available for inspection at the AGM.

Role of the Senior Independent Director

Hugo Tudor has served as Senior Independent Director since 23 July 2020. The Senior Independent Director provides a sounding board for the Chair and serves as an intermediary for the other directors when necessary. The Senior Independent Director is available to shareholders if they have concerns and where contact through the normal channels has failed to resolve such concerns or for which such contact is inappropriate.

During the year Hugo met with shareholders to discuss governance and remuneration matters and to address any queries or concerns raised.

The Senior Independent Director also leads the appraisal of the Chair of the Board's performance with the non-executive directors.

Conflicts of interest

The Board has agreed a policy for managing conflicts and a process to identify and, if appropriate, authorise any conflicts that might arise in relation to significant shareholdings and / or third parties. At each meeting of the Board and its committees, actual or potential conflicts of interest in respect of any director are reviewed. A conflicts register is also maintained by the Company Secretary.

The Board recognises the benefits that can flow from non-executive directors holding other appointments but requires them to disclose the nature and extent of any such commitments to the Board (in accordance with the Articles of Association) before entering into any arrangements that might affect the time they can devote to the Group.

Executive directors would not normally be expected to hold any significant external directorships. However, where external directorships are held or proposed to be held, this is discussed with the Chair and disclosed to the Company Secretary for individual consideration.

Company Secretary

All directors have access to the advice and services of the Company Secretary, who is responsible for ensuring that board procedures are complied with, advising the Board on governance matters, supporting the Chair, and helping the Board and its committees to function efficiently. Both the appointment and removal of the Company Secretary are matters reserved for the Board. The Board approved the appointment of Ciara Murphy as Company Secretary effective from 1 October 2022, at its September meeting. The former Company Secretary, Marius Van Niekerk, will continue to attend board meetings in his role as General Counsel.

Subsidiary governance

A number of the corporate entities within the Group are regulated either by the PRA and / or the FCA. The Company has oversight of these entities as part of its overall responsibility for the management of the Group and ensures that the Group's values and standards in regulated spheres are met.

Composition and succession

Composition and succession for the Board and senior management are considered within the Nomination Committee's report (see Section B5).

The Board is mindful of the FCA Listing Rule requirements in relation to gender and ethnic diversity at board and executive management level, which are applicable to the Group from its financial year which began on 1 October 2022. These requirements are and have been a particular area of focus for the Board and the Nomination Committee. Material steps have already been taken to ensure that the Group will be fully compliant with these requirements for its year ending 30 September 2023 and thereafter.

Board evaluation and training

The Board, individual directors and the Board's main committees are reviewed annually, and the Group's policy is that externally facilitated reviews should take place triennially, as required by the Code. The externally facilitated Board evaluation for 2022 has been deferred until 2023, when the new Chair will have been in position for a reasonable period of time. This will enable a more valid, meaningful and useful evaluation to be conducted. Further details are given in Section B4.4.

The non-executive directors have received training during the year on various topics relevant to the Group. Further detail on the training undertaken is set out in Section B3.3 and Section B4.4.

Audit, risk and internal control

Information on how the Group has applied the provisions of the Code relating to audit, risk and internal control is set out in Section B6.

The directors' responsibility for the financial statements is described in Section B10.

Remuneration

Information on how the Group has applied the provisions of the Code relating to remuneration is set out in the Directors' Remuneration Report in Section B7.

Whistleblowing

The Group maintains a whistleblowing process to enable employees to raise concerns anonymously. Information on whistleblowing is provided in Section B4.5.

Further information

Documents referred to in the Corporate Governance section are available on the Group's website (www.paragonbankinggroup.co.uk). These include:

- Matters Reserved for the Board
- Division of responsibilities between the Chair, CEO and Senior Independent Director
- Terms of Reference – Audit, Disclosure, Nomination, Remuneration and Risk and Compliance Committees
- Group Corporate Governance Policy Framework
- Internal Audit Charter
- Tax Strategy

B4.3 Board and Stakeholders

Board and stakeholders

In addition to good corporate governance, maintaining a reputation for high standards of business conduct in all the Group's operations is a key priority for the Board, and management of conduct risk is a key part of the risk management framework. Section A6 sets out information on corporate responsibility, including the Group's people policies and engagement with employees, involvement in industry initiatives, support for the community and environmental, social and conduct impacts.

The Board, in its deliberations and decision-making processes, takes into account the views of the Group's stakeholders and, where applicable, considers the impact of those decisions on the communities and environment within which the Group operates. The Board is mindful of its duty to act in good faith and to promote the success of the Group for the benefit of its shareholders and with regard to the interests of all of its stakeholders.

The Board is kept updated on all material issues affecting stakeholders by the executive directors and receives regular updates from ExCo members, other senior managers and external advisers. Members of the Board also engage directly with employees, shareholders and regulators, as further detailed below.

The Board confirms that, for the year ended 30 September 2022, it has acted to promote the success of the Group for the benefit of its members as a whole and continues to have due regard to the following matters laid out in S172 (1) of the Companies Act 2006:

a. The likely consequences of any decision in the long-term;

b. The interests of the Company's employees;

c. The need to foster the Company's business relationships with suppliers, customers and others;

d. The impact of the Company's operations on the community and the environment;

e. The desirability of the Company maintaining a reputation for high standards of business conduct; and

f. The need to act fairly as between members of the Company.

Companies are required to describe in the Annual Report how the directors have had regard to the matters set out above when performing their duties. The table below sets out how the Board and senior management take the above factors into account when engaging with the Group's key stakeholders, how this is aligned to the Group's strategic priorities and culture and why the stakeholders listed are significant for the Group.

Shareholders

Creating long-term shareholder value through growing profits and dividends (s172 a, f)

Our strategy is to build a specialist bank for our customers, which delivers sustainable growth and shareholder returns through a low risk and robust model.

How we engage and / or monitor

- The Group has an Investor Relations Programme, under which over forty meetings were held with shareholders. In addition, the CEO and CFO hold regular meetings with analysts
- A comprehensive update on Investor Relations is included in the CEO's report to each Board meeting
- The Chair and SID / Chair of the Remuneration Committee undertook a wide-ranging consultation process, covering remuneration policy and other governance issues, with a number of major shareholders and shareholder advisory groups
- The Board receives an in-depth update on Investor Relations, which includes investor feedback, following the publication of the Company's financial results

Outcome

- The data on shareholder feedback provided helps the Board align the Group's strategy with the interests of shareholders
- Shareholder feedback was taken into account when designing the new Remuneration Policy to be put to shareholders at the 2023 AGM
- Increasing shareholder interaction is helping to frame the Group's response to reporting and targeting in relation to sustainability matters, in particular climate change risk
- At the AGM in March 2022, all resolutions were approved by shareholders, with over 90% of votes cast in favour of each resolution
- A fully hybrid AGM was held in 2022 to ensure that shareholders had the opportunity to participate in the meeting in the event that travel restrictions were in effect
- A total dividend for the year of 28.6 pence per share is proposed, and a further share buy-back programme of up to £75.0 million was authorised in the year

Capital management

Growth

Diversification

Specialisation

Further information on how the Group seeks to engage with and consider the views of all shareholders is given below. The Group's approach to capital and distributions is set out in Section A4.3. Discussions with investors on remuneration matters are discussed in the Remuneration Report (Section B7).

Customers

Supporting the ambitions of the people and businesses of the UK by delivering specialist financial services (s172 c)

Our customers are at the heart of our business and our eight core values underpin the way we interact with them every day. Engagement with our customers enables us to maintain our deep understanding of them and the markets they operate in, designing products to meet their needs and continually striving to exceed their expectations.

How we engage and / or monitor

- Regular customer satisfaction surveys on key product lines are reported to the Board
- Focussed analysis on key customer groups is undertaken
- The Board receives Customer Insight updates bi-annually
- The Board was briefed on the new FCA Consumer Duty at one of its quarterly training sessions and has been updated on progress throughout the year
- Customer metrics are a key element of the Performance Share Plan ('PSP')

Specialisation

Sustainability

Diversification

Outcome

- Customer feedback on key product lines, as measured by customer satisfaction surveys, has remained strong
- The Board approved the implementation plan for the new FCA Consumer Duty and a non-executive director was recently appointed as Consumer Duty Champion
- Greater understanding of customers and their priorities is used to refine product offerings, documentation and processes
- All employees received training on how to identify and support customers in vulnerable circumstances, with customer-facing employees receiving additional in-depth training
- Complaint levels remain low by industry standards

Further information on the Group's relationship with its customers is set out in Section A6.2.

Employees

Helping all of our people to develop their career and reach their potential (s172 b)

By working together, we help our customers to achieve their ambitions and we need a wide range of skills and expertise to succeed. Our shared values and focus on employee engagement provide the foundation for our success and help us to attract, develop and retain talent.

Sustainability

How we engage and / or monitor

- All employees were invited to complete an anonymous survey as part of the Investor in People ('IiP') triennial assessment, which included specific questions on the Group's culture
- The Chief People Officer updates the Board and ExCo on employee feedback from surveys and from the People Forum, as well as other metrics
- The Chair and non-executive directors attend the Group's People Forum on a regular basis
- Designated ExCo members with responsibility for gender diversity and wider diversity regularly report progress on these matters
- The Group's EDI network is sponsored by a member of ExCo and, throughout the year, members of the Board and ExCo have attended employee listening circles
- The Nomination Committee receives six-monthly updates on succession planning and feedback from the EDI network from the Chief People Officer
- People metrics are a key element of the PSP

Outcome

- The Group was reaccredited as an Investor in People and achieved Platinum IiP status
- Adoption of a permanent hybrid working model following several successful pilots
- Feedback from the People Forum and regular updates from the Chief People Officer enable the Board to support and understand employees and their engagement
- Tailored career development programmes embedded across the Group for apprentices through to high potential senior leaders
- The Code of Conduct, which articulates the Group's culture, purpose and values, was rolled out to 100% of employees
- Enhanced annual leave provisions for all employees in the year

Further information on the involvement of the Group's people and the impact of policies on them, can be found in Section A6.3.

Regulators

Engaging transparently and openly with regulators to ensure we comply with current legislation and maintain the Company's reputation for high standards of business conduct (s172 c, e)

One of our key values is to be honest and open in everything we do. Frequent and transparent communication with regulators enables us to plan for regulatory change and maintain our high ethical standards.

How we engage and / or monitor

- Regular engagement with the PRA, throughout the year on key regulatory matters, including the IRB implementation
- Direct contact between the Chair and non-executive directors and regulators
- ExCo and the Board are kept updated on all interaction with the FCA and PRA
- SMCR is embedded across the Group, with conduct measures monitored monthly, overseen by the ERC
- A revised framework to identify Material Risk Takers ('MRTs') and process their remuneration packages was embedded during the financial year following the Bank becoming a Level 2 firm for remuneration purposes on 1 October 2021
- Dialogue maintained with HMRC, with the CFO designated as Senior Accounting Officer, directly responsible for the Group's tax policies
- The risk element of the PSP includes an assessment of any material regulatory breaches

Capital management

Sustainability

Outcome

- All changes to the Board and Senior Management Functions are approved by the regulator, where required
- A Risk Adjustment Review Group has been established to identify instances of potential risk adjustment for MRTs and others on a more structured and formal basis than had previously been the case

Further information on the Group's tax policies is set out in Section A6.5.

Society and community

Helping the UK economy grow and supporting the communities in which we operate (s172 d)

We aim to be an energetic and valuable contributor to the communities in which we operate. Our commitment includes active involvement in a range of community volunteering and charity partnerships.

How we engage and / or monitor

Sustainability

- Members of the senior team are active in industry bodies, gaining insight into thinking about how the sector impacts communities and public policy
- ExCo members actively support community activities within the business
- Employees support a nominated charity each year via payroll donations and fund-raising efforts
- All employees are given one day per year to volunteer for specific initiatives

Outcome

- In the twelve months ended 31 December 2021 our employees had raised nearly £43,000 for the Alzheimer's Society and during the nine months ended 30 September 2022 our employees raised over £31,000 for Mind
- The Group's Charity Committee is sponsored by a member of ExCo
- Employees were supported to take part in a range of volunteering activities
- 286 employee volunteering days were used to support specific initiatives in our local communities

Further information on the Group's community involvement is set out in Section A6.5.

Environment and climate change

Continually reducing our environmental impact and designing products that support positive environmental change (s172 d)

We take care to identify, manage and minimise our impact on the environment, both in terms of the impact of our lending products and our own operational impact.

Sustainability

How we engage and / or monitor

- The Group has an executive level Sustainability Committee which addresses all climate-related issues on a cross-group basis
- Climate change is designated a principal risk within the Group's risk management framework
- The Board receives updates on the potential risks and strategic impacts of climate change
- The Group has joined Bankers for Net Zero
- The CFO has been designated as the responsible director for climate change matters
- The Group's ICAAP includes a climate change scenario analysis module
- The Group complies with all applicable laws and regulations relating to the environment

Outcome

- The Group offers a range of green mortgages which encourage landlords to invest in energy efficient properties
- Loans to finance battery electric vehicles, including light commercial vehicles, are offered by the Group's motor finance business
- Southampton office moved to a more energy-efficient location
- The Board has objectives in place against current energy performance to further reduce consumption
- Operational emissions for the year have been offset with purchased carbon credits certified by Gold Standard or VCS
- Environmental / climate change targets are considered as part of the new Remuneration Policy
- The Group publishes an annual sustainability report and has a dedicated Sustainability section on its website.

Further information on the Group's management of climate change risk and its environment policies is set out in Section A6.4

Business partners and suppliers

Commitment to the fair treatment of all business partners. In return, we expect our partners to help us deliver a high standard of service to our customers and act responsibly (s172 c)

We believe that working well with our business partners and suppliers is central to our purpose and key to our continued success.

Sustainability

How we engage and / or monitor

- Key business partner relationships, including intermediaries and suppliers are identified, actively monitored and reported to ExCo and the Board
- Regular feedback surveys conducted amongst intermediaries with the results fed back to ExCo and Board
- The Group has a Supplier Code of Conduct which sets out our overall approach to supplier engagement and corporate responsibility
- A supplier satisfaction survey was undertaken to seek the views of third party suppliers on their experience with the Group, which will be used to identify and action any areas for improvement

Outcome

- Intermediary feedback key to designing new broker portals and other operational systems
- Our suppliers understand the minimum standards we expect from them and our commitments and expectations around bribery and corruption, data protection and modern slavery
- Ongoing engagement with our key suppliers ensuring operational resilience and reduced risk
- The Group is a signatory to the UK's Prompt Payment Code, with ensuring prompt payment a priority in the year

The Group's management of business partner relationships is discussed further in Section A6.7.

Shareholders

The Board encourages communication with the Company's institutional and private investors. All shareholders have at least twenty working days' notice of the AGM, at which the directors and committee chairs are available for questions. The AGM is normally held in London during business hours and provides an opportunity for directors to report to investors on the Group's activities, to answer their questions and receive their views. At all AGMs shareholders have an opportunity to vote separately on each resolution and all proxy votes lodged are counted and the balances for, against and directed to be withheld in respect of each resolution are announced.

The 2023 AGM will take place at 9am on 1 March 2023 at the offices of UBS AG London Branch, 5 Broadgate, London, EC2M 2QS.

The CEO and CFO have a full programme of meetings with institutional investors and during the year ended 30 September 2022, meetings were held with investors from the UK, Europe and North America.

From time-to-time other presentations are made to institutional investors and analysts to enable them to gain a greater understanding of important aspects of the Group's business.

The Chair of the Board and the Senior Independent Director, who is also the Chair of the Remuneration Committee, held meetings with shareholder advisory groups covering governance and remuneration matters as set out in the Remuneration Report in B7. Invitations to discuss the new remuneration policy were also extended to the Company's largest shareholders, who collectively represent over 79% of the Company's total voting rights, and nearly three-quarters of these shareholders, representing 60% of the Company's total voting rights, responded and shared their views.

The Board believes that engagement with shareholders is an important part of both the governance framework of the Group and the stewardship aims of investors, and investors' comments from all of these interactions are communicated to the Board who take those views into account when determining strategy.

The Senior Independent Director is also made aware of views expressed by shareholders to other members of the Board, via the Company's brokers or through the Investor Relations team. Meetings between the Senior Independent Director and shareholders can be arranged via the Company Secretary.

The External Relations Director updates each meeting of the Performance ExCo on changes in the Group's shareholder base and on shareholder interactions.

B4.4 Board evaluation and development

Board evaluation

The effectiveness of the Board, individual directors and the Board's main committees is ordinarily reviewed annually. During the year, the Board monitored progress on the recommendations from the internal review carried out in 2021, all of which are now fully implemented. Given the change of Board Chair in September, a decision was made to defer the externally facilitated evaluation until 2023 given it would be more meaningful for this to take place once the new Chair has been in the role for a reasonable period of time. The outcome of this review will be reported in the 2023 Annual Report and Accounts.

Notwithstanding the postponement of the 2022 evaluation, elements of board performance were reviewed. These included consideration by the Nomination Committee of the time required from, and independence of, the non-executive directors, the continuing appropriateness of the Board Skills Matrix, as well as the proposed re-election of directors at the 2023 AGM.

2021 internal evaluation findings – Progress report

Following last year's internally facilitated evaluation, significant progress has been made on addressing actions arising out of the evaluation, with all actions completed during the year. Progress highlights are set out in the table:

Issue	Recommendation / action
Board	
Length of papers	
Shorten papers, where possible.	The use of the resources section of the board portal was increased, where appropriate, and discussions were held with other presenters with a view to making papers more concise.
Board skills	
The need to address gaps in BAME representation / ethnic diversity and PLC experience.	Board and Nomination Committee succession planning deliberations actively considered the need for BAME representation / ethnic diversity on the Board. The level of PLC experience on the Board was enhanced during the year via additional board training and an additional non-executive director was appointed.
Risk	
Wider horizon scanning to be undertaken.	The CRO and CEO regularly bring emerging risk updates to the Risk and Compliance Committee and Board for discussion and challenge.
Audit Committee	
More finance team members to present papers at Audit Committee meetings.	The Audit Committee Chair and the CFO will keep this under review, with Audit Committee meeting attendance by additional finance team members to be arranged when appropriate.
More work on combined assurance is required.	The Risk and Compliance Committee monitored progress on combined assurance work during the year following Risk and Compliance Committee, Audit Committee and Board discussions on the matter.
Risk and Compliance Committee	
Over time, greater delineation between Risk and Compliance Committee and Board should be achieved, after which Risk and Compliance Committee membership should be reconsidered.	The Risk and Compliance Committee continued to keep its membership and effectiveness under review.

The Nomination Committee evaluation of non-executive directors considered: whether each director had sufficient time to devote to their board duties; the independence of non-executive directors; and whether each director should be put forward for re-election at the 2023 AGM, with recommendations then put to the Board for deliberation.

A review of the performance of the executive directors took place at the Remuneration Committee meeting in September 2022 that considered remuneration packages for 2022/23.

At the 2023 AGM, the Chair will confirm to shareholders, when proposing the re-election of any non-executive director, that, following formal performance evaluation, the individual's performance continues to be effective and demonstrates commitment to the role. The letters of appointment of the non-executive directors will be available for inspection at the AGM.

Induction

All directors receive an induction training schedule tailored to their individual requirements upon joining the Board. The induction, which is designed and arranged by the Chief People Officer in consultation with the Chair and Company Secretary, includes meetings with existing directors, senior management and other key personnel, to assist new directors in increasing their knowledge of the Group's operations, management and governance structures, as well as key issues for the Group.

During the year Robert East, who was appointed Chair on 1 September 2022, has had meetings with senior employees from areas across the organisation to brief him on the work of their respective areas and the particular issues within those areas most relevant to his position as Chair of the Board.

Further, Tanvi Davda, who was appointed on 1 September 2022, began her induction programme and met with stakeholders across the business.

Development

Further to the 2021 board evaluation, a skills matrix was produced for completion by each board member, the aim of which was to identify the key areas for ongoing board development and to assess the necessary skills and experience when considering future board succession planning. Further detail on training undertaken by the Board during the year can be found in Section B3.3.

A number of topics have been agreed for board development over the coming year in order to retain a diverse balance of skills and increase coverage in key areas to support oversight and delivery of the corporate plan.

Separately, ongoing individual development opportunities will be provided during the forthcoming financial year. A training schedule is maintained by the Group's Human Resources department in conjunction with the Company Secretary.

The non-executive directors have received presentations during the year on various aspects of the Group's activities to support their on-going business awareness and development. The Board has dedicated a number of days during the year to training and will undertake additional training as required by the Group's strategy and operational needs.

Topics for board training sessions are recommended by the Board, and provide for a balance of technical, risk, management, governance and professional development. All directors completed a variety of regular training modules that are mandatory for Group employees.

Further business insight and awareness sessions and deep dives on particular areas are held regularly to provide non-executive directors with the appropriate depth of knowledge to contribute effectively at board meetings on key topics. In particular, during the year the Board received training on topics related to risk, anti money laundering, the ERMF, the new FCA Consumer Duty, cyber security, operational resilience and sustainability. More detail is available in section B3.3.

B4.5 Whistleblowing

The Group has an established procedure whereby employees can make disclosures regarding potential wrongdoing within the Group on a confidential basis, in accordance with the Public Interest Disclosure Act 1998 ('PIDA'). The policy also makes provision to ensure that no employee making such a disclosure suffers any detriment by doing so. A whistleblowing service is operated for the Group, at arm's length, by a third-party charity, Protect. This process was supervised by the Board during the year, in accordance with Code requirements, and any amendments to the policy required the approval of the Chair.

The Chair of the Audit Committee, an independent non-executive director, is the Group's designated Whistleblowing Champion. She is responsible for overseeing the integrity, independence and effectiveness of the Whistleblowing policy.

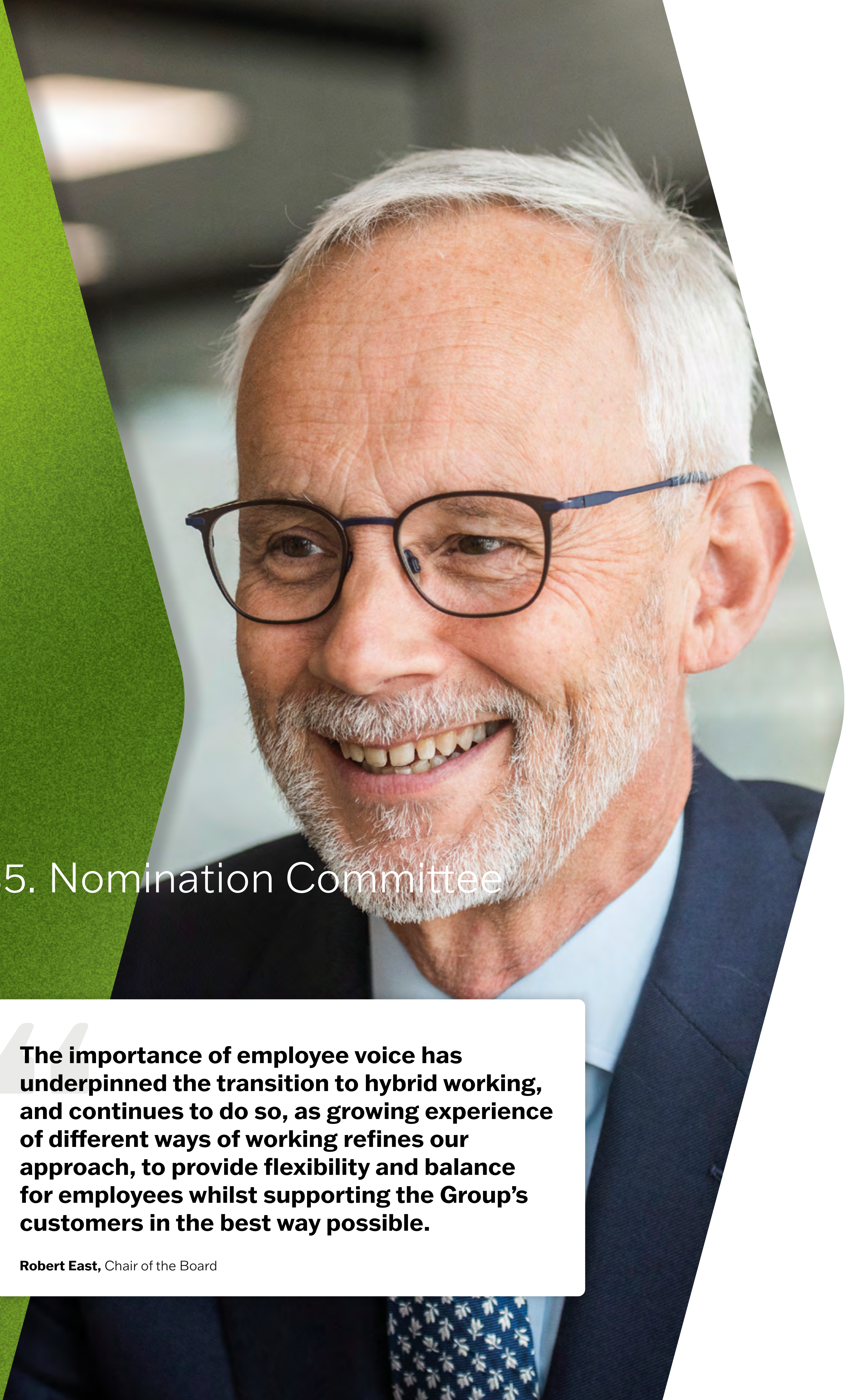
Management oversight of the process is provided by the Whistleblowing Group, which ensures that disclosures are properly assessed, whistleblowers' identities are protected, and all cases are handled in an appropriate, fair and consistent manner. The Whistleblowing Group comprises the Chief People Officer, Chief Risk Officer, Internal Audit Director, Conduct and Compliance Director and the Whistleblowing Champion.

If an employee is dissatisfied with the investigation, or any action taken as a result, they may request a confidential meeting with any member of the Whistleblowing Group to discuss the matter further.

To ensure that the policy is embedded in the operations of the Group, all employees received training on the requirements of PIDA and the Group's policy during the year. There were also internal publicity campaigns promoting the whistleblowing procedures.

During the year ended 30 September 2022, there were two instances of whistleblowing which resulted in a requirement for full consideration and investigation by the Whistleblowing Group (2021: none). Both cases have been fully investigated and concluded with no further action required.

Procedures whereby customers who are dissatisfied with the Group's response to any complaint about their treatment may seek recourse to an external party are discussed in Section A6.2.



B5. Nomination Committee

> **The importance of employee voice has underpinned the transition to hybrid working, and continues to do so, as growing experience of different ways of working refines our approach, to provide flexibility and balance for employees whilst supporting the Group's customers in the best way possible.**

Robert East, Chair of the Board

B5.1 Introduction by the Chair

Dear Shareholder

The Nomination Committee is the forum used by the Board to consider certain governance matters. These are vital issues for the Board and the Group, and the Committee has continued to fulfil its duties with a full programme of activity. The Chair of the Board serves concurrently as Chair of the Nomination Committee, and I was pleased to take up that position in September 2022.

During the year the Committee has overseen the appointment of an additional non-executive director and my appointment as the Chair of the Board. The primary aim of the Committee in both processes was to ensure each person appointed had the requisite skills and knowledge for their role, benchmarked against the board skills matrix, bringing an increased diversity of experience to complement the existing skillset of the Board.

Fiona Clutterbuck had served as Chair of the Board and of this Committee since May 2018. However, given her tenure on the Board reached nine years in September 2021 the Nomination Committee, led by the Senior Independent Director, oversaw the process to appoint a new Chair. I was delighted to take up the role of Chair having completed an orderly handover process with Fiona, and I look forward to working with the management team to build on the successes of the Group.

Tanvi Davda was appointed to the Board as a non-executive director from September 2022. Tanvi has exemplary finance, advisory and regulatory experience, and her skillset will benefit the Group considerably. She combines a history of working in large global corporates with the experience of co-founding a successful wealth management business. During her executive career, which she retired from in 2021, Tanvi undertook a number of non-executive director roles in a variety of organisations. The Committee supports the objectives of the Parker Review and Tanvi's appointment means the Group has met its Parker Review requirements ahead of the 2024 deadline.

The Committee has noted the new FCA Listing Rule requirements in relation to gender and ethnic diversity at board and executive management level, which apply for financial years beginning on or after 1 April 2022. It will be a key priority and area of focus to ensure these requirements are met by 30 September 2023, the end of the Group's first financial year for which they apply.

The remit of the Committee also covers people-related sustainability issues. There have been noteworthy contributions to the Group's diversity agenda in the period, which has seen the Group continue to meet all its Women in Finance Charter targets. The Group became a founding partner of Progress Together, an initiative to increase socio-economic diversity at senior levels in the financial services sector, led by the City of London Corporation. I would like to congratulate Richard Rowntree, the Group's executive sponsor for equality, diversity and inclusion, and his colleagues across the industry for their work in getting this important project off the ground.

The importance of employee voice has underpinned the transition to hybrid working, and continues to do so, as growing experience of different ways of working refines our approach, to provide flexibility and balance for employees whilst supporting the Group's customers in the best way possible.

I look forward to the contribution these initiatives will continue to make to the Group's strategy and culture in the future.

Overall, I believe the Committee has enjoyed a year of positive achievement and fully satisfied its mandate from the Board.

Robert East

Chair of the Board and the Nomination Committee

6 December 2022

B5.2 Operation of the Committee

The Nomination Committee is chaired by the Chair of the Board and includes three independent non-executive directors. The Committee's role is to ensure that there is a formal, rigorous and transparent procedure for the appointment of new directors to the Boards of the Company and of Paragon Bank PLC; to lead the process for board appointments and make recommendations to the Board. Ultimate responsibility for any appointment remains with the Board. Its role also includes:

- Keeping under review the structure, size and composition of the Board (including its skills, experience, independence, knowledge and diversity) and making any recommendations it deems necessary to ensure that it is effective and able to operate in the best interests of shareholders and other stakeholders
- Considering re-appointment of directors, re-election of directors and the independence of non-executive directors
- Ensuring that plans are in place for orderly succession to positions on the Board and in senior management and overseeing the development of a diverse pipeline for succession to such roles
- Overseeing the Group's initiatives on the promotion of diversity in the workforce, with a particular focus on its participation in external programmes, such as the Women in Finance Charter, and reporting including gender paygap reporting
- Monitoring workforce engagement and seeking employee feedback on behalf of the Board

The membership of the Committee and the record of their attendance at meetings is given in Section B3.3.

B5.3 Matters considered by the Committee during the year

Board appointments

During the year, the Committee recommended the appointment of a new Board Chair, Robert East, to succeed Fiona Clutterbuck, who stepped down from the Board at the beginning of September 2022. This was approved by the Board following regulatory approval. Robert followed a structured induction and handover prior to starting his role and his induction will continue during his first year of appointment. Robert brings with him over 40 years' experience in UK financial services, gained during his executive and non-executive career. He has held positions as Chair of Vanquis Bank, Skipton Building Society and Hampshire Trust Bank, where he was also Chair of the Risk Committee.

The Committee also recommended the appointment of an additional non-executive director, Tanvi Davda, who joined the Board at the beginning of September 2022. Tanvi's executive career was spent in consulting, capital markets and wealth management. She was Managing Director for Barclays Wealth and Investment Management, having previously worked for RBS/ABN Amro, IBM UK and Credit Suisse. She went on to co-found Saranac Partners, a wealth management business, where she served as Managing Partner. Tanvi's appointment complements the existing skillset of the Board, broadly maintains the balance of gender diversity on the Board and meets the Parker Review requirements ahead of the 2024 deadline. Tanvi also joined the Risk and Compliance and Remuneration Committees on her appointment.

The search process for the new Chair was led by Hugo Tudor, Senior Independent Director. The search process for the additional non-executive director, was led by the previous Chair, Fiona Clutterbuck, with input from Robert East. Both processes were supported by Anne Barnett, Chief People Officer, and undertaken in conjunction with Jamie Risso-Gill from Per Ardua Associates Limited. Per Ardua Associates do not have any connection with the Group or any of its directors.

For both appointments, the Committee reviewed and agreed the role profile and a shortlist of candidates. A series of interviews with members of the Board was undertaken. For the Chair's appointment, interviews took place with non-executive directors only, although the final shortlisted candidates spent time with the then Chair and executive directors to ensure a strong cultural fit for the Group was evident, and to support the candidates' own due diligence processes.

In initiating these two appointments the Committee also considered the consequent increase in the size of the Board from eight to nine members. This was considered appropriate in view of the increasing size of the Group and of growing regulatory expectations which accompany this. It also enables the Board to maintain a female representation above 33% in support of the original FTSE Woman Leaders target.

The Committee has noted that new Listing Rule requirements in relation to gender and ethnic diversity at board and executive management levels will apply to the Group from its financial year commencing 1 October 2022, and will be working towards meeting those requirements in the coming year.

In November 2023, Hugo Tudor will reach his nine-year tenure on the Board. The Committee will begin the process to oversee the appointment of his successor as a non-executive director, Senior Independent Director and Chair of the Remuneration Committee in the coming months.

As it has done for a number of years, the Committee considered the appropriateness of the annual re-appointment of the serving directors and recommended to the Board that resolutions for their re-appointment should be proposed at the AGM.

Succession planning

Succession plans for the Board and the Executive Committees were reviewed during the financial year. The tenure of non-executive directors is monitored by the Committee. Emergency cover is in place for executive directors and their direct reports.

The Human Resources department has a wider succession development plan for senior management roles across the Group, prioritising those positions likely to require recruitment within the next five years. Bespoke development plans are in place for strong performers identified as having high potential, and their progress is overseen by the Committee. During the period, this approach was extended to the senior management teams across each business area, providing further depth of development planning, which has been particularly beneficial in light of the tightening of the labour market seen across financial services this year.

Risk mitigation for the loss of senior employees continues to include the ongoing development of employees, as well as work to further validate potential candidates for senior positions. Development work on potential candidates occurs with those employees remaining in their current roles, as this training is undertaken to minimise business impact while ensuring that candidates are enabled to undertake a more senior role in due course.

The Group's preference, where possible, is that internal candidates are developed and supported to undertake more senior roles, as this assists in the ongoing maintenance of its strong culture and values. It also acknowledges the benefits which can arise from the hire of strong external candidates to add experience and bring a fresh perspective to strategic thinking. In addition, the senior leadership development programme is also focussing on increasing the diversity of the Group's talent pool in support of the overall approach to equality and diversity.

Board skills matrix

The Committee considered a revised skills matrix at its September 2022 meeting following the outputs from the Group's strategy event in June 2022. This was reviewed and subsequently approved by the Board in October 2022.

The matrix reflects the Group's strategic aim of becoming a technology-enabled specialist bank, and the skills considered include matters such as:

- Demonstrating sound knowledge of the UK macro environment affecting the retail banking environment
- The Group's key lending markets
- Understanding capital requirements and liquidity models
- Considering the application of digital technology in a financial services environment
- Customer insight, marketing and communications in the specialist lending sector
- Sustainability matters including financed, operational and supply chain environmental impacts, social responsibility and governance standards.

The board skills matrix is reviewed annually by the Committee and forms the basis for continuing professional development and future succession plan requirements. The application of the skills matrix in developing board training in the year is described in section B4.4.

Diversity

The Group recognises the importance of diversity, including gender and ethnic diversity, at all levels of the organisation. The Group strongly values diversity on the Board, not only of gender, but also of experience and background, recognising the contribution such diversity can make towards achieving the appropriate balance of skills and knowledge which an effective board of directors requires. The Board is pleased to have maintained a consistent female representation of 38.1% at board and senior management level (2021: 38.7%), exceeding the original Hampton-Alexander Review targets and the Group is aligned to the ongoing objectives of the FTSE Women Leaders Review.

When the Group signed up to HM Treasury's Women in Finance Charter initiative during 2016 its target was to achieve 35% female representation at senior management level by January 2022, increasing from 26% at the time the targets were set. On 1 October 2021, the Group met this target, and all its other Women in Finance targets, ahead of the deadline and is proud to have maintained this position throughout the year. As well as the headline target for women in senior positions, the Women in Finance commitments also included targets on women and ethnic minorities in management roles more widely, set out in section A6.3, helping to build a platform for the next phase of the initiative. The Group is committed to increasing the number of women in senior positions, and has set a new headline Woman in Finance target of 40% female representation at board and senior management level by 30 September 2025. Other, broader, targets are in the process of development.

The Committee was pleased with the continuing development of the Group's Equality, Diversity and Inclusion ('EDI') Network and of the broadening of the EDI agenda beyond gender and ethnicity. In particular, the Group's part in the launch of the Progress Together initiative on socio-economic diversity in senior roles in UK financial services was a notable achievement.

The Committee is pleased that 60% of employees provided diversity data for analysis at the beginning of the year and this increased to 73.1% by 30 September 2022. This supports the Group's culture and commitment to EDI matters and has helped shape EDI activities, including focused communication campaigns to raise awareness and celebrate differences, and to provide more development opportunities for under-represented groups. The Committee has monitored these activities with interest and is pleased with the Group's progress in this area.

More details of the activities delivered with the involvement of the EDI Network, including the commitments made by the Group under the Race at Work Charter and the Disability Confident Employer Scheme are provided in Section A6.3.

During the year the Committee reviewed the Group's gender pay report and supporting analysis. It carefully examined changes since the previous report and considered the underlying challenges with the reporting rules, in the management structure and in the nature of strategic developments in the Group that make closing the gender pay gap difficult, as it is for other financial services firms. However, the Committee was pleased to note the improvements in the headline rates achieved in the year, which are discussed further in section A6.3 This will continue to be a focus for the Committee.

The Group's diversity policies were updated during the year and are described in Section A6.3. Information on the composition of the workforce, including the gender and ethnic balance of those in senior management and their direct reports is given in Section A6.3. The Group's gender pay gap statistics are also discussed in that section.

Workforce engagement

The Committee has received regular updates on workforce engagement and board members have engaged directly with the workforce throughout the year through both formal and informal channels.

Additionally, non-executive directors have attended People Forum meetings during the year to discuss topics including executive pay and reward; pay and reward for the wider workforce; hybrid working practices and the Group's sustainability goals. These meetings provide employees with an opportunity to ask questions of board members and provide direct feedback. These meetings form a regular feature of the board calendar.

In February 2022, the Group received its triennial Investors in People ('IiP') external assessment. Part of the assessment included an anonymised employee survey in which 73% of employees shared their views (2019: 64%). The overall IiP assessment result placed the Group first in the finance and insurance sector for firms with 1,000 or more employees, and third for all firms with between 250 and 4,999 employees. This resulted in the Group being awarded Platinum Status, which has been achieved by only 5% of UK companies assessed. The full IiP report was shared with the Committee and the strength of workforce engagement was noted as a very positive achievement.

B6. Audit Committee

> **The principal accounting challenge for the Group in the period has again been the estimation of expected credit losses under IFRS 9, one shared with many other businesses in the banking sector… and the Committee's duty to rigorously challenge those judgements is fundamental.**

Alison Morris, Chair of the Audit Committee

B6.1 Statement by the Chair of the Audit Committee

Dear Shareholder

The economic and political environment in which the Group operated in the year has developed in ways which no one could have expected and the prospects for the future remain changeable and uncertain. This once more results in my letter to you focussing on the level of challenge this has posed for the Committee, as seems to have become customary in recent years.

While the impacts of the Covid pandemic have begun to recede, the long term effects, especially for SME businesses are still to play out fully. The geopolitical impacts of Russia's intervention in Ukraine have formed a backdrop to a growing cost of living crisis in the UK during the year, and responsibility for the direction of UK economic policy has changed hands far more frequently than has normally been the case.

All these factors present new questions to the Committee as it considers the appropriateness of the various accounting judgements required to compile these accounts, assess whether they provide the information users require and, more widely, evaluate the continuing strength of the Group's control systems.

The principal accounting challenge for the Group in the period has again been the estimation of expected credit losses under IFRS 9, one shared with many other businesses in the banking sector. In a situation where expected future conditions have little direct precedent in recent experience, with interest rates and inflation rising to levels, and at speeds, not seen in many years, models based on historic data have inherent limitations. In these circumstances the use of management judgement to ensure that loss expectations reflected in the accounts are appropriate is essential, and the Committee's duty to rigorously challenge those judgements is fundamental to ensuring the accounts fairly represent the position of the business.

This is a duty which the Committee takes very seriously, and which has been the subject of much thought and discussion. We have considered a great deal of both qualitative and quantitative information from across the Group and engaged with financial and operational management ,and with KPMG, the external auditor, to support our conclusion that the numbers presented are appropriate.

During the year the Committee was pleased to receive the results of a review of the Group's accounts for the year ended 30 September 2021 carried out by the Corporate Reporting Review team of the FRC. No substantive matters were raised, which was particularly pleasing given that these accounts described the impacts of the Covid pandemic on the Group, and the issues arising from it.

For the current year's reporting, the Committee considered particularly the development of reporting around climate change, with a new Listing Rule coming into force for these accounts, and the presentation of information about expected credit losses, in light of both the developing situation and the most recent regulatory guidance.

The progress of the BEIS review into auditing, reporting and governance continued to be monitored by the Committee. These proposals have not developed as quickly as might have been expected this time last year, and it is disappointing that more clarity on final expectations and timescales is yet to be provided. More information is due to be published in the new financial year and I will hopefully be able to provide you with further information on likely impacts on the Group in next year's Audit Committee reporting.

The internal audit function continued to develop with the Group's businesses and systems, and I value the insight which it brings to the Committee's consideration of the effectiveness of the Group's control and governance systems.

KPMG LLP have now audited the last seven sets of the Group's accounts. Simon Ryder, the engagement partner, is to retire from KPMG and this will be his last year in that position. I would like to thank Simon, on behalf of the Committee, for his direction of the engagement and for his communication and challenge over his two years in office. As required by regulation, the Committee considered its intentions for the future tendering of the audit mandate and concluded that there was no present need to retender for any year earlier than that required by law or independence requirements.

In the coming financial year ending 30 September 2023, the Committee's main priorities will include:

- Continuing to monitor the potential impacts of the developing economic situation in the UK and more widely on the Group's accounting, particularly accounting for expected loss
- Considering the continuing need for and appropriate level of judgemental provisioning adjustments, as economic and business conditions revert to a position which can be dealt with more easily by the Group's impairment models
- Supervising the development of the Group's IFRS 9 impairment approach in line with emerging best practice, regulatory guidance and developments in the Group's businesses
- Analysing regulatory developments in accounting, reporting and auditing, particularly the progress of the BEIS proposals, and ensuring the Group is properly positioned to respond
- Supervising preparatory work for the Group's next audit tender, which must be completed in time for audit for the financial year ending 30 September 2026
- Ensuring that the Group's control processes, and internal audit capabilities, continue to evolve alongside developments in the business

I would like to thank my colleagues on the Committee for their application and diligence in what has turned out to be a much more challenging year than might have been hoped for. I would also like to note our appreciation for the work done by people across the business to support us in our deliberations and to ensure that this report properly reflects the Group and the story of its year.

I commend the Annual Report to shareholders and ask you to support the resolutions concerning the reappointment of KPMG as auditors and their remuneration at the AGM in March 2023.

Alison Morris

Chair of the Audit Committee

6 December 2022

B6.2 Operations of the Committee

The Audit Committee currently comprises four independent non-executive directors of the Company whose relevant experience is set out in Section B3. All members served throughout the year.

The terms of reference of the Committee include all matters indicated by Disclosure and Transparency Rule DTR 7.1 and the Code. These terms of reference were most recently updated in September 2022 and are available on the Group's website. The Committee's key responsibilities include:

- Monitoring the integrity of the Group's financial reporting
- Reviewing the Group's risk management and internal financial control systems
- Monitoring and reviewing the effectiveness of the Group's internal audit function
- Monitoring the relationship between the Group and the external auditor

It also provides a forum through which the Group's external and internal audit functions report to the non executive directors.

The Internal Audit Director, Sarah Mayne, reports to the Chair of the Committee. She attends all meetings of the Committee and also reports regularly to the Risk and Compliance Committee.

The Committee considers that, as a whole, it possesses the competence relevant to the sector in which the Group operates which the Code requires. Alison Morris has competence in accounting and auditing while other committee members have experience in various aspects of the financial services industry.

The Committee meets at least four times a year and has an agenda linked to events in the Group's financial calendar. Meetings generally take place before the half year and year end reporting dates in March and September and before the approval of results in May and December. The Committee normally invites the Chair of the Board, the executive directors, CRO, Group Financial Controller, Internal Audit Director and a partner and other representatives from the external auditor to attend meetings of the Committee, although it reserves the right to request any of these individuals to withdraw if appropriate.

For part of each meeting the Committee meets separately with representatives of the external auditor and with the Internal Audit Director without any other persons present.

During the year ended 30 September 2022, the Committee met four times. Its principal activities were:

- The review of the annual and half-yearly financial statements to ensure these properly present the Group's activities in accordance with accounting standards, law, regulations and market practice
- The consideration of the appropriateness and application of the Group's accounting policies for the recognition of interest income and loan impairment, amongst other significant accounting issues
- The review of other financial information published by the Group, such as Pillar III disclosures required by banking regulations
- Review of the terms of reference of the Committee and approval of revised terms
- Considering the final report of the FRC Audit Quality Review ('AQR') of KPMG's audit of the Group's accounts for the year ended 30 September 2020
- Considering the results of the review by the FRC Corporate Reporting Review team of the Annual Report and Accounts of the Group for the year ended 30 September 2021
- Consideration of the Group's readiness to address other forthcoming accounting and reporting changes which will affect it
- Approval of the Group's Internal Audit Plan ('IAP') and monitoring progress against it
- Assessing the adequacy of the resources available to the Internal Audit function
- Receiving and considering reports on internal audit reviews conducted across the Group

From time to time, where there are major changes in the Group's accounting policies or audit arrangements in progress, the Chair of the Committee will hold meetings with shareholders.

Details of the Committee members' attendance at meetings and of the Board's evaluation of the Committee's effectiveness are given in Section B3.3.

B6.3 Significant issues addressed by the Committee in relation to the Financial Statements

The Committee considers whether the accounting policies adopted by the Group are suitable and whether significant estimates and judgements made by management are appropriate. In evaluating the Group's financial statements for the year ended 30 September 2022 the Committee particularly considered:

- The levels of impairment provision against loan assets under IFRS 9 and particularly the interlinked uncertainties resulting from increased living costs, a rising interest rate environment, the impact on the economy of the conflict in Ukraine and the long term damage to businesses of the Covid pandemic
- The calculation of interest income under the Effective Interest Rate ('EIR') method for both internally originated and purchased loan assets
- The requirement for any impairment provision against the purchased goodwill carried in the Group's balance sheet, based on the most recent forecasts for the businesses concerned
- The valuation of the surplus in the Group's defined benefit pension scheme
- The viability statement which the Group is required to make under the Code
- The Group's capital and funding position and the Group forecasts for future periods and their impact on the going concern assessment for the Group

In each case the Committee considered whether these matters were clearly and sufficiently disclosed in the accounts with appropriate sensitivities shown for all significant estimates.

The Committee also considered whether this Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy.

In each of these areas the Committee was provided with papers prepared by management and reviewed by the external auditor discussing the position shown in the accounts, the underlying market conditions and assumptions and the methodology adopted for any calculations. The papers also detailed any changes in approach from previous periods. These were reviewed in detail and discussed with the relevant group employees and the results of this work were considered, together with the results of testing by the external auditor. There were no material or significant disagreements between the management and the external auditor.

Particular matters which the Committee focussed on in each of these areas were:

Matter	Particular areas of focus
Loan impairment	IFRS 9 requires that companies provide for future ECL's on any financial asset held on the balance sheet on the amortised cost basis. Their forward-looking nature means that such provisions are heavily dependent on the use of judgement and estimation techniques to evaluate the likelihood of loss on accounts and the potential amount of that loss. The current economic environment, with rising UK inflation and interest rates, and a developing cost of living crisis, makes the consideration of ECL particularly complex. The Group's ECL models are based on observed data from the recent low rate, low inflation environment and therefore may not be as reliable outside that economic framework. The longer-term impacts of the Covid pandemic on the UK economy, and on the Group's SME customers, also still remain uncertain. These factors increase the potential requirement for management judgement in arriving at final ECL estimates and hence the level of scrutiny required of the Committee. In order to satisfy itself that the process applied by the Group resulted in an appropriate level of provisioning in accordance with IFRS 9, the Committee considered particularly: • The methods used to estimate probabilities of loss and potential losses, both mechanical and judgemental • The assumptions used as inputs in these calculations • The economic projections used in deriving ECLs and the weightings applied to each scenario • The appropriateness of the calculated provisions in light of the economy more generally • The appropriateness of judgemental adjustments made to compensate for factors not fully addressed in the modelling To substantiate these decisions, the Committee considered actual results in the year compared to those predicted by the impairment methodology and the continuing relevance of historical information used in the process based on present economic conditions, lending and account administration practices. The Committee also considered other intelligence on the credit prospects of the Group's customers available through wider management information to ensure that the provisioning approach was consistent with all known data. A particular focus continued to be given to the Group's receiver of rent portfolios and the level to which their ultimate loss levels accorded with expectations. *Further information on these estimates can be found in note 67a to the accounts, the impairment charge for the year and the movements in provision for impairment are shown in notes 19 to 24.* *The Group's exposure to credit risk is discussed in note 61.*

Matter	Particular areas of focus
Interest income recognition	As required by IFRS 9, the Group recognises income from loan balances on an EIR basis, which is intended to produce a constant yield throughout the behavioural life of the loan, taking account of such matters as costs of procuration, and initially fixed or discounted interest rates. The calculation therefore rests on assumptions about the future behaviour of the Group's customers, particularly at the end of a fixed rate period. The Committee assessed the appropriateness of the assumptions made, considering performance of the portfolios against expectations and the impact of changes in product specifications. Redemption profiles used in the modelling of mortgage books were an area of focus, particularly as the earliest substantial tranches of five-year fixed rate products reached maturity. *Further information on these estimates can be found in note 67b to the accounts, and the interest income and expense recognised on this basis is shown in notes 4 and 5.*
Goodwill impairment	The Group is required to assess, at least at the end of the year, whether the carrying value of the acquired goodwill balance in its accounts, which is not subject to amortisation under IFRS, remains appropriate or whether any impairment has occurred. In considering whether any impairment of goodwill had occurred the Committee particularly considered the Group's forecasts for the future cash flows of the acquired businesses and their reasonableness in light of current trading performance, together with the Group's strategy for these operations. The derivation of the discounting rate used was also an area of focus. *The potential impairment of goodwill is discussed in notes 67c and 30.*
Defined benefit pension obligations	The surplus on the Group's defined benefit pension plan is valued in accordance with IAS 19, which requires an actuarial valuation of the plan liabilities. Such a valuation is based on assumptions including market interest rates, inflation and mortality rates in the Plan. In order to satisfy itself as to the appropriateness of these assumptions, the Committee considered their derivation and the market data underlying them. These were compared to market benchmarks and advice from the Group's actuarial advisers. The Committee also considered benchmarking data provided by the external auditor. *Further information on the Plan surplus, the basis of valuation and the assumptions underlying it can be found in note 58 to the accounts, along with an analysis of sensitivities to the more significant assumptions.*
Viability statement	The Board is required by the Code and the Listing Rules to make a viability statement in the Annual Report. The Committee has been asked to express an opinion to the Board as to whether this statement could properly be made. The Committee considered aspects of the work of the Board and its various committees which addressed the Group's business model, risk profile, access to funds and future strategy. They also considered guidance issued by the FRC and stress testing which had been carried out in the year, particularly focussing on the levels of potential variability in the forecasting. *A fuller discussion of the directors' consideration of the viability statement is set out in Section A5.*
Going concern	The Board is required by the Code and the Listing Rules to make a going concern statement in the Annual Report. The Committee has been asked to express an opinion to the Board as to whether this statement could properly be made. The Committee considered the Group's detailed forecasts and the implicit cash and capital requirements. It also considered internal stress testing procedures, including the ICAAP and ILAAP outputs, prepared for regulatory purposes. The Committee discussed availability of funding, potential stress events and the impact of the economic environment, including the uncertainties created by increasing inflation and bank rates, the UK economy generally and the Group's operations in particular. *A fuller discussion of the directors' consideration of the going concern statement is set out in Section A5.*

Matter	Particular areas of focus
Internal control and risk management	The Board is required to make statements in the Annual Report and Accounts relating to the Group's systems of internal controls and risk management. The Committee considered evaluations prepared by the Risk and Internal Audit functions, together with the findings of internal audit reports in the year and its own engagement with the management information of the Group and the executive directors. *The Board statements on internal control and risk management are set out in Section B8 and B9.*
Fair, balanced and understandable	The Board is required by the Code to state whether, in its view, the Annual Report is fair, balanced and understandable. The Committee has been asked to express an opinion to the Board as to whether this statement could properly be made. The Committee considered the draft Annual Report for the financial year, as a whole, satisfying itself that the process for the preparation and review of its various sections, was appropriate. The Committee especially focussed on areas where disclosure requirements had changed or where new activities or considerations were to be reported on. For all significant judgement areas the Committee considered whether the disclosures made were consistent with its understanding of those matters and provided sufficient and appropriate information to a user of the accounts. Based on this exercise, and the Committee's own understanding of the business in the year, it determined whether the Annual Report, overall, portrayed the Group's activities, position and results properly.

The Committee was able to reach satisfactory conclusions on all these areas and therefore resolved to commend the Annual Report to the Board for approval, and to advise the Board that it can conclude that the Annual Report is fair, balanced and understandable.

Earlier in the year the Committee had considered each of these areas, where applicable, in the same manner in concluding that it could commend the Group's half-yearly financial report for the six months ended 31 March 2022 to the Board for approval.

The Committee's consideration of the financial statements for the year ended 30 September 2021, which took place in the year under review, is discussed in the Audit Committee report for that year.

The PRA Rulebook and, previously the Capital Requirements Regulation ('CRR') requires that a firm's Pillar III report is subject to the same review processes as its annual report and accounts. The Committee therefore reviewed the Group's annual and half-yearly Pillar 3 reports, considering whether they included all material matters required by the PRA Rulebook or the CRR and its supporting requirements, as appropriate, and whether it formed a fair representation of these matters.

During the year the Committee considered the results of a review of the annual report and accounts for the year ended 30 September 2021 carried out by the Corporate Reporting Review team of the FRC, in accordance with Part 2 of the FRC Corporate Reporting Review Operating Procedures. Such reviews are based solely on the annual report and accounts and do not benefit from either a detailed knowledge of the business or an understanding of the underlying transactions entered into. They are, however, conducted by staff of the FRC who have an understanding of the relevant legal and accounting framework.

The Committee was pleased to note that the regulator raised no questions or queries requiring a response from the Group, and considered the other observations made by the FRC as part of the preparation of these financial statements.

B6.4 External Auditor

The Committee is responsible for assessing the effectiveness of the external audit process, for monitoring the independence and objectivity of the external auditor and for making recommendations to the Board in relation to the appointment and remuneration of external auditors. The Committee is also responsible for developing and implementing the Group's policy on the provision of non-audit services by the external auditor, which was reviewed in the year.

AQR Review

During the year the FRC AQR team concluded a review of KPMG's audit of the Group's financial statements for the year ended 30 September 2020, with the Chair of the Committee engaging with the AQR team as part of this process.

The Committee had been briefed by the KPMG team on the progress of this review as it progressed, and the final report was received during the period. The AQR raised no significant issues. The Committee was satisfied by this outcome and noted that all the matters raised by the AQR had already been communicated by the external auditor. These points had been considered by the Committee and discussed with the audit team, and therefore no further action was thought to be required.

Audit tendering

The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 (the 'Order') requires that only the Committee can agree the fees and terms of service of the external auditors, initiate and supervise a tendering process or recommend the appointment of an external auditor to the Board following a tender process. The Group has complied with the requirements of the Order during the year.

KPMG were appointed as auditors, following a competitive tender process, with effect from the year ended 30 September 2016 at the AGM in February 2016. The financial year ended 30 September 2022 is the seventh reported on by KPMG. This is the second year for which Simon Ryder has served as engagement partner. Simon has informed the committee of his intention to step down after the completion of the current audit and a new engagement partner will take over for the year ending 30 September 2023. It is the policy of both the Group and the external auditor that no engagement partner should serve for more than five years.

The Group is not subject to a legal requirement to undertake an audit tender until ten years have elapsed. However as the current financial year is the sixth for which the external audit was not subject to a formal tender process, the Committee is required to consider when it would be in the best interests of the Group and its stakeholders for the next tender to take place, and report its conclusions to shareholders.

Having considered the performance of the external auditors to date, the potential impacts on the Group's future requirements for external audit services of strategic, legal and regulatory developments, together with the resources required by any tender process, the Committee concluded that currently, on balance, it would not be beneficial to put the Group's external audit out to tender at an earlier date than required by law. The Committee therefore currently intends to conduct a tender process for external audit services for the year ending 30 September 2026 at a time that avoids any issues of independence for potential bidders.

The Committee will keep this decision under review in light of any changes in either strategic or regulatory requirements and in conjunction with its ongoing monitoring of external audit quality and will provide an update to shareholders annually in the Audit Committee Report.

Other than the legal requirements of the Order and the general constraints imposed by the current structure of the UK audit market, including independence requirements, the Committee has not identified any factors which might restrict its choice of external auditor.

Audit effectiveness

The Committee has considered the effectiveness of the external audit for the year ended 30 September 2022 and the Group's relationship with the external auditor, KPMG, on an on-going basis, and has conducted a formal review of the effectiveness of the annual audit before commending this Annual Report to the Board. This review consisted of the following steps:

- A list of relevant questions was considered by senior management, who submitted their responses in writing to the Committee in advance of the meeting convened to consider the Annual Report
- The Committee members considered their experience of the audit process in advance of that meeting
- At the meeting the Committee discussed the results of the exercise with the senior financial management of the Group, without the external auditor present
- The Committee then addressed the evaluation, as appropriate, with the external auditors

The Committee was able to conclude, on the basis of this exercise and its experience over the year, that the external audit process remained effective, and that the auditor was independent and objective, up to the signing date of this report. A further review will be carried out following the completion of audit procedures on all Group companies and reported on in next year's Annual Report.

The effectiveness review addressing the conduct of the 2021 audit, undertaken at the time of approval of the Group's 2021 consolidated accounts, was updated once the external audit process for all Group companies had been completed. This affirmed the original conclusion, that the external audit was independent and objective and that the audit process was effective for that financial year.

In conjunction with the effectiveness review, before recommending the re-appointment of the external auditor, the Committee must consider whether they are able to provide the required service to the appropriate standard and are independent of the Group. To this end, the Committee considered whether KPMG's understanding of the Group's business, their access to appropriate financial services and regulatory specialists within their firm, both locally and nationally, and their understanding of the sectors in which the Group operates were appropriate to the Group's needs.

As part of this exercise the Committee also considered the transparency report published by the external auditor, the FRC's AQR review of the Group's 2020 external audit and the regulator's most recent audit inspection review on KPMG, published in July 2022.

As a result of these exercises the Committee concluded that it would recommend to the Board that a resolution to reappoint KPMG as external auditor for the year ending 30 September 2023 should be proposed at the forthcoming AGM.

Independence policy

Both the Committee and the external auditor have safeguards in place to avoid any compromise of the independence and objectivity of the external auditor. The Committee considers the independence of the external auditor annually and the Group has a formal policy setting out measures to ensure that independence is preserved. The policy is designed to ensure that neither the nature of the service to be provided nor the level of reliance placed on the services could impact the objectivity of the external auditor's opinion on the Group's financial statements.

The current policy, which is consistent with the FRC Ethical Standard for auditors, limits the use of the external auditor to supply non-audit services to those services where the use of the external auditor is expected or mandated by legislation or regulation. The Committee must approve any engagement of the external auditor for non-audit work, except where the fee involved is clearly trivial. The policy also sets out rules for the employment of former employees of the external auditor and procedures for monitoring such persons within the organisation.

The Committee reviews, on a regular basis, the levels of fees paid to all major accounting firms and the nature of any ongoing relationships with the Group to identify any matters which might impact on those firms' ability to tender for the group audit at any future date.

Fees paid to the external auditor

Fees paid to the external auditor are shown in note 10 to the accounts. The 'other services' provided by KPMG include only services required to be provided by external auditors by legislation or regulation, including the review of half-yearly financial information and profit verification for regulatory purposes, and assurance services expected to be provided by external auditors on central bank funding transactions

Audit fees of Group entities for the year have increased by 15.7% to £2,102,000 (2021: £1,817,000). This was principally a result of general inflation in professional services fees, particularly for more specialist resource.

The EU Audit Regulation (which remains directly applicable in the UK under Brexit legislation for the time being) contains a 70% cap on non-audit fees for services provided to EEA Public Interest Entities ('PIEs'). For this purpose, non-audit services include audit-related services other than those services required by EU or national law such as reporting on interim financial information and regulatory profit confirmations, which are required by non-statutory regulations.

Non-audit fees paid to the auditor for the year ended 30 September 2022 should be no more than 70% of the average of the audit fees for 2019, 2020 and 2021. As this average was £1,688,000, the non-audit fee cap for the year was £1,182,000. Fees paid to KPMG, the Group's external auditor, for non-audit services, as defined by the Regulation, during the year were £213,000 (2021: £210,000), well within the cap. All these fees were for services related to the Group's audit, as described above.

The Group actively considers other providers for the type of non-audit services typically provided by accounting firms. It maintains on-going relationships relating to tax, remuneration and regulatory advice with firms other than the external auditor's firm and considers discrete projects on a case-by-case basis. The Group has engaged with a number of firms, including some outside the 'big four' largest audit firms, in considering appointments for assignments during the year, assessing each firm's appropriateness for the particular assignment before an appointment was made. Fees paid to audit firms (excluding VAT), excluding the Group audit and related fees can be analysed as shown below:

	2022	2021
	£000	£000
Auditors – KPMG	**38**	32
Other big four firms	**2,677**	2,780
Other firms	**-**	-
	2,715	2,812

The Group maintains relationships with all the major accounting firms and considers a variety of providers for these types of assignment.

Corporate Governance

B6.5 Internal Audit

The Committee is responsible for considering and approving the remit of the internal audit function, approving the internal audit plan, and ensuring it has adequate resources and appropriate access to information to enable it to perform its function effectively and in accordance with the relevant professional standards. It also receives the function's reports and evaluates the adequacy of Group's responses to them. The Committee also ensures that the internal audit function has adequate standing and is free from management or other restrictions which may impair its independence.

Objective

The purpose of Internal Audit is to provide independent assurance to the Group's Board and Audit Committee that the governance, risk management and control systems within the Group are adequate, effective and functioning properly, forming the third line of defence in the risk management model (Section B8). The scope and responsibilities of Internal Audit are set out in the Internal Audit Charter, which is reviewed annually by the committee, most recently in May 2022. A copy of the current Charter is available in the Governance section of the Group's website.

Internal Audit maintains a good working relationship with the external audit team, meeting regularly throughout the year, independently of other Group management.

The function is led by an Internal Audit Director, Sarah Mayne, who reports directly to, and has a close working relationship with, the Chair of the Committee. She attends all meetings of Performance ExCo and ERC as an observer.

Operations

In September 2022, the Committee considered and approved the annual Internal Audit Plan ('IAP') for the year ending 30 September 2023, which is based on an assessment of the key risks faced by the Group. The IAP is produced on a six (month) plus six basis, to facilitate its revision during the year, based on the ongoing assessment of key risks or in response to the requirements of the Group. The IAP for the current financial year ended 30 September 2022 was approved before the beginning of the year, with the plus six review for the 21/22 plan year completed by the Committee in March 2022, when a small number of changes were approved.

Progress in respect of the plan is monitored throughout the year with the Internal Audit Director providing an update to each meeting of the Committee. A private session is also held between the Internal Audit Director and the Committee without management present at least twice a year.

The Internal Audit Director met regularly throughout the year with the Chair of the Committee to discuss progress against plan, outstanding agreed actions, and departmental resourcing. Ahead of finalisation of the audit plan for the year ending 30 September 2023, the Chair of the Committee met with the Internal Audit Director to discuss audit planning priorities, key business risks and assess current resourcing.

All internal audit reports are circulated to the Board. During the year the Board has received reports covering themes including: prudential and credit risk management; the operation of lending and customer servicing areas; data, IT and operational resilience; as well as assurance over the management of the Group's change portfolio.

Significant findings of internal audit reports and management's responses are discussed at meetings of the Committee throughout the year. Overdue actions graded medium or above are reviewed and challenged at both the Committee and the Risk and Compliance Committee. The Internal Audit Director also provides an update on key risk themes emerging from Internal Audit reviews to the Risk and Compliance Committee and is an attendee at all executive risk sub-committees. (see section B8.2)

On an annual basis, Internal Audit reports to the Committee on their assessment of the effectiveness of the operation of risk management and control arrangements, including details of themes raised within audit reports. The last report in November 2022 concluded that these arrangements were operating effectively (Section B6.3). The Committee also considered and concluded upon the independence of the Internal Audit function at this time.

Resources

The Internal Audit Director provides the Committee with regular assessments of the skills required to conduct the IAP and whether the internal audit budget is sufficient to recruit and retain staff, or to procure other resources, with relevant expertise and experience. The Committee assesses, on an ongoing basis, whether the internal audit function has sufficient and appropriate skilled resources to complete the plan and, alongside review and approval of the IAP, formally confirms that it is satisfied that these resources are appropriate.

During the year, several technical and specialist reviews have been co-sourced under agreements with third-party firms on a subject matter expertise basis where it was deemed by the Internal Audit Director that such skills would complement and develop those of the internal team.

Effectiveness

The Committee assesses the effectiveness of the internal audit function by reference to standards published by the Chartered Institute of Internal Auditors on an annual basis. In May 2022, the Committee considered the output of an internally produced effectiveness review which was supported by feedback from stakeholders across the Group; this concluded that the function was operating effectively in accordance with required standards.

An external quality assessment ('EQA') was last commissioned in 2018 to benchmark internal audit activities against best practice and peers. As a matter of policy, the Committee intends to commission an EQA at least every five years and, as such, an EQA review will take place during the year ending 30 September 2023.

> **The outstanding performance and results for the year are reflected in the annual variable remuneration outcomes of the executive directors and other employees.**
>
> **Hugo Tudor,** Chair of the Remuneration Committee

B7. Remuneration Committee

This report covers the activities of the Remuneration Committee for the year ended 30 September 2022 and sets out the remuneration details for the executive and non-executive directors of the Company. It has been prepared in accordance with Schedule 8 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, as amended, and the principles of the Code.

This report consists of the Statement by the Chair of the Committee (B7.1), the Annual Report on Remuneration (B7.2) and the full Remuneration Policy (B7.3) proposed to apply from the close of the Annual General Meeting to be held on 1 March 2023.

B7.1 Statement by the Chair of the Remuneration Committee

The information provided in this section is not subject to audit

Dear Shareholder

This year I undertook one of the most important and challenging parts of the role of Remuneration Committee Chair, that of discussing proposed changes to the Directors' Remuneration Policy (the 'Policy') with shareholders and shareholder advisory bodies to ensure that the Policy remains effective and rewarding for executive directors whilst stretching, risk appropriate and aligned to the Group's strategy and to shareholder interests.

The Group's performance has been exceptionally strong for the year ended 30 September 2022 and this is reflected in the outturns for the executive directors. All of these themes are expanded on further in this report as a whole and in the remainder of this letter.

Business performance

The Group's performance for the year has built on the strong outturn for the prior year, delivering record profits, record volumes, record NIM and a cost:income ratio below 40%. At the same time the Group has maintained a cautious approach to assessing expected credit losses that reflects the uncertainties stemming from an escalating cost of living crisis on the wider economy. In this environment, the Group's approach to managing interest rate risk has supported both current and future NIM, the latter demonstrated by the £191.9 million fair value credit reflected in the profit and loss account. This item reverses over time but demonstrates the value of the approach to pipeline hedging, with the full benefit reflecting the costs that would otherwise have been borne by the Group over the coming years if hedging only took place at loan completion.

Detailed analysis and commentary on performance is contained throughout this report and particularly in the Chair of the Board's and the Chief Executive's reports in Sections A1 and A3. The outstanding performance and results for the year are reflected in the annual variable remuneration outcomes of the executive directors and other employees. When considering variable remuneration awards the Committee noted that the Group's capital position had been enhanced during the year, with the CET1 ratio at 16.3% after growing the net loan book by 6% and reflecting the £75 million share buy-back in the period. It also noted the continuing development of the Group and the ongoing delivery of its multi-business line digitalisation strategy.

Variable pay earned in the year

Both executive directors are being awarded an annual bonus of 96% of total opportunity. The balanced scorecard assessment shown later in this report records and expands on the outstanding performance in all areas. When determining the annual bonus the Committee noted the outstanding financial performance for the year with 100% outcome for both financial metrics. This strong performance was also reflected in the increased bonus awards to other employees, as can be seen in the 'Comparison of annual change in directors' pay with the average employee' table in Section B7.2.

The Performance Share Plan ('PSP') awards that are due to vest in December 2022 will vest at 93.13%. This also reflects strong performance over the period including TSR performance above the upper quartile of the peer group and EPS materially above the threshold for maximum vesting, being up 161.6% across the three years on the statutory basis and 36.8% on an underlying basis. This year also saw the first vesting with non-financial metrics relating to people and customer and despite the challenges of the early part of the performance period caused by the pandemic, the Committee was pleased to see a strong performance against both of these conditions.

Windfall gains

Shareholders will recall that these PSP awards were granted in July 2020. The Committee made a commitment to review the extent to which any adjustment should be made on vesting to reflect any windfall gains. The Committee considered this and determined that participants have not benefited from windfall gains and that therefore, no adjustment is required. In reaching this decision the Committee considered a number of factors including (i) the share price used for determining the grant and subsequent share price performance over the performance period, (ii) the degree of vesting, and (iii) the wider shareholder experience. In particular the Committee noted the outperformance of the share price against the comparator group which demonstrates that the uplift in the share price was specific to the Company's performance.

Policy and incentive metrics review

This year, as noted above, the Committee undertook its triennial review of the Policy, the current version of which was approved by shareholders in 2020. This Policy was designed to meet the regulatory requirements of a Level 2 bank, which the Bank transitioned to on 1 October 2021. In renewing the Policy, the Committee has sought to address both specific feedback from and the evolving expectations of shareholders and other stakeholders.

The primary objective has been to develop a policy that is simpler, more transparent and fit for the long term, while aligning with shareholder expectations. We have simplified our fixed pay structure, ensuring that a greater proportion is delivered in shares to further strengthen the link to the shareholder experience. We have also aligned the pensions of executives to those of the wider workforce.

In seeking to simplify the Policy, we have undertaken some minor rebalancing between fixed pay and variable pay such that total maximum pay has reduced on a 2022 equivalent basis, while maintaining target pay. Finally, the Committee has made a number of changes to the bonus scorecard to increase the transparency of outcomes to shareholders, resulting in 60% now being linked to clearly quantifiable financial metrics and 40% to non-financial metrics.

Additionally, the Committee has also reviewed the long term incentive metrics and for the first time a climate condition will be included in future grants from December 2022. The climate metric is detailed later in the report and looks at the Group's environmental footprint both through its own operations and its commercial activities.

Further detail on the proposed changes is included in Section B7.3 later in this report

Other work of the Committee during the year

Cost of living crisis

The growing cost of living crisis during the financial year has been closely monitored by the Committee. The Group as a whole has been conscious of the impact of this on its employees and the Committee considered the Group's actions on this, which were taken out of the usual salary review cycle, in July 2022. The actions taken included applying a consistent salary increase across the Group, instead of on an individual basis as is usually the case, with most employees except senior leaders receiving a 5% pay rise in October (and senior leaders receiving a 3% pay rise). There were some exceptions to these reviews including those whose roles had changed during the year receiving above the 5% increase. The executive directors will receive a 3% pay rise to their re-structured 2022 base pay.

Additionally, there was an out of cycle variable pay award of £1,000 (gross) made in July to all those employees who would usually receive a Profit Related Pay ('PRP') award in December. This £1,000 being an advance on PRP of £500, together with an additional matching payment from the Group of £500. The PRP award will take place in December as usual (less the advance made in July).

Updated Share Plan rules

The PSP is due for renewal at the 2023 AGM as it will reach the end of its 10 year life cycle in February 2023. The proposed plan incorporates updated wording to reflect general changes in the operation of share plans over the past 10 years and to reflect that the awards under the plan are being granted to employees of a bank which was not the case in 2013. Further information regarding the proposed plan can be found in the Notice of AGM. Additionally, we have decided to put our Deferred Share Bonus Plan ('DSBP') to shareholders to enable allotted shares to be used to fulfil the awards should that be deemed appropriate. A deferred share bonus plan has been in operation for a number of years but to date it has been restricted to market purchase shares and consequently not required shareholder approval. Whilst it is likely that market purchase shares will remain the primary mechanism for fulfilling awards under this plan, the Committee considers it appropriate to request this additional flexibility.

Conclusion

During the summer there was positive engagement with major shareholders and shareholders' advisory groups about the proposed Policy and changes to the metrics and I would like to thank all those who engaged with and provided views to the Committee. These have been considered and reflected on by the Committee when drafting the final proposed Policy and incentive structures. In particular, as a result of the feedback received the Committee has elected to further increase the weighting towards clearly quantitative financial targets in the annual bonus.

I trust that shareholders will support how the Group's remuneration philosophy has been implemented during the year. Further, I hope you consider that the proposed new Policy reflects your views and that it continues to reflect the Group's remuneration philosophy for executive directors and all employees. I recommend this report to shareholders and ask you to continue to support the work of the Committee by supporting the resolutions to approve the Company's Directors' Remuneration Report set out in Section B7.2, the new Remuneration Policy set out in Section B7.3 and the updated rules for the Paragon Performance Share Plan and Paragon Deferred Bonus Plan that are being put to the AGM in March 2023.

Hugo Tudor

Chair of the Remuneration Committee

6 December 2022

B7.2 Annual Report on Remuneration

Contents of the annual remuneration report

Remuneration summary

The information provided in this section of the Directors' Remuneration Report is not subject to audit

Examples of how we aligned remuneration to our strategy during the financial year:

Strategic priority	How success is measured	Where the priority is measured	
		Bonus	**PSP**
Growth	Loan book growth and margins	Future value of new business and financial performance	EPS and relative TSR
Diversification	Liquidity - increasing sources of funding Growing profitability outside buy-to-let	Risk measures and financial performance	EPS, relative TSR and risk assessment
Digitalisation	Increasing direct business flows and reducing customer lead times	Future value of new business	EPS and relative TSR
Capital management	Credit quality	Risk measures and financial performance	Risk assessment and EPS
	Capital strength and efficiency	Risk measures	Relative TSR and risk assessment
	Cost control	Profit measures and personal objectives	EPS
Sustainability	Sustainable earnings	Financial performance	Relative TSR, EPS and risk assessment
	Reducing the impact our operations have on the environment together with a customer and people focussed culture	Personal objectives include ensuring good customer outcomes and support for Paragon's customers	Customer metrics focus on the views of customers across their Paragon lifecycle, people metrics focus on the employee journey and climate metrics focus on emissions of the Group and its portfolios

B7.2.1 The Remuneration Committee, key responsibilities and advisers

The information provided in this section of the Directors' Remuneration Report is not subject to audit

Committee membership

The Committee during the year comprised the following independent non-executive directors (the Chairs of the Board being considered independent on appointment):

Name	Period of appointment
Hugo Tudor (Chair of the Committee)	All year
Fiona Clutterbuck (Chair of the Board)	Until 1 September 2022
Robert East (Chair of the Board)	From 1 September 2022
Tanvi Davda	From 1 September 2022
Alison Morris	All year
Graeme Yorston	All year

The relevant experience of each director is set out in Section B3.1. Information on the number of Committee meetings held and the individual attendance of members is given in section B3.3.

None of the Committee members has any personal financial interest (other than as a shareholder) or conflict of interest arising from cross-directorships or day-to-day involvement in running the business. The Committee is mindful of conflicts of interest arising in the operation of the Remuneration Policy and has measures in place to address this such as no individual being present when decisions are made on their own remuneration.

Key responsibilities

The Committee:

- Decides the Company's policy on executive remuneration, including pension rights and compensation payments of the executive directors
- Sets the remuneration for each of the executive directors, the Chair of the Board, the Company Secretary and all MRTs under the rules of the PRA / FCA which includes all members of the Executive Committee, the Internal Audit Director and CRO
- Reviews workplace remuneration and related policies and the alignment of incentives and rewards with culture; and when setting the policy for executive director remuneration, takes into account those matters
- Considers the group-wide Internal Remuneration Policy for all employees and considers and approves the identification of the Group's MRTs, under financial services regulatory remuneration rules

Attendees

The CEO, Chief People Officer, CRO, General Counsel, Director of External Relations, other non-executive directors (including the Chair of the Risk and Compliance Committee) and external remuneration advisors attend by invitation.

Advisors

During the year, the Committee considered advice from:

- Independent advisors - PricewaterhouseCoopers LLP ('PwC')
- The CEO, the Chair of the Risk and Compliance Committee, the Chief People Officer, the CRO and the Director of External Relations in determining remuneration for the year for executive directors and senior management

Independent advisors: additional information

Appointment process – PwC were appointed by the Committee following review processes in the financial year ended 2021 and are members of the Remuneration Consultants Group and as such voluntarily operate under its Code of Conduct in relation to executive remuneration in the UK. This supports the Committee's view that all advice received during the year was objective and independent.

Connections to the Group – the Committee is satisfied that the PwC team providing remuneration advice to the Committee does not have any connection with the Group, or any individual director, that may impair its independence and / or its objectivity.

Fees – the total fees paid to PwC for advice to the Committee during the year amounted to £175,680 (including VAT) on a part fixed fee and part time and materials basis. This support splits as follows (both inclusive of VAT):

- Business as usual support: £110,280
- Support with the Director's Remuneration Policy: £65,400

Other services – PwC provided other professional services to the Group during the year including regulatory support, risk modelling services and support with the Group's IRB implementation.

Statement of voting at Annual General Meeting

The table below sets out actual voting in respect of the resolution to approve the Annual Report on Remuneration at the Company's AGM on 2 March 2022 and the outcome for the resolution to approve the Remuneration Policy at the AGM on 13 February 2020.

Resolution	Votes for	% for	Votes against	% against	Total votes cast	Votes withheld
Annual Report on Remuneration (2022)	186,403,903	97.48%	4,825,862	2.52%	191,229,765	39,027
Remuneration Policy (2020)	157,352,402	74.33%	54,331,483	25.67%	211,683,885	3,082

B7.2.2 Directors' remuneration for the year ended 30 September 2022

The information provided in this section of the Directors' Remuneration Report has been audited

This section discusses the remuneration of the executive directors, the Chair and the non-executive directors in respect of the year, together with their interests in the shares of the Company and the shareholding requirements expected of them.

Single total figure of remuneration and supporting disclosures

Single total figure of remuneration for executive directors

	Note	N S Terrington	R J Woodman	Total
Year ended 30 September 2022		**£000**	**£000**	**£000**
Fixed remuneration				
Salaries		**629**	**396**	**1,025**
Allowances and benefits	*(a)*	**17**	**14**	**31**
Role based allowance	*(b)*	**140**	**90**	**230**
Pension allowance	*(c)*	**126**	**79**	**205**
Total fixed remuneration		**912**	**579**	**1,491**
Variable remuneration				
Bonus	*(d)*	**905**	**570**	**1,475**
Share awards	*(e)*	**1,636**	**1,030**	**2,666**
Total variable remuneration		**2,541**	**1,600**	**4,141**
Total		**3,453**	**2,179**	**5,632**

	Note	N S Terrington	R J Woodman	Total
Year ended 30 September 2021		**£000**	**£000**	**£000**
Fixed remuneration				
Salaries		599	377	976
Allowances and benefits	*(a)*	14	12	26
Role based allowance	*(b)*	140	90	230
Pension allowance	*(c)*	120	75	195
Total fixed remuneration		873	554	1,427
Variable remuneration				
Bonus	*(d)*	863	544	1,407
Share awards	*(e)*	1,255	791	2,046
Total variable remuneration		2,118	1,335	3,453
Total		2,991	1,889	4,880

a) Allowances and benefits

Included within this total in the single figure tables are private health cover and a company car allowance (£10,000 to £12,000). Also included are reimbursements from the Company in respect of: (i) costs associated with the purchase of shares for the RBA and (ii) certain travel costs incurred in connection with the performance of executive director duties, both of which constitute taxable benefits in kind. The Group provides the amount required to cover the tax liability. The amount will vary with the amount of brokerage costs / travel undertaken by the executive director.

b) Role based allowance ('RBA')

This allowance was introduced following the AGM in 2020. The fixed pay allowance is paid quarterly in shares and released over five years in equal tranches. The RBA is not subject to performance conditions.

c) Pension allowance

Both Nigel Terrington and Richard Woodman received a cash allowance in lieu of pension of 20% of salary for the year ended 30 September 2022.

d) Bonus

Bonus opportunity during the year was, in line with the Policy, 150% of salary.

In respect of the annual bonus for the year ended 30 September 2022 a bonus of 96% of maximum opportunity was awarded to each of the executive directors. The Committee determined that the formulaic outcomes under the bonus framework were fair and appropriate in light of the very strong financial and non-financial performance and exemplary leadership shown over the period, therefore it was decided that no discretion should be applied to the outcomes. Outturn was based on performance measures as detailed in the assessment below:

Balanced scorecard assessment

Measure	Weighting	Threshold	Target	Maximum	Actual	Outcome
Financial performance	**30%**					**30%**
Operating profit	50%	£187.1m	£198.8m	£203.4m	£226.0m	15.0%
RoTE (underlying)	20%	13.1%	14.4%	15.3%	16.0%	6.0%
NIM progression	10%	+3bp	+7bp	+11bp	+30bp	3.0%
Cost: income ratio (underlying)	10%	44.4%	43.2%	42.8%	39.4%	3.0%
CET1 ratio (adjusted for buy-backs)	10%	13.9%	14.5%	15.1%	16.3%	3.0%

Measure	Weighting	How measured	Outcome
Future value and strategy	**30%**	Qualitative assessment by the Remuneration Committee of:	**30%**
Development activities	25%	• Significant system development including buy-to-let customer retention, development finance platform and SME lending portal phase 1 • Sale of residual unsecured Idem Capital portfolio • Material reduction in buy-to-let receiver of rent portfolio	7.5%
Pipeline	25%	• £1.3bn buy-to-let • £0.7m commitments in development finance	7.5%
Embedded value	25%	• Gross new advances up over 23% • Margins widened by 30 basis points • Hedging strategy has developed significant value in protecting future NIM	7.5%
Liability management	25%	• Enhanced utilisation of third party platforms • Deposit costs improved significantly whilst providing competitive rates for customers • Contingent funding capacity improved	7.5%
Risk	**20%**	Qualitative assessment by the Remuneration Committee of:	**18%**
		• ERMF embedding and all principal risks operating within risk appetite • Liquidity management supporting NIM accretion	
Personal performance	**20%**	Qualitative assessment by the Remuneration Committee of individual targets as detailed below for each director.	**18%**
			96.0%

Corporate Governance

	Individual targets	Actual performance
Nigel Terrington	Strong leadership to deliver the Group's business plan and financial performance, upholding our values and always delivering good customer outcomes	• Record operating profit before tax of £226.0 million increased by 16.4% from 2021 • Savings expansion to £10.7 billion with margin enhancement of 30 basis points • Regular surveys of intermediaries and customers show that good outcomes were achieved
	Continue with technology development to digitalise the business for our customers, with improved service delivery, faster decision making and improved cost efficiencies	• Technology roadmap delivered the Commercial Lending origination portal, auto-decisioning, surveyors' system, secure payments and development finance platform • Significant investments in infrastructure, cybersecurity and data controls • Progressed towards digital self-service for buy-to-let
	Continue to develop the Group's savings strategy, expanding the addressable market and over time, utilising technology, including open banking, to broaden the customer reach	• Launched a green savings bond • Further strengthened the Group's platform relationships • Progressed plans to expand the addressable savings market
	Develop the Group's sustainability strategy by supporting customers to meet their climate change requirements and obligations	**Operations:** • Baseline year and offsetting principles approved at Sustainability Committee • Improved energy efficiency of key sites with all new sites to be EPC B at least • All new company cars will be PHEVs or EVs with electric vehicles only from 2026 **Lending:** • Delivered on supervisory expectation arising from 'Enhancing banks' and insurers' approaches to managing the financial risks from climate change' (April 2019) • ICAAP climate change module delivered to Board • Further green product incentives launched across mortgages and development finance • Lending on electric vehicles in motor finance • Data enhancement – EPC MI and green bond reporting to Sustainability Committee and Executive Committee
	Continue to build a succession plan pipeline for Executive Committee roles	• Succession plans detailed for management teams below ExCo's direct reports with leadership and specialist development plans now in place • Senior leadership development programme is successfully supporting career development for top talent

	Individual targets	Actual performance
Richard Woodman	Strong leadership to deliver the Group's business plan and financial performance, upholding our values and always delivering good customer outcomes	• Strong financial metrics delivered during 2022 • Capital remains strong, supporting growth and future returns to shareholders • Group's financial accounting system successfully moved to the cloud during the year – project delivered ahead of target
	Maintain appropriate capital, liquidity and funding buffers to allow the Group to both support its customers and other stakeholders in stress and enhance capital efficiency	• Capital and liquidity ratios remained strong with significant coverage over current and projected requirements • Strong asset generation supported • Contingent liquidity sources expanded
	Further develop the Group's thinking on the risks of climate change and embed the management of climate related risks within the Group's strategic plans, risk appetites and disclosures	• First capital impacts quantified in assessment of EPC requirements and material enhancement to disclosures to meet best practice and TCFD requirements • Strong EPC product mix improving in both new originations and portfolio • Further briefings given to Board
	Prioritise and embed IRB to boost the Group's risk capability and longer-term capital efficiency	• IRB programme managed efficiently but remains subject to delays outside of the Group's control
	Continue to provide oversight and management of the Investor Relations programme	• Reporting processes running smoothly • Close engagement with investment community

e) Share awards: Paragon Performance Share Plan:

The PSP value for the year ended 30 September 2022 has been determined using the average closing share price for the three months ended 30 September 2022 as an estimate. The actual value of the awards, following the testing of the performance condition, will not be finalised until the closing share price is known when the awards vest in December 2022 following the Preliminary Results announcement.

The share awards value for the year ended 30 September 2021 has been restated to reflect the market value of the shares received for the PSP grant that vested on 14 December 2021, as at that date.

Awards vesting in respect of the year ended 30 September 2022

Awards granted in July 2020 under the Group's PSP are subject to performance conditions measured over the three financial years ended 30 September 2022. The metrics are split between financial and non-financial performance conditions.

The awards were granted at 180% of salary. Overall vesting as total of maximum award was 93.13% being a total of 167.63% of salary at grant.

The detail of the outturns of each part of the condition was as follows:

PSP grant in July 2020: financial performance conditions

	Weighting	Threshold vesting for 25% of maximum award	Maximum vesting	Actual performance	Vesting outcome
Relative TSR	25%	Median performance (being (10.0%))	Upper quartile performance (being 22.8%)	Upper quartile performance (being 32.6%)	100.0%
EPS	25%	60 pence	67 pence or more	69.9 pence[1]	100.0%

[1]Reported EPS is 129.2 pence. However, the Committee chose to exclude a material fair value gain from this calculation and for the PSP metric compare the underlying performance which provided an actual of 69.9 pence. The Committee has agreed to continue to use this measure in future years being EPS excluding fair value movements.

PSP grant in July 2020: non-financial performance conditions

		Actual performance		Vesting outcome
Risk	12.5%	50% of the risk metric is determined by the Committee based on an assessment by the CRO of six key elements of the Group's risk appetite: regulatory breaches, customer service, conduct, operational, capital and liquidity and credit losses. This noted that over the vesting period: • There were no material regulatory breaches • Key credit risk appetite metrics relating to arrears and losses were within risk appetite throughout the period • Complaints management performance was excellent throughout the period • Surplus capital has been maintained and excess capital has significantly increased		85.0%
	12.5%	Based on an assessment by the Committee, the strategic risk assessment reflects the management of risk with regard to the delivery of the Group's medium-term strategy noting that over the vesting period: • Paragon Pension Plan is now in surplus (previously in deficit) • Earnings have been diversified • Operational resilience has been updated and governance restructured		98.0%
Customer	12.5%	Customer insight feedback on key product lines	• NPS in line with industry average of +46 • Industry average for customer satisfaction was 78% with the Group's at 79%	77.0%
		Customer complaints relative to risk appetite levels	• Complaints consistently below risk appetite tolerance • Complaints resolved within eight weeks was above 95% for the period	
People	12.5%	Employee engagement	• Outcome for the full engagement survey in June 2021 was +10 above industry norm • Wellbeing surveys during the pandemic (April 2020 to October 2021) delivered consistently positive scores for mental, physical and overall wellbeing • Independent all-employee survey for IiP achieved scores at or above the IiP average, resulting in the achievement of Platinum status	85.0%
		Voluntary attrition compared to the industry norm	• Voluntary attrition increased across the period but remained below the industry average of 13.7% as reported by XpertHR in 2021 and that published by Reward Gateway for the banking and finance sector in 2022 of 18.6%	
		Gender diversity of senior management	• Gender diversity above the target level throughout the performance period	

There is straight-line vesting between the threshold and maximum for the TSR and EPS conditions and for the customer and people metrics there is 25% vesting at threshold performance and 50% vesting at target performance. There is no reward below threshold performance.

The customer condition was amended for all extant grants with the removal of the target relating to the average overturn rate for customer complaints relative to the FOS reported rates, as it had become apparent that the data required to enable comparisons against other banks / financial service firms was not sufficiently and consistently available.

Vesting was also subject to the Committee's determination that individual performance and the underlying financial performance of the Group were satisfactory given the level of vesting. In respect of both these points the Committee concluded that the vesting level was appropriate for all participants.

Awards which will vest in respect of the year ended 30 September 2022: impact of the share price on vested awards

Details of the shares which will vest in December 2022, following the announcement of the Preliminary Results, are set out below. The table also shows that the vesting value in 2022, determined as noted below, reflected a 48.57% increase in the share price between grant and vesting.

	Total shares granted	Grant basis £	Vesting outcome	Vested shares	Share price[1] £	PSP value[2] £000	Impact of share price appreciation £000
July 2020 PSP awards							
N S Terrington	312,429	3.4496	93.13%	290,965	5.1250	1,636	487
R J Woodman	196,763	3.4496	93.13%	183,245	5.1250	1,030	307
	509,192					**2,666**	**794**

[1]The PSP value has been estimated using the average closing share price for the three months ended 30 September 2022. These awards will be revalued when the performance condition is determined in December 2022 and valued at that date.

[2]In accordance with the rules of the PSP, participants are entitled to receive dividend equivalents over the period between the grant date and vesting date. Accordingly, the share award values also include £0.4940 per vested share in respect of such dividends.

For the executive directors the PSPs will not vest for another two years in line with the holding period in the Policy. During this period the executive directors will continue to be entitled to dividend equivalents.

Awards which vested in respect of the year ended 30 September 2021: impact of the share price on vested awards

The final vesting value of the awards which vested in respect of the 2018 PSP showed a 15.81% increase from date of grant. This table has been restated from that shown in the 2021 Annual Report and Accounts using the closing price on the date of vest. Previously the average closing share price for the three months ended 30 September 2021 had been used.

	Total shares granted	Grant basis £	Vesting outcome	Vested shares	Share price[1] £	PSP value[1] £000	Impact of share price appreciation £000
2018 PSP awards							
N S Terrington	227,156	4.43	97.0%	220,341	5.1305	1,255	154
R J Woodman	143,059	4.43	97.0%	138,767	5.1305	791	97
	370,215					**2,046**	**251**

[1]The PSP value has been restated based on the market value on the date of vesting being 14 December 2021.

Awards granted during the year ended 30 September 2022

On 15 December 2021 the following awards were granted, as nil-cost options, under the PSP with a face value of 180% of salary in line with Policy.

Executive director	Salary £000	Percentage grant	Face value of grant £000	Share price[1] £	Number of shares
N S Terrington	629	180%	1,132	5.427	208,611
R J Woodman	396	180%	713	5.427	131,325

[1]Based on the average closing mid-market price of the Company's shares on each of the five dealing days following the announcement of the Company's results for the year ended 30 September 2021.

Delivery timeframe for 2022 remuneration

Delivery of annual bonus and the PSP (ie total variable remuneration) to be awarded in December 2022 (in respect of the financial year ended 30 September 2022) will be in line with regulatory requirements and will therefore be delivered as follows.

Executive director	Total bonus	Bonus delivered in 2022	Bonus held for a year as shares[1]	Deferred bonus[2]	PSP	PSP and deferred bonus delivered from Year 3 to Year 7[3]
	£000	£000	£000	£000	£000	
N S Terrington	905	407	407	91	1,132	20% of vested PSP and 20% of deferred bonus
R J Woodman	570	257	257	56	713	20% of vested PSP and 20% of deferred bonus

[1]Bonus held for a year as shares will be delivered as shares, with all shareholder rights except the right to transfer shares until a year from award date has lapsed when the shares can be transferred or sold.

[2]In order to satisfy the regulatory requirement for 60% of total variable remuneration to be deferred, part of the bonus will be deferred under the DBSP as nil cost options which vest in accordance with regulatory requirements from year three to year seven.

[3]From year three 20% of the DBSP awards and up to 20% of the PSP will be delivered to the executive directors. All of the DBSP and PSP awards vesting will be subject to a one year holding period post vest operating as detailed in point 1 above.

The PSP awards granted in December 2021 are subject to the following performance conditions, with a performance period of three years, from 1 October 2021, ending on 30 September 2024. The executive directors' awards, which are tested over the three-year performance period, will vest after five years, following the end of a two year holding period.

Performance measure	Weighting	Threshold vesting for 25% of maximum award	Maximum vesting
Relative TSR	25.0%	Median performance	Upper quartile performance
Basic EPS	25.0%	63.0 pence	72.0 pence or more
Risk	25.0%	50% weighting is determined by the Committee based on an assessment by the CRO of the five key elements of the Group's risk appetite: regulatory breaches, conduct, operational, capital and liquidity and credit losses 50% weighting on a strategic risk assessment to reflect the management of risk with regard to the delivery of the Group's medium-term strategy	
Customer	12.5%	Consideration will be given to (i) customer insight feedback on key product lines and (ii) customer complaints and associated customer outcomes	
People	12.5%	Consideration will be given to (i) employee engagement, (ii) voluntary attrition compared to industry averages and (iii) gender diversity of senior management	

There is no vesting for below threshold performance. For the EPS and TSR metrics vesting rises from 25% at threshold to 100% at maximum on a straight line basis. For the customer and people metrics threshold vesting is 25% with 50% vesting for on-target performance. The risk scorecard is assessed across a number of elements as set out above and can result in any outcome between 0% and 100%.

In addition, prior to any awards vesting, the Committee must be satisfied that the individual performance and underlying financial performance of the Group are satisfactory given the level of vesting.

Relative TSR measure

The comparator group for the purposes of the relative TSR condition is:

Amigo Holdings PLC	**Arbuthnot Banking Group PLC**	**Barclays PLC**
Close Brothers Group PLC	**Funding Circle Holdings PLC**	**LendInvest PLC**
Lloyds Banking Group PLC	**Metro Bank PLC**	**NatWest Group PLC**
OSB Group PLC	**Provident Financial PLC**	**Secure Trust Bank PLC**
S&U PLC	**Virgin Money UK PLC**	

Single figure of total remuneration for the Chair of the Board and non-executive directors

	Year ended 30 September 2022			Year ended 30 September 2021		
	Fees £000	**Benefits[1] £000**	**Total £000**	Fees £000	Benefits[1] £000	Total £000
Chair of the Board						
R D East[2]	**21**	**-**	**21**	-	-	-
F J Clutterbuck[3]	**235**	**13**	**248**	255	14	269
Non-executive directors						
T P Davda[4]	**6**	**-**	**6**	-	-	-
P A Hill[5]	**90**	**-**	**90**	76	-	76
A C M Morris	**90**	**-**	**90**	85	-	85
B A Ridpath	**70**	**-**	**70**	65	-	65
H R Tudor	**100**	**-**	**100**	95	-	95
F F Williamson[6]	**-**	**-**	**-**	21	-	21
G H Yorston	**70**	**-**	**70**	65	-	65
Total	**682**	**13**	**695**	662	14	676

[1]The former Chair of the Board received a company car allowance and was eligible for private health cover on an individual or family basis in the same way as the executive directors. The current Chair does not receive a car allowance. The Chair of the Board is also eligible for life cover.

[2]R D East was appointed to the Board on 1 September 2022

[3]F J Clutterbuck resigned from the Board on 1 September 2022

[4]T P Davda was appointed to the Board on 1 September 2022

[5]P A Hill was appointed to the Board on 27 October 2020

[6]F F Williamson resigned from the Board on 31 December 2020

Payments for loss of office

No payments for loss of office were made during the year ended 30 September 2022.

Directors' interest in shares and shareholding requirements

Directors' share interests

The interests of the executive directors in the shares of the Company as at 30 September 2022 (including those held by their connected persons) were:

	N S Terrington Number	R J Woodman Number
Unvested awards subject to performance conditions		
PSP	445,272	280,371
Unvested awards not subject to performance conditions		
DSBP	247,641	153,331
Sharesave	4,245	4,245
Total unvested awards	697,158	437,947
Vested but unexercised awards		
PSP[1]	290,965	183,245
DSBP	168,232	-
Total vested but unexercised awards	459,197	183,245
Shares beneficially held[2]	1,200,636	531,805
Total interest in shares	**2,356,991**	**1,152,997**
Awards exercised in the year		
PSP	510,098	389,264
CSOP[3]	4,186	4,186
DSBP	138,897	84,059
Total awards exercised in the year	**653,181**	**477,509**

Awards under the PSP and DSBP schemes noted above were granted in the form of nil cost options.

[1]For the purposes of the table above the awards granted in July 2020, to Nigel Terrington and Richard Woodman are assumed to be vested but unexercised in respect of the percentage which will vest, 93.13%, and to have lapsed in respect of the balance.

[2]Shares beneficially held include shares obtained under the RBA, being for Nigel Terrington 35,628 shares and for Richard Woodman 22,906 shares. These shares are not subject to performance conditions but are subject to restrictions related to disposal.

[3]As part of the December 2017 PSP award, each executive director was granted a tax-qualifying option under the Company Share Option Plan ('CSOP'). In prior years as the value in aggregate of the PSP which was granted at the same time as the CSOP option was equivalent to that of a PSP award once abated by the CSOP options, the options were disregarded in determining value and not included separately in the above table. However, on exercise the abatement of the PSP award by the CSOP occurs and it becomes possible to determine the number of each of the PSP awards and CSOP options which were exercised and this has been shown above.

The interests of the Chair of the Board and the non-executive directors at 30 September 2022, which consist entirely of ordinary shares, beneficially held, were as follows:

	2022
R D East	**10,000**
T P Davda	**-**
P A Hill	**2,659**
A C M Morris	**4,168**
B A Ridpath	**4,358**
H R Tudor	**70,000**
G H Yorston	**7,517**

As at 2 December 2022, the last practicable date prior to approving this Report, the Company has not been advised of any changes to the interests of the directors and their connected persons as set out in the tables above.

Share ownership guidelines

Executive directors are required to hold a minimum number of shares in the Company with a value of 200% of their salary, calculated as at 31 December each year. The valuation is calculated on a net of income tax and national insurance basis where relevant.

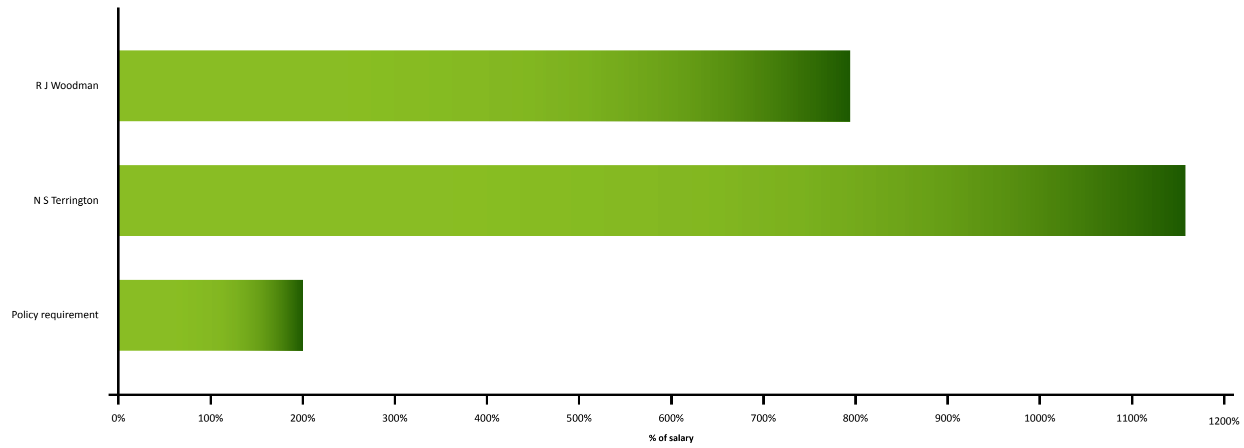
The shares which count towards the aggregate shares held by each director for the purposes of this calculation are:

1. Unexercised but vested share awards
2. Share awards with no performance conditions attached such as the DSBP and RBA and share awards with performance conditions no longer attached such as PSP awards once the performance conditions have been tested
3. Shares purchased with own funds where those shares are unconnected to a share award exercise
4. Other beneficially owned shares such as exercised and retained share awards and shares held in the name of spouses etc

The chart below compares the executive directors' holdings at 30 September 2022 to those required by the guidelines, expressed in value terms as a percentage of salary. Valuation is based on a three month average price at 30 September 2022.

Directors' shareholding guidelines

(30 September 2022)



At 30 September 2022, the holdings of executive directors were in accordance with guideline levels.

Post-employment shareholding requirement

The post-cessation shareholding requirement requires that for two years following cessation of employment, based on their immediately pre-cessation salary, an executive director must retain such of their 'relevant' shares as have a value (as at cessation) equal to the shareholding guideline, or (if lower) the number of shares actually held at the date of departure.

'Relevant' shares are shares acquired under items 1 and 2 above. They may also include shares noted under item 4 above if such shares were originally derived from a share award exercise. It does not include shares acquired under item 3 above.

No former directors are subject to these guidelines.

B7.2.3 Application of remuneration policy for the year ending 30 September 2023

The information provided in this section of the Directors' Remuneration Report is not subject to audit.

Overview

The proposed changes to the executive directors' remuneration arising from the proposed new Policy being put to the AGM in March 2023 are detailed in B7.3. It is intended, subject to approval of the new Policy at the AGM, that the proposed changes to salary and pension are backdated to 1 October 2022.

Executive directors

Fixed pay

The rebalancing of fixed and variable pay arising from the simplification of the remuneration policy, subject to approval at the AGM, results in the following outcomes for fixed pay:

		Fixed pay with effect from 1 October 2022
		£000
N S Terrington	Salary – paid in cash	737
	Salary – paid in shares[1]	184
	Pension – 10% of cash salary	74
	Benefits (based on 2022 information)	17
Total fixed pay		**1,012**
R J Woodman	Salary – paid in cash	465
	Salary – paid in shares[1]	116
	Pension – 10% of cash salary	46
	Benefits (based on 2022 information)	14
Total fixed pay		**641**

[1]In the financial year ending 30 September 2023, subject to approval at the AGM, salary payment will include payment in shares. This payment maintains alignment to certain of the conditions of the RBA namely that this payment will not be pensionable and will be released to executive directors on a pro-rata basis over a five year period. However, as part of the overall simplification of remuneration structures it will form part of the salary for the purpose of calculating variable pay awards.

The effect of the rebalancing as a whole (of which the above is only the fixed element) is detailed in the introduction to the policy report (B7.3).

Annual bonus

In line with the new Policy, the bonus opportunity for the financial year 2023 will be 98% of salary. In combination with the PSP, the bonus will be delivered in line with regulatory requirements.

The Committee has determined that performance will be assessed against a balanced scorecard of measures consisting of: financial performance (60%) including core profit and RoTE, together with a range of other quantifiable metrics derived from the Group's financial plans and strategic development; risk management (20%); and personal performance (20%). The two primary measures of underlying profit and underlying RoTE comprise 70% of the financial performance award, but the Committee annually determines the appropriate secondary measures by reference to the strategic focus for the year. For 2023 the secondary measures will continue to be underlying NIM progression, CET1 and cost: income ratio.

The Committee has chosen not to disclose, in advance, the targets which apply to these measures as it considers them to be commercially sensitive. Retrospective disclosure of the targets and performance against them will be set out in next year's Annual Report on Remuneration except to the extent that any measure / target remains commercially sensitive.

PSP awards

PSP award levels for executive directors are currently 180% of base salary and this percentage will be used for the grant intended to be made in December 2022 as this element of variable pay relates to the financial year ended 30 September 2022. The level of the award to be made in December 2023 will reflect the new Policy to be approved at the upcoming AGM.

The performance conditions and weightings (in respect of TSR, EPS, risk, climate, customer and people metrics) are as noted below. In addition, there is an individual performance condition and a Group underlying performance underpin which must be met prior to any vesting occurring.

Performance measure	Weighting	Threshold vesting for 25% of maximum award	Maximum vesting
Relative TSR	25%	Median performance	Upper quartile performance
Basic EPS	25%	74.4 pence	88.1 pence or more
Risk	20%	50% weighting is determined by the Committee based on an assessment from the CRO of the six key elements of the Group's risk appetite: regulatory breaches, conduct, operational, capital, liquidity and credit losses 50% weighting on a strategic risk assessment to reflect the management of risk with regard to the delivery of the Group's medium-term strategy	
Climate	10%	Consideration will be given to (i) the development of an emissions balance sheet, (ii) progress in the development of targets for the management of financed emissions and (iii) establishment and progress with a framework to set and subsequently manage the Group's own emission reduction targets	
Customer	10%	Consideration will be given to (i) customer insight feedback on key product lines and (ii) customer complaints relative to risk appetite levels	
People	10%	Consideration will be given to (i) employee engagement, (ii) voluntary attrition compared to industry averages and (iii) gender diversity of senior management	

TSR Metric

The TSR grouping has been updated to reflect changes in the peer group by the removal of Amigo Holdings PLC. The comparator group for the purposes of the relative TSR condition is:

Arbuthnot Banking Group PLC	**Barclays PLC**	**Close Brothers Group PLC**
Funding Circle Holdings PLC	**LendInvest PLC**	**Lloyds Banking Group PLC**
Metro Bank PLC	**NatWest Group PLC**	**OSB Group PLC**
Provident Financial PLC	**Secure Trust Bank PLC**	**S&U PLC**
Virgin Money UK PLC		

EPS Metric

The EPS targets have been updated to reflect the current macro-economic climate whilst maintaining an appropriate level of stretch compared to the Group's financial forecasts. The Group's Covid response saw impairments inflate materially in 2020, with a correction then seen in 2021. When considering the degree of stretch in the targets, the Committee considered them both in relation to the internal targets and to a normalised figure for the year ended 30 September 2021 of 55.1p, based on the 2019 cost of risk, to take account of the unusual pattern of impairments in the financial years ended 2020 and 2021. The EPS metrics build from the very strong outturns in 2022 with the threshold to stretch conditions implying growth rates of between 11.7% and 27.5% over the three year period at a time of a highly uncertain economic outlook. On this basis, the Committee was satisfied that the targets represent a very strong performance if achieved and are therefore appropriately stretching.

Climate metric

In developing a climate related metric, the Committee considered the Group's strategic aims together with its environmental footprint both through its own operations and via its commercial activities. Climate reporting is a developing area, and it is likely that the metrics within this condition will change as recognised good practice and reporting and management frameworks are enhanced in future awards. The climate metric, as with the other metrics, will be kept under annual review. For the grant to be made in December 2022 the Committee has agreed the following measures: development and delivery of the process to manage (i) the Group's operational emissions and (ii) the financed emissions attributable to asset portfolios.

In respect of the Group's own operational footprint the Committee will consider progress in the ongoing development and delivery of the framework to set and subsequently manage Paragon's own emission reduction targets.

Success in respect of financed emissions will be measured by progress towards the development of an emissions balance sheet utilising standards published by PCAF (a global organisation focussed on harmonised and transparent greenhouse gas accounting). This will focus in part on the quality of data available to support the Group's understanding of emissions (for example, EPC matching) and will be used to establish internal targets that shadow Net Zero Banking Alliance expectations.

For both the Group's operational footprint emissions and its financed emissions there will be reporting of outcomes both internally and externally as appropriate.

Risk metric

The risk metric has been updated so that capital and liquidity now form separate parts of the assessment by the CRO of the Group's key risk elements.

Customer and people metrics

There have been no changes to the matters considered in the people and customer metrics.

Other factors

There is no vesting for below threshold performance. For the EPS and TSR metrics vesting rises from 25% at threshold to 100% at maximum on a straight line basis. For the risk, climate, customer and people metrics these are assessed across a number of elements as set out above and can result in any outcome between 0% and 100%.

In addition, prior to any awards vesting, the Committee must be satisfied that the individual performance of the employee and the underlying financial performance of the Group are satisfactory given the level of vesting.

Chair of the Board's and non-executive director fees

The Board reviewed and approved an increase to both the senior independent director's fee and the fee for chairing a board sub-committee of £10,000 per annum, effective from 1 October 2022. Additionally, a fee was introduced for non-executive directors who are members of a committee but neither its chair nor the senior independent director. This fee is only payable up to a maximum of £10,000 per annum as it does not increase where a non-executive director is a member of more than one committee. These increases were approved to reflect the increasing responsibilities and time commitment of these roles as the Group grows in size and complexity.

No other changes were made in respect of non-executive director or Chair of the Board's fees.

	Fee with effect from	
	1 October 2022	1 October 2021
	£000	£000
Chair of the Board's fee	**255**	255
Base fee for non-executive directors	**70**	70
Additional fee for Senior Independent Director	**20**	10
Additional fee for chairs of committees[1]	**30**	20
Additional fee for being a member of a committee	**10**	-

[1]The additional fee for chairing a committee is currently payable to the Chairs of the Remuneration, Audit, and Risk and Compliance Committees but not the Nomination Committee and would be payable for the chairing of such additional committees as might be authorised by the Board.

B7.2.4 Other information

The information provided in this section of the Directors' Remuneration Report is not subject to audit.

This section provides various items of information related to remuneration within the Group. This includes information that shows the overall approach to all employee remuneration at the Group and how executive directors' remuneration aligns and compares with other employees and aligns with stakeholders' interests.

Fair pay

Fair pay: groupwide remuneration philosophy

Paragon is committed to rewarding all of its employees fairly for their contribution, whilst ensuring they are motivated to always deliver the best outcomes for its customers. The Group's approach to remuneration reflects its culture, vision and values and supports its purpose whilst being aligned to the long-term interests of the Group and helping to deliver fair customer outcomes.

As in the previous year a review was undertaken by the Committee related to the fair pay agenda which enabled the Committee to confirm its view that the Group is a fair pay employer. It can be seen from the comparison of the 'Annual change in directors' pay with the average employee' table that the increase in the variable remuneration percentage amount for all employees, both this year and last, was significantly ahead of the percentage increases for executive directors, reflecting strong Group performance in both years.

This commitment to fair pay is reflected in the Group's:

- Support since 2016 for the minimum wage payable to all employees being that stated by the Living Wage Foundation (which from 1 October 2022 is £21,255 per annum outside London)
- Payment of PRP to around 88% of the workforce
- Share schemes being available at both an all employee and senior management level which help to align employees' interests with shareholders
- Alignment between executive pay and that of other senior managers as well as other employees
- People Forum providing an additional arena for discussion and feedback on executive and all employee remuneration structures

Further information on the above points can be found in the remainder of this section. In addition, the commitment to fair pay is reflected in the Group's commitment to various sustainability related matters which support and enhance fair pay and the remuneration philosophy and are detailed in Section A6.

How our pay principles aligned to the Code during the year ended 30 September 2022:

Principle	Application	Example
Clarity	The executive director and Group remuneration policies are clearly communicated to directors and all employees. The Remuneration Committee Chair and the Chair of the Board regularly consult with our major shareholders as part of our commitment to a transparent and open relationship.	The Remuneration Report in this document is available to all employees as is the group-wide Internal Remuneration Policy. Details on the application of the Directors' Remuneration Policy, including incentive outcomes for the current year as well as proposed performance measures and targets for future years, are clearly set out in this report. The internal policy details the available remuneration structures which are aligned across the Group and consist of salary; pension; variable cash bonuses; share schemes and benefits. Discussion on executive remuneration and how it aligns to the workforce forms part of the regular People Forum discussions with the Committee Chair.
Simplicity	Straightforward remuneration structures apply to all levels of the Group's employees. The Committee has sought to ensure that the Directors' Remuneration Policy and outcomes under the Policy are easy to understand for both participants and shareholders.	
Proportionality	Bonus awards reflect annual performance and PSP awards reflect performance over the longer term with performance measures and targets clearly linked to strategy. The Committee also has the discretion to override formulaic outturns to ensure outcomes do not reward poor performance.	The links between awards and delivery of strategy and performance are shown in the table above which is entitled 'Examples of how we aligned remuneration to our strategy during the financial year'. Performance conditions require a minimum level of performance to be achieved before any pay-out under variable pay schemes is considered.
Predictability	Minimum, target and maximum levels of award for executive directors are shown within the Remuneration Policy.	See Section B7.3 for the new Policy and Section B6.3 in the 2019 Annual Report and Accounts for the current full Policy.
Alignment to culture	The Group's strong culture is reflected throughout its pay structures through consideration of the demonstration of the Group's values. This applies when determining incentive outcomes for all employees as well as through its commitments to EDI policies and the Living Wage Foundation. The current and proposed Remuneration Policies are fully aligned with our pay principles.	Demonstration of the Group's values underpins our variable incentive frameworks. Currently, 25% of PSP awards for executive directors and other senior managers are assessed against Customer and People metrics. For awards to be granted in December 2022, 30% of PSP awards will be assessed against ESG related metrics, including both Customer and People metrics, as well as a new Climate condition, to ensure alignment to our full sustainability strategy. The Group has paid the Living Wage Foundation rate for a number of years as part of its commitment to workforce equality and is committed to reducing its gender pay gap (see the remainder of this Section B7.2.4 for more details and Section A6).
Risk	The pay arrangements for executive directors are consistent with and promote effective risk management through alignment with the Group's risk appetite. Risk conditions are included within variable remuneration arrangements to align with regulatory expectations and shareholder interests. All members of the Remuneration Committee are also members of the Risk and Compliance Committee, ensuring that risk is appropriately taken into account when determining remuneration policy and its outturns.	The risk conditions in the annual and long term incentives are tested annually by the Committee. The Committee has discretion to override formulaic outcomes. Both annual bonus for MRTs and PSP outcomes for all participants are subject to malus and clawback provisions.

How the Committee considers the views of all employees

The People Forum considers the relationship between executive remuneration and pay and reward across the Group. Meetings with the Chair of the Committee on executive remuneration to engage and explain its operation and to discuss remuneration across the wider workforce took place in November 2022 and November 2021 and form a regular part of the Forum's annual calendar.

Additionally, employees have the opportunity to make comments on any aspects of the Group's activities through surveys and the views of employees are taken into account by Human Resources. One of the duties of the Chief People Officer is to brief the Board on employee views and, as a regular invitee to committee meetings, this also helps to ensure that decisions are made with appropriate insight to employees' views.

How all employee remuneration is aligned with stakeholders' interests

Within the Remuneration Policy Report (Section B7.3) information is provided on how the remuneration packages for executive directors' link to strategy; how they operate; maximum opportunity and any performance conditions. Noted below is the equivalent information for all employees in respect of base salary, benefits and retirement benefits. The purpose and link to strategy that is detailed for the executive directors' remuneration components is the same for all employees and is consequently not repeated here. Further the following points should be noted:

- **RBA** – in the year ended 30 September 2022 RBA were only available to executive directors
- **Sharesave** – opportunities to participate in Sharesave are the same for all employees and therefore the information provided in the executive director table equally applies to all employees. Paragon's Sharesave scheme has operated for many years, usually on an annual basis, and encourages employees to become shareholders in the Group through this tax efficient mechanism. Take-up in currently outstanding SAYE grants is about 64% of eligible employees reflecting the continued and ongoing alignment between employees and shareholders and employee commitment to the growth of the Group.

Operation	Maximum opportunity	Performance conditions
Base salary		
Same as executive directors (see Policy Report Section B7.3).	Salaries are determined in line with performance, culture, external market conditions and retention factors. The Committee is made aware of the outcomes of salary reviews across the Group before it determines those of the executive directors, Company Secretary and MRTs. As it has done for a number of years, the Living Wage Foundation rate is the minimum that is paid to all employees, as well as contractors' staff employed at Paragon sites such as cleaners and security personnel who are not on a training rate of pay (for example apprenticeships).	Same as executive directors (see Policy Report Section B7.3).
Benefits		
Provision of market competitive benefits (contractual and voluntary) designed to promote financial and emotional wellbeing, and which allows individuals to tailor benefits to suit their lifestyle. This includes the choice of private healthcare on the same basis as the executive directors for senior employees. A number of legacy arrangements exist.	Private healthcare is provided on the same basis as it is for the executive directors, and this is also the case for other benefits (contractual and voluntary) that an employee chooses to receive. The maximum level of benefits for all employees is determined on the same basis as the executive directors.	None.

Operation	Maximum opportunity	Performance conditions
Retirement benefits		
The majority of employees can join the Paragon Worksave Pension Plan, the Group's defined contribution pension plan. In this plan employee contributions are matched equally by percent by the employer up to 6% of salary; employee contributions from 6% upwards are matched by an employer contribution of 10% of salary. A number of legacy arrangements exist including the Paragon Pension Plan.	Maximum contribution for Paragon Worksave Pension Plan is 10% of salary. Maximum contribution to Paragon Pension Plan is 25% of salary. Maximum cash supplement contribution (where a former member of the Paragon Pension Plan has left the Plan) is 45% of salary.	None.

In respect of annual bonus and PSP awards the comparison is made between the executive directors and senior employees with the purpose and link to strategy being the same as for the executive directors and therefore not repeated below:

Operation	Maximum opportunity	Performance conditions
Annual bonus		
This operates for senior management as it does for the executive directors except that malus and clawback and deferral* apply to a small number of senior management and MRTs only.	Maximum bonus potential varies across the Group depending on role and experience and for a limited and small number of roles maximum can be in excess of that noted for the executive directors, however awards of this level are rarely received. Bonus awards are usually made to senior management but can be made in certain circumstances to other employees.	Objectives which are used to help determine bonuses are set on a regular basis for all employees and reflect the employee's role and seniority level.

**Deferral:*

All MRTs will have deferral in line with regulatory requirements. Other employees may be subject to deferral from time to time in line with the operational requirements of the Group and the Committee's determination.

Operation	Maximum opportunity	Performance conditions
Paragon Performance Share Plan ('PSP')		
Same as executive directors (see Policy Report Section B7.3).	The maximum award level (except in exceptional circumstances) outside of the executive directors is 100% of salary which is generally only granted to members of the Executive Committee.	Same as executive directors (see Policy Report Section B7.3).

Other variable pay opportunities

The Group provides other variable pay opportunities to certain groups of employees:

- **Profit related pay** – for many years a cash-based PRP distribution of 1% of group profits, has been paid and forms a part of the Group's culture of ensuring a strong connection between the outcomes of the business and employees. Employees below director and head of function level are eligible to participate in this scheme, which pays out a flat sum to all eligible employees
- **Discretionary bonus** – all employees whose performance has exceeded expectations are eligible for a discretionary bonus
- **Other** – in addition to the above noted certain employees below management level are eligible for overtime pay. Further there are a few financial incentive schemes, separate to the annual variable bonus noted above, which operate in certain operational areas of the business from time to time. All such schemes are required to be approved by the Chief People Officer, CFO and Conduct and Compliance Director before implementation and then reviewed at least annually and if they are applicable to MRTs are considered by the Committee.

Remuneration comparisons

Comparison of annual change in directors' pay with the average employee

The table below shows, for the last three financial years, the percentage change in the salary, benefits and bonuses of each of the directors who held office during both the year and the previous year, compared against the percentage change in each of those components of pay for an average employee.

The table does not contain prior year information on directors who are no longer directors in 2022. Neither does it contain information for the year of appointment for A C M Morris, P A Hill (appointed in financial year ended 2020 and 2021 respectively) and R D East or T P Davda who were appointed in September 2022, as they did not receive any remuneration in the comparator period.

			Salaries and fees %	Allowances and benefits %	Bonus %
2022					
N S Terrington			**5.0%**	**21.4%**	**4.9%**
R J Woodman			**5.0%**	**16.7%**	**4.8%**
F J Clutterbuck	To 01/09/22	*(a)*	**(7.8)%**	**(7.1)%**	**-**
P A Hill	From 27/10/20	*(b)*	**18.4%**	**-**	**-**
A C M Morris			**5.9%**	**-**	**-**
B A Ridpath			**7.7%**	**-**	**-**
H R Tudor			**5.3%**	**-**	**-**
G H Yorston			**7.7%**	**-**	**-**
Average Employee			**5.1%**	**(2.1)%**	**15.0%**
2021					
N S Terrington			6.4%	(46.2)%	45.3%
R J Woodman			6.5%	-	45.5%
F J Clutterbuck			-	-	-
A C M Morris	From 26/03/20	*(b)*	93.2%	-	-
B A Ridpath			-	-	-
H R Tudor		*(c)*	9.2%	-	-
G H Yorston			-	-	-
Average Employee			**1.0%**	**(5.9)%**	**101.7%**
2020					
NS Terrington			11.9%	4.0%	(33.9)%
RJ Woodman			11.7%	-	(33.9)%
F J Clutterbuck			-	-	-
B A Ridpath			-	-	-
H R Tudor		*(c)*	2.3%	-	-
G H Yorston			-	-	-
Average Employee			**8.5%**	**19.2%**	**(25.7)%**

(a) Resigned during the year

(b) Appointed during the comparator year

(c) Change of responsibilities in year

Corporate Governance

Further information in respect of the constituents of the above noted comparison of annual change in directors' pay with the average employee table is provided below using the sections noted in the table as titles:

For differences between prior years please see the relevant prior years' Annual Report and Accounts.

- **'Salaries and fees'** – these are calculated using the 'Salaries and fees' data provided in the single figure tables above. It does not include 'Pension allowance' or the RBA. Whilst the 'Pension allowance' and RBA are fixed pay and are detailed as such in the single figure table for the executive directors, they are not included in this table to enable a more direct comparison with the average employee information

- **'Allowances and benefits'** – these are calculated using the data provided in the single figure tables

  As noted previously 'Allowances and benefits' include a reimbursement from the Company in respect of:

  i) costs associated with the purchase of shares for the RBA

  ii) certain travel costs incurred in connection with the performance of executive directors duties

  both of which constitute taxable benefits in kind. The Group provides the amount required to cover the tax liability. The amount will vary with the amount of brokerage costs / travel undertaken by the executive director.

  The changes in the average employee section of the table for this item in cash terms are due to a decrease of less than £40 between 2022 and 2021.

CEO pay comparatives over 10 years

The following table shows the total remuneration, as included in the single figure table, and the amount vesting under short-term and long-term incentives as a percentage of the maximum that could have been achieved, in respect of the CEO, Nigel Terrington, over the past ten years.

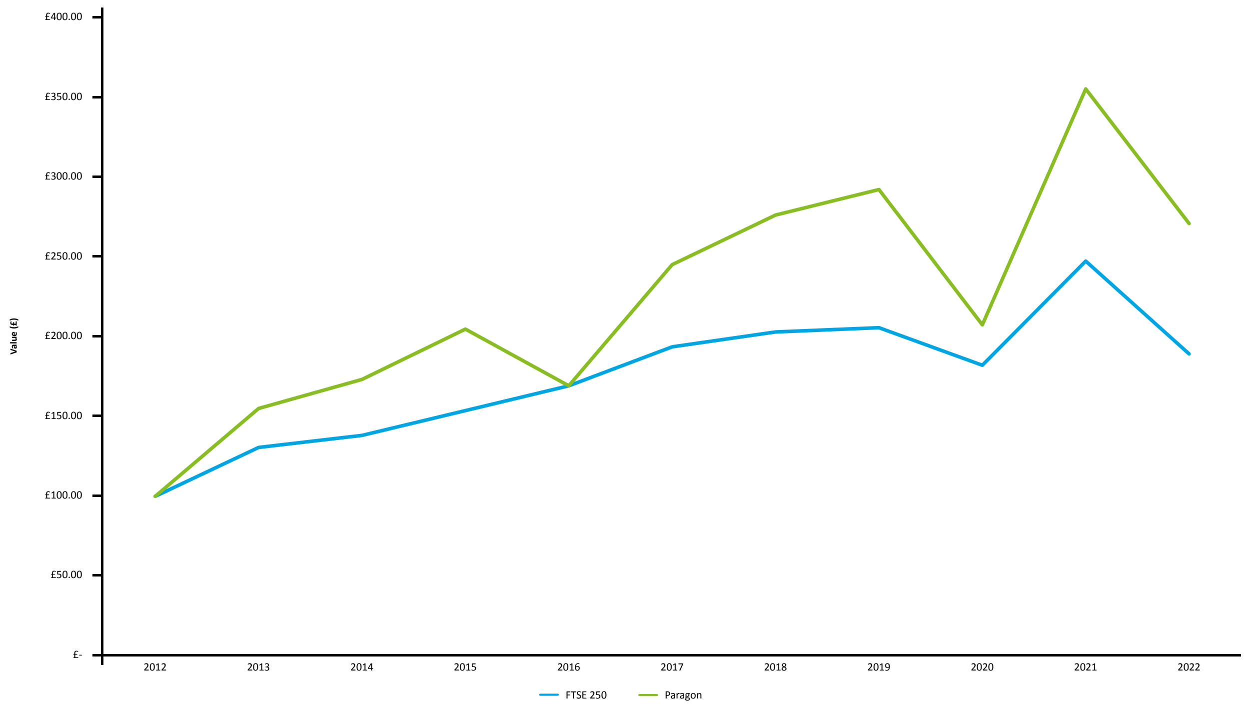
	Single figure of total remuneration £000	Annual bonus earned against maximum opportunity %	Long-term incentive vesting outcome against maximum opportunity %
2022	3,453	96.0	93.13
2021	2,991	96.1	97.00
2020	2,174	66.1	72.00
2019	3,001	89.4	95.44
2018	2,426	90.0	72.47
2017	2,305	90.0	63.51
2016	1,956	75.0	50.00
2015	2,546	100.0	100.00
2014	3,113	100.0	100.00
2013	2,655	85.0	100.00

Performance graph and table

The following graph shows the Company's TSR performance compared with the performance of the FTSE 250 index. This graph shows the value, by 30 September 2022, of £100 invested in Paragon Banking Group PLC on 30 September 2012, compared with £100 invested in the FTSE 250 index.

Ten-year return index for the FTSE 250

(Ten years ended 30 September 2022)



CEO pay ratio

The table below sets out the CEO pay ratio compared to the 25th, median and 75th percentile employee within the Group. In each of the years reported the Group used Option A as defined in The Companies (Miscellaneous Reporting) Regulations 2018, as this calculation methodology was considered to be the most accurate method. This option is calculated in accordance with the single figure table methodology as at 30 September 2022.

The 25th, median and 75th percentile pay ratios were calculated using the full-time equivalent remuneration (prepared in the same manner as those for the single figure table) for all UK employees during the financial year. Certain employees participate in discretionary bonus schemes and long-term incentive schemes.

Remuneration decisions for all employees, including the executive directors, are made taking into account the Group's remuneration philosophy. The CEO pay ratio, as an outcome of those decisions, is therefore reflective of the Group's reward and progression policies.

Year	Method	25th percentile pay ratio	Median pay ratio	75th percentile pay ratio
2022	Option A	114:1	86:1	53:1
2021	Option A	113:1	83:1	50:1
2020	Option A	88:1	64:1	37:1
2019	Option A	125:1	95:1	55:1

The base salaries and total remuneration details relating to the relevant identified employees in the two most recent years are shown below.

	25th percentile pay	**Median pay**	**75th percentile pay**	25th percentile pay	Median pay	75th percentile pay
		2022			2021	
	£	**£**	**£**	**£**	**£**	**£**
Base salary	**22,000**	**29,000**	**55,000**	22,000	33,000	53,000
Total remuneration	**30,000**	**40,000**	**65,000**	27,000	36,000	60,000

Change in CEO pay ratios

The changes shown in CEO pay ratios between 2022 and 2021 are reflective of the substantially different approach to remuneration and the resulting outcomes to remuneration awards for executive directors compared to other employees. The lower ratios in 2020 are reflective of the early part of the Covid pandemic and year-on-year comparison is more aligned between 2022, 2021 and 2019 than 2020.

Further, changes in the CEO pay ratio from year to year also reflect the difference in the remuneration package of the CEO relative to the wider employee population. In particular, the higher variable opportunity which is not replicated across the wider employee population. As a result, it is expected that the CEO pay ratio will be volatile from year-to-year, reflective of the bonus and PSP outcomes in any year.

Gender pay

Details of the Group's gender pay gap analysis are shown in Section A6.3 Corporate Responsibility. Gender pay review and reporting are overseen by the Nomination Committee as part of its responsibilities in respect of diversity.

Relative importance of spend on pay

Set out below is a summary of the Group's levels of expenditure on pay and other significant cash outflows.

	Note	**2022**	2021	Change
		£m	£m	£m
Wages and salaries	*55*	**81.9**	65.1	16.8
Dividend paid	*46*	**68.9**	54.6	14.3
Share buy-backs	*45*	**66.9**	37.7	29.2
Loan advances		**3,214.7**	2,601.5	613.2
Corporation tax paid	*47*	**56.5**	48.3	8.2

Loan advances is shown above as this is the principal application of cash used to generate income for the Group. Corporation tax is contributed out of profit to the UK Government.

B7.3 Policy Report

The information provided in this part of the Directors' Remuneration Report is not subject to audit.

B7.3.1 Introduction

(This introduction does not form part of the Policy, which is set out in section B7.3.2)

This part of the Directors' Remuneration Report sets out the Directors' Remuneration Policy that will be subject to shareholder approval at the Annual General Meeting to be held on 1 March 2023. This Policy is expected to apply for a period of three years, unless revised by a vote of shareholders ahead of that time.

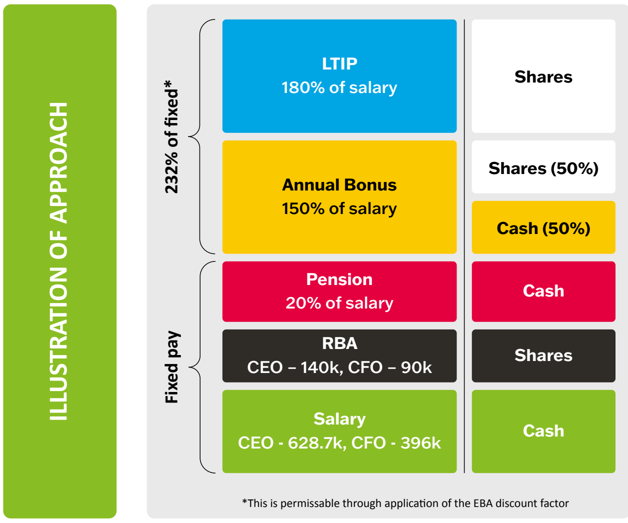
The Company's current Directors' Remuneration Policy was approved at the 2020 AGM and took effect from the date of that meeting. This Policy can be found in the 2019 Annual Report and Accounts on pages 113 to 123.

As highlighted in the Remuneration Committee Chair's statement, a number of changes are being proposed.

The changes represent a minor rebalancing between variable and fixed pay such that total maximum pay has reduced on a 2022 equivalent basis, while maintaining target pay. These changes also simplify the structure of fixed pay. Part of the simplification results in there being no need for reliance on the EBA discount factor as is currently the case. Additionally, a greater proportion of the package will be delivered in shares.

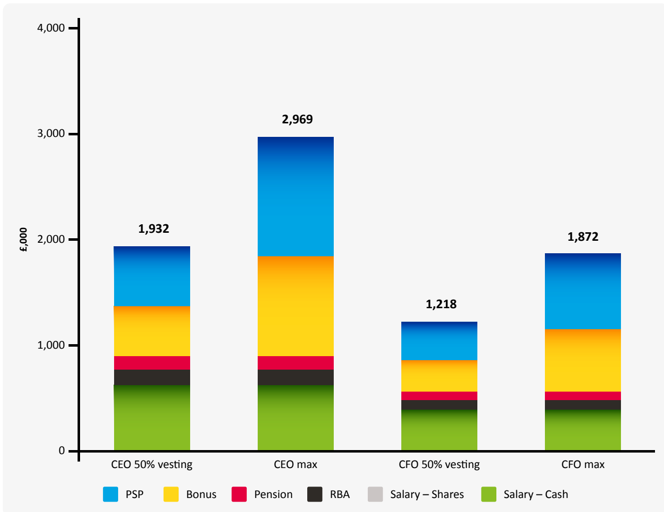
Overall, the rebalancing changes can be seen in the following charts and are also expanded on below:

Structure **Current plan**

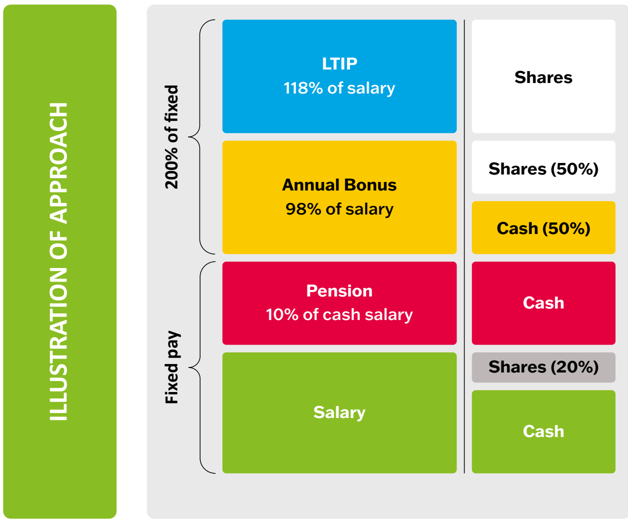


*This is permissable through application of the EBA discount factor

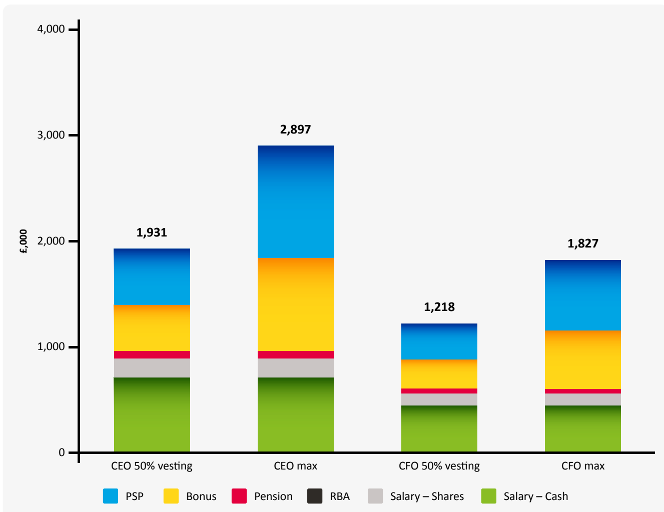
Schematic – 2022 equivalent



Structure **Proposed plan**



Schematic – 2022 equivalent



The impact on remuneration of the rebalancing as a whole (before the application of the annual 3% increase in salary) is that:

- Maximum remuneration is reduced by £71,000 for the CEO and £41,000 for the CFO
- Fixed pay increases of £71,000 for the CEO and £41,000 for the CFO
- Overall remuneration for both executive directors does not change if incentives vest at 50%
- There is a modest rebalancing towards fixed pay from 30% to 33% of total remuneration at maximum
- The proportion of fixed pay delivered in shares is increased compared to the current Policy from 15.7% to 18.5%

Proposed change	Reason for change
Salary 20% of salary to be delivered in shares released over five years *Currently an RBA is in operation, and this will be removed*	• Reduces complexity • Delivers a greater proportion of fixed remuneration in shares • Increases shareholder alignment for executive directors
Pension contribution Pension level set at 10% of cash salary (ie excluding the share element of salary) for both current and new executive directors *Currently incumbent executive director pension is 20% of salary and 10% for new hires*	• Aligns pension opportunity level to that available for the majority of employees including new hires
Variable quantum Maximum annual bonus opportunity of 98% of salary Maximum PSP opportunity of 118% of salary *Current maximum bonus is 150% of salary and PSP maximum is 180% of salary*	• Improves transparency by removing the need to use the EBA discount factor • Removes the potential for breach of bonus cap in the event of high bonus outcomes
Annual bonus performance assessment To contain 60% quantifiable detailed financial performance targets *Currently the bonus includes at least 50% financial measures*	• Improves transparency • Reflects shareholder expectations for the majority of the performance assessment to be based on quantifiable financial measures

B7.3.2 Proposed policy

Elements of the remuneration policy for executive directors

The executive directors receive a combination of fixed and performance-related elements of remuneration. Fixed remuneration consists of salary, benefits and pension scheme contributions or alternative retirement benefit provision. Performance-related remuneration consists of participation in the annual bonus plan (including deferral) and the award of shares under the PSP. The performance-related elements of remuneration are intended to represent an appropriate proportion of executive directors' potential total remuneration.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Base salary			
To provide a competitive, fixed component that reflects the scope of individual responsibilities and recognises sustained individual performance in the role.	Base salaries are typically reviewed annually, taking into account a number of factors including (but not limited to) the value of the individual to the business, the scope of their role, their skills and experience and their performance. The Committee also takes into account pay and conditions of employees in the Group as a whole, business performance and prevailing market conditions. For current incumbents this payment will be made 20% in shares and 80% in cash. The portion in shares will be subject to a holding requirement and released over a five year period.	While there is no maximum salary, if the Committee is satisfied with the individual's performance, increases will usually broadly follow those awarded for the rest of the organisation, in percentage of salary terms. Increases above the level awarded for the rest of the organisation may be awarded in appropriate circumstances which may include, but are not limited to: • Changes in the scope or responsibilities of a director's role; • Development or performance in role; • A change in the size and/or complexity of the business; • Change in market practice or a director's salary substantially falling behind a market competitive rate; and/or • External factors such as changes in regulatory requirements	Whilst no formal performance conditions apply, an individual's performance in role is taken into account in determining any salary increase.
Benefits			
To provide market levels of benefits on a cost-effective basis.	Private health cover for the executive and their family, life insurance cover of up to seven times' salary and company car or cash alternative. Private health care benefits are provided through third party providers and therefore the cost to the company and the value to the director may vary from year-to-year. Other benefits may be offered from time to time taking into account individual circumstances.	Whilst no absolute maximum level of benefits has been set, the level of benefits provided is determined taking into account individual circumstances, overall cost to the business and market practice.	None.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Retirement benefits			
To provide competitive post-retirement benefits.	Executive directors receive an annual contribution to the Company defined contribution pension scheme or a cash supplement in lieu of contribution (or a combination thereof).	Maximum 10% of cash salary (ie excluding the element paid in shares) for both incumbent and newly recruited executive directors.	None.
Annual bonus			
To incentivise executive directors to achieve specific, predetermined goals that drive delivery of the Company's operational objectives. To reward individual performance. To encourage retention and alignment with shareholders' interests with a proportion of the bonus awarded in shares.	Each executive director's annual bonus is based on a mix of financial and non-financial performance measures measured over one year. The annual bonus is non-pensionable. Malus and clawback apply to the annual bonus as described in the notes to this table. The annual bonus will be delivered in shares and / or cash which, in combination with the PSP award, will be structured in line with the regulatory requirements on the deferral of variable pay under the PRA remuneration rules. A maximum of 50% of the upfront bonus earned will be paid in cash, and 50% will be paid in shares. Any shares delivered will normally be immediately vested and may take the form of shares which must be retained for at least 12 months, or a right to acquire shares at the end of the holding period.	Maximum annual bonus potential is 98% of salary in respect of any given financial year. For threshold performance a bonus of 25% of maximum will be awarded, for target 50% of maximum. For performance below threshold, no bonus is payable. If a bonus is based on a strategic measure or personal objective, the Committee will determine the extent of vesting between 0% and 100% based on its assessment of the extent to which the measure or objective has been achieved.	The performance targets are set by the Committee at the start of the year with input, as appropriate, from the Chair of the Board and CEO. Performance measures and their weightings are reviewed annually to maintain appropriateness and relevance. Performance is assessed against a range of measures, with at least 60% relating to quantifiable financial metrics and any balance reflecting non-financial measures (including risk) and / or achievement of key personal and strategic measures.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Performance Share Plan ('PSP')			
To incentivise executive directors to achieve enhanced returns for shareholders. To encourage long-term retention of key executives. To align the interests of executives and shareholders.	An annual award of shares subject to continued service and performance conditions assessed over a three-year performance period. The performance conditions used are reviewed on an annual basis to ensure they remain appropriate. At the end of the performance period, the performance outcome will be used to assess the percentage of the awards that will vest in five equal tranches, with the first vesting on or around the third anniversary of the grant date and the last instalment vesting on or around the seventh anniversary of the grant date, in accordance with the PRA remuneration rules Each vested tranche will be subject to an additional one year holding period, taking the form of shares which must be retained for at least the holding period. Awards are structured as nil cost options with a ten-year life, a conditional award of shares or an award of forfeitable shares.	Maximum award is 118% of salary in respect of any financial year. Up to 25% of the award will vest for threshold performance. Where regulations prevent the payment of dividend equivalents over the vesting period, the number of shares awarded will be calculated by reference to a discounted share price reflecting the lack of entitlement to dividends or dividend equivalents.	The Committee will take into consideration prior performance when assessing the value of the PSP grant. Forward-looking performance is measured against a long-term scorecard of challenging performance measures that reflect the Company's strategic priorities. Performance conditions may include financial measures (such as adjusted EPS and / or relative TSR), and non-financial measures which may include risk-based, people, customer, and climate measures. Performance measures and their weightings, where multiple measures are used, are reviewed annually to maintain appropriateness and relevance.
Sharesave plan			
To provide all employees with the opportunity to become shareholders on the same terms.	Periodic invitations are made to participate in the Company's Sharesave Plan. A savings contract over three or five years where the funds are used on maturity to either purchase shares by exercising options or are returned to the participant. The option is granted at a discount to the share price at the time of grant of up to 20%. The Sharesave Plan provides tax benefits in the UK subject to satisfying certain HMRC requirements and is operated on an 'all employee' basis.	HMRC monthly savings limits apply.	None.

Malus and clawback

Annual bonus and PSP awards are subject to malus and clawback provisions in exceptional circumstances including the following:

- If a higher payment than would otherwise have been the case is paid as a result of a material misstatement of a group company's results
- Any error or inaccurate or misleading information or assumptions relating to a financial year
- If an individual was party to behaviour that resulted in serious reputational damage to a group company or a relevant business unit
- Occurrence of a material corporate failure in a group company or a relevant business unit
- If there is reasonable evidence of employee misbehaviour, material error or misconduct
- A group company or relevant business unit suffers a material failure of risk management, taking account of the individual's proximity to and / or responsibility for the event
- If the participant contributed to any regulatory sanctions
- If the Group, Company or relevant business unit suffers a material downturn in its financial performance
- Situations where there is a significant increase in the Group's or business unit's economic or regulatory capital base

Any incentive awards may be reduced or cancelled before vesting or clawed back for a period of up to seven years from the grant date. This may be extended to ten years in the event of ongoing internal / regulatory investigation at the end of the seven-year period.

Shareholding guidelines

All executive directors are required to hold a number of shares in the Company with a market value of 200% of their salary. The guideline must be met within a reasonable timeframe (typically expected to be within five years of appointment) and executive directors are normally required to retain 50% of the shares paid as salary or acquired as annual bonus, PSP or DSBP awards (after sales to cover tax) until the guideline is met.

The number of shares, net of income tax and national insurance, subject to share-based awards that are no longer subject to further performance requirements granted under the annual bonus, DSBP and PSP or obtained as part of the payment of the fixed role-based allowance or salary paid in shares count towards the aggregate shares held by each director for these purposes.

Reflecting best practice, the Committee has a post-cessation shareholding requirement. This requires that for two years following cessation of role, an executive director must retain a number of shares (determined on cessation) equal to their shareholding guideline (or their actual shareholding if lower). Shares that have been purchased by the executive director will not be included for the purposes of determining the number of shares to be retained.

Operation of share plans

Awards under the Company's share plans (and any applicable performance conditions) may be adjusted in the event of any variation of the Company's share capital, demerger, or special dividend.

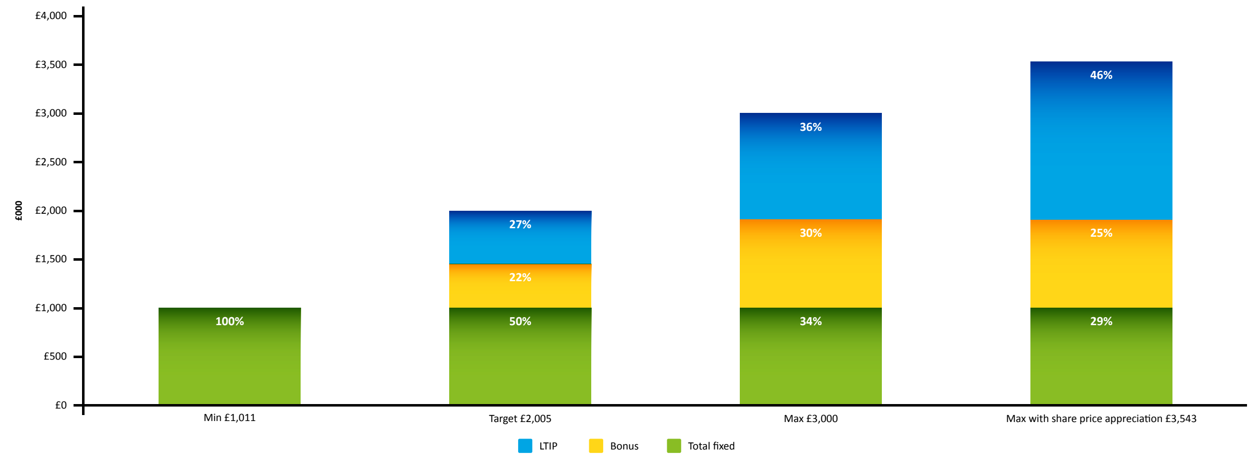
Awards under the Company's share plans may vest early in the event of demerger, special dividend, or other event which the Committee considers would affect the Company's share price, or in the event of a change of control. The extent to which PSP awards will vest will be determined considering the extent to which performance conditions have been satisfied (as assessed by the Committee) and, unless the Committee determines otherwise, the proportion of the vesting period that has elapsed.

Awards granted over shares may be settled in cash, in whole or in part. The Company does not intend to settle awards, or dividend equivalents on awards, granted to executive directors in cash and would do so only where the particular circumstances make that appropriate, for example where there is a regulatory restriction on the delivery of shares or to enable the payment of tax liabilities relating to the award.

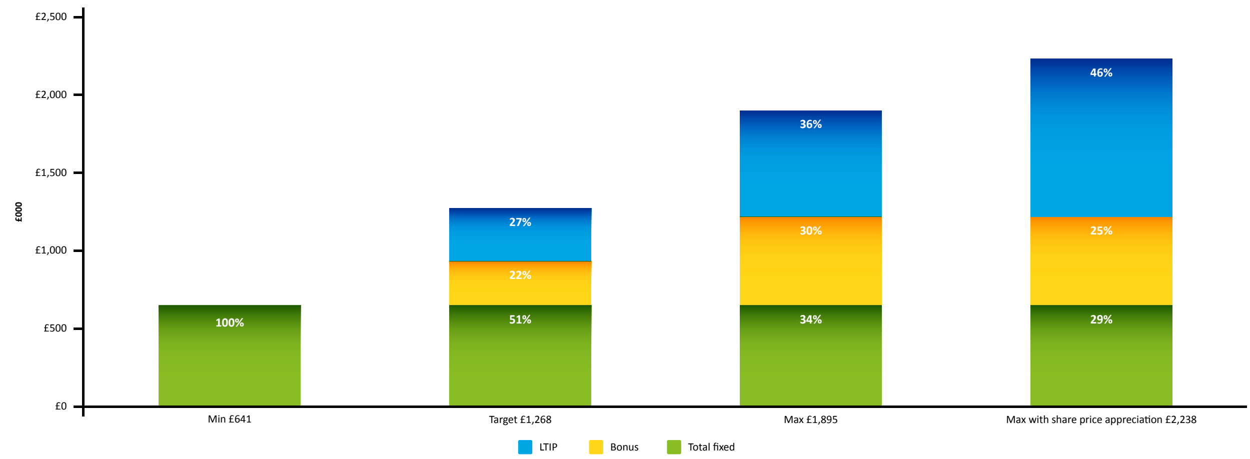
Illustrations of the application of the remuneration policy

The chart below illustrates the remuneration opportunity provided to each executive director at different levels of performance for the coming year:

N S Terrington



R J Woodman



The basis of calculation for the above graphs and key assumptions used are as follows:

	Minimum	Target	Maximum	Maximum with 50% share price growth
Fixed elements of remuneration	• Total fixed pay is based on the rebalanced salary including the 3% annual increase as described in Section B7.2.3 • Pension is the value of the cash supplement in lieu of pension • Benefits are value based on the estimated cash cost to the company			
Annual bonus *(pay-out as percentage of maximum opportunity)*	0%	50%	100%	100%
PSP *(vesting as percentage of maximum opportunity)*	0%	50%	100%	100% plus 50% share price growth

As Sharesave awards are provided on an all employee basis, they have not been included in the above analysis.

Elements of the remuneration policy for the Chair of the Board and non-executive directors

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Fees			
To ensure that the Group can attract and retain the appropriate number and mix of non-executive directors with the correct experience to provide balance, oversight and challenge.	Non-executive director fees are reviewed annually and are subject to the Articles of Association. The Chair's fee is set by the Committee, whilst the non-executive directors' fees are determined by the Board on the basis of external advice. The Board will exercise judgement in determining the extent to which non-executive directors' fees are altered in line with market practice, given the requirement to attract and retain the appropriate skills and the expected time commitments. Non executive directors are paid an annual base fee with additional fees for additional roles (for example, Senior Independent Director or chair of a board committee). They are not entitled to receive compensation for early termination of their terms of engagement.	The Board will review fees periodically to assess whether they remain competitive and appropriate in light of changes in roles, responsibilities and / or time commitment of the non-executive directors. Increases above those awarded for the rest of the organisation may be made to reflect the periodic nature of any review. The Articles of Association of the Company contain a maximum level of fees that can be paid annually to non-executive directors (currently £2,000,000). This is reviewed by the Board from time to time.	None.
Benefits			
To ensure that the Group can attract and retain the appropriate mix of non-executive directors with the correct experience to provide balance, oversight and challenge.	The Chair is eligible for private health cover on an individual or family basis in the same way as the executive directors. The Chair is also entitled to life assurance. Neither the Chair nor the non-executive directors are eligible to participate in any of the Company's incentive or pension schemes. The Chair and non-executive directors may be eligible to receive reimbursement for travel and other reasonable expenses incurred as part of performing their duties.	Where benefits are provided to non-executive directors, they will be provided at a level considered to be appropriate, taking into account individual circumstances.	None.

Choice of performance measures and approach to target setting

Annual bonus

The choice of the performance measures applicable to the annual bonus scheme reflects the Committee's belief that incentives should be appropriately challenging and tied to the achievement of financial and non-financial measures (including risk and other strategic measures) and key personal objectives.

The Committee reviews the measures each year and varies them as appropriate to reflect the priorities for the business in the year ahead. A sliding scale of targets is set for each measure to encourage continuous improvement and the delivery of above-target performance.

PSP

The Committee will take into consideration prior Group and individual performance when assessing the value of the PSP grant level for executive directors.

Forward-looking performance is measured against a long-term scorecard of financial and non-financial performance measures that reflect the Company's strategic priorities.

Financial metrics could include EPS, which would measure long-term profitability, and / or TSR that considers shareholder value creation as a measure of market expectations of future performance. Other non-financial metrics could include risk, customer, people or climate measures that would provide a focus on key measures of the Company's long-term sustainability-related strategic aims. Non-financial metrics would be assessed across a range of quantitative and qualitative measures which are business critical.

Performance measures and their weightings are reviewed annually to maintain appropriateness and relevance.

Discretion

The Committee retains the flexibility to make adjustments to the formulaic vesting level of incentive awards in instances where the outcome would otherwise be unreflective of the wider shareholder experience and / or materially inappropriate in the context of unexpected or unforeseen circumstances relating to the Company.

Changes to performance conditions

If an event occurs which results in the annual bonus or PSP performance conditions and / or targets being deemed no longer appropriate (eg a material acquisition or divestment) then the Committee will have the ability to adjust the measures and/or targets and alter weightings so that the conditions achieve their original purpose.

Recruitment and conditions of service

Policy on recruitment and promotion

Salaries for newly recruited directors will be set to reflect their skills and experience, the Company's intended pay positioning and the market rate for the role. If it is considered appropriate to appoint a new director on a below market salary (for example, to allow the director to gain experience in the role) the individual's salary may be increased to a market level by way of a series of above inflation increases over such period as the Committee determines, subject to their performance and development in the role. The Committee will determine the proportion of salary to be delivered in shares, taking into account the circumstances of the appointment. Pension will be in line with the Policy.

A new appointment would be offered benefits comparable to existing directors, as well as other reasonable expenses such as legal, tax equalisation and relocation costs (if necessary, on a net of tax basis).

The prevailing maximum bonus opportunity for existing directors will not be exceeded for any newly recruited director and would normally be pro-rated to reflect the proportion of the year worked. It may be necessary to set different performance measures and targets initially dependent on the timing of the appointment and the nature of the role taken up. Guaranteed bonuses will not be offered.

Long-term incentive awards will be granted in line with the policy outlined for existing directors, with the same maximum opportunity for any newly recruited director. Awards may be granted shortly after an appointment (subject to the Company not being in a prohibited period).

The Committee may make payments or grant awards to a newly recruited executive to buy out entitlements or opportunities (for example, bonus and share awards) which will lapse on the executive's departure from a previous position. In doing so, the Committee will take into account relevant factors, including performance conditions attached to the lapsing arrangements and the time over which they would have vested. The approach to buy-out awards will be in line with the PRA remuneration rules, which state that the terms of any replacement awards should be no more generous than the award forfeited on departure from the former employer.

Notice periods and terms of engagement

The executive directors hold one year rolling contracts in line with current market practice and the Committee reviews the terms of these contracts periodically. The current service contracts for the executive directors are dated as follows:

Director	Contract date
N S Terrington	1 September 1990 (as amended 7 January 1993, 16 February 1993, 30 October 2001 and 10 March 2010)
R J Woodman	8 February 1996 (amended 10 March 2010)

All new executive directors will have service contracts that are terminable by the Company and the executive director on a maximum of twelve months' notice.

Chair and non-executive director appointments are for three years unless terminated earlier by, and at the discretion of, the director or the Company. The required notice period is one year for the Chair and three months for the non-executive directors.

Current terms of engagement for the Chair and non-executive directors apply for the following periods:

Director	Original appointment date	Current letter of appointment end date
R D East	1 September 2022	31 August 2025
T P Davda	1 September 2022	31 August 2025
P A Hill	27 October 2020	26 October 2023
A C M Morris	26 March 2020	25 March 2023
B A Ridpath	20 September 2017	19 September 2023
H R Tudor	24 November 2014	23 November 2023
G H Yorston	20 September 2017	19 September 2023

Policy on termination payments

The Company has discretion to make a payment in lieu of notice in respect of all or part of the notice period. Any such payment would consist of salary, benefits, and pension for the relevant part of the notice period. Specific change of control provisions or entitlements to enhanced redundancy payments are excluded.

Salary delivered in shares

Executive directors will be entitled to receive their salary delivered in shares in respect of any notice period (or any notice period that would have applied but for the making of a payment in lieu of notice). Ordinarily these payments will be made at the usual time.

Shares delivered as part of salary will be released over the originally anticipated period, although the Committee has discretion to release shares early in specific circumstances, for example, in the event of the death of an executive director.

Annual bonus for the year of cessation

The payment of annual bonuses will be at the discretion of the Committee on an individual basis and the decision as to whether or not to award an annual bonus in full or in part will be dependent on a number of factors, including the circumstances of the individual's departure. For example, in certain good leaver situations (injury or disability, redundancy, employment transferred outside the Group, or any other reason the Committee decides) a bonus may be payable at the Committee's discretion, based on an assessment of performance. Any annual bonus award amounts paid will be pro-rated for time in service during the annual bonus period and will, subject to performance, be paid at the usual time and in the usual form (although the Committee retains discretion to pay the annual bonus award earlier in appropriate circumstances).

Unvested DSBP Awards

For awards granted under the DSBP, good leaver status would result in awards vesting at the usual time, unless the Committee determines they should vest earlier in appropriate circumstances. In other circumstances, DSBP awards will lapse.

Bonus awards subject to a holding period

If an individual leaves employment during a holding period, the default position will be for the holding period to continue for its originally anticipated length. The Committee may end the holding period early, subject to regulatory requirements.

Unvested PSP Awards

The default treatment for outstanding unvested PSP awards will be that they lapse on cessation of employment. In good leaver circumstances (as described above), unvested awards will continue until the normal vesting date, vest subject to the satisfaction of the performance conditions, and be released at the end of the originally anticipated holding period. However, the Committee may permit the award to vest and be released at cessation subject to the satisfaction of the performance conditions (as assessed by the Committee) or vest and be released at the end of the performance period subject to the satisfaction of the performance conditions. In any such case, the extent of vesting will be reduced to reflect the proportion of the performance period that has elapsed at the date of cessation, unless the Committee determines otherwise.

PSP Awards subject to a holding period

If an individual leaves employment during a holding period, the default position will be for the holding period to continue for its originally anticipated length. The Committee may permit the award to be released early, subject to any regulatory considerations. If the holding period is operated on the basis that the executive director is only entitled to acquire vested shares at the end of the holding period, the award will lapse if the executive director is dismissed for misconduct.

Other payments

The leaver provisions for any buyout award granted in connection with the recruitment of a director would be determined at the time of grant.

Any statutory entitlements or sums to settle or compromise claims in connection with the termination would be paid as necessary. In the appropriate circumstances, outplacement services, legal fees and relocation expenses may be provided at normal market rates for directors, along with payments in respect of accrued holiday.

There are no obligations in the non-executive directors' letters of appointment that could give rise to payments for loss of office.

Consideration of employment conditions elsewhere in the Group

There is no employee representative on the Committee. However, employees have the opportunity to make comments on any aspect of the Group's activities through employee forums and surveys and the views of employees are taken into account by Human Resources. One of the duties of the Chief People Officer is to brief the Board on employee views and, as a regular invitee to Committee meetings, this ensures that decisions are made with appropriate insight to employees' views. In addition, the People Forum will consider the relationship between executive remuneration and pay and reward across the Group on a regular basis.

Directors and senior executives participate in the annual bonus scheme, which is designed to incentivise employees to achieve specific, predetermined goals, reward individual performance and encourage retention through deferral of a proportion of the bonus. All employees whose performance has exceeded expectations are eligible for a discretionary bonus.

Employees below director and head of function level are eligible to participate in the Group's profit related pay scheme, which pays out a flat sum to all eligible staff based on a percentage of the Group's profits.

Directors and senior employees are eligible to participate in the PSP. The plan is in place to encourage the long-term retention of key employees who are considered to have the potential to influence shareholder value creation and awards are not offered to employees generally.

In determining pay levels for the employees as a whole, the Group annually considers externally provided benchmark levels for comparable jobs as well as individual development and performance. The general level of increase resulting from this review informs the Committee's deliberations on appropriate pay levels for the executive directors, together with external data specific to their roles which is used to ensure that the levels of remuneration are appropriate.

Consideration of shareholders' views

The Committee considers shareholder feedback received in relation to the AGM each year. This feedback, plus any additional feedback received during any meetings from time to time, is then considered as part of the annual review of the Directors' Remuneration Policy.

In addition, the Chair of the Committee and the Chair of the Board regularly engage directly with major shareholders and their representative bodies and report their views back to the Committee, who take them into account when formulating any material changes to the Policy. During the year under review, for the purposes of discussing this proposed Policy, shareholders representing 60% of the Company's equity (based on the total voting rights and shareholder analysis as at 30 September 2022) were contacted and account was taken of their views in shaping the Policy. As a result of previously received feedback the Committee agreed to align executive director pensions with that of the majority of the workforce and include a climate related metric in the PSP. Following the consultation in the summer of 2022, the Committee has also elected to further increase the weighting towards financial metrics in the annual bonus.

Legacy arrangements

The Committee retains discretion to make any remuneration payment or payment for loss of office (including the exercising of any discretion available in respect of any such payment) outside of this Remuneration Policy:

- Where the terms of the payment were agreed before this Remuneration Policy came into effect, provided in the case of any payment whose terms were agreed after 6 February 2014 and before this Remuneration Policy became effective, the remuneration payment or payment for loss of office was permitted under the Company's relevant former Directors' Remuneration Policy
- Where the terms of the payment were agreed at a time when the relevant individual was not a director of the Company and, in the opinion of the Committee, the payment was not in consideration of the individual becoming a director of the Company

For these purposes, 'payment' includes the satisfaction of awards of variable remuneration and, in relation to an award over shares, the terms of the payment are agreed at the time the award is granted.

B7.4 Approval of Director’s Remuneration Report

The information provided in this part of the Directors’ Remuneration Report is not subject to audit.

This Directors’ Remuneration Report, section B7 of the Annual Report and Accounts, including the Statement by the Chair of the Committee, the Annual Report on Remuneration and the Policy Report, has been prepared in accordance with Schedule 8 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 as amended and has been approved by the Board of Directors.

Signed on behalf of the Board of Directors.

Hugo Tudor
Chair of the Remuneration Committee
6 December 2022

B8. Risk management

> **Significant progress has been made in further strengthening risk culture during the year, with a number of initiatives designed to formalise this and ensure it is inextricably linked to the strategy and operations of the Group.**
>
> **Peter Hill,** Chair of the Risk and Compliance Committee

B8.1 Statement by the Chair of the Risk and Compliance Committee

Dear Shareholder

I am pleased to write to you as Chair of the Risk and Compliance Committee to explain how we, as a committee, have discharged our responsibilities in the last year. The risk agenda has shifted considerably during the year. Whilst 2021 was dominated by navigating the challenges of the pandemic, the fall-out from this, compounded by global economic challenges and the war in Ukraine have provided a complex set of issues facing the whole of the financial services sector. My priority as Chair of the Committee continues to be to ensure that we remain a forward-looking body and continue to consider those emerging risks which may impact the strategy or operating capability of the Group.

Throughout the year I have remained very impressed with the way the Group has dealt with, and continues to deal with the differing challenges in the risk landscape.

The ability of the Group to react in an agile and effective way to emerging risks is enabled through its robust and maturing risk management capabilities. Significant work has been undertaken over the last year to enhance the Enterprise Risk Management Framework ('ERMF'). Its evolution to ensure it is commensurate with the size and complexity of the Group's operations, whilst being effective is a key strategic priority. During the year excellent progress has been made in delivering further components of the framework and enhancing and embedding the work done to date. Particularly important to this has been the roll-out of a comprehensive policy framework across all principal risks which has in turn helped drive ownership and accountability across all three lines of defence.

Fundamental to the successful implementation of the policies and the wider programme has been the comprehensive work undertaken in respect of the Group's risk culture. The effective operation of the ERMF is based on having a strong risk culture, embedded in day-to-day decision making and understood at all levels of the organisation. Significant progress has been made in further strengthening risk culture during the year, with a number of initiatives designed to formalise this and ensure it is inextricably linked to the strategy and operations of the Group. I have been pleased with the new Code of Conduct and risk culture framework, both of which are critical to ensuring that risk management considerations lie at the heart of all decision-making.

As I mentioned in my last letter, a strong ERMF is key to enabling the Committee to effectively discharge its responsibilities and to ensure it is able to focus on those matters of greatest significance to the Group. I feel that during the last year we have continued to deliver in line with this objective and the continual refinement of the risk framework remains a priority for the next year and beyond. The Committee will continue to oversee this as the Group focusses on embedding the components and particularly looks to refine risk reporting now that many of the key building blocks are in place to ensure this robustly informs the Board's risk strategy and appetite.

The primary responsibility of the Committee continues to be the maintenance of oversight of the effectiveness of the Group's ERMF and its systems and controls for compliance with statutory and regulatory obligations. This oversight is enabled through strong and embedded governance structures.

In my last letter last I set out the Committee's priorities for the current year and I am pleased to say that these commitments have comprehensively been met, whilst balancing the need to address any new and evolving issues. I can confirm the Committee has effectively provided oversight and consideration of the following:

- Assessment of any lasting risk implications of Covid as the immediate challenges of the pandemic period recede
- Continuous assessment of the impacts on the Group of the consequences of the UK's withdrawal from the EU
- Potential impacts on the Group from supply chain issues including energy and other commodities across the UK, particularly given the inherent inflationary pressures which are now widespread
- Ongoing oversight of the Group's response to the 'Dear CEO' letter on financial crime systems and controls and the programme of work to further enhance the Group's financial crime framework and capabilities
- Evaluating the challenges posed by Government proposals to improve energy efficiency of both owner-occupied and privately rented homes by mandating minimum EPC ratings
- Ensuring that customers receive fair outcomes, including monitoring the treatment of vulnerable customers, and ensuring that the management of conduct risk remains a key priority for the Group particularly in light of the new FCA Consumer Duty requirements
- Undertaking deep dives in relation to specific risk categories and business areas on both a rolling and ad hoc basis

Whilst delivering on these priorities, the Committee's agenda has evolved during the year to respond promptly to new and emerging issues, whilst balancing the need to maintain oversight of those core responsibilities as laid out in its terms of reference. During the year the Committee has provided close oversight of specific risk issues including:

- Monitoring the ongoing situation in respect of increasing inflation and rising interest rates with the associated implications on the cost of living for both customers and employees
- Challenges around recruitment and retention as workplace practices evolve in the post pandemic environment
- Continued oversight of the Group's project to implement an IRB approach for credit risk, and activity to address PRA feedback received following submission of Phase 2 of the buy-to-let application
- Monitoring the development of the plans and progress to address the requirements of the new FCA Consumer Duty following the finalisation of the rules
- Ongoing progress in rolling out and embedding of the ERMF and further refinement of risk appetites to ensure these underpin the business model
- Overseeing the Group's progress on responding to the increasing challenges posed by climate change and the further embedding of climate change risk into the broader risk framework with a focus on the development of a range of metrics to support ongoing monitoring as the Group's strategy in managing this risk is further defined
- Review of the Group's ongoing embedding of its approach to Operational Resilience including the self-assessment undertaken in March 2022 to meet regulatory deadlines and subsequent enhancement activity identified through this process

In addition, aligned with its overarching governance mandate, the Committee has reviewed the assumptions and updates to the Group's Recovery Plan, ICAAP and ILAAP documents.

The ability of the Committee to provide effective oversight is complemented by a comprehensive board education programme on risk matters. During the year the members of the Committee have attended sessions on a wide variety of relevant risk topics from internal and external subject matter experts including: Consumer Duty, Stress and Scenario Testing, Interest Rate Risk, Cyber Risk, Operational Resilience and Macro-Economic Trends. I can also confirm that during the year the Committee held a private session with the CRO.

Overall, I am pleased to confirm that in the last year the Committee has again, in my view, met its key objectives and carried out its role effectively.

The year ahead promises again to be challenging given political and economic uncertainties and the Committee will continue to monitor these wider macro trends and their associated impacts on the Group. Whilst the full impacts of these are being assessed on an ongoing basis and the operating environment continues to evolve, the Committee will continue to balance oversight of these with its commitments to continuous improvement in its risk framework and culture.

As we look ahead to 2023 it is anticipated many of the areas of the Committee's focus over the last year will again dominate the risk agenda. Whilst the Committee will continue to oversee all the principal risks facing the Group and ensure that robust assessment of these is undertaken, other priorities for the Committee will include:

- Ongoing monitoring of the emerging economic challenges with particular attention on the assessment of customer affordability and the impact on lending decisions. Credit appetites and policies are kept under constant review and will be adjusted accordingly to reflect circumstances, ensuring that appropriate support is provided to customers. The Group's response to Covid has already evidenced the effectiveness of its approach to dealing with such challenges
- Consideration of potential impacts on the Group of possible supply issues which are anticipated to affect the distribution of energy over the coming winter
- Monitoring the programme of work being undertaken to ensure the Group is on track to meet the 2023 implementation dates for the new FCA Consumer Duty following formal approval of the plan by the Board in October 2022. The Committee will provide continuous oversight of progress ensuring alignment with regulatory expectation and the Group's commitment to ensuring that customers receive fair outcomes
- Oversight of the ongoing IRB application including review of Phase 3 documentation for buy-to-let and Phase 2 for development finance which are awaiting the PRA's invitation to submit
- Review and oversight of the further embedding of the financial crime risk and controls framework following the investment in resources, systems and processes during 2022
- Further assessment of the potential impacts of the post-Brexit financial services regulatory regime as additional clarity is received through the expected adoption of the Financial Services and Markets Bill during 2023
- Continuing to drive the embedding of the Group's risk culture as the key enabler of the maturing ERMF, with focus on further refining the risk reporting capability to really enable the Committee to focus on high materiality matters and enhance its horizon scanning capability

Whilst this year has undoubtedly posed new challenges, I am extremely confident that the Group has the skills and experience to manage the risks it is likely to encounter in the next year. It remains critical that the Group continues to anticipate any potential impact and demonstrates its agility in the event that circumstances change materially. However, given the well-established Risk function which continues to provide the Committee with oversight of the risk landscape and the effectiveness of the three lines of defence model, I believe the Group and the Committee are well-placed to respond to the uncertainties ahead.

Peter Hill

Chair of the Risk and Compliance Committee

6 December 2022

B8.2 Risk governance

The Group's approach to governance and the committee structures are described in Section B4. The risk committee structure and lines of oversight in place throughout the year are set out below.

Risk and Compliance Committee

The Risk and Compliance Committee assists the Board in fulfilling its responsibilities for risk management. It comprises the independent non-executive directors and the Chair of the Board. The terms of reference, which were reviewed and approved by the Board in December 2021 and again in December 2022, after the end of the year, align with the 2018 Code and good practice.

The Committee's responsibilities include reviewing:

- Recommendations and matters escalated from the ERC
- The effectiveness of the Group's ERMF and the extent to which risks inherent in the Group's business activities and strategic objectives are controlled within the risk appetite established by the Board
- The effectiveness of the Group's systems and controls for compliance with statutory and regulatory obligations
- The appropriateness of the Group's risk culture, to ensure it supports the Group's stated risk appetite
- The effectiveness of the Group's strategy in promoting the fair treatment of customers and integrity in the market as central to its operations and culture.
- The effectiveness of the Group in addressing issues requiring remedial attention to ensure actions are completed in a timely manner and minimise the potential for risk appetite thresholds to be exceeded

The Committee provides ultimate oversight and challenge to the Group's enterprise-wide risk management arrangements, which are managed through the ERC. It also retains oversight responsibility for model risk within the Group. The Committee delegates day-to-day oversight for model risk to the MRC.

The Committee meets at least four times a year and normally invites the executive directors, CRO, Chief Operating Officer, General Counsel and Internal Audit Director to attend its meetings. However, it reserves the right to request any of these individuals to withdraw or to request the attendance of any other Group employee.

The Committee aims to meet annually with the CRO, without the presence of executive management, to discuss his remit and any issues arising from it.

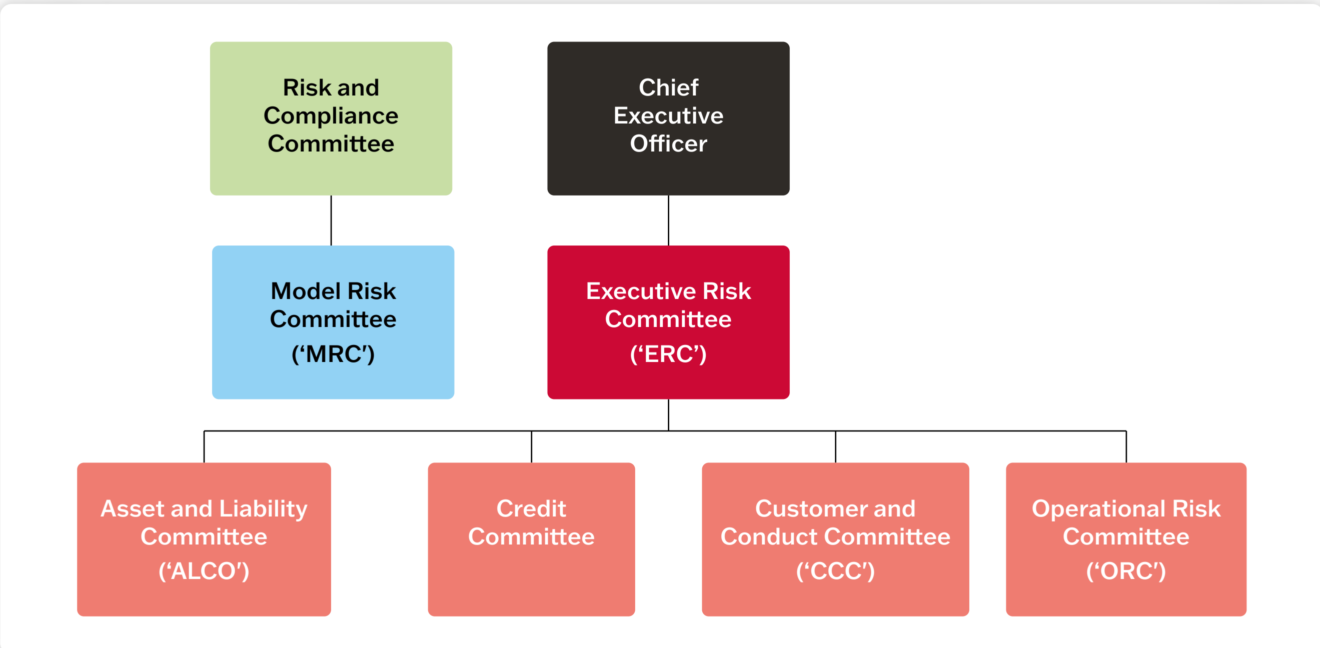
The Committee also has the power to requisition a meeting with the Internal Audit Director and/or the external auditor without the presence of executive management to discuss any matters that any of these parties believe should be discussed privately.

Standing items covered in each meeting of the Committee include:

- Reviews of the principal risks facing the Group, which included a comprehensive refresh of the risks during the year
- Consideration of new or emerging risks and regulatory developments and their impact on the Group
- Consideration and challenge of management's rating of the various risk categories to which the Group is exposed
- Consideration of the root causes and impact of material risk events and the adequacy of actions undertaken by management to address them

In addition, during the last year, the Committee:

- Reviewed the Group's risk appetite to ensure it remained consistent with the delivery of the Group's strategic objectives, proposing any required changes to the Board
- Continued to monitor progress in respect of the Group's application for regulatory approval of its IRB approach to credit risk management
- Provided ongoing oversight as the Group assesses the impact of the FCA Consumer Duty on its products and services and seeks to address the requirements through a dedicated project
- Conducted deep dive reviews into targeted risk areas, including the impact of rising interest rates following the Bank of England's increases in the base rate and expected future rises, rising inflation and the broader consequences of the cost of living crisis



Corporate Governance

- Continued to monitor the challenges around recruitment and retention of employees together with the wider impacts of a changing workplace in light of hybrid working patterns
- Considered regular focussed reviews of key risk areas including credit risk, capital risk, liquidity and market risk, climate change risk, conduct risk and across the different categories of operational risk
- Continued to closely monitor the progress of the Group in addressing its approach to operational resilience ensuring it successfully met the 2022 policy implementation deadline
- Reviewed, challenged and approved the Management Responsibilities Map
- Reviewed, challenged and approved the terms of reference of the MRC
- Reviewed, challenged and approved the Compliance Monitoring Plan and subsequent updates to that plan
- Reviewed, challenged and approved the Money Laundering Reporting Officer's annual report
- Considered and challenged reports in relation to ICAAP, ILAAP and Recovery Plan recommending approval to the Board
- Challenged and approved various key risk policies

During the year, Graeme Yorston a non-executive director and a member of the committee was designated as Consumer Duty champion, as part of the Group's response to the new FCA Consumer Duty rules.

Executive Risk Committee ('ERC')

The purpose of the ERC is to assist the CEO in designing and embedding the Group's risk management framework, monitoring adherence to risk appetite statements and identifying, assessing and controlling the principal risks within the Group. The ERC was established under the specific authority of the CEO, it is chaired by the CRO and includes all Executive Committee members, with the Internal Audit Director attending as an observer. The ERC monitors the interaction and integration of the Group's business objectives, strategy and business plans with the Group's risk appetite and risk strategy and escalates breaches and significant matters to the Risk and Compliance Committee, recommending changes as appropriate.

Key areas of focus for the ERC include:

- Developing and, at least annually, reviewing the appropriateness and effectiveness of the overall risk management framework to manage and mitigate risk
- Reviewing the Group's approach to controlling each principal risk and its capability to identify and manage such risks
- Reviewing emerging risks as they arise, including consideration of their potential impact on the Group's business objectives, strategy and business plans, as well as risk choices, appetite and thresholds
- Periodically reviewing the effectiveness of the Group's internal control and risk systems including the Group's material outsourced arrangements and risks associated therewith, particularly where they might impact customers
- Ensuring compliance with relevant PRA and FCA regulations (excluding the SMCR, which is overseen by the Executive Committee)
- Reviewing the process and outcome of the Group's ICAAP, ILAAP, Recovery Plan and Resolution Pack together with recommendations to the Risk and Compliance Committee and Board for approval
- Considering the implications of any proposed legislative or regulatory changes that may be material to the Group's risk appetite, risk exposure, risk management and regulatory compliance

The ERC is supported by an Asset and Liability Committee, Customer and Conduct Committee, Credit Committee, and Operational Risk Committee, which focus on specific aspects of the Group's risk profile. Each of these executive committees operates within terms of reference formally approved by the ERC. Their primary functions are described below.

The ERC retains direct responsibility for those principal risk areas which impact across multiple aspects of the Group's operations, including climate change risk, reputational risk and strategic risk.

Asset and Liability Committee ('ALCO')

ALCO comprises heads of relevant functions and is chaired by the Balance Sheet Risk Director.

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

Customer and Conduct Committee ('CCC')

The CCC comprises heads of relevant functions and is chaired by the Conduct and Compliance Director.

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

Credit Committee

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

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

Operational Risk Committee ('ORC')

The ORC comprises heads of relevant functions and is chaired by the Enterprise Risk Director.

The ORC is responsible for overseeing the Group's operational risk and resilience arrangements, including those systems and controls intended to counter the risk that the Group might be used to further financial crime. The Committee remit includes risks arising from personnel, technology and environmental matters within the business, including those arising from the use of third parties. The Committee considers key operational risk information such as key risk indicators, themes within risk registers, emerging risks, loss events, control failures, and operational resilience measures. It also monitors performance against risk appetite on an on-going basis.

Model Risk Committee ('MRC')

The MRC reports directly to the Risk and Compliance Committee and comprises senior managers from Risk, Finance and the main business areas. It is chaired by the CRO and attended by Hugo Tudor, a non-executive director. The role of the MRC is to review and make recommendations on all material aspects of the rating and estimation processes in relation to key credit and finance models. The MRC also acts as the 'Designated Committee' for IRB purposes, approving all material aspects of IRB rating systems.

B8.3 Risk management culture

The Board is committed to establishing and maintaining a strong risk culture as a fundamental element of the Group's corporate culture. This risk culture promotes effective risk management that is consistent and commensurate with the nature, complexity and risk profile of the business.

The importance of risk management is embedded at all levels of the business and all employees are expected to understand and have accountability for the risks they take. Appropriate risk management and the behaviours expected to deliver this are core to the Group's performance management process.

Ensuring the ongoing maturity of, and further formalising the approach to, the Group's risk culture has been a priority activity throughout the financial year. An effective risk culture is seen as a key enabler to the successful delivery and execution of the Group's ERMF, which remains a focus of ongoing investment. Therefore, various initiatives have been undertaken during the year underlining the importance of ensuring that the risk culture continues to support the Group's approach to its management of risk. These include:

- A series of focus groups representing a cross section of employees which evaluated their understanding of risk matters, leading to targeted actions to improve risk knowledge
- Further formalisation of the Group's risk culture based on the four agreed components – Leadership and Direction, Individual Commitment, Joint Ownership, and Governance – together with clear measures to evidence these
- The development of a group-wide code of conduct which reiterates individual responsibilities in the management of risk

These enhancements are designed to reinforce the Group's existing strong risk culture which is embedded through various practices which support and protect its wider strategic goals. This approach is essential to protecting the Group's customers, shareholders, creditors, and its reputation. In particular:

- The fair treatment of customers and the delivery of fair outcomes, particularly for those customers considered to be vulnerable, is central to the Group's risk management approach
- Robust risk management, conducted within an open and transparent environment, remains at the heart of all decision-making
- Business is carried out only where the potential risk to the Group and its customers has been evaluated together with the potential reward, and where the residual risk exposure remains within defined risk appetites
- The risk management framework ensures that risks are owned and managed in a consistent way

The Group's risk culture has been central in ensuring historically low levels of credit and operational losses and the absence of any material conduct issues affecting customers.

B8.4 Risk management framework

Introduction

The Group's enterprise risk management framework ('ERMF') is designed to enable management to identify and focus attention on the risks most significant to its objectives and to provide an early warning of events that put those objectives at risk. The framework and the associated governance arrangements are designed to ensure that there is a clear organisational structure with distinct, transparent and consistent lines of accountability and responsibility in the facilitation of risk management.

Effective risk management is core to the execution of the Group's strategy. The Group continues to ensure the framework evolves to reflect the changing business, regulatory and economic landscape and emerging threats. Therefore, the Group remains committed to ongoing investment and enhancement in its enterprise-wide risk management system. Core to this approach is ensuring that tools for effective risk identification, assessment, treatment, monitoring and reporting are appropriate and embedded at all levels of the Group's businesses.

During the past twelve months significant progress has been made in further strengthening the ERMF to support the Group's strategic aspirations. The recruitment of experienced risk resource in 2021 has ensured the completion of a comprehensive planned programme of work during the year. Key achievements have included the roll-out of a standardised policy framework across the principal risk categories, which has supported refinement of risk appetites and better articulation and measurement of risks and controls. Delivery of these enhancements has been facilitated by further embedding the Group's risk culture, through effective stakeholder management, targeted education and a collaborative approach between business areas and the Risk and Compliance function. Work will continue to progress this further through the coming financial year.

Key priorities for the next twelve months include focussing on the alignment of business areas' risk management and control activities to risk appetite, and the enhancement of existing risk information to provide better insight into risk profiles and to support decision making at senior management level.

Enterprise risk management framework

The ERMF is intended to provide a robust, proportionate, structured and consistent approach to the management of risk within agreed appetites thereby supporting the achievement of the Group's strategic objectives. The key objectives of the ERMF are to:

- Define a strategy for the Group's attitude to risk, including outlining the approach taken to setting qualitative statements and quantitative metrics to define and assess the Group's appetite and tolerance for risk across the principal risk exposures
- Establish a consistent risk taxonomy, describing the principal risk categories and the more granular aspects of each of these risks
- Promote an appropriate risk culture across the Group, ensuring that risk is considered as part of all key strategic and business decision making
- Establish standards for the consistent identification, assessment, treatment, monitoring and reporting of risk exposure and loss experience
- Promote risk management techniques to proactively reduce the frequency and severity of risk events, driving control improvements where necessary
- Facilitate adherence to regulatory requirements, including threshold conditions, capital standards and support the regulatory requirements associated with the ICAAP, ILAAP and the Recovery Plan
- Provide senior management and relevant committees with risk reporting that is relevant and appropriate, enabling timely action to be taken in response
- Define risk policies which align to the Group's principal risks and identify the minimum control requirements and key indicators to manage and measure these risks

Three lines of defence model

The Group employs a 'three lines of defence model' to delineate responsibilities in the management of risk ensuring adequate segregation in the oversight and assurance of risk as follows:

Three lines of defence

Line 1	Line 2	Line 3
Operational and support areas that own and manage risk within agreed limits	Risk and Compliance function designing, implementing and overseeing the ERMF and providing support and challenge	Internal Audit function independently assessing effectiveness of risk management

- The *first line of defence* ('Line 1'), comprising executive directors, managers and employees in operational and support areas. Line 1 has day-to-day responsibility for:
    - Risk identification, assessment, treatment, monitoring and reporting
    - Control implementation, and ongoing monitoring and assessment of operations
    - Management, escalation and reporting of risk issues against stated appetites

  Risk Champions are appointed within all business areas to support the embedding of an effective risk culture across the Group
- The *second line of defence* ('Line 2') is provided by the independent risk and compliance function. This division is headed by the CRO, who is a member of the Group's Performance Executive Committee and ERC. The function is overseen by the Risk and Compliance Committee and its supporting executive committees. Line 2 provides support and independent challenge on all risk related issues specifically:
    - Developing, maintaining and monitoring effectiveness of the ERMF across the Group
    - Developing and maintaining supporting risk processes within that framework, ensuring these are consistent with the Board's risk appetite
    - Ensuring that risks identified by Line 1 are measured, monitored, controlled and reported consistently and on a timely basis

- Maintaining open and constructive engagement with the regulatory authorities

The CRO attends meetings of the Risk and Compliance Committee and the Board to report directly to the directors on risk issues and has a close working relationship with the Chair of the Risk and Compliance Committee, an independent non-executive director.

- The *third line of defence* ('Line 3') is provided by the Internal Audit function which is responsible for reviewing the effectiveness of the first and second lines of defence. This function is overseen by the Audit Committee and led by the Internal Audit Director who reports directly to the Audit Committee. Internal Audit provides independent assurance on:

  - Line 1 and Line 2 risk management activities
  - Effectiveness of the ERMF
  - The appropriateness and effectiveness of internal controls
  - Effectiveness of policy implementation

  Further information on the work of the Internal Audit function is given in the report of the Audit Committee (Section B6).

Risk appetite framework

The risk appetite framework outlines the Group's approach to setting and monitoring risk appetite. The framework stipulates the approach to setting risk appetite statements, measures, tolerances and reporting requirements, escalation obligations and the frequency of review. The framework is subject to annual board approval.

The following principles are integral in determining the Group's risk appetite:

- Alignment to principal risks
- Alignment to strategic objectives
- Appropriateness of calibration to drive timely action
- Facilitation of ongoing monitoring of the risk profile

The Group has developed a tiered approach to setting and monitoring of risk appetite. A set of board-owned (Level 1) metrics has been established. These are monitored by the Risk and Compliance Committee on an ongoing basis and any threshold breaches in respect of these are immediately escalated to the Board. These board-level metrics are underpinned by more extensive executive-level metrics, which are reportable to the ERC. Any threshold breaches of the executive-level metrics are reviewed by the ERC to determine whether these are sufficiently material to be reported to the Risk and Compliance Committee.

Risk appetite is central to the effective implementation and operation of the ERMF. The risk appetite framework has been enhanced during the financial year to align with the enhancements made to the ERMF. These enhancements have facilitated ongoing refinement of the Group's risk appetites for all principal risks and ensure that:

- All principal risks have strategically aligned qualitative risk appetite statements and quantitative measures
- There are appropriate board and executive level risk appetite metrics monitored on an ongoing basis
- Calibration of appetite thresholds is appropriate and drives timely management action

B8.5 Principal risks and mitigations

The Group is exposed to a number of principal risks and uncertainties that arise from the operation of its business model and strategy. A summary of those risks and uncertainties which could prevent the achievement of the Group's strategic objectives, how the Group seeks to mitigate those risks and the change in the perceived level of each risk in the last financial year are described below. These risks are discussed in more granular detail in the Group's Pillar III report, published on the Group's website.

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

The risks are set out in accordance with the Group's classification of its principal risks, approved by the Board in the year. The principal risks remain consistent from the previous financial year.

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

Risk increasing	Risk decreasing	Risk stable
↑	↓	← →

Capital Risk

Description	Mitigation	Year-on-year change
The Group faces the risk of insufficient capital to operate effectively including meeting minimum regulatory requirements, operating within Board approved risk appetite and supporting the Group's strategic goals. Following the year end the Bank of England published their Consultation Paper regarding the process for the implementation of the Basel 3.1 standards in the UK, which will be effective from on 1 January 2025.	A robust process exists over capital reporting, both internally and to the PRA, with a comprehensive annual ICAAP assessment including all material capital risks. An internal capital buffer is maintained in excess of minimum regulatory requirements to protect against unexpected losses or risk-weighted asset growth. The Group submitted the second stage of its application for the accreditation of its IRB approach to buy-to-let credit risk for capital adequacy purposes to the PRA in March 2021 and is currently responding to PRA feedback on various elements of this phase, ahead of a formal PRA panel assessment. The project continues to progress to plan, and work will continue through the next financial year. The Bank of England Basel 3.1 proposals largely follow the core Basel proposals and, as such, are materially in line with expectations. The Consultation Paper also highlighted enhancements to the IRB accreditation process and an increase in the Bank's threshold for Strong and Simple treatment to £20 billion of assets, each of which would have a favourable impact on the Group if retained in the ultimate rules.	← → While there has been little impact on the overall capital risk framework in the financial year the global and UK economic outlook has deteriorated significantly since Russia's intervention in Ukraine, with global inflationary pressures intensifying sharply. Although downside risks will present headwinds, the Group's strengthening profitability and the progress made in balance sheet management mean that capital ratios remain strong with considerable headroom over requirements. This, in turn, provides significant capacity to support lending to households and businesses.

Liquidity and Funding Risk

Description	Mitigation	Year-on-year change
The Group is exposed to the risk that it has insufficient funds to meet its obligations as they fall due. Retail deposit taking is central to the Group's funding plans and therefore changes in market conditions could impact the ability of the business to maintain the level of funding required to sustain normal business activity.	The Group maintains a diversified range of both retail and wholesale medium and long-term funding sources to cover future business requirements and liquidity to cover shorter term funding needs. Internally, comprehensive treasury policies are in place to ensure sufficient liquid assets are maintained and that all financial obligations can be met as they fall due, even under stressed conditions. The Group has a dedicated Treasury function which is responsible for the day-to-day management of its overall liquidity and wholesale funding arrangements. The Board, through the delegated authority provided to the ALCO, sets limits as to the level, composition and maturity of funding and liquidity resources.	← → The Group remains well placed to access funding from a wide range of sources to meet its future funding requirements. Access to the retail savings market has been effective during the year through both direct and intermediated deposit platform distribution channels.

Market Risk

Description	Mitigation	Year-on-year change
The Group is exposed to the risk that changes in interest rates at which it lends and those at which it borrows may adversely affect its net interest income and profitability.	This risk is managed within Board approved risk appetite limits with comprehensive treasury polices in place to ensure that the risks posed by changes and mismatches in interest rates are effectively managed. Day-to-day management of interest rate risk within Board approved limits is the responsibility of Treasury, with control and oversight provided by ALCO. The Group seeks to match the maturity profile of assets and liabilities and uses financial instruments, such as interest rate swaps, to hedge the exposure arising from repricing gaps.	↑ The Group's overall market risk profile, relative to its balance sheet, has remained broadly similar and therefore associated risk levels remain generally stable compared to previous periods. However, the rise in the Bank of England base rate to its highest level in over a decade has increased volatility in pricing levels on both the asset and liability sides of the balance sheet, requiring particular focus on risk management in this area.

Credit Risk

Description	Mitigation	Year-on-year change
Credit risk elements which could expose the Group to the risk of unexpected material losses include: • Customer risks through failure to screen potential borrowers, and manage repayments • Concentration risk in credit portfolios through an uneven distribution of exposures of borrowers, asset classes, sectors or geographies • Reduction in value of collateral owned by the Group, or secured against debt owed to it • Wholesale counterparty risk • Outsourcer default risk	The Group has a robust limit framework supported by comprehensive policies in place that set out detailed criteria which must be met before loans are approved. Exceptions to credit policies require approval by the Credit Risk function, operating under a mandate from the Credit Committee. The Group uses a range of sources to inform expectations of key external factors such as interest rate movements and house price inflation which are in turn used to guide policy and underwriting. The Group also continues to exploit opportunities to diversify the range of its activities and income streams, consistent with its strategic objective of operating as a prudent, risk-focussed specialist lender. The majority of the Group's loans by value continue to be secured against UK residential property at conservative loan-to-value levels. The primary collateral therefore forms part of a highly mature, sustainable market demonstrated over many decades of operation. Exposure to wholesale counterparty credit risk is limited to counterparties that meet specific credit rating criteria per the Group's comprehensive treasury policies. Exposure to approved counterparties is monitored daily by senior management within the Group's Treasury function with all exposure managed within ALCO approved limits. Ongoing monitoring of the credit rating and financial performance of all outsourced relationships and critical suppliers is undertaken.	↑ Prudent credit policies combined with the Group's consistently high lending standards have ensured that customer loan repayments have been maintained in line with expectations, and arrears and losses remain at historically low levels. Tracking of customer risk profiles across lending areas shows little indication of stress, and asset equity coverage continues to provide significant credit risk mitigation. Whilst current loan performance remains exemplary, the Group continues to monitor the potential future impact of the increasing interest rate environment and higher costs of living and has reviewed and adjusted credit policy and affordability models accordingly. As a result of these broader economic movements, in particular the rapid increase in market interest rates, the credit risk profile has marginally increased compared to 30 September 2021.

Model Risk

Description	Mitigation	Year-on-year change
Models are used across the Group to inform financial decision making and hence it is imperative that the environment in which the models are designed, implemented and operate is subject to appropriate rigour.	As the use of internally developed models has increased across the Group, a robust framework and governance has been developed to manage the associated risks. This includes the MRC which oversees the development, implementation and ongoing monitoring of models across the Group. The Model Risk Management Framework provides a structured and disciplined approach to the management of model risk. This includes clear development, implementation and ongoing oversight principles together with the requirements for independent validation based on model materiality criteria.	← → It is recognised that the increasing use of internally developed models will drive a commensurate risk to the Group. However, given the strength of the framework and oversight processes, model risk remains within appetite and the outlook remains stable. The Group is reviewing the contents of the recent PRA Consultation Paper (CP 6/22) on model risk management principles for banks to ensure it will be compliant with the proposed Supervisory Statement when published.

Reputational Risk

Description	Mitigation	Year-on-year change
Maintenance of a strong reputation across all business lines and operational activities is core to the Group's philosophy. Detrimental reputational impacts may result from crystallisation of other principal risks, but also through failure to safeguard the integrity of the Group's brand or failing to meet external expectations in its business practices.	The reputational impacts of any changes to strategy, pricing or processes are explicitly considered in the decision-making process and are reviewed by the Director of External Relations, and the Group will not undertake any activity it considers might be damaging to its reputation. The Group has an experienced External Relations function which manages all Group communications and ensures that the reputational profile of the Group remains protected at all times. All material risk events are reviewed for reputational impact and mitigating actions are initiated as appropriate.	← → The Group continues to manage its reputation effectively in all its dealings. Whilst it is mindful that threats to its reputation can emanate from many sources, the Group remains well-placed to respond quickly and efficiently to any potential reputational issue.

Strategic Risk

Description	Mitigation	Year-on-year change
The Group's strategy as a specialist lender is key to its operating model and business planning. However, there is a risk that changes to its business model, or macroeconomic, geopolitical, regulatory, competitive or other external factors may impact delivery of strategic objectives.	The Group closely monitors economic developments in the UK and overseas, with support from leading independent macro-economic and other advisors. Stress testing is performed to assess its expected performance under a range of operating conditions. This provides the Board with an informed understanding and appreciation of the Group's capacity to withstand shocks of varying severities. The Group continues to exploit opportunities to diversify the range of its activities and income streams, consistent with its strategic objective of operating as a prudent, risk focussed lender.	← → Prospects for the UK's economic performance remain uncertain. Short-term disruption from Covid has been replaced by a material increase in both the cost of living and input costs for businesses, putting pressure on household and corporate disposable income. Taken alongside a sharp reversal in monetary policy and political instability, the near-term economic outlook remains uncertain while the medium and longer-term impacts of Covid, together with the implications of the UK's new trading relationships post-Brexit, are still to be determined. During the year the Group continued to make progress against its strategy, with significant milestones reached in its digitalisation programme. Whilst the Group has remained resilient throughout this prolonged period of economic uncertainty, and activity levels have been strong, the potential for disruption as the economy resets to higher interest rates presents a risk.

Climate Risk

Description	Mitigation	Year-on-year change
The Group considers the impact of climate change either directly on the Group or indirectly through its third-party relationships or its lending activities. This includes both the transitional risk to its strategy and profile through external measures to progress to a low carbon environment and any physical risks arising from changes to the natural environment that could impact the calculation and valuation of assets and liabilities.	The Group proactively manages physical risk and has specific underwriting policies aimed at the mitigation of, for example, risks associated with flooding, coastal erosion and subsidence. The potential for transition risk is monitored within the different business lines, with external events prompting consideration of amendments to credit policy and underwriting criteria. Joining Bankers For Net Zero ('B4NZ') and establishing targets for offsetting the Group's operational footprint emissions are key building blocks in embedding governance and oversight of the risks from climate change. Longer term strategic planning will be informed by ongoing and enhanced analysis, supported by scenario testing. The Sustainability Committee provides comprehensive oversight of climate initiatives across each business line, whilst the Credit Committee monitors the performance of property collateral against EPC data.	↑ The Group has continued to make progress on its climate change agenda, with activity focused on identifying implications across business lines and the signing up to B4NZ. However, the levels of regulatory scrutiny and public interest in this area have continued to increase during the period and therefore the overall risk is considered to have increased over the year.

Conduct Risk

Description	Mitigation	Year-on-year change
The commitment to delivering good customer outcomes is at the heart of the Group's culture and strategy. Conduct risk arises where the culture and behaviours fail to promote the customer's best interests and avoid foreseeable consumer harm, resulting in unfair outcomes for the customer.	The management of conduct risk within the Group is tailored to the specific product and customer type and includes dedicated quality and control teams which validate process adherence, the delivery of good customer outcomes and the appropriate management of those customers showing signs of vulnerability. All employees are required to undertake conduct risk related training. The Group's approach to employee remuneration means that very few employees are included in financial incentive schemes. The incentive scheme framework is reviewed by the CCC annually and individual schemes require approval from the Chief People Officer, CFO and Conduct and Compliance Director before implementation.	↑ Whilst the Group is well-placed to provide appropriate support, the current economic environment and cost of living crisis is likely to put a strain on some of the Group's customers, potentially increasing vulnerabilities. In addition, the introduction of the FCA's Consumer Duty raises the expectations of firms to proactively seek to prevent causes of foreseeable harm.

Operational Risk

Description	Mitigation	Year-on-year change
Operational Risk arises across the Group through the possible inadequacy or failure of internal processes, people and systems or from external events. Operational risk is inherently diverse in nature. All the Group's activities create various forms of operational risk which need to be managed through a strong control and oversight structure. Exposure to operational risk is exacerbated through any periods of transformation and / or stress.	The Group has an established operational risk framework which enables timely and accurate analysis of operational risk exposures and drives accountability and remedial actions where issues are identified. Management of operational risk is enabled through a comprehensive framework of policies which are designed to ensure that all key operational risks are managed consistently across the business. This includes risk areas such as Change Management, Procurement, Data Protection, Financial Crime and People. The Group is committed to ensuring it remains resilient, particularly in respect of IT capability. Significant investment has been undertaken to ensure it is well-protected in the face of the evolution of cyber threats particularly as the Group increasingly moves to cloud-based infrastructure and looks to harness digital capability as part of its IT roadmap. Whilst the Group continues to drive through strategic transformation across all its lending lines, there remains a continuing focus on ensuring that these changes do not compromise overall resilience. A well-embedded change framework ensures that changes are managed in a controlled way. The Group relies on third party providers for a number of key services including in the provision of its savings offering and in respect of material IT services. The robust oversight of third parties is also seen as critical to overall resilience. Despite industry-wide challenges in recruiting and retaining skilled employees, continued investment in people has been undertaken to ensure that risk exposures are minimised. This includes management of key dependency risk through effective succession planning, recruitment, development and retention strategies.	← → Whilst the Group continues to maintain a robust control environment and successfully navigated the operational challenges posed by Covid, the new post-pandemic challenges have further impacted the operating environment. The Group has made progress on its strategic transformation programme during the year, and it is expected that this will benefit operational risk management in the longer term. However these types of programme have an inherent execution risk, which the Group is managing carefully. Changing working patterns and economic uncertainty have influenced the recruitment market driving increased competition between firms to attract the strongest candidates. Impacts of the war in Ukraine and the wider cost of living challenges have further increased risk exposures across key operational risk categories such as cyber risk and financial crime. Against this background, regulatory compliance expectations continue to rise, and the Group is committed to ensuring that it remains compliant in its operational activities. There is potential that as expectations increase gaps may be identified which will need addressing to reduce inherent operational risk exposures.

B9. Directors' report

The directors of Paragon Banking Group PLC (registered number 2336032) submit their Report prepared in accordance with Schedule 7, which also includes additional disclosures made in accordance with the Listing Rules and the Disclosure Guidance and Transparency Rules of the FCA.

Certain information required by these requirements is included in other sections of this Annual Report and incorporated in this Directors' Report by reference. These items are discussed in detail at the end of this report.

Directors

The names of the directors of the company at the date of this report, together with their biographical details, are given in Section B3.1. All the directors listed in that section were directors of the company throughout the year, apart from Robert East and Tanvi Davda, who were appointed as directors on 1 September 2022. In addition, Fiona Clutterbuck stepped down from the Board on 1 September 2022.

Directors' interests

The directors' interests in the shares of the Company are disclosed in the Directors' Remuneration Report in Section B7. There have been no changes in the directors' interests in the share capital of the Company since 30 September 2022.

Other than as outlined in the Directors' Remuneration Report in Section B7, the directors had no interests in securities issued by the Company. The directors have no interests in the shares or debentures of the Company's subsidiary companies.

A director has a statutory duty to avoid a situation in which he or she has, or can have, an interest that conflicts or possibly may conflict with the interests of the Company. A director will not be in breach of that duty if the relevant matter has been authorised in accordance with the Articles of Association of the Company (the 'Articles') by the other directors. The Articles include the relevant authorisation for directors to approve such conflicts, if appropriate.

None of the directors had, either during or at the end of the year, any material interest in any contract of significance with the Company or its subsidiaries. Further details on the directors' remuneration and service contracts / appointment letters can be found in the Directors' Remuneration Report in Section B7.

Directors' powers and appointment of directors

The appointment and replacement of the Company's directors is governed by the Articles, the Code, the Companies Act 2006 and related legislation, and the individual service contracts and terms of appointment of the directors. The powers of the directors, and their service contracts and terms of appointment, are described in the Corporate Governance section, Section B4.

The Articles may only be amended by special resolution of the Company's shareholders in a general meeting and were last amended in 2021. The Company's Articles set out the powers of the directors and rules governing the appointment and removal of directors. The Articles can be viewed at the Group's website at www.paragonbankinggroup.co.uk.

Under Article 83 of the Articles, all directors are required to submit themselves for reappointment annually, in accordance with the Code. Accordingly, all current directors will retire and seek reappointment at the AGM, in March 2023.

None of the directors has a service contract with the Company requiring more than 12 months' notice of termination to be given.

Directors' indemnity and insurance

Under Article 159 of the Articles, the Company has qualifying third party indemnity provisions for the benefit of its directors, for the purposes of section 234 of the Companies Act 2006, which were in place throughout the year, and which remain in force at the date of this report, in the form of directors' and officers' liability insurance. The directors' and officers' liability insurance covers all directors of the Company's subsidiary entities.

Share capital and distributions

Share capital

Details of the issued share capital of the Company, together with details of movements in its issued share capital in the year, are given in note 43 to the accounts. The Company has one class of ordinary shares which carries no right to fixed income. Each ordinary share carries the right to one vote at general meetings of the Company. The rights and obligations attaching to ordinary shares are set out in the Articles.

There are no specific restrictions on the size of a member's holding or on the transfer of shares. Both of these matters are governed by the general provisions of the Articles and prevailing legislation. The directors are not aware of any agreements between holders of the Company's shares in respect of voting rights or which might result in restrictions on the transfer of securities.

Details of employee share schemes are set out in note 57 to the accounts. Votes attaching to shares held by the Group's employee benefit trust are not exercised at general meetings of the Company.

The Company presently has the authority to issue ordinary shares up to a value of £83.2 million and to make market purchases of up to 24.8 million £1 ordinary shares. These authorities expire at the conclusion of the forthcoming AGM on 1 March 2023 and resolutions will be put to that meeting proposing that they be renewed.

Purchase of own shares

The existing authority under section 724 of the Companies Act 2006, referred to above, given to the Company at the AGM on 2 March 2022 enables it to purchase its own ordinary shares up to a limit of 10% of its issued share capital, excluding treasury shares (the Company's own shares already purchased by it but not cancelled).

This authority will expire at the conclusion of the next AGM, and the Board considers it would be appropriate to renew this authority. It therefore intends to seek shareholder approval to purchase ordinary shares of up to 10% of its issued share capital at the forthcoming AGM in line with current investor sentiment. Details of the resolution renewing the authority will be included in the Notice of AGM. These shares will be initially held in treasury. Shares held as treasury shares can in the future be cancelled, re-sold or used to provide shares for employee share schemes.

On 8 June 2021 the Group announced a share buy-back programme of up to £40.0 million which was completed in the current year. The reasons for this purchase were set out in Section 3.3 of the Half Year Report for the six months ended 31 March 2021. On 7 December 2021 a further buy-back programme of £50.0 million was announced. The reasons for this purchase were set out in Section 3.3 of the preliminary results announcement for the year ended 30 September 2021. This programme was extended to £75.0 million on 14 June 2022 for reasons set out in Section 4.3 of the Half Year Financial Report for the six months ended 31 March 2022, published on that day. During the year 13,011,285 £1 ordinary shares (2021: 6,882,132) having an aggregate nominal value of £13,011,285 (2021: £6,882,132), were purchased under these programmes and initially held as treasury shares. Total consideration paid in the year was £66.9 million, including costs (2021: £37.7 million). This programme was completed on 7 November 2022, following the year end.

On 24 November 2021, 12,100,834 ordinary shares, being all the shares then held in treasury, were cancelled. These shares had a nominal value of £12,100,834 and represented 4.83% of the issued share capital excluding treasury shares at that time.

On 8 September 2022, 9,370,766 of the treasury shares acquired under the share buy-back programme were cancelled. These shares had a nominal value of £9,370,766 and represented 3.91% of the issued share capital excluding treasury shares at that time.

The number of treasury shares held at 30 September 2022 was 3,640,519 (2021: 12,100,834), representing 1.53% of the issued share capital excluding treasury shares (2021: 4.83%). The maximum holding of treasury shares during the year was 12,100,834 (2021: 12,100,834) representing 4.83% of the issued share capital excluding treasury shares at that time (2021: 4.83%).

Dividends

An interim dividend of 9.4 pence per share was paid during the year (2021: 7.2 pence per share).

The directors recommend a final dividend of 19.2 pence per share (2021: 18.9 pence per share) which would give a total dividend for the year of 28.6 pence per share (2021: 26.1 pence per share).

Major shareholdings

Notifications of the following major voting interests in the Company's ordinary share capital, notifiable in accordance with Chapter 5 of the FCA's Disclosure and Transparency Rules, had been received by the Company as at 30 September 2022.

Shareholder	% Held	Notification date
Royal London Asset Management	**5.99**	16/06/2021
Liontrust Investment Partners LLP	**5.07**	21/09/2020
Janus Henderson Group PLC	**5.01**	27/09/2022
Dimensional Funds Advisors LP	**5.00**	21/07/2021
Pendal Group	**4.98**	20/08/2021
Franklin Templeton Fund Management	**4.96**	10/01/2022

On 28 March 2022 BlackRock, Inc. advised that their holding had dropped below 5%.

On 21 June 2022 M&G Plc advised that their holding had dropped below 5% and they no longer held a notifiable interest.

The percentages quoted above were calculated by reference to the total voting rights ('TVR') at the relevant date.

The following changes to the position set out above were notified to the Company after the year end.

- On 1 November 2022, Pendal Group notified the Company that it had reduced its interest to below 5%, calculated by reference to the TVR at 31 October 2022
- On 15 November 2022, Janus Henderson Group PLC notified the Company that it had reduced its interest to below 5% calculated by reference to the TVR at 14 November 2022

As at 6 December 2022, no further changes had been notified to the Company.

Significant agreements

A change of control of the Company, following a takeover bid, may cause a number of agreements to which the Company is a party to alter or terminate. These include certain insurance policies and employee share plans.

The Company does not have any agreements with any director or employee that would provide compensation for loss of office or employment resulting from a takeover of the Company, except that provisions of the Company's share based remuneration arrangements may cause outstanding awards and options to vest and become exercisable on a change of control, subject, where applicable, to the satisfaction of any performance conditions at that time and any required pro-rating of awards.

Research and Development

During the year, the Group undertook certain projects to develop its IT capabilities which met the definition of research and development set out in the guidelines issued by the Department of Business Innovation and Skills in 2010. Claims in respect of these activities were made in the Group's tax returns. The amounts involved were modest in the context of the Group's accounts.

Political expenditure

During the year ended 30 September 2022 no political donations were made by any Group company (2021: £nil).

Auditors

The directors have taken all reasonable steps to make themselves and the Company's auditors, KPMG, aware of any information needed in preparing the audit of the Annual Report and Financial Statements for the year, and, as far as each of the directors is aware, there is no relevant audit information of which the auditors are unaware. This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

The directors, having considered the requirements for rotation of auditors, the length of service of KPMG and the conduct of the audit concluded there was no present need to retender the audit. Therefore, a resolution for the reappointment of KPMG, who have expressed their willingness to continue in office, as the auditors of the Company is to be proposed at the forthcoming AGM, as well as a resolution to give the directors the authority to determine the auditors' remuneration.

The full text of the relevant resolutions is set out in the Notice of AGM accompanying this Annual Report. The evaluation process is described more fully in the Audit Committee Section B6.

Annual General Meeting

The AGM of the Company will take place on 1 March 2023 in London. A notice convening the AGM and outlining the resolutions to be proposed at the AGM is being circulated to shareholders with this Annual Report and Accounts.

Listing Rule LR9.8.4

There are no matters which the Company is required to report under Listing Rule LR9.8.4, other than certain matters concerning its employee share ownership trust (note 45).

The Paragon Banking Group PLC Employee Trust is an independent trust which holds shares for the benefit of employees and former employees of the Group in order to satisfy awards under employee share plans. The Company funds the trust from time to time, to enable it to acquire shares to satisfy these awards. During the year, the trust made market purchases of 2.5 million ordinary shares (2021: 0.8 million). As the shares included in these arrangements are held on the consolidated balance sheet, this has no effect on the amounts reported by the Group.

The trustee will only vote on those shares in accordance with the instructions given to the trustee and in accordance with the terms of the trust deed. The trustee has waived the trust's right to dividends on all shares held within the trust.

Details of the shares held by the trust are set out in note 45 and details of the share-based remuneration arrangements are given in note 57.

Information presented in other sections

Certain information required to be included in a directors' report by Schedule 7 can be found in the other sections of the Annual Report, as described below. All of the information presented in these sections is incorporated by reference into this Directors' Report and is deemed to form part of this report. Readers are also referred to the cautionary statement on page 2.

- The Group's business activities, together with commentary on the likely future developments in the business of the Group (including the factors likely to affect future development and performance) and its summarised financial position are included in the Strategic Report (Section A)
- A description of the Group's financial risk management objectives and policies, including hedging policies, and its exposure to risks (including price/credit/liquidity/cash flow risk) arising from its use of financial instruments is set out in note 60 to the accounts and related notes
- Information concerning directors' contractual arrangements and entitlements under share-based remuneration arrangements is given in Section B7, the Directors' Remuneration Report
- An explanation of the Board's activities in relation to assessing and monitoring how the Company has aligned with its stated purpose and culture can be found in Sections B1 and B3.3
- Information concerning employment practices, employee engagement, the Group's approach to diversity, the employment of disabled persons and the involvement of employees in the business, is given in Section A6.3 – 'People'
- Information on the Group's business relationships and how the directors have had regard to the need to foster these relationships with suppliers, customers and other stakeholders, and the effect of that regard, including on the principal decisions taken by the Group during the financial year (which is crucial to the long-term sustainability of the business), can be found in Section B4.3 of the Corporate Governance Report and in Section A6 of the Strategic Report
- Disclosures concerning greenhouse gas emissions are given in Section A6.4 – 'Environmental Issues'
- Disclosures concerning the Group's ability to continue to adopt the going concern basis of accounting and the Group's viability statement are given in Section A5

Rule DTR7.2.1 of the Disclosure Guidance and Transparency Rules requires the Group's disclosures on Corporate Governance to be included in the Directors' Report. This information is presented in Sections B2, B3, B4, B5, B6, B7 and B8 and the information in these sections is incorporated by reference into this Directors' Report and is deemed to form part of this report.

Rule DTR4.1.5 of the Disclosure Guidance and Transparency Rules requires that the annual report of a listed company contains a management report containing certain prescribed information. This Directors' Report, including the other sections of the Annual Report incorporated by reference, comprises a management report for the Group for the year ended 30 September 2022, for the purposes of the Disclosure Guidance and Transparency Rules.

This section B9 of this Annual Report, together with the other sections of the Annual Report incorporated by reference, comprise a directors' report for the Company which has been drawn up and presented in accordance with, and in reliance upon, applicable English company law and the liabilities of the directors in connection with this report shall be subject to the limitations and restrictions provided by such law.

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

Ciara Murphy

Company Secretary

6 December 2022

B10. Statement of directors' responsibilities

in respect of financial statements

The directors are responsible for preparing this Annual Report, including the consolidated and company financial statements in accordance with applicable law and regulations.

Company law, including the Companies Act 2006 (the 'Companies Act'), requires the directors to prepare consolidated financial statements for the Group and separate financial statements for the Company in respect of each financial year. In respect of the financial statements for the year ended 30 September 2022, that law requires the directors to prepare the consolidated financial statements in accordance with UK-adopted international accounting standards in conformity with the requirements of the Companies Act and they have also elected to prepare the separate financial statements of the Company on the same basis.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Company and the Group's profit or loss for the year. In preparing each of the consolidated and company financial statements the directors are also required to:

- Select suitable accounting policies and apply them consistently
- Make judgements and estimates that are reasonable, relevant and reliable
- State whether the consolidated and company financial statements have been prepared in accordance with UK-adopted international accounting standards
- Assess the ability of the Group and the Company to continue as a going concern, disclosing, as applicable, matters related to going concern
- Use the going concern basis of accounting unless they intend to liquidate the Company and / or the Group or to cease operation or they have no realistic alternative to doing so
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information
- Provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance

The directors are responsible for keeping adequate accounting records for the Company that are sufficient to record and explain its transactions, disclose with reasonable accuracy at any time its financial position and enable them to ensure that its financial statements comply with the requirements of the Companies Act.

They are responsible for the implementation of such internal control processes as they deem necessary to enable the preparation of financial statements which are free from material misstatements, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for the preparation of a strategic report, directors' report, directors' remuneration report and corporate governance statement, which comply with that law and those regulations.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website (www.paragonbankinggroup.co.uk). Legislation in the UK governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

In accordance with DTR 4.1.14R of the FCA Disclosure Guidance and Transparency Rules, the financial statements will form part of the annual financial report published in the single electronic reporting format specified in the TD ESEF Regulation (the UK version of the EU Commission Delegated Regulation (EU) 2019/815). The independent auditor's report on these financial statements provides no assurance over the ESEF format.

Confirmation by the Board of Directors

The Board of Directors currently comprises:

R D East (Chair of the Board)	H R Tudor (Senior Independent Director)	A C M Morris (Non-executive director)
N S Terrington (CEO)	B A Ridpath (Non-executive director)	P A Hill (Non-executive director)
R J Woodman (CFO)	G H Yorston (Non-executive director)	T P Davda (Non-executive director)

Each of the directors named above confirms that, to the best of their knowledge:

- The financial statements, prepared in accordance with applicable accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and of the Group taken as a whole
- The Directors' Report, including those other sections of the Annual Report incorporated by reference, comprises a management report for the purposes of the DTR, and includes a fair review of the development and performance of the business and the consolidated position of the Group taken as a whole, together with a description of the principal risks and uncertainties that it faces
- The Annual Report (including the consolidated and company financial statements), taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position, performance, business model and strategy

Approved by the Board of Directors as the persons responsible within the Company.

Signed on behalf of the Board.

Ciara Murphy

Company Secretary

6 December 2022

C.

Independent Auditor's Report

On the financial statements

INTEGRITY

To be honest and open in everything we do

> **Integrity is about building trust and you can only do that if you're honest. We need to be true to our values and deliver our promises, meeting the expectations we've set, and taking feedback on board so that we're continually improving our service to customers.**

Rina, Customer Assurance

C1. Independent auditor's report

To the members of Paragon Banking Group PLC

1. Our opinion is unmodified

We have audited the financial statements of Paragon Banking Group PLC ('the Company' or the 'Parent Company') for the year ended 30 September 2022 which comprise the:

- Consolidated Statement of Profit or Loss
- Consolidated Statement of Comprehensive Income
- Consolidated and Company Balance Sheets
- Consolidated and Company Cash Flow Statements
- Consolidated and Company Statements of Changes in Equity
- Related notes, including the accounting policies in note 65 other than the disclosures labelled as unaudited in note 59.

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 30 September 2022 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with UK-adopted international accounting standards;
- the Parent Company financial statements have been properly prepared in accordance with UK-adopted international accounting standards and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ('ISAs (UK)') and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the Audit Committee.

We were first appointed as auditor by the shareholders on 9 February 2016. The period of total uninterrupted engagement is for the seven financial years ended 30 September 2022. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed public interest entities. No non-audit services prohibited by that standard were provided.

2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters (unchanged from 2021) in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

Key audit matter	Our response
Impairment allowances on loans to customers Risk vs 2021 ↑ (£63.5 million; 2021: £65.4 million) *Refer to the Audit Committee Report, accounting policy note and notes 19 to 24 (financial disclosures).* **Subjective estimate** The measurement of expected credit losses ('ECL') involves significant judgements and estimates. The risk of material misstatement of ECL is heightened in the current year due to the increased judgement and estimation uncertainty as a result of the ongoing economic uncertainties. The key areas where we identified greater levels of management judgement and therefore increased levels of audit focus in the Group's estimation of ECL are: **Economic scenarios** – IFRS 9 requires the Group to measure ECL on a forward-looking basis reflecting a range of future economic conditions. Significant management judgement is applied to determine the economic scenarios used, particularly in the current economic environment, and the probability weightings assigned to each economic scenario. **Qualitative adjustments** – Management makes adjustments to the model-driven ECL results to address issues relating to model responsiveness or emerging trends relating to the current economic environment as well as risks not captured by the models. Such adjustments are inherently subjective and significant management judgement is involved in estimating these amounts. **Significant Increase in Credit Risk ('SICR')** – The criteria selected to identify a significant increase in credit risk is a key area of judgement within the Group's ECL calculation as these criteria determine whether a 12-month or lifetime provision is recorded. **Model estimations** – Inherently judgmental modelling is used to estimate ECLs which involves determining Probabilities of Default ('PD'), Loss Given Default ('LGD'), and Exposures at Default ('EAD'). The LGD models used in the portfolios are the key drivers of the Group's ECL results and are therefore the most significant judgmental aspect of the Group's ECL modelling approach. The effect of these matters is that, as part of our risk assessment, we determined that the impairment of loans to customers has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. The financial statements disclose the sensitivities estimated by the Group (note 24). **Disclosure quality** The disclosures regarding the Group's application of IFRS 9 are important in explaining the key judgements and material inputs to the IFRS 9 ECL results, as well as the sensitivity of the ECL results to changes in these judgements or management's assumptions, in light of the estimation uncertainty arising.	We performed the following audit procedures rather than seeking to rely on the Group's controls because the nature of the balance is such that we would expect to obtain audit evidence primarily through the detailed procedures described: • **Test of details:** Key aspects of our testing involved: - Testing the key inputs and assumptions impacting the Group's overall ECL calculation to assess their reasonableness. This included performing sensitivity analysis to understand the significance of certain assumptions; benchmarking procedures to compare the Group's key assumptions to comparable peer group organisations; and assessing the key assumptions against the Group's historical experience; and - Performing recalculations of the ECL measured on each of the Group's loan portfolios. • **Our economic scenario expertise:** We involved our own economic specialists to assist us in assessing the appropriateness of the Group's methodology for determining the economic scenarios used and the probability weightings applied to them. We assessed the overall reasonableness of the economic forecasts by comparing the Group's forecasts to our own modelled forecasts. As part of this work, we assessed the reasonableness of the Group's considerations of the economic uncertainty arising at the reporting date. • **Qualitative adjustments:** For each of the adjustments to the model-driven ECL we assessed the reasonableness of the adjustments by challenging the basis of risks not addressed by the models in the current economic environment and the completeness of post-model adjustments ('PMAs') recognised, assessing the appropriateness of key assumptions and performing sensitivity analysis in respect of the PMAs. • **SICR:** We assessed the ongoing predictability of the SICR criteria and independently recalculated the loans' stage for 100% of Paragon's loans and receivables. • **Our financial risk modelling expertise:** We involved our own financial risk modelling specialists in evaluating certain IFRS 9 models. We used our knowledge of the Group and our experience of the industry that the Group operates in to independently assess the appropriateness of the Group's IFRS 9 models and key components. • **Sensitivity analysis:** We performed sensitivity analysis over the key assumptions including the economic scenarios and weightings as well as certain PD and LGD assumptions, by applying alternative assumptions based upon the above procedures. • **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the Group's overall ECL. As a part of this, we assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the key judgments and assumptions made was sufficiently clear. **Our results** The results of our testing were satisfactory, and we considered the ECL charge, provision recognised and the related disclosures to be acceptable (2021: acceptable).

Key audit matter	Our response
Interest receivable on originated loan accounts Risk vs 2021 ↑ (£486.7 million; 2021: £440.0 million) *Refer to the Audit Committee Report, accounting policy note and note 4 (financial disclosures).* **Subjective estimate** The recognition of interest receivable on originated loan accounts under the effective interest rate ('EIR') method requires management to apply judgement, with the most critical estimate being the loans' expected behavioural life. The expected life assumptions utilise repayment profiles which represent how customers are expected to pay. These profiles extend significantly into the future which creates a high degree of estimation uncertainty and subjects the judgement to future market changes. The Group makes its expected life assumptions based on its forecasting process which incorporates historical experience. Recent developments in the UK economy result in an elevated degree of subjectivity in this assessment. The cohorts of loans and advances for which the expected behavioural life assumptions are most significant are buy-to-let products which were originated by the Group post-2010. The effect of these matters is that, as part of our risk assessment, we determined that interest receivable on originated loan accounts has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole. The financial statements disclose the sensitivities estimated by the Group (note 67). **Disclosure quality** The disclosures regarding the Group's application of EIR accounting are important in explaining the key judgements and material inputs to the EIR adjustment, as well as the sensitivity of the EIR adjustment to changes in these judgements or management's assumptions, in light of the estimation uncertainty arising.	We performed the following audit procedures rather than seeking to rely on the Group's controls because the nature of the balance is such that we would expect to obtain audit evidence primarily through the detailed procedures described: • **Historical comparison:** We critically assessed the Group's analysis and key assumptions over the repayment profiles by comparing them to the Group's historical trends and actual portfolio behaviour. This included considering the potential impact of uncertainties arising from the current economic environment on the behavioural life forecasts. • **Our sector experience:** We critically assessed key assumptions behind the Group's expected behavioural lives against our own knowledge of industry experience and trends and challenged the appropriateness of the level of segmentation applied to the loan portfolios by management. • **Sensitivity analysis:** We performed sensitivity analysis over the repayment profiles by applying alternative profiles based upon the above procedures. • **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the Group's EIR adjustments and interest receivable. As a part of this, we assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the critical estimates and assumptions made, was sufficiently clear. **Our results** The results of our testing were satisfactory, and we found the resulting estimate of interest receivable on originated loan accounts and the related disclosures to be acceptable (2021: acceptable).

Key audit matter	Our response
Recoverability of goodwill Risk vs 2021 ↑ (£164.4 million; 2021: £164.4 million) *Refer to the Audit Committee Report, accounting policy note and note 30 (financial disclosures).* **Forecast-based valuation** The carrying amount of goodwill is significant to the financial statements and at risk of irrecoverability due to changes in market factors since acquisition. The estimated recoverable amount is subjective due to the inherent uncertainty involved in determining the assumptions used in the assessment. The most significant assumptions are considered to be the forecast future cash flows and the discount rate. Recent developments in the UK economy result in an elevated degree of subjectivity in this assessment. The effect of these matters is that, as part of our risk assessment, we determined that the recoverable amount has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole. The financial statements (note 30) disclose the sensitivity estimated by the Group. **Disclosure quality** The disclosures regarding the Group's goodwill are important in explaining the key judgements and material inputs to the goodwill impairment assessment, as well as the sensitivity of the recoverable amount (and therefore the impairment conclusion) to changes in these judgements or management's assumptions in light of the estimation uncertainty arising.	We performed the following audit procedures rather than seeking to rely on the Group's controls because the nature of the balance is such that we would expect to obtain audit evidence primarily through the detailed procedures described: • **Historical comparison:** We compared the Group's previous forecasting of cash flows with actual results to assess forecasting accuracy; • **Benchmarking assumptions:** We compared the Group's assumptions to externally derived data in relation to key inputs such as discount rates and challenged management on the forecast business performance. This included considering the impact of uncertainties arising from the current economic environment in the forecasts. • **Our sector experience:** We used our knowledge of the Group and our experience of the industry that the Group operates in to independently assess the appropriateness of the key assumptions, including the discount rate and cash flow forecasts. • **Sensitivity analysis:** We performed break-even analysis and applied alternative scenarios based on the assumptions noted above. • **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the estimated recoverable amount. As a part of this, we assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the key judgments and assumptions made, was sufficiently clear. **Our results** The results of our testing were satisfactory, and we found the resulting carrying amount of goodwill and the related disclosures to be acceptable (2021: acceptable).

Key audit matter

Valuation of the retirement benefit pension obligation

Risk vs 2021 ↑

(£97.6 million, 2021: £155.6 million)

Refer to the Audit Committee Report, accounting policy note and note 58 (financial disclosures).

Subjective estimate

The Group operates a defined benefit pension scheme which has been closed to new members for several years. At year end, the Group holds a net retirement benefit scheme asset on the balance sheet, which includes gross pension obligations.

Small changes in the assumptions and estimates used to value the Group's pension obligation (before deducting scheme assets) would have a significant effect on the Group's net defined benefit pension asset. The most significant assumptions are considered to be the discount rate, inflation rate and mortality rates / life expectancy. Recent developments in the UK economy result in an elevated degree of subjectivity in this assessment.

The effect of these matters is that, as part of our risk assessment, we determined that the valuation of the retirement benefit pension obligation has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole. The financial statements disclose the sensitivity estimated by the Group (note 58).

Our response

We performed the following audit procedures rather than seeking to rely on the Group's controls because the nature of the balance is such that we would expect to obtain audit evidence primarily through the detailed procedures described:

- **Evaluation of actuary:** We evaluated the competence, independence and objectivity of the Group's actuary in assessing management's reliance upon their expert valuation services.
- **Benchmarking assumptions:** We critically assessed, using our own actuarial specialists, the key assumptions applied, such as the discount rate, inflation rate and mortality rate/life expectancy against externally derived data and internal experience.
- **Assessing transparency:** We assessed the adequacy of the Group's disclosures in respect of the sensitivity of the obligation to the actuarial assumptions.

Our results

The results of our testing were satisfactory, and we found the valuation of the defined benefit scheme obligation and the related disclosures to be acceptable (2021: acceptable).

Key audit matter

Recoverability of Parent Company's investment in subsidiaries

Risk vs 2021 ← →

(£638.7 million; 2021: £638.7 million)

Refer to the accounting policy note and note 31 (financial disclosures).

Low risk, high value

The carrying amount of the Parent Company's investments in subsidiaries represents 65.8% (2021: 58.7%) of the Parent Company's total assets.

Their recoverability is not at a high risk of significant misstatement or subject to significant judgement. However, due to their materiality in the context of the Parent Company financial statements, this is the area that had the greatest effect on our overall Parent Company audit.

Our response

We performed the following audit procedures rather than seeking to rely on the Group's controls because the nature of the balance is such that we would expect to obtain audit evidence primarily through the detailed procedures described:

- **Tests of detail:** We compared the carrying amount of 100% of investments with the relevant subsidiary's draft balance sheet to identify whether their net assets, being an approximation of their minimum recoverable amount, were in excess of their carrying amount and assessing whether those subsidiaries have historically been profit-making.

Our results

The results of our testing were satisfactory, and we found the resulting carrying amount of the investments in subsidiaries to be acceptable (2021: acceptable).

3. Our application of materiality and an overview of the scope of our audit

Materiality for the Group financial statements as a whole was set at £8.8 million, determined with reference to a benchmark of Group profit before tax, normalised to exclude unusually significant fair value net gains in 2022, of £226.0m (2021: £8.1 million determined with reference to a benchmark of Group profit before tax). This materiality level represents 3.9% (2021: 3.7%) of the stated benchmark.

Materiality for the Parent Company financial statements as a whole was set at £3.9 million (2021: £3.9 million), determined with reference to a benchmark of current year net assets, of which it represents 0.6% (2021: 0.6%).

In line with our audit methodology, our procedures on individual account balances and disclosures were performed to a lower threshold, performance materiality, so as to reduce to an acceptable level the risk that individually immaterial misstatements in individual account balances add up to a material amount across the financial statements as a whole.

Performance materiality was set at 75% (2021: 75%) of materiality for the financial statements as a whole, which equates to £6.6 million (2021: £6.1 million) for the Group and £2.9 million (2021: £2.9 million) for the Parent Company. We applied this percentage in our determination of performance materiality because we did not identify any factors indicating an elevated level of risk.

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.44 million (2021: £0.40 million), in addition to other identified misstatements that warranted reporting on qualitative grounds.

Of the Group's two (2021: two) reporting components, we subjected two (2021: two) to full scope audits for Group purposes. The components within the scope of our work accounted for 100.0% (2021: 100.0%) of total Group revenue, 100.0% (2021: 100.0%) of Group profit before tax, and 100.0% (2021: 100.0%) of Group total assets. The work on the two components was performed by the Group team and the Group team performed procedures on the items excluded from normalised Group profit before tax.

We were able to rely upon the Group's internal control over financial reporting in several areas of our audit, where our controls testing supported this approach, which enabled us to reduce the scope of our substantive audit work; in the other areas the scope of the audit work performed was fully substantive.

4. The impact of climate change on our audit

In planning our audit, we considered the potential impact of risks arising from climate change on the Group's business and its financial statements. The Group has set out its strategy regarding climate change, together with further information, in the Group's Environmental Impact section of the 2022 Annual Report on pages 64 to 76.

Climate change risks and opportunities, the Group's own commitments and changing regulations could have a significant impact on the Group's business and operations. There is the possibility that climate change risks, both physical and transitional, could affect financial statement balances through estimates such as credit risk and the forward-looking cash flows used in goodwill impairment assessments. There is enhanced narrative in the Annual Report on climate matters.

As part of our audit we performed a risk assessment of the impact of climate change risk on the financial statements and our audit approach. As a part of this we held discussions with our own climate change professionals to challenge our risk assessment. In doing this we performed the following:

- Understanding management's processes: We made enquiries to understand management's assessment of the potential impact of climate change risk on the Group's Annual Report and the Group's preparedness for this. As a part of this we made enquiries to understand management's risk assessment process as it relates to the possible effects of climate change on the Annual Report.
- Credit risk: We assessed how the Group considers the impact of physical risks on the valuation of mortgage collateral. Specifically, we performed data and analytics-driven risk assessment procedures to understand the potential impact of flooding and subsidence on the valuation of mortgage collateral and made enquiries of management to understand how this is considered within its own collateral valuation process.
- Forward looking estimates: We considered how the Group's forward looking cash flows may be impacted within the relevant CGUs. As part of this, we made enquiries to understand management's own considerations and assessed the reasonableness of the forward-looking forecasts in the context of the business.
- Annual Report narrative: We made enquiries of management to understand the process by which climate-related narrative is developed including the primary sources of data used and the governance process in place over the narrative. As a part of our risk assessment, we read the climate-related information in the front half of the Annual Report and considered its consistency with the financial statements and our audit knowledge.

On the basis of the procedures performed above, taking into account the nature of the Group's lending exposures and available headroom in the impairment assessment of goodwill, we concluded that, while climate change posed a risk to the determination of asset values in the current year, the risk was not significant. As a result, there was no material impact from this on our key audit matters.

5. Going concern

The directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Group or the Company or to cease their operations, and as they have concluded that the Group's and the Company's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over their ability to continue as a going concern for at least a year from the date of approval of the financial statements ('the going concern period').

We used our knowledge of the Group, its industry, and the general economic environment to identify the inherent risks to its business model and analysed how those risks might affect the Group's and Company's financial resources or ability to continue operations over the going concern period. The risks that we considered most likely to adversely affect the Group's and Company's available financial resources over this period were:

- the availability of funding and liquidity in the event of a market-wide stress scenario; and
- the impact on regulatory capital requirements in the event of an economic slowdown or recession.

We considered whether these risks could plausibly affect the liquidity and regulatory capital in the going concern period by comparing severe, but plausible downside scenarios that could arise from these risks individually and collectively against the level of available financial resources indicated by the Group's financial forecasts.

We considered whether the going concern disclosure in note 68 to the financial statements gives a full and accurate description of the directors' assessment of going concern.

Our conclusions based on this work:

- we consider that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate;
- we have not identified, and concur with the directors' assessment that there is not, a material uncertainty related to events or conditions that, individually or collectively, may cast significant doubt on the Group's or Company's ability to continue as a going concern for the going concern period;
- we have nothing material to add or draw attention to in relation to the directors' statement in note 68 to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Group and Company's use of that basis for the going concern period, and we found the going concern disclosure in note 68 to be acceptable; and
- the related statement under the Listing Rules set out on page 56 is materially consistent with the financial statements and our audit knowledge.

However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the above conclusions are not a guarantee that the Group or the Company will continue in operation.

6. Fraud and breaches of laws and regulations – ability to detect

Identifying and responding to risks of material misstatement due to fraud

To identify risks of material misstatement due to fraud ('fraud risks') we assessed events or conditions that could indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.

Our risk assessment procedures included:

- Enquiring of directors, Internal Audit and inspection of policy documentation as to the Group and Parent Company's high-level policies and procedures to prevent and detect fraud, including the Internal Audit function, and the Group and Parent Company's channel for 'whistleblowing', as well as whether they have knowledge of any actual, suspected or alleged fraud.
- Reading Board, Audit Committee and Risk Committee minutes.
- Considering remuneration incentive schemes and performance targets for management and directors, including the Financial Performance metrics in the Annual Bonus and Performance Share Plan.
- Using analytical procedures to identify any unusual or unexpected relationships.

We communicated identified fraud risks throughout the audit team and remained alert to any indications of fraud throughout the audit.

As required by auditing standards, and taking into account possible pressures to meet profit targets and our overall knowledge of the control environment, we perform procedures to address the risk of management override of controls, and the risk of fraudulent revenue recognition, in particular the risk that the EIR adjustment on interest income may be misstated, the risk that Group management may be in a position to make inappropriate accounting entries, and the risk of bias in accounting estimates and judgements including the impairment allowances on loans to customers and the recoverability of goodwill.

Further detail in respect of interest income on originated loans, impairment allowances on loans to customers and the recoverability of goodwill is set out in the key audit matter disclosures in section 2 of this report.

We performed procedures including:

- Identifying journal entries to test based on risk criteria and comparing the identified entries to supporting documentation. These included those posted and approved by the same user and those including specific descriptors;
- Assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and
- Understanding the business purpose of significant unusual transactions.

Identifying and responding to risks of material misstatement due to non-compliance with laws and regulations

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience, through discussion with the directors and other management (as required by auditing standards), and from inspection of the Group's regulatory and legal correspondence and discussed with the directors and other management the policies and procedures regarding compliance with laws and regulations.

As the Group is regulated, our assessment of risks involved gaining an understanding of the control environment including the entity's procedures for complying with regulatory requirements.

We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the Group is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies legislation), distributable profits legislation and taxation legislation and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Group is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of the Group's licence to operate. We identified the following areas as those most likely to have such an effect: specific areas of regulatory capital and liquidity, conduct, money laundering and financial crime and certain aspects of company legislation recognising the financial and regulated nature of the Group's activities. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. Therefore, if a breach of operational regulations is not disclosed to us or evident from relevant correspondence, an audit will not detect that breach.

Context of the ability of the audit to detect fraud or breaches of law or regulation

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it.

In addition, as with any audit, there remained a higher risk of non-detection of fraud, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. Our audit procedures are designed to detect material misstatement. We are not responsible for preventing non-compliance or fraud and cannot be expected to detect non-compliance with all laws and regulations.

7. We have nothing to report on the other information in the Annual Report

The directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Strategic report and directors' report

Based solely on our work on the other information:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

Directors' remuneration report

In our opinion the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Disclosures of emerging and principal risks and longer-term viability

We are required to perform procedures to identify whether there is a material inconsistency between the directors' disclosures in respect of emerging and principal risks and the viability statement, and the financial statements and our audit knowledge.

Based on those procedures, we have nothing material to add or draw attention to in relation to:

- the directors' confirmation within the 'Future Prospects' section on page 55 that they have carried out a robust assessment of the emerging and principal risks facing the Group, including those that would threaten its business model, future performance, solvency and liquidity;
- the Principal Risks disclosures describing these risks and how emerging risks are identified, and explaining how they are being managed and mitigated; and
- the directors' explanation in the Viability Statement of how they have assessed the prospects of the Group, over what period they have done so and why they considered that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We are also required to review the Viability Statement, set out on page 56 under the Listing Rules. Based on the above procedures, we have concluded that the above disclosures are materially consistent with the financial statements and our audit knowledge.

Our work is limited to assessing these matters in the context of only the knowledge acquired during our financial statements audit. As we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of anything to report on these statements is not a guarantee as to the Group's and Company's longer-term viability.

Corporate governance disclosures

We are required to perform procedures to identify whether there is a material inconsistency between the directors' corporate governance disclosures and the financial statements and our audit knowledge.

Based on those procedures, we have concluded that each of the following is materially consistent with the financial statements and our audit knowledge:

- the directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable, and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy;
- the section of the annual report describing the work of the Audit Committee, including the significant issues that the Audit Committee considered in relation to the financial statements, and how these issues were addressed; and
- the section of the Annual Report that describes the review of the effectiveness of the Group's risk management and internal control systems.

We are required to review the part of the Corporate Governance Statement relating to the Group's compliance with the provisions of the UK Corporate Governance Code specified by the Listing Rules for our review. We have nothing to report in this respect.

8. We have nothing to report on the other matters on which we are required to report by exception

Under the Companies Act 2006, we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

9. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out in Section B10, the directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and Parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the Parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

10. The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Simon Ryder (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

66 Queen Square

Bristol

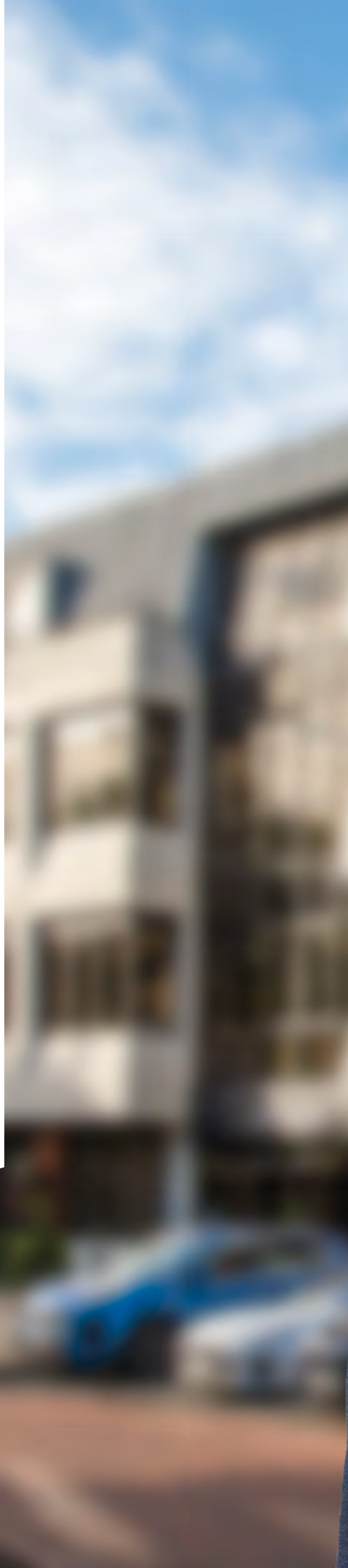
BS1 4BE

6 December 2022

D.

The Accounts

Showing the financial position, results and cash flows of the Group and the Company prepared in accordance with IFRS and UK law



COMMITMENT

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

> **I link commitment very closely to customer service. It means putting myself in the customer's shoes and making sure they receive a high level of service. Commitment to great customer service is one of the most important ways we can help them to achieve their goals.**

Darren, Portfolio Management

D1. Primary Financial Statements

D1.1 Consolidated statement of profit or loss

For the year ended 30 September 2022

	Note	**2022**	**2022**	2021 (Restated*)	2021 (Restated*)
		£m	**£m**	£m	£m
Interest receivable	*4*		**545.7**		443.5
Interest payable and similar charges	*5*		**(174.5)**		(133.0)
Net interest income			**371.2**		310.5
Other leasing income	*6*	**24.6**		20.4	
Related costs	*6*	**(20.0)**		(16.9)	
Net operating lease income		**4.6**		3.5	
Gain on disposal of financial assets	*7*	**4.6**		-	
Other income	*8*	**12.6**		10.9	
Other operating income			**21.8**		14.4
Total operating income			**393.0**		324.9
Operating expenses	*9*		**(153.0)**		(135.4)
Provisions for losses	*11*		**(14.0)**		4.7
Operating profit before fair value items			**226.0**		194.2
Fair value net gains / (losses)	*12*		**191.9**		19.5
Operating profit being profit on ordinary activities before taxation			**417.9**		213.7
Tax charge on profit on ordinary activities	*13*		**(104.3)**		(49.2)
Profit on ordinary activities after taxation for the financial year			**313.6**		164.5

	Note	**2022**	2021
Earnings per share			
- basic	*15*	**129.2p**	65.2p
- diluted	*15*	**125.9p**	63.0p

The results for the current and preceding years relate entirely to continuing operations.

*See Note 4.

D1.2 Consolidated statement of comprehensive income

For the year ended 30 September 2022

	Note	**2022**	**2022**	2021	2021
		£m	**£m**	£m	£m
Profit for the year			**313.6**		164.5
Other comprehensive income					
Items that will not be reclassified subsequently to profit or loss					
Actuarial gain / (loss) on pension scheme	*58*	**15.3**		8.2	
Tax thereon		**(3.7)**		(0.9)	
			11.6		7.3
Items that may be reclassified subsequently to profit or loss					
Cash flow hedge (losses) taken to equity	*25*	-		(3.0)	
Tax thereon		-		0.5	
			-		(2.5)
Other comprehensive income / (expenditure) for the year net of tax			**11.6**		4.8
Total comprehensive income for the year			**325.2**		169.3

D1.3 Consolidated balance sheet

For the year ended 30 September 2022

	Note	2022	2021	2020
		£m	£m	£m
Assets				
Cash – central banks	*16*	**1,612.5**	1,142.0	1,637.1
Cash – retail banks	*16*	**318.4**	218.1	287.9
Loans to customers	*17*	**13,650.4**	13,408.2	12,741.1
Derivative financial assets	*25*	**779.0**	44.2	463.3
Sundry assets	*26*	**39.2**	69.2	128.0
Current tax assets	*27*	**5.4**	-	5.7
Deferred tax assets	*42*	**-**	14.4	6.2
Retirement benefit obligations	*58*	**7.1**	-	-
Property, plant and equipment	*28*	**71.4**	70.4	66.1
Intangible assets	*29*	**170.2**	170.5	170.1
Total assets		**16,653.6**	15,137.0	15,505.5
Liabilities				
Short-term bank borrowings		**0.4**	0.3	0.4
Retail deposits	*32*	**10,569.5**	9,297.4	7,867.0
Derivative financial liabilities	*25*	**102.1**	43.9	132.4
Asset backed loan notes	*33*	**409.3**	516.0	3,270.5
Secured bank borrowings	*34*	**586.0**	730.0	657.8
Retail bond issuance	*35*	**112.3**	237.1	296.8
Corporate bond issuance	*36*	**149.2**	149.0	149.8
Central bank facilities	*37*	**2,750.0**	2,819.0	1,854.4
Sundry liabilities	*38*	**513.1**	90.7	100.0
Current tax liabilities	*27*	**-**	1.4	-
Deferred tax liabilities	*42*	**44.4**	-	-
Retirement benefit obligations	*58*	**-**	10.3	20.4
Total liabilities		**15,236.3**	13,895.1	14,349.5
Called up share capital	*43*	**241.4**	262.5	261.8
Reserves	*44*	**1,223.9**	1,056.1	932.0
Own shares	*45*	**(48.0)**	(76.7)	(37.8)
Total equity		**1,417.3**	1,241.9	1,156.0
Total liabilities and equity		**16,653.6**	15,137.0	15,505.5

Approved by the Board of Directors on 6 December 2022.

Signed of behalf of the Board of Directors.

N S Terrington
Chief Executive

R J Woodman
Chief Financial Officer

D1.4 Company balance sheet

For the year ended 30 September 2022

	Note	2022	2021	2020
		£m	£m	£m
Assets				
Cash – retail banks	*16*	**19.7**	19.6	12.6
Sundry assets	*26*	**39.2**	73.1	84.6
Current tax assets	*27*	**-**	-	-
Property, plant and equipment	*28*	**14.6**	16.0	17.4
Investment in subsidiary undertakings	*31*	**897.1**	978.5	1,030.1
Total assets		**970.6**	1,087.2	1,144.7
Liabilities				
Retail bond issuance	*35*	**112.3**	237.1	296.8
Corporate bond issuance	*36*	**149.2**	149.0	149.8
Sundry liabilities	*38*	**51.1**	41.9	43.1
Deferred tax liabilities	*42*	**0.1**	1.8	1.8
Total liabilities		**312.7**	429.8	491.5
Called up share capital	*43*	**241.4**	262.5	261.8
Reserves	*44*	**445.5**	455.6	414.4
Own shares	*45*	**(29.0)**	(60.7)	(23.0)
Total equity		**657.9**	657.4	653.2
		970.6	1,087.2	1,144.7

Approved by the Board of Directors on 6 December 2022.

Signed of behalf of the Board of Directors.

N S Terrington
Chief Executive

R J Woodman
Chief Financial Officer

The Accounts

D1.5 Consolidated cash flow statement

For the year ended 30 September 2022

	Note	**2022**	2021
		£m	£m
Net cash generated by operating activities	*47*	**1,168.7**	878.1
Net cash (utilised) by investing activities	*48*	**(2.4)**	(4.3)
Net cash (utilised) by financing activities	*49*	**(595.6)**	(1,438.6)
Net increase / (decrease) in cash and cash equivalents		**570.7**	(564.8)
Opening cash and cash equivalents		**1,359.8**	1,924.6
Closing cash and cash equivalents		**1,930.5**	1,359.8
Represented by balances within:			
Cash	*16*	**1,930.9**	1,360.1
Short-term bank borrowings		**(0.4)**	(0.3)
		1,930.5	1,359.8

D1.6 Company cash flow statement

For the year ended 30 September 2022

	Note	**2022**	2021
		£m	£m
Net cash generated by operating activities	*47*	**191.3**	115.9
Net cash generated by investing activities	*48*	**69.5**	47.3
Net cash (utilised) by financing activities	*49*	**(260.7)**	(156.2)
Net (decrease) in cash and cash equivalents		**0.1**	7.0
Opening cash and cash equivalents		**19.6**	12.6
Closing cash and cash equivalents		**19.7**	19.6
Represented by balances within:			
Cash	*16*	**19.7**	19.6
Short-term bank borrowings		**-**	-
		19.7	19.6

D1.7 Consolidated statement of movements in equity

For the year ended 30 September 2022

	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	-	-	-	-	-	**313.6**	-	**313.6**
Other comprehensive income	-	-	-	-	-	**11.6**	-	**11.6**
Total comprehensive income	-	-	-	-	-	**325.2**	-	**325.2**
Transactions with owners								
Dividends paid (note 46)	-	-	-	-	-	**(68.9)**	-	**(68.9)**
Own shares purchased	-	-	-	-	-	-	**(79.5)**	**(79.5)**
Irrevocable instruction accrual	-	-	-	-	-	-	**(10.8)**	**(10.8)**
Exercise of share awards	**0.4**	**1.0**	-	-	-	**(10.3)**	**9.6**	**0.7**
Shares cancelled	**(21.5)**	-	**21.5**	-	-	**(109.4)**	**109.4**	-
Charge for share based remuneration (note 55)	-	-	-	-	-	**9.2**	-	**9.2**
Tax on share based remuneration	-	-	-	-	-	**(0.5)**	-	**(0.5)**
Net movement in equity in the year	**(21.1)**	**1.0**	**21.5**	-	-	**145.3**	**28.7**	**175.4**
Opening equity	**262.5**	**70.1**	**50.3**	**(70.2)**	-	**1,005.9**	**(76.7)**	**1,241.9**
Closing equity	**241.4**	**71.1**	**71.8**	**(70.2)**	-	**1,151.2**	**(48.0)**	**1,417.3**

For the year ended 30 September 2021

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Cash flow hedging reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m
Transactions arising from								
Profit for the year	-	-	-	-	-	164.5	-	164.5
Other comprehensive income	-	-	-	-	(2.5)	7.3	-	4.8
Total comprehensive income	-	-	-	-	(2.5)	171.8	-	169.3
Transactions with owners								
Dividends paid (note 46)	-	-	-	-	-	(54.6)	-	(54.6)
Own shares purchased	-	-	-	-	-	-	(42.2)	(42.2)
Irrevocable instruction accrual	-	-	-	-	-	-	-	-
Exercise of share awards	0.7	1.4	-	-	-	(3.3)	3.3	2.1
Shares cancelled	-	-	-	-	-	-	-	-
Charge for share based remuneration (note 55)	-	-	-	-	-	8.9	-	8.9
Tax on share based remuneration	-	-	-	-	-	2.4	-	2.4
Net movement in equity in the year	0.7	1.4	-	-	(2.5)	125.2	(38.9)	85.9
Opening equity	261.8	68.7	50.3	(70.2)	2.5	880.7	(37.8)	1,156.0
Closing equity	262.5	70.1	50.3	(70.2)	-	1,005.9	(76.7)	1,241.9

D1.8 Company statement of movements in equity

For the year ended 30 September 2022

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m
Transactions arising from							
Profit for the year	-	-	-	-	**136.5**	-	**136.5**
Other comprehensive income	-	-	-	-	-	-	-
Total comprehensive income	-	-	-	-	**136.5**	-	**136.5**
Transactions with owners							
Dividends paid (note 46)	-	-	-	-	**(68.9)**	-	**(68.9)**
Own shares purchased	-	-	-	-	-	**(66.9)**	**(66.9)**
Irrevocable instruction accrual	-	-	-	-	-	**(10.8)**	**(10.8)**
Exercise of share awards	**0.4**	**1.0**	-	-	-	-	**1.4**
Shares cancelled	**(21.5)**	-	**21.5**	-	**(109.4)**	**109.4**	-
Charge for share based remuneration (note 55)	-	-	-	-	**9.2**	-	**9.2**
Net movement in equity in the year	**(21.1)**	**1.0**	**21.5**	-	**(32.6)**	**31.7**	**0.5**
Opening equity	**262.5**	**70.1**	**50.3**	**(23.7)**	**358.9**	**(60.7)**	**657.4**
Closing equity	**241.4**	**71.1**	**71.8**	**(23.7)**	**326.3**	**(29.0)**	**657.9**

For the year ended 30 September 2021

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m
Transactions arising from							
Profit for the year	-	-	-	-	85.5	-	85.5
Other comprehensive income	-	-	-	-	-	-	-
Total comprehensive income	-	-	-	-	85.5	-	85.5
Transactions with owners							
Dividends paid (note 46)	-	-	-	-	(54.6)	-	(54.6)
Own shares purchased	-	-	-	-	-	(37.7)	(37.7)
Irrevocable instruction accrual	-	-	-	-	-	-	-
Exercise of share awards	0.7	1.4	-	-	-	-	2.1
Shares cancelled	-	-	-	-	-	-	-
Charge for share based remuneration (note 55)	-	-	-	-	8.9	-	8.9
Net movement in equity in the year	0.7	1.4	-	-	39.8	(37.7)	4.2
Opening equity	261.8	68.7	50.3	(23.7)	319.1	(23.0)	653.2
Closing equity	262.5	70.1	50.3	(23.7)	358.9	(60.7)	657.4

D2. Notes to the Accounts

For the year ended 30 September 2022

1. General information

Paragon Banking Group PLC is a company domiciled in the United Kingdom and incorporated in England and Wales under the Companies Act 2006 with company number 2336032. The address of the registered office is 51 Homer Road, Solihull, West Midlands, B91 3QJ. The nature of the Group's operations and its principal activities are set out in the Strategic Report in Section A2.

These financial statements are presented in pounds sterling, which is the currency of the economic environment in which the Group operates.

The remaining notes to the accounts are organised into four sections:

- Analysis – providing further analysis and information on the amounts shown in the primary financial statements
- Employment costs – providing information on employee and key management remuneration arrangements including share schemes and pension arrangements
- Capital and Financial Risk – providing information on the Group's management of operational and regulatory capital and its principal financial risks
- Basis of preparation – providing details of the Group's accounting policies and of how they have been applied in the preparation of the financial statements

D2.1 Notes to the Accounts - Analysis

For the year ended 30 September 2022

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

2. Segmental information

The Group analyses its operations, both for internal management reporting and external financial reporting, on the basis of the markets from which its assets are generated. The segments used internally were revised during the year, following the disposal of the unsecured consumer loan assets of the former Idem Capital segment (note 7). The segments used at 30 September 2022 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

Comparative disclosures have been restated to correspond to the new segments.

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

Gains on derecognition of financial assets have not been allocated to segment results.

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

Retail deposits and their related costs are allocated to the segments based on the utilisation of those deposits. Retail deposits raised in advance of lending are not allocated.

Other assets and liabilities are not allocated between segments.

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

Financial information about these business segments, prepared on the same basis as used in the consolidated accounts of the Group, is shown below. The presentation of interest receivable and interest payable below has been revised as described in Note 4.

Year ended 30 September 2022

	Mortgage Lending	Commercial Lending	Unallocated items	Total Segments
	£m	£m	£m	£m
Interest receivable	**400.3**	**135.8**	**9.6**	**545.7**
Interest payable	**(138.8)**	**(22.7)**	**(13.0)**	**(174.5)**
Net interest income	**261.5**	**113.1**	**(3.4)**	**371.2**
Other operating income	**7.4**	**9.8**	**4.6**	**21.8**
Total operating income	**268.9**	**122.9**	**1.2**	**393.0**
Operating expenses	**(24.4)**	**(24.9)**	**(103.7)**	**(153.0)**
Provisions for losses	**(4.6)**	**(9.4)**	**-**	**(14.0)**
	239.9	**88.6**	**(102.5)**	**226.0**

Year ended 30 September 2021 (restated)

	Mortgage Lending	Commercial Lending	Unallocated items	Total Segments
	£m	£m	£m	£m
Interest receivable	367.7	115.0	(39.2)	443.5
Interest payable	(129.0)	(19.8)	15.8	(133.0)
Net interest income	238.7	95.2	(23.4)	310.5
Other operating income	6.4	8.0	-	14.4
Total operating income	245.1	103.2	(23.4)	324.9
Operating expenses	(22.5)	(23.9)	(89.0)	(135.4)
Provisions for losses	7.6	(2.9)	-	4.7
	230.2	76.4	(112.4)	194.2

The segmental profits disclosed above reconcile to the group results as shown below.

	2022	2021
	£m	£m
Results shown above	**226.0**	194.2
Fair value items	**191.9**	19.5
Operating profit	**417.9**	213.7

The assets and liabilities attributable to each of the segments at 30 September 2022, 30 September 2021 and 30 September 2020 on the basis described above were:

	Note	**Mortgage Lending**	**Commercial Lending**	**Total Segments**
		£m	**£m**	**£m**
30 September 2022				
Segment assets				
Loans to customers	*17*	**12,328.7**	**1,881.6**	**14,210.3**
Operating lease assets	*28*	**-**	**41.6**	**41.6**
Cross-currency basis swaps	*25*	**-**	**-**	**-**
Securitisation cash	*16*	**240.5**	**-**	**240.5**
		12,569.2	**1,923.2**	**14,492.4**
Segment liabilities				
Allocated deposits		**11,864.7**	**2,193.7**	**14,058.4**
Securitisation funding		**995.3**	**-**	**995.3**
		12,860.0	**2,193.7**	**15,053.7**

	Note	**Mortgage Lending**	**Commercial Lending**	**Total Segments**
		£m	**£m**	**£m**
30 September 2021 (restated)				
Segment assets				
Loans to customers	*17*	11,829.6	1,573.1	13,402.7
Operating lease assets	*28*	-	39.3	39.3
Cross-currency basis swaps	*25*	-	-	-
Securitisation cash	*16*	123.3	-	123.3
		11,952.9	1,612.4	13,565.3
Segment liabilities				
Allocated deposits		10,943.2	1,901.2	12,844.4
Securitisation funding		1,246.0	-	1,246.0
		12,189.2	1,901.2	14,090.4

	Note	**Mortgage Lending**	**Commercial Lending**	**Total Segments**
		£m	**£m**	**£m**
30 September 2020 (restated)				
Segment assets				
Loans to customers	*17*	11,101.1	1,530.3	12,631.4
Operating lease assets	*28*	-	39.5	39.5
Cross-currency basis swaps		445.3	-	445.3
Securitisation cash	*16*	223.4	-	223.4
		11,769.8	1,569.8	13,339.6
Segment liabilities				
Allocated deposits		7,914.6	1,895.9	9,810.5
Securitisation funding		3,928.3	-	3,928.3
		11,842.9	1,895.9	13,738.8

An analysis of the Group's financial assets by type and segment is shown in note 17. All the assets shown above were located in the UK.

The additions to non-current assets, excluding financial assets, in the year which are included in segmental assets above, are investments of £14.5m (2021: £13.0m) in assets held for leasing under operating leases. These are included in the Commercial Lending segment. No other fixed asset additions were allocated to segments.

The segmental assets and liabilities may be reconciled to the consolidated balance sheet as shown below.

	2022	2021
	£m	£m
Total segment assets		
Unallocated assets	**14,492.4**	13,565.3
Central cash and investments	**1,690.4**	1,236.8
Unallocated derivatives	**779.0**	44.2
Operational property, plant and equipment	**29.8**	31.1
Intangible assets	**170.2**	170.5
Other	**(508.2)**	89.1
Total assets	**16,653.6**	15,137.0

	2022	2021
	£m	£m
Total segment liabilities	**15,053.7**	14,090.4
Unallocated liabilities		
Unallocated retail deposits	**(3,389.2)**	(3,544.0)
Derivative financial instruments	**102.1**	43.9
Central borrowings	**3,011.9**	3,205.4
Tax liabilities	**44.4**	1.4
Retirement benefit obligations	**-**	10.3
Other	**413.4**	87.7
Total liabilities	**15,236.3**	13,895.1

3. Revenue

	Note	**2022**	2021 (Restated)
		£m	£m
Interest receivable	*4*	**545.7**	443.5
Operating lease income	*6*	**24.6**	20.4
Other income	*8*	**12.6**	10.9
Total revenue		**582.9**	474.8
Arising from:			
Mortgage Lending		**407.7**	374.1
Commercial Lending		**165.6**	139.9
Total revenue from segments		**573.3**	514.0
Unallocated revenue		**9.6**	(39.2)
Total revenue		**582.9**	474.8

4. Interest receivable

The Group has reconsidered the analysis it presents of net interest income in its accounts in light of the increasing magnitude of hedging impacts on these balances, with derivative income and expense attributed to the hedged transaction and shown separately. This will provide better information to users and is consistent with approaches currently used by comparable firms. Information in respect of the year ended 30 September 2021 has been restated on the same basis. While this change affects the total reported amounts of interest receivable and interest payable (note 5) by the amount reported as 'effect of fair value hedging of loan assets' below, total net interest is unaffected.

Interest receivable is analysed as follows.

	2022	2021 (Restated)
	£m	£m
Interest receivable in respect of		
Loans and receivables	**486.7**	440.0
Finance leases	**45.0**	40.4
Factoring income	**3.4**	2.3
Interest on loans to customers	**535.1**	482.7
Effect of fair value hedging of loan assets	**(1.5)**	(40.7)
Interest on loans to customers after hedging	**533.6**	442.0
Other interest receivable	**12.1**	1.5
Total interest on financial assets	**545.7**	443.5

The above amounts relate to:

	2022	2021 (Restated)
	£m	£m
Financial assets held at amortised cost	**502.2**	443.8
Finance leases	**45.0**	40.4
Derivative financial instruments held at fair value	**(1.5)**	(40.7)
	545.7	443.5

5. Interest payable and similar charges

The Group's interest payable disclosure has been reanalysed, and comparative amounts restated as described in note 4.

In the 2021 disclosures as originally presented, transactions relating to fair value hedging were included in 'interest payable on retail deposits' (£26.3m) and 'interest payable on asset backed loan notes' (£8.4m). These amounts have been reanalysed between 'effect of fair value hedging of deposits' below and 'effect of fair value hedging of loan assets' in note 4.

	Note	**2022**	2021 (Restated)
		£m	£m
On financial liabilities			
Retail deposits		**108.8**	94.2
Effect of fair value hedging of deposits		**4.2**	(6.0)
Interest on retail deposits after hedging		**113.0**	88.2
Asset backed loan notes		**9.1**	9.5
Bank loans and overdrafts		**13.3**	6.6
Corporate bonds		**6.6**	9.3
Retail bonds		**9.1**	15.4
Central bank facilities		**22.2**	2.2
Repurchase agreements		**-**	0.1
Total interest on financial liabilities		**173.3**	131.3
Pension scheme deficit	*58*	**0.2**	0.3
Discounting on contingent consideration	*39*	**0.1**	0.3
Discounting on lease liabilities		**0.2**	0.2
Other finance costs		**0.7**	0.9
		174.5	133.0

The above amounts relate to:

	2022	2021 (Restated)
	£m	£m
Financial liabilities held at amortised cost	**169.1**	137.3
Derivative financial instruments held at fair value	**4.2**	(6.0)
Other items	**1.2**	1.7
	174.5	133.0

6. Net operating lease income

	Note	**2022**	2021
		£m	£m
Income			
Operating lease rentals		**17.7**	15.2
Maintenance income		**6.9**	5.2
Total operating lease income		**24.6**	20.4
Costs			
Depreciation of lease assets	*28*	**(10.1)**	(8.9)
Maintenance salaries	*55*	**(2.7)**	(2.3)
Other maintenance costs		**(7.2)**	(5.7)
Total operating lease costs		**(20.0)**	(16.9)
Net operating lease income		**4.6**	3.5

7. Gain on derecognition of financial assets

On 8 June 2022 the Group disposed of almost all of its unsecured consumer loan balances, which had been held within the Idem Capital Segment. The Group has no continuing interest in these assets. The carrying value of the loans disposed of was £74.1m and cash consideration of £78.9m was received, resulting in a gain on disposal of £4.6m after allowing for costs arising from the transaction.

This disposal significantly reduced the size of the Idem Capital segment, and subsequently the Group reorganised its segmental reporting as described in note 2.

8. Other income

	2022	2021
	£m	£m
Loan account fee income	**6.1**	5.1
Broker commissions	**2.3**	1.9
Third party servicing	**3.5**	3.5
Other income	**0.7**	0.4
	12.6	10.9

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

9. Operating expenses

	Note	**2022**	2021
		£m	£m
Employment costs	*55*	**103.6**	87.9
Auditor remuneration	*10*	**2.5**	2.3
Amortisation of intangible assets	*29*	**2.0**	2.0
Depreciation of operational assets	*28*	**3.5**	4.3
Other administrative costs		**41.4**	38.9
		153.0	135.4

The Group incurred no costs in respect of short-term operating leases in the year (2021: none).

10. Auditor remuneration

The analysis of fees payable to the Company's auditors (KPMG LLP) and their associates, excluding irrecoverable VAT, required by the Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2008 is set out below.

	2022	2021
	£m	£m
Audit fee of the company	**0.7**	0.7
Other services		
Audit of subsidiary undertakings pursuant to legislation	**1.2**	1.0
Total audit fees	**1.9**	1.7
Audit related assurance services		
Interim review	**0.2**	0.2
Other	**-**	-
Total fees	**2.1**	1.9
Irrecoverable VAT	**0.4**	0.4
Total cost to the Group (note 9)	**2.5**	2.3

Fees paid to the auditors and their associates for non-audit services to the Company are not disclosed because the consolidated accounts of the Group are required to disclose such fees on a consolidated basis.

11. Loan impairments – provisions charged / credited to income

The amounts charged / (credited) to the profit and loss account in the year are analysed as follows.

	Mortgage Lending	Commercial Lending	Total
	£m	£m	£m
30 September 2022			
Provided in period	**5.1**	**10.7**	**15.8**
Recovery of written off amounts	**(0.5)**	**(1.3)**	**(1.8)**
	4.6	**9.4**	**14.0**
Of which			
Loan accounts	**4.6**	**2.4**	**7.0**
Finance leases	**-**	**7.0**	**7.0**
	4.6	**9.4**	**14.0**
30 September 2021 (Restated)			
(Released) / provided in period	(7.1)	4.0	(3.1)
Recovery of written off amounts	(0.5)	(1.1)	(1.6)
	(7.6)	2.9	(4.7)
Of which			
Loan accounts	(7.6)	(2.1)	(9.7)
Finance leases	-	5.0	5.0
	(7.6)	2.9	(4.7)

12. Fair value net gains / (losses)

	2022	2021
	£m	£m
Ineffectiveness of fair value hedges (note 25)		
Portfolio hedges of interest rate risk		
Deposit hedge	**11.6**	(0.3)
Loan hedge	**15.1**	6.6
	26.7	6.3
Ineffectiveness of cash flow hedges	**-**	-
Other hedging movements	**4.7**	9.9
Net gains / (losses) on other derivatives	**160.5**	3.3
	191.9	19.5

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

The impact of hedging arrangements on the Group's balance sheet is summarised in note 25 which also provides a full description of the Group's use of derivative financial instruments for hedging purposes.

13. Tax charge on profit on ordinary activities

(a) Analysis of charge in the year

	2022	2021
	£m	£m
Current tax		
UK Corporation Tax on profits of the period	**50.6**	54.4
Adjustment in respect of prior periods	**0.3**	1.7
Total current tax	**50.9**	56.1
Deferred tax (note 42)	**53.4**	(6.9)
Tax charge on profit on ordinary activities	**104.3**	49.2

The standard rate of corporation tax in the UK applicable to the Group in the year was 19.0% (2021 : 19.0%), based on legislation enacted at the year end. During the year ended 30 September 2021, the UK Government enacted legislation increasing the standard rate of corporation tax in the UK from 19.0% to 25.0% from April 2023. Therefore legislation currently in force will increase the standard rate of corporation tax applicable to the Group to 22.0% in the year ending 30 September 2023 and to 25.0% in the year ending 30 September 2024 and thereafter. The effect of these changes on deferred tax balances was accounted for in the year ended 30 September 2021.

The Bank Corporation Tax Surcharge subjects any taxable profits arising in the Group's banking subsidiary, Paragon Bank PLC (and no other Group entity), to an additional 8.0% of tax to the extent these profits exceed £25.0m. The effect of the surcharge shown in note (b) below.

In the current financial year the UK Government enacted legislation which will reduce the rate of the Banking Surcharge from 8.0% to 3.0%, also from April 2023, while increasing the profit threshold at which the surcharge applies to £100.0m from £25.0m. This will result in the surcharge applicable to Paragon Bank reducing to 5.5% with a threshold of £62.5m in the financial year ending 30 September 2023 and 3.0%, with a threshold of £100.0m, thereafter. The impact of this change on deferred tax balances has been accounted for in the current period.

(b) Factors affecting tax charge for the year

Accounting standards require companies to explain the relationship between tax expense and accounting profit. This may be demonstrated by reconciling the tax charge to the product of the accounting profit and the 'applicable rate', generally the domestic rate of tax levied on corporate income in the jurisdiction in which the entity operates.

The Group operates wholly in the UK and all the Group's income arises in UK resident companies. Consequently, it is appropriate to use the prevailing UK corporation tax rate as the comparator to the effective tax rate. As noted in (a) above, the UK corporation tax rate applicable to the Group for the year was 19.0% (2021: 19.0%).

The impact of the Banking Surcharge is shown as a difference between tax at this rate and the actual tax charge in the table below.

	2022	2021
	£m	£m
Profit on ordinary activities before taxation	**417.9**	213.7
Profit on ordinary activities multiplied by the UK standard rate of corporation tax	**79.4**	40.6
Effects of:		
Permanent differences		
Recurring disallowable expenditure and similar items	**(0.1)**	(1.1)
Mismatch in timing differences	**0.8**	(0.3)
Change in rate of taxation on current and deferred tax (excluding Bank Surcharge)	**10.9**	(1.4)
Impact of Bank Surcharge on current and deferred tax	**13.1**	10.6
Prior year charge	**0.2**	0.8
Tax charge for the year	**104.3**	49.2

The timing difference mismatch arises because tax relief for share based payments is given on a different basis from that on which the accounting charge for the provision of these awards is recognised under IFRS 2.

Change in rate of taxation includes the effect of providing for deferred tax balances at rates other than the comparator rate. This includes deferred tax provision on fair value gains in the year.

Had the reduction in the Bank Surcharge legislated for in the year been enacted at the same time as the other changes which had been due to come into force on 1 April 2023, the tax charge for the year ended 30 September 2021 would have been reduced by £0.5m, with a corresponding increase in the current year.

(c) Factors affecting future tax charges

While the UK Government has made various announcements on the future direction of tax policy during the period and since the year end, none of these proposals have yet been legislated for and it is uncertain which of them might be. The future direction of UK tax policy will significantly affect the tax payable by the Group, and this remains uncertain.

The Group's overall future effective tax rate will also be impacted by the future level of the Surcharge and by the proportion of its taxable profit subject to it, with the increase in the threshold at which it applies likely to narrow the differential between the Group's effective tax rate and the standard rate of corporation tax.

The Group includes various asset leasing businesses within its Commercial Lending division. Whilst such businesses do not, in general, have significant permanent differences, the taxable profits in a given accounting period are usually significantly different from the accounting profits due to temporary differences.

At the balance sheet date there were no material tax uncertainties and no significant open matters with the UK tax authorities. The Group has no material exposure to any other tax jurisdiction.

As a wholly UK based business the Group does not expect to be significantly impacted by the OECD project on Base Erosion and Profit Shifting ('BEPS').

14. Profit attributable to members of Paragon Banking Group PLC

The Company's profit after tax for the financial year amounted to £136.5m (2021: £85.5m). A separate income statement has not been prepared for the Company under the provisions of section 408 of the Companies Act 2006.

The Company has no other items of comprehensive income for the years ended 30 September 2022 or 30 September 2021.

15. Earnings per share

Earnings per ordinary share is calculated as follows:

	2022	2021
Profit for the year (£m)	**313.6**	164.5
Basic weighted average number of ordinary shares ranking for dividend during the year (m)	**242.7**	252.3
Dilutive effect of the weighted average number of share options and incentive plans in issue during the year (m)	**6.4**	8.9
Diluted weighted average number of ordinary shares ranking for dividend during the year (m)	**249.1**	261.2
Earnings per ordinary share		
- basic	**129.2p**	65.2p
- diluted	**125.9p**	63.0p

16. Cash and cash equivalents

'Cash and Cash Equivalents' includes current bank balances, money market placements and fixed rate sterling term deposits with London banks, and balances with the Bank of England. It is analysed as set out below.

	2022 £m	2021 £m	2020 £m
Deposits with the Bank of England	**1,612.5**	1,142.0	1,637.1
Balances with central banks	**1,612.5**	1,142.0	1,637.1
Deposits with other banks	**318.4**	218.1	287.9
Balances with other banks	**318.4**	218.1	287.9
Cash and cash equivalents	**1,930.9**	1,360.1	1,925.0

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 Trustee of the Group's employee share ownership plan ('ESOP') may only be used to invest in the shares of the Company, pursuant to the aims of that plan. This is shown as 'ESOP cash' below.

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

	2022 £m	2021 £m	2020 £m
Available cash	**1,689.1**	1,236.5	1,701.1
Securitisation cash	**240.5**	123.3	223.4
ESOP cash	**1.3**	0.3	0.5
	1,930.9	1,360.1	1,925.0

The 'Cash and Cash Equivalents' amount of £19.7m (2021: £19.6m, 2020: £12.6m) shown in the Company balance sheet is not subject to restrictions.

Cash and cash equivalents are classified as Stage 1 exposures (see note 20) for the purposes of impairment provisioning. The probabilities of default have been assessed to be so low as to require no significant impairment provision.

17. Loans to customers

The Group's loans to customers at 30 September 2022, analysed between the segments described in note 2 are as follows:

	Note	2022	2021 (Restated)	2020 (Restated)
		£m	£m	£m
First mortgages		**12,122.4**	11,460.6	10,636.9
Second charge mortgages		**206.3**	281.7	354.5
Unsecured consumer loans		-	87.3	109.7
Total Mortgage Lending		**12,328.7**	11,829.6	11,101.1
Finance lease receivables	*18*	**825.2**	720.3	724.4
Development finance		**719.9**	608.2	609.0
Other secured commercial lending		**238.1**	168.0	134.4
Other commercial loans		**98.4**	76.6	62.5
Total Commercial Lending		**1,881.6**	1,573.1	1,530.3
Loans to customers		**14,210.3**	13,402.7	12,631.4
Fair value adjustments from portfolio hedging	*25*	**(559.9)**	5.5	109.7
		13,650.4	13,408.2	12,741.1

The segmental analysis shown above has been restated in line with the revision of the Group's segments described in Note 2. Total balances of each class of lending are unaffected by this change.

Other secured commercial lending includes structured lending, aviation mortgages and invoice finance.

Other commercial loans includes principally professions finance, discounted receivables, term loans issued under the RLS, CBILS and BBLS schemes, and other short term commercial balances.

The Group's purchased loan portfolios are analysed below.

	2022	2021
	£m	£m
First mortgage loans	**10.9**	13.4
Consumer loans	**64.4**	171.8
Motor finance loans	**0.5**	4.3
	75.8	189.5

Information on the Estimated Remaining Collections ('ERCs'), the undiscounted forecast collectible amounts, for first mortgages and consumer loans is given in note 61. All other loans above are internally generated or arise from acquired operations.

The amounts of the Group's first mortgage assets pledged as collateral under the central bank facilities described in note 38 or under the securitisation and warehouse funding arrangements described in notes 34 and 35 are shown below. These include notes retained by the Group described in note 62. The table also shows assets prepositioned with the Bank of England for use in future drawings.

	2022	2021	2020
	£m	£m	£m
Pledged as collateral in respect of			
Asset backed loan notes	**2,099.8**	2,414.5	4,106.4
Warehouse facilities	**850.8**	1,041.1	881.9
Central bank facilities	**3,790.9**	2,901.0	2,875.3
Total pledged as collateral	**6,741.5**	6,356.6	7,863.6
Prepositioned with Bank of England	**2,675.5**	3,190.1	1,072.3
Other first mortgage assets	**2,705.4**	1,913.9	1,701.0
Total first mortgage assets	**12,122.4**	11,460.6	10,636.9

No assets of other classes were pledged as collateral at 30 September 2022, 30 September 2021 or 30 September 2020.

18. Finance lease receivables

The Group's finance leases can be analysed as shown below.

	2022 £m	2021 £m	2020 £m
Motor finance	**261.3**	229.2	272.4
Asset finance	**498.8**	440.5	452.0
RLS and CBILS	**65.1**	50.6	-
Carrying value	**825.2**	720.3	724.4

The minimum lease payments due under these loan agreements are:

	2022 £m	2021 £m	2020 £m
Amounts receivable			
Within one year	**284.7**	255.5	269.5
Within one to two years	**244.4**	220.3	221.5
Within two to three years	**189.5**	164.8	163.6
Within three to four years	**136.5**	105.0	104.1
Within four to five years	**60.5**	50.5	43.2
After five years	**46.2**	41.6	41.6
	961.8	837.7	843.5
Less: future finance income	**(119.8)**	(96.3)	(103.4)
Present value	**842.0**	741.4	740.1

The present values of those payments, net of provisions for impairment, carried in the accounts are:

	2022 £m	2021 £m	2020 £m
Amounts receivable			
Within one year	**248.7**	225.0	236.5
Within two to five years	**554.0**	480.2	467.1
After five years	**39.3**	36.2	36.5
Present value	**842.0**	741.4	740.1
Allowance for uncollectible amounts	**(16.8)**	(21.1)	(15.7)
Carrying value	**825.2**	720.3	724.4

19. Impairment provisions on loans to customers

The following notes set out information on the Group's impairment provisioning under IFRS 9 for the loans to customers balances set out in note 17, including both finance leases, accounted for under IFRS 16, and loans held at amortised cost, accounted for under IFRS 9, as both groups of assets are subject to the IFRS 9 impairment requirements. The disclosures are set out within the following notes:

- 20 Loan impairments – Basis of provision
- 21 Loan impairments by stage and division
- 22 Loan impairments – Provision movements in the year
- 23 Loan impairments – Economic inputs to calculations
- 24 Loan impairments – Sensitivity analysis

The impact on the Group's profit and loss account for the year is set out in note 11.

20. Loan impairment – basis of provisions

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

The Group's process for determining its provisions for impairments is summarised below. This includes:

i. The methods used for the calculation of ECL

ii. How it defines SICR

iii. How it defines default

iv. How it identifies which loans are credit impaired, as defined by IFRS 9

v. How the ECL estimation process is monitored and controlled

vi. How the Group develops and enhances the models it uses in the ECL estimation process

vii. vii. How the Group uses judgemental adjustments to ensure all elements of credit risk are fully addressed

i) Calculation of expected credit loss ('ECL')

For the majority of the Group's loan assets, the ECL is generated using statistical models applied to account data to generate PD and LGD components. In determining for which portfolios a statistically modelled approach is appropriate, the Group considers the volume of available data and the level of similarity of the credit characteristics of the underlying accounts.

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

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

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

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

In extreme or unprecedented economic conditions, it is likely that mechanical models will be less predictive of outcomes as the historical data used for modelling will be insufficiently representative of present conditions. This may be the case where economic indicators at the reporting date and future expectations for those indicators lie outside the range of the observations used to construct the models. In such circumstances, management carefully review all outputs to ensure provision is adequate.

At 30 September 2022 the UK economy was subject to levels of inflation and interest rates not seen for some considerable time and not represented sufficiently in the data sets used to create the Group's models. There was also a level of uncertainty as to the direction of government policy which was unusual for the UK. The situation was evolving rapidly at the year end, meaning that there was a risk that credit metrics and external credit bureau data might not fully reflect increasing risks, which would lead to a potential understatement of PDs.

These factors led management to conclude that current and forecast economic conditions were not ones under which the Group's models would necessarily perform well, and that judgemental adjustments might be required to compensate for these weaknesses.

ii) Significant Increase in Credit Risk ('SICR')

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

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

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

As part of its determination of whether model outputs form a reliable basis for impairment provisioning, the Group considered whether it had any evidence of groups of accounts demonstrating factors indicating a higher level of credit risk than other accounts in the same portfolios. No such evidence was noted at 30 September 2022, and hence no additional accounts were identified as having an SICR.

At 30 September 2021 the Group had identified accounts where the customer had been granted a Covid-related payment holiday as being at increased credit risk and an additional £599.8m of balances were designated as having an SICR. The performance of such accounts was monitored through the period and management were able to conclude that, given the passage of a further 12 months, accounts would either have stabilised or be identified as defaulted or as at SICR through the Group's normal process. No similar adjustment was therefore required at 30 September 2022.

While no requirement to identify additional SICR cases has arisen in 2022, the approach is consistent with that adopted at 30 September 2021, and will be kept under review in future periods.

iii) Definitions of default

As the IFRS 9 definition of ECL is based on PD, default must be defined for this purpose. The analysis of these default cases provides the foundation for the Group's PD modelling. IFRS 9 provides a rebuttable presumption that an account is in default when it is 90 days overdue and this was used as the basis of the Group's definition, combined with qualitative and quantitative factors specific to each portfolio.

The most influential quantitative factor in the majority of portfolios is the arrears level, while the principal qualitative factors relate to internal account management statuses. In particular the decision to commence a process of enforcement will be considered as a default in all portfolios. In the Group's buy-to-let mortgage portfolio the appointment of a receiver of rent to manage the property on the customer's behalf is considered a default, while for portfolios assessed on a case-by-case basis, such as the Group's development finance loans, the movement of an account to the highest risk category is considered as a default.

This ensures that Group's definitions of default for its various portfolios are materially aligned to the regulatory definitions of default used internally, and are broadly aligned to its internal operational procedures, allowing for the arbitrary nature of the 90-day cut-off, which is a regulatory rather than an operational requirement. In particular the Group's receiver of rent cases are defined as defaulted for modelling purposes as the behaviour of the case after that point is significantly influenced by internal management decisions.

iv) Credit Impaired loans

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

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

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

Loans are retained in Stage 3 for three months after the point where they cease to exhibit the characteristics of default. After this point, they may move to Stage 2 or Stage 1 depending on whether an SICR trigger remains.

All default cases are considered to be credit impaired, including all receiver of rent cases and all cases with at least one payment more than 90 days overdue, even where such cases are being managed in the expectation of realising all of the carrying balance.

In order to provide better information for users, additional analysis of credit impaired accounts has been presented below distinguishing between probationary accounts, receiver of rent accounts, accounts subject to realisation / enforcement procedures and long term managed accounts, all of which are treated as credit impaired. While other indicators of default are in use, the categories shown account for the overwhelming majority of Stage 3 cases.

v) Monitoring of ECL estimation processes

The Group's ECL models are compiled on the basis of the analysis of relevant historical data. Before a model is adopted for use its operations and outputs are examined to ensure that it is expected to be appropriately predictive and, if it is an updated model, expected to be more predictive than any existing model. Before a new model is adopted the changes and impacts will be considered by the CFO, alongside any advice from the Group's independent model review functions. The performance of all models is reviewed on an ongoing basis, by senior finance and risk management, including the CFO. Monitoring packs comparing actual and predicted loss levels are produced at regular intervals, set on the basis of the materiality of each model. The continuing appropriateness of model assumptions is also reviewed as part of this process.

Models are revisited on a regular basis to ensure that they continue to reflect the most recent data as the available information increases over time.

On a monthly basis all model outputs, model overlays and provisions calculated for non-modelled books are reviewed by senior finance management including the CFO in conjunction with the latest credit risk operational and economic metrics to ensure that the impairment provision by asset type remains appropriate. This exercise will be the subject of particular focus at the year end and the half year.

This information is summarised for the Audit Committee on a biannual basis, and they have regard to this data in forming their conclusions on the appropriateness of provisioning levels.

vi) Model development

The models used by the Group are updated from time to time to allow for changes in the business, developments in best practice and the availability of additional data with the passing of time. During the year ended 30 September 2021 a major update to the buy-to-let PD model took place.

The adoption of this model has enabled the reporting process in the year to be more streamlined and supported increased use of scenario analysis.

The Group's programme of model development continued during the year with a particular focus on analysing how default and loss data recorded over the period of the Covid pandemic should be reflected in forward-looking models, given the unprecedented nature of the pandemic and the national and international response to it.

All revised models and model enhancements are carefully reviewed and tested before adoption, and are subject to a governance process for their approval.

The impacts of the adoption of the new PD model in the year ended 30 September 2021 on the calculated provision were not significant.

vii) Judgemental Adjustments

In order to ensure that its loan portfolios are adequately provisioned, the Group considers whether there are factors not fully captured by the modelling process, including economic conditions more generally, which indicate a need for judgemental adjustments. Information considered includes credit data, customer and broker feedback received, the results of insight surveys, industry intelligence and expert knowledge within the business lines.

During the year, the dominance of Covid in these considerations reduced as the short-term impact of the pandemic receded and other economic factors such as the UK cost of living, rising interest rates and the conflict in Ukraine became more significant.

Towards the end of the year the consensus view of the likely severity of these impacts became markedly more pessimistic, and together with political instability in the UK Government and emerging negative economic indicators this generated a situation where very careful assessment of credit prospects was required.

Where management has identified a requirement to amend the calculated provision as a result of either model deficiencies or idiosyncratic behaviour in part of the portfolio, judgemental adjustments are applied to the modelled outputs so that the ECL recognised corresponds to expert judgement, taking into account the widest possible range of current information, which might not be factored into the modelling process.

In normal circumstances the Group's objective is to develop its modelling to the point where the level of judgemental adjustments required is minimal, but in economic conditions where previous relevant experience is limited or non-existent, some form of judgemental adjustment is always likely to be necessary. While high interest rate and inflation scenarios have occurred in the UK in the past, market conditions, products and regulatory expectations have moved on considerably in the meantime, and most such observations would pre-date the existence of buy-to-let mortgages as a distinct asset class. This means that the value of past history as a guide to future credit performance is reduced.

The current model behaviour and the potential for unobserved credit issues have meant that the requirement for such adjustments over recent periods has been significant. Evidence considered by management included internal performance data, customer feedback, evidence on the wider economy and quantitative and qualitative data and statements from industry, government and regulatory bodies. These are combined to form a broad estimate of the level of provision required across the Group.

The requirement for judgemental adjustments is considered on a portfolio-by-portfolio basis, and the potential for the existence of significant groups of assets being particularly exposed to credit risk in the expected economic scenarios is also considered.

The total amounts of judgemental adjustments provided across the Group are set out below by segment.

	2022	2021 (Restated)
	£m	£m
Mortgage Lending	**5.0**	9.2
Commercial Lending	**10.0**	10.2
	15.0	19.4

The movements in the period represent a transition from Covid-related overlays to ones which relate more to the responsiveness of the Group's provision models to current economic conditions.

In the Mortgage Lending book it is considered that where Covid-related adjustments were made at 30 September 2021, this credit risk is now either reflected in credit metrics or has reduced. The adjustment at 30 September 2022 is principally a result of a disconnect between the credit metrics which drive the models and the economic expectations of management, brokers and customers at the year end date.

In the Commercial Lending segment the adjustment has remained of a similar size, but relates to more general economic exposures than it did at 2021, with outlook for the sector less positive than credit metrics might indicate. However, the potential long-term impacts of Covid in the forms of business weakness and the continuing government backed funding of SMEs, through CBILS and similar schemes, still play a part in this assessment.

The Group's analysis found no evidence of particular concentrations of credit risk below portfolio level. Given this, and the high level nature of the exercise undertaken, the judgemental adjustments have been apportioned across the Group's buy-to-let mortgage and SME lending portfolios to individual cases. As such they are included in the credit risk disclosures required by IFRS 7.

The Group will continue to monitor the requirement for these adjustments as the economic situation develops and its impacts begin to be reflected in model outputs. It is anticipated that a more normal economic situation would require a lower value of adjustments, but the timescale in which such a scenario might be reached appears uncertain.

The Group has adopted the terminology for impairment adjustments proposed by the Taskforce on Disclosures about Expected Credit Loss ('DECL') which restricts the use of the term 'Post Model Adjustment' ('PMA') to those adjustments calculated on an account-by-account basis and therefore no longer uses that term for other judgemental adjustments.

21. Loan impairments by stage and division

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

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

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

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

An analysis of the Group's loan portfolios between the stages defined above is set out below. The segmental analysis included in this note for the year ended 30 September 2021 has been restated for the changes in the segments reported (Note 2).

	Stage 1	Stage 2*	Stage 3*	POCI	Total
	£m	£m	£m	£m	£m
30 September 2022					
Gross loan book					
Mortgage Lending	**10,339.6**	**1,886.4**	**119.3**	**21.4**	**12,366.7**
Commercial Lending	**1,817.4**	**77.2**	**5.1**	**7.4**	**1,907.1**
Total	**12,157.0**	**1,963.6**	**124.4**	**28.8**	**14,273.8**
Impairment provision					
Mortgage Lending	**(5.8)**	**(6.1)**	**(26.1)**	**-**	**(38.0)**
Commercial Lending	**(19.7)**	**(1.9)**	**(2.4)**	**(1.5)**	**(25.5)**
Total	**(25.5)**	**(8.0)**	**(28.5)**	**(1.5)**	**(63.5)**
Net loan book					
Mortgage Lending	**10,333.8**	**1,880.3**	**93.2**	**21.4**	**12,328.7**
Commercial Lending	**1,797.7**	**75.3**	**2.7**	**5.9**	**1,881.6**
Total	**12,131.5**	**1,955.6**	**95.9**	**27.3**	**14,210.3**
Coverage ratio					
Mortgage Lending	**0.06%**	**0.32%**	**21.88%**	**-**	**0.31%**
Commercial Lending	**1.08%**	**2.46%**	**47.06%**	**20.27%**	**1.34%**
Total	**0.21%**	**0.41%**	**22.91%**	**5.21%**	**0.44%**

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

	Stage 1	Stage 2*	Stage 3*	POCI	Total
	£m	£m	£m	£m	£m
30 September 2021 (restated)					
Gross loan book					
Mortgage Lending	10,396.2	1,212.7	145.3	113.1	11,867.3
Commercial Lending	1,504.2	66.4	19.0	11.2	1,600.8
Total	11,900.4	1,279.1	164.3	124.3	13,468.1
Impairment provision					
Mortgage Lending	(2.1)	(10.3)	(25.3)	-	(37.7)
Commercial Lending	(12.9)	(1.0)	(13.6)	(0.2)	(27.7)
Total	(15.0)	(11.3)	(38.9)	(0.2)	(65.4)
Net loan book					
Mortgage Lending	10,394.1	1,202.4	120.0	113.1	11,829.6
Commercial Lending	1,491.3	65.4	5.4	11.0	1,573.1
Total	11,885.4	1,267.8	125.4	124.1	13,402.7
Coverage ratio					
Mortgage Lending	0.02%	0.85%	17.41%	-	0.32%
Commercial Lending	0.86%	1.51%	71.58%	1.79%	1.74%
Total	0.13%	0.88%	23.68%	0.16%	0.49%

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

Finance leases included above, analysed by staging, were:

	Stage 1	Stage 2	Stage 3	POCI	Total
	£m	£m	£m	£m	£m
30 September 2022					
Gross loan book	**801.7**	**35.4**	**4.4**	**0.5**	**842.0**
Impairment provision	**(13.3)**	**(1.5)**	**(2.0)**	**-**	**(16.8)**
Net loan book	**788.4**	**33.9**	**2.4**	**0.5**	**825.2**
Coverage Ratio	**1.66%**	**4.24%**	**45.45%**	**-**	**2.00%**
30 September 2021					
Gross loan book	704.9	14.9	17.3	4.3	741.4
Impairment provision	(7.9)	(0.5)	(12.7)	-	(21.1)
Net loan book	697.0	14.4	4.6	4.3	720.3
Coverage Ratio	1.12%	3.36%	73.41%	-	2.85%

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

POCI balances included in the Commercial Lending segment arise principally from acquired businesses, where those assets were identified as credit impaired at the point of acquisition when the acquired portfolios as a whole were evaluated. Additional provision arising on these assets post-acquisition is shown as 'Impairment Provision' above.

The Group's acquired consumer loans are included in the Mortgage Lending segment, together with legacy (originated pre-2010) second charge mortgages. Acquired loans which were performing on acquisition are included in the staging analysis above.

Acquired portfolios within the Mortgage Lending segment 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.

The value of accounts in stage 2 has increased across all categories as a result of the generally worsening economic outlook. The largest increase is in those cases in the buy-to-let book identified with an SICR through PD movements, a result of the updated economic scenarios and weightings (note 23).

Provision levels and coverage in the Mortgage Lending division have both reduced, however, due to the impact of the strong growth in house prices on security values. Coverage levels in the Commercial Lending division have increased, largely as a result of the nature of the items included in this stage at 30 September 2022 compared to a year earlier, and a more pessimistic outlook for security values.

	< 1 month arrears	Recent arrears	> 1 <= 3 months arrears	Total
	£m	£m	£m	£m
30 September 2022				
Gross loan book				
Mortgage Lending	**1,850.0**	**10.8**	**25.6**	**1,886.4**
Commercial Lending	**74.2**	**0.2**	**2.8**	**77.2**
Total	**1,924.2**	**11.0**	**28.4**	**1,963.6**
Impairment provision				
Mortgage Lending	**(5.4)**	**(0.1)**	**(0.6)**	**(6.1)**
Commercial Lending	**(1.6)**	**-**	**(0.3)**	**(1.9)**
Total	**(7.0)**	**(0.1)**	**(0.9)**	**(8.0)**
Net loan book				
Mortgage Lending	**1,844.6**	**10.7**	**25.0**	**1,880.3**
Commercial Lending	**72.6**	**0.2**	**2.5**	**75.3**
Total	**1,917.2**	**10.9**	**27.5**	**1,955.6**
Coverage ratio				
Mortgage Lending	**0.29%**	**0.93%**	**2.34%**	**0.32%**
Commercial Lending	**2.16%**	**-**	**10.71%**	**2.46%**
Total	**0.36%**	**0.91%**	**3.17%**	**0.41%**

	< 1 month arrears	Recent arrears	> 1 <= 3 months arrears	Total
	£m	£m	£m	£m
30 September 2021 (restated)				
Gross loan book				
Mortgage Lending	1,187.7	8.7	16.3	1,212.7
Commercial Lending	61.1	0.2	5.1	66.4
Total	1,248.8	8.9	21.4	1,279.1
Impairment provision				
Mortgage Lending	(9.9)	(0.1)	(0.3)	(10.3)
Commercial Lending	(0.9)	-	(0.1)	(1.0)
Total	(10.8)	(0.1)	(0.4)	(11.3)
Net loan book				
Mortgage Lending	1,177.8	8.6	16.0	1,202.4
Commercial Lending	60.2	0.2	5.0	65.4
Total	1,238.0	8.8	21.0	1,267.8
Coverage ratio				
Mortgage Lending	0.83%	1.15%	1.84%	0.85%
Commercial Lending	1.47%	-	1.96%	1.51%
Total	0.86%	1.12%	1.87%	0.88%

Analysis of Stage 3 loans

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

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

Where an account meets two of the criteria, it will be assigned to the category shown first in the list above.

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 gross values of Stage 3 accounts at 30 September 2022 are significantly reduced from those at 30 September 2021 as the number of new defaults in the year remained low and historic cases were resolved.

Other than the impact of the Commercial Lending write-offs, coverage levels remained broadly similar to the previous year end position. Ratios in Stage 3 will naturally be subject to a wider range of fluctuation than those elsewhere, given the low number of accounts involved, the consequent potential for mix effects and the idiosyncratic nature of some of the cases.

	Probation	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m	£m
30 September 2022					
Gross loan book					
Mortgage Lending	**6.0**	**37.5**	**49.6**	**26.2**	**119.3**
Commercial Lending	**0.2**	**0.7**	**-**	**4.2**	**5.1**
Total	**6.2**	**38.2**	**49.6**	**30.4**	**124.4**
Impairment provision					
Mortgage Lending	**(0.4)**	**(1.0)**	**(17.2)**	**(7.5)**	**(26.1)**
Commercial Lending	**-**	**(0.2)**	**-**	**(2.2)**	**(2.4)**
Total	**(0.4)**	**(1.2)**	**(17.2)**	**(9.7)**	**(28.5)**
Net loan book					
Mortgage Lending	**5.6**	**36.5**	**32.4**	**18.7**	**93.2**
Commercial Lending	**0.2**	**0.5**	**-**	**2.0**	**2.7**
Total	**5.8**	**37.0**	**32.4**	**20.7**	**95.9**
Coverage ratio					
Mortgage Lending	**6.67%**	**2.67%**	**34.68%**	**28.63%**	**21.88%**
Commercial Lending	**-**	**28.57%**	**-**	**52.38%**	**47.06%**
Total	**6.45%**	**3.14%**	**34.68%**	**31.91%**	**22.91%**

	Probation	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m	£m
30 September 2021 (Restated)					
Gross loan book					
Mortgage Lending	8.0	42.0	80.9	14.4	145.3
Commercial Lending	0.6	11.4	-	7.0	19.0
Total	8.6	53.4	80.9	21.4	164.3
Impairment provision					
Mortgage Lending	(0.3)	(1.9)	(17.4)	(5.7)	(25.3)
Commercial Lending	(0.1)	(10.3)	-	(3.2)	(13.6)
Total	(0.4)	(12.2)	(17.4)	(8.9)	(38.9)
Net loan book					
Mortgage Lending	7.7	40.1	63.5	8.7	120.0
Commercial Lending	0.5	1.1	-	3.8	5.4
Total	8.2	41.2	63.5	12.5	125.4
Coverage ratio					
Mortgage Lending	3.75%	4.52%	21.51%	39.58%	17.41%
Commercial Lending	16.67%	90.35%	-	45.71%	71.58%
Total	4.65%	22.85%	21.51%	41.59%	23.68%

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

	2022	2021
	£m	£m
First mortgages	**66.2**	74.7
Second mortgages	**14.6**	15.4
Asset finance	**1.6**	4.7
Motor finance	**0.7**	2.0
	83.1	96.8

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

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

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

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

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

	30 September 2022		30 September 2021	
	No.	**£m**	No.	£m
Managed accounts				
Appointment date				
2010 and earlier	**199**	**31.2**	333	56.3
2011 to 2013	**42**	**6.3**	56	9.1
2014 to 2016	**14**	**1.9**	24	3.3
2016 and later	**79**	**10.2**	86	12.2
Total managed accounts	**334**	**49.6**	499	80.9
Accounts in the process of realisation	**141**	**23.5**	54	10.2
	475	**73.1**	553	91.1

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

22. Loan impairments – provision movements in the year

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

	Mortgage Lending £m	Commercial Lending £m	Total £m
At 30 September 2021	37.7	27.7	65.4
Provided in period (note 11)	5.1	10.7	15.8
Amounts written off	(3.6)	(12.9)	(16.5)
Assets derecognised	(1.2)	-	(1.2)
At 30 September 2022 (note 21)	**38.0**	**25.5**	**63.5**
At 30 September 2020	53.2	28.6	81.8
(Released) / provided in period (note 11)	(7.1)	4.0	(3.1)
Amounts written off	(8.4)	(4.9)	(13.3)
Assets derecognised	-	-	-
At 30 September 2021 (note 21)	37.7	27.7	65.4

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

At 30 September 2022, enforceable contractual balances of £4.9m (2021: £8.8m) were outstanding on non-POCI assets written off in the period. This excludes those accounts where a full and final settlement was agreed and those where the contractual terms do not permit any further action. Enforceable balances are kept under review for operational purposes, but no amounts are recognised in respect of such accounts unless further cash is received or there is a strong expectation that it will be.

A more detailed analysis of these movements by IFRS 9 stage on a consolidated basis for the year ended 30 September 2022 and 30 September 2021 is set out below.

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

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

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

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total
Loss allowance at 30 September 2021	15.0	11.3	38.9	0.2	65.4
New assets originated or purchased	7.2	-	-	-	7.2
Changes in loss allowance					
Transfer to Stage 1	2.6	(2.3)	(0.3)	-	-
Transfer to Stage 2	(1.6)	2.3	(0.7)	-	-
Transfer to Stage 3	(0.2)	(0.4)	0.6	-	-
Changes on stage transfer	(2.4)	1.8	4.3	-	3.7
Changes due to credit risk	4.9	(4.7)	3.4	1.3	4.9
Loans sold	-	-	(1.2)	-	(1.2)
Write offs	-	-	(16.5)	-	(16.5)
Loss allowance at 30 September 2022	**25.5**	**8.0**	**28.5**	**1.5**	**63.5**
Loss allowance at 30 September 2020	22.2	15.8	43.4	0.4	81.8
New assets originated or purchased	8.1	-	-	-	8.1
Changes in loss allowance					
Transfer to Stage 1	4.7	(2.6)	(2.1)	-	-
Transfer to Stage 2	(1.4)	2.1	(0.7)	-	-
Transfer to Stage 3	(0.2)	(0.7)	0.9	-	-
Changes on stage transfer	(3.8)	1.8	3.1	-	1.1
Changes due to credit risk	(14.6)	(5.1)	7.6	(0.2)	(12.3)
Loans sold	-	-	-	-	-
Write offs	-	-	(13.3)	-	(13.3)
Loss allowance at 30 September 2021	15.0	11.3	38.9	0.2	65.4

During the year ended 30 September 2022 the impairment allowance remained relatively stable, due to the opposing effects of the easing of Covid-related pressures on the UK economy and mounting concerns about the nation's economic health more generally, with inflation and interest rates increasing and the potential for impacts from the conflict in Ukraine.

The increase in stage 1 provision came mostly from new lending, coupled with the need to make judgemental increases in the provision balance. Stage 2 provisions fell slightly as the impacts of additional Covid-related SICRs in 2021 fell away. Stage 3 provision reduced as bought forward cases were resolved, in both the Commercial Lending and Mortgage Lending divisions.

The principal movements in the impairment provision in the year ended 30 September 2021 were downwards, with a more benign economic outlook reducing both the estimated likelihood of losses and the expected loss on defaulted cases as security values improved. However coverage levels still remained in excess of those pre-Covid, with PMAs in place to compensate for the potential impact of credit issues not apparent in the data.

While fewer accounts had been granted payment holiday extensions in that year than in the year ended 30 September 2020, this had driven further transfers from Stage 1 to Stage 2. Transfers to Stage 3 reflected principally a small number of realisation cases and other cases identified through credit review. Write offs largely related to the realisation of already provided losses on cases being worked out on a long-term basis.

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

	Stage 1	Stage 2	Stage 3	POCI	Total
	£m	£m	£m	£m	£m
Balance at 30 September 2021	11,900.4	1,279.1	164.3	124.3	13,468.1
New assets originated or purchased	3,020.8	-	-	-	3,020.8
Changes in staging					
Transfer to Stage 1	519.4	(516.8)	(2.6)	-	-
Transfer to Stage 2	(1,365.2)	1,378.2	(13.0)	-	-
Transfer to Stage 3	(29.5)	(16.6)	46.1	-	-
Redemptions and repayments	(2,311.2)	(230.4)	(55.6)	(33.1)	(2,630.3)
Loans sold	-	-	(1.5)	(73.8)	(75.3)
Write offs	-	-	(16.5)	-	(16.5)
Other changes	422.3	70.1	3.2	11.4	507.0
Balance at 30 September 2022	**12,157.0**	**1,963.6**	**124.4**	**28.8**	**14,273.8**
Loss allowance	(25.5)	(8.0)	(28.5)	(1.5)	(63.5)
Carrying value	12,131.5	1,955.6	95.9	27.3	14,210.3
Balance at 30 September 2020	11,329.7	1,045.4	176.1	162.0	12,713.2
New assets originated or purchased	2,419.4	-	-	-	2,419.4
Changes in staging					
Transfer to Stage 1	158.5	(149.5)	(9.0)	-	-
Transfer to Stage 2	(514.2)	519.6	(5.4)	-	-
Transfer to Stage 3	(23.7)	(21.6)	45.3	-	-
Redemptions and repayments	(1,884.9)	(158.6)	(35.7)	(53.1)	(2,132.3)
Loans sold	-	-	-	-	-
Write offs	-	-	(13.3)	-	(13.3)
Other changes	415.6	43.8	6.3	15.4	481.1
Balance at 30 September 2021	11,900.4	1,279.1	164.3	124.3	13,468.1
Loss allowance	(15.0)	(11.3)	(38.9)	(0.2)	(65.4)
Carrying value	11,885.4	1,267.8	125.4	124.1	13,402.7

Other changes includes interest and similar charges.

23. Loan impairments – economic inputs to calculations

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

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

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

The central scenario used for IFRS 9 impairment purposes is consistent with the scenario which forms the basis of the Group's business planning and forecasting and will therefore generally carry the highest probability weighting. In its September 2022 forecasting cycle (the 'October forecast'), the Group has adopted a central economic scenario derived using a broadly equivalent approach to that used in September 2021, with the starting point of the scenario updated to reflect the actual movements of economic variables and expectations in the year. The general trend of the Group's central forecast is broadly negative in the short term, with interest rates and inflation increasing sharply by historical terms in the early part of the five year forecast period before normalising. Short term falls in house prices are also anticipated.

Compared to the central scenario adopted at 30 September 2021, the new central forecast is based on a significantly higher interest rate environment throughout the period, reflecting increases already seen in the second half of the year and clear market expectations of higher rates to come. Inflation is much higher in the early years of the forecast than anticipated twelve months ago, with credit growth more constricted. GDP growth is slowed and house prices less positive in the short term, but recover later. These all reflect a worsening outlook for the UK than anticipated 12 months ago especially in the first two years of the period.

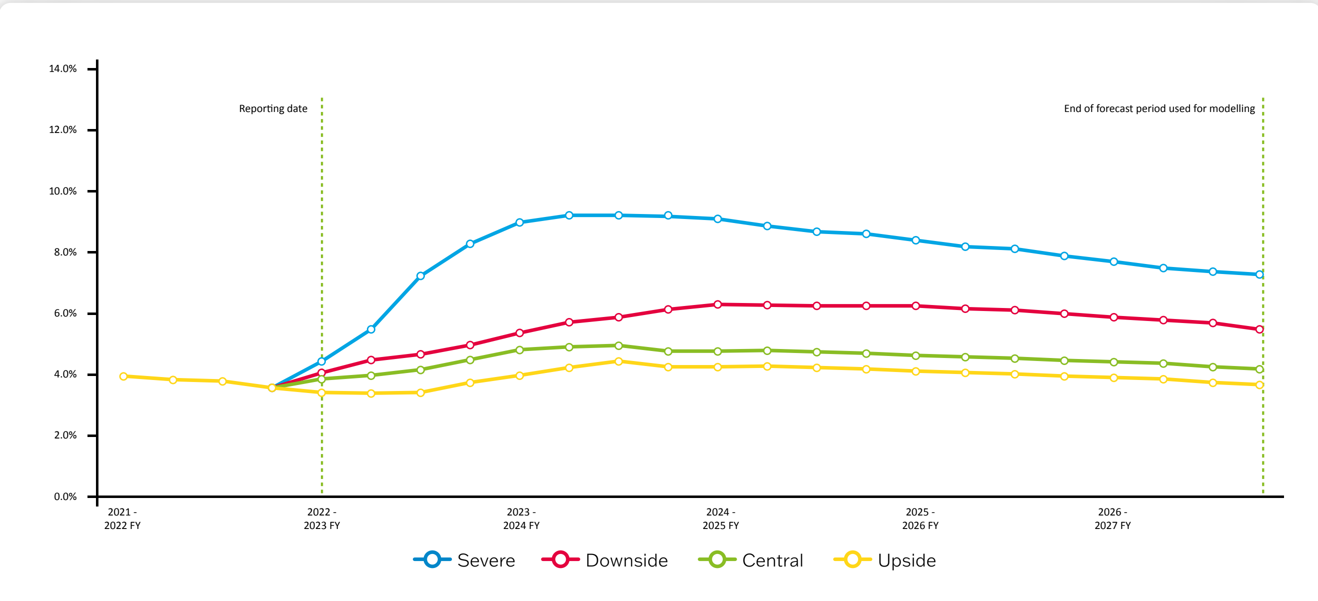
The upside and downside scenarios continue to be derived from the central scenario, as they have been in previous periods. The shapes of these three scenarios are broadly similar across the period, but the degree of divergence of the upside and downside scenarios from the central scenario has been reviewed to ensure that the asymmetrical nature of credit risk is properly accounted for and the full universe of possible outcomes adequately represented.

The severe scenario has been derived from stress testing scenarios published by the Bank of England, as in previous periods, with the 2022 Annual Cyclical Scenario being used at 30 September 2022. This scenario is based on a deep recession, higher interest rates and falling asset prices. To ensure that the scenario is appropriately severe in the Group's circumstances a slightly higher unemployment level and a slightly worse outcome on house prices were assumed, otherwise the appreciation of security values in the later part of the forecast period would negate other impacts.

The overall shape of the scenarios adopted, and the change in the forecasts year-on-year is illustrated by the forecasts of the UK's unemployment rate set out in the charts below. The unemployment rate has been presented as it is the principal indicator of general economic activity used in modelling losses in the Group's buy-to-let mortgage portfolio.

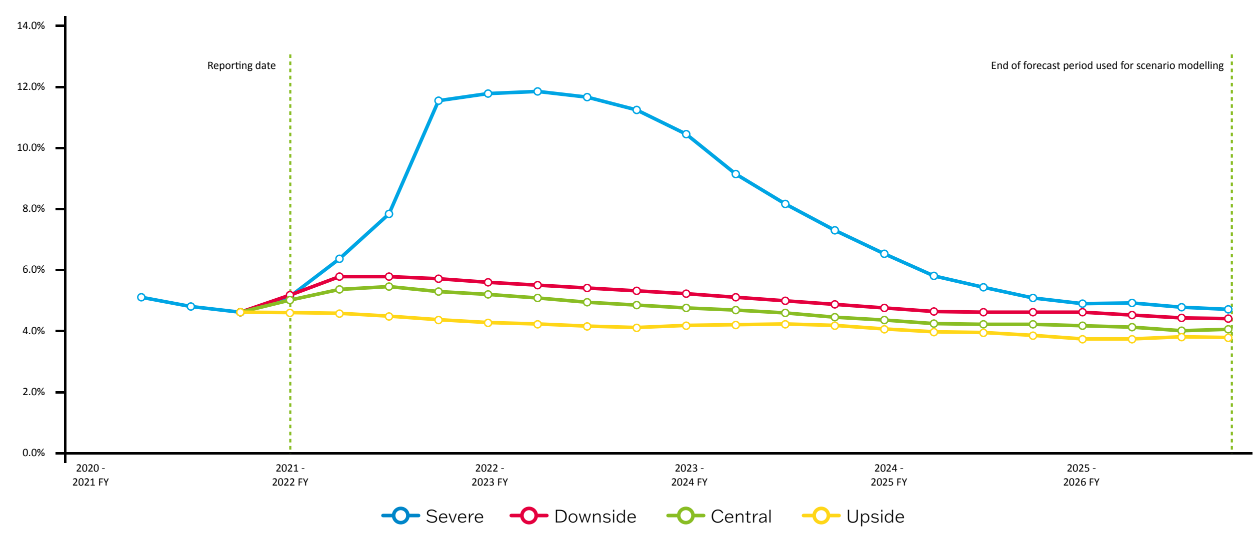
Historical and forecast Unemployment rates (End point measure)

As at September 2022



Historical and forecast Unemployment rates (End point measure)

As at September 2021



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 amend the scenario weightings used at 30 September 2021 for the current year

While the direct impacts of the Covid pandemic have begun to recede, fresh uncertainties, particularly around cost of living issues in the UK and the conflict in Ukraine, arose in the period and increased rapidly towards the year end, as the political climate in the UK became more unstable. This expanded the range of potential economic outcomes and the Group considered it was appropriate to increase the weighting of the severe scenario and reduce that of the downside scenario to allow for this. Sensitivities showing the impact of this change, and comparing the effect of these weightings with those which might be seen in a more normal economic environment are set out in Note 24.

The weightings attached to each scenario are set out below:

	2022	2021
Central Scenario	**40%**	40%
Upside Scenario	**10%**	10%
Downside Scenario	**30%**	35%
Severe Scenario	**20%**	15%
	100%	100%

The Group's economic scenarios comprise seven variables based on standard publicly available metrics for the UK. These variables are

- Year-on-year change in Gross Domestic Product ('GDP') as measured by the Office of National Statistics ('ONS')
- Year-on-year change in the House Price Index ('HPI') as measured by the Nationwide Building Society
- Bank Base Rate ('BBR'), as set by the Bank of England
- Consumer Price Inflation ('CPI') rate, as measured by the ONS
- Unemployment rate, as measured by the ONS
- Annual change in secured lending, as measured by the Bank of England 'mortgage advances' data series
- Annual change in consumer credit, as measured by the Bank of England 'unsecured advances' data series

The projected average annual values of each of these variables in each of the first five financial years of the forecast period are set out below.

30 September 2022

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

	2023	2024	2025	2026	2027
Central Scenario	0.4%	1.3%	1.3%	1.9%	1.2%
Upside Scenario	1.9%	3.0%	2.2%	2.7%	1.7%
Downside Scenario	(2.2)%	0.6%	1.4%	1.9%	1.2%
Severe Scenario	(3.6)%	(0.2)%	1.2%	1.2%	1.2%

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

	2023	2024	2025	2026	2027
Central Scenario	(0.6)%	0.8%	3.9%	4.2%	4.4%
Upside Scenario	4.7%	4.7%	6.8%	6.8%	5.0%
Downside Scenario	(6.5)%	(3.3)%	4.4%	4.0%	4.0%
Severe Scenario	(7.2)%	(15.4)%	(14.4)%	2.7%	5.5%

Bank Base Rate ('BBR') (rate)

	2023	2024	2025	2026	2027
Central Scenario	4.6%	4.3%	3.8%	3.3%	3.0%
Upside Scenario	4.1%	4.3%	3.8%	3.4%	3.1%
Downside Scenario	5.0%	4.4%	3.8%	3.3%	3.0%
Severe Scenario	5.8%	5.8%	5.1%	4.3%	3.5%

Consumer Price Inflation ('CPI') (rate)

	2023	2024	2025	2026	2027
Central Scenario	10.4%	3.9%	2.2%	1.6%	1.9%
Upside Scenario	9.7%	2.9%	1.9%	2.0%	1.9%
Downside Scenario	13.0%	8.8%	2.9%	2.0%	1.9%
Severe Scenario	16.7%	10.0%	3.0%	2.3%	2.0%

Unemployment (rate)

	2023	2024	2025	2026	2027
Central Scenario	4.2%	4.9%	4.8%	4.6%	4.3%
Upside Scenario	3.5%	4.3%	4.3%	4.1%	3.8%
Downside Scenario	4.6%	5.8%	6.3%	6.2%	5.7%
Severe Scenario	6.4%	9.2%	8.8%	8.2%	7.5%

Secured lending (annual change)

	2023	2024	2025	2026	2027
Central Scenario	3.3%	2.6%	2.5%	3.5%	3.5%
Upside Scenario	4.1%	3.3%	3.2%	4.2%	4.3%
Downside Scenario	2.6%	1.8%	1.7%	2.7%	2.8%
Severe Scenario	0.2%	(0.7)%	1.3%	3.0%	3.7%

Consumer credit (annual change)

	2023	2024	2025	2026	2027
Central Scenario	**3.6%**	**3.1%**	**3.6%**	**3.5%**	**3.5%**
Upside Scenario	**4.4%**	**3.9%**	**4.4%**	**4.3%**	**4.3%**
Downside Scenario	**2.9%**	**2.4%**	**2.9%**	**2.8%**	**2.8%**
Severe Scenario	**(3.7)%**	**(4.4)%**	**0.1%**	**2.8%**	**4.7%**

30 September 2021

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

	2022	2023	2024	2025	2026
Central Scenario	7.2%	2.0%	1.3%	1.6%	1.9%
Upside Scenario	8.6%	2.5%	2.1%	1.8%	1.9%
Downside Scenario	3.9%	3.4%	2.1%	1.9%	1.9%
Severe Scenario	(3.7)%	8.9%	4.9%	2.6%	2.0%

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

	2022	2023	2024	2025	2026
Central Scenario	0.7%	2.1%	2.7%	3.2%	3.0%
Upside Scenario	4.0%	3.9%	4.5%	4.7%	2.6%
Downside Scenario	(4.9)%	(5.9)%	-	2.1%	2.1%
Severe Scenario	(10.9)%	(11.6)%	(7.9)%	(1.8)%	0.7%

Bank Base Rate ('BBR') (rate)

	2022	2023	2024	2025	2026
Central Scenario	0.1%	0.1%	0.4%	0.7%	0.8%
Upside Scenario	0.1%	0.5%	0.9%	1.0%	1.0%
Downside Scenario	0.1%	0.1%	0.2%	0.3%	0.5%
Severe Scenario	-	(0.1)%	-	-	0.1%

Consumer Price Inflation ('CPI') (rate)

	2022	2023	2024	2025	2026
Central Scenario	3.8%	2.3%	1.9%	2.0%	2.0%
Upside Scenario	3.0%	2.1%	2.0%	2.0%	2.0%
Downside Scenario	4.2%	3.0%	2.1%	2.0%	2.0%
Severe Scenario	0.9%	0.4%	0.9%	1.5%	1.9%

Unemployment (rate)

	2022	2023	2024	2025	2026
Central Scenario	5.4%	5.1%	4.7%	4.3%	4.2%
Upside Scenario	4.6%	4.3%	4.3%	4.0%	3.8%
Downside Scenario	5.8%	5.5%	5.1%	4.7%	4.6%
Severe Scenario	9.4%	11.5%	8.7%	5.8%	4.9%

Secured lending (annual change)

	2022	2023	2024	2025	2026
Central Scenario	4.4%	3.6%	3.1%	3.2%	3.3%
Upside Scenario	5.3%	4.8%	4.3%	3.8%	3.8%
Downside Scenario	3.3%	2.8%	2.9%	3.6%	3.9%
Severe Scenario	1.5%	(2.4)%	(1.0)%	1.3%	2.5%

Consumer credit (annual change)

	2022	2023	2024	2025	2026
Central Scenario	2.6%	4.4%	5.5%	6.1%	6.2%
Upside Scenario	4.3%	6.5%	7.3%	8.0%	8.3%
Downside Scenario	2.3%	2.0%	2.0%	2.0%	2.3%
Severe Scenario	0.6%	5.1%	1.2%	1.7%	4.0%

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

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

30 September 2022

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max	Min	Max	Min	Max	Min	Max	Min
	%	%	%	%	%	%	%	%
Economic driver								
GDP	**2.2**	**(0.3)**	**3.5**	**1.2**	**2.2**	**(2.7)**	**1.2**	**(5.0)**
HPI	**4.8**	**(4.5)**	**7.5**	**3.3**	**4.9**	**(13.1)**	**5.7**	**(17.8)**
BBR	**5.0**	**3.0**	**4.5**	**3.0**	**5.5**	**3.0**	**6.0**	**3.3**
CPI	**10.8**	**1.4**	**10.3**	**1.7**	**14.0**	**1.8**	**17.0**	**1.8**
Unemployment	**5.0**	**3.9**	**4.5**	**3.4**	**6.3**	**4.1**	**9.2**	**4.5**
Secured lending	**4.0**	**2.3**	**4.8**	**3.1**	**3.3**	**1.6**	**3.7**	**(1.2)**
Consumer credit	**5.0**	**2.5**	**5.8**	**3.3**	**4.3**	**1.8**	**4.8**	**(5.2)**

30 September 2021

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max	Min	Max	Min	Max	Min	Max	Min
	%	%	%	%	%	%	%	%
Economic driver								
GDP	11.5	1.1	13.3	1.6	7.3	0.9	14.3	(5.9)
HPI	6.1	(4.0)	7.7	0.6	2.9	(9.8)	2.4	(16.9)
BBR	0.8	0.1	1.0	0.1	0.5	0.1	0.2	(0.1)
CPI	4.0	1.8	3.8	1.8	4.5	1.8	2.0	0.2
Unemployment	5.5	4.1	4.7	3.8	5.9	4.5	11.9	4.8
Secured lending	4.8	3.0	5.5	3.5	4.0	2.5	3.1	(2.5)
Consumer credit	6.4	0.4	8.5	1.9	4.6	(0.1)	9.2	(8.9)

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.

	2022	2021 (Restated)
	£m	£m
Provision using central scenario 100% weighted		
Mortgage Lending	**29.1**	26.7
Commercial Lending	**24.2**	26.0
	53.3	52.7
Calculated impairment provision	**63.5**	65.4
Effect of multiple economic scenarios	**10.2**	12.7

24. Loan impairments – sensitivity analysis

The calculation of impairment provisions under IFRS 9 is subject to a variety of uncertainties arising from assumptions, forecasts and expectations about future events and conditions. To illustrate the impact of these uncertainties, sensitivity calculations have been performed for some of the most significant.

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

Economic conditions

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

Scenarios	**2022**		2021	
	Provision	**Difference**	Provision	Difference
	£m	**£m**	£m	£m
Central	**53.3**	**(10.2)**	52.7	(12.7)
Upside	**46.8**	**(16.7)**	47.1	(18.3)
Downside	**62.5**	**(1.0)**	68.1	2.7
Severe downside	**100.3**	**36.8**	106.1	40.7

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.

Scenario weightings

In order to illustrate the impact of scenario weightings on the outcomes, the impairment provision requirements were sensitised using alternative weightings. Sensitivity A is based on the weightings used at IFRS 9 transition on 1 October 2018. The use of the 2018 weighting is intended to represent a more settled outlook than has been evident at either of the two most recent year ends. Sensitivity B uses the weightings used at the previous year end and is included so that the impact of the change in weightings can be seen. Judgemental adjustments are assumed to remain constant in both cases.

The weightings used, and the results of applying these sensitivities to the 30 September 2022 scenarios are set out below.

	Weighting				**Impairment**	**Difference**
	Central	**Upside**	**Downside**	**Severe**	**£m**	**£m**
As reported	40%	10%	30%	20%	63.5	-
Sensitivity A	40%	30%	25%	5%	55.5	(8.0)
Sensitivity B	40%	10%	35%	15%	61.1	(2.4)

Significant increase in credit risk

The most important driver of SICR is relative PD. If all PDs across the Group's principal buy-to-let mortgage book were increased by 10%, loans with a gross value of £136.8m would transfer from Stage 1 to Stage 2 (2021: £99.0m), and the total provision would increase by £0.9m from the combined effects of higher PDs on expected losses and the impact of providing for expected lifetime losses, rather than 12-month losses on the additional Stage 2 cases (2021: £1.1m).

Value of security

The principal assumptions impacting on LGD are the estimated security values. If the rate of growth in house prices assumed by the model after the forecast minimum were halved, ignoring any PD effects, then the provision for the Group's first and second mortgage assets under the central scenario would increase by £2.7m (2021: £3.3m).

Receiver of rent

The majority of receiver of rent cases, which are included in Stage 3, are managed long-term and therefore their assumed realisation date has an important impact on the provision calculation. If the assumed rate of realisations was increased by 20%, the impairment provision in the central scenario would increase by £0.4m (2021: £0.6m).

25. Derivative financial instruments and hedge accounting

Introduction

The Group uses derivative financial instruments such as interest rate swaps for risk management purposes only. Each such derivative contract is entered into for economic hedging purposes to manage a particular identified risk (as described in notes 61 to 64) and any gains or losses arising are incidental to this objective. No trading in derivative financial instruments is undertaken.

Hedge accounting is applied where appropriate, though some derivatives, while forming part of an economic hedge relationship, do not qualify for this accounting treatment under the IAS 39 rules, particularly where the hedged risk relates to an off balance sheet item. In other cases, hedge accounting has not been adopted either because natural accounting offsets are expected or because complying with the IAS 39 hedge accounting rules would be particularly onerous.

The Group's hedging arrangements can be analysed for accounting purposes between:

- Fair value hedges of portfolio interest rate risk, which are used to manage the interest rate risk inherent in fixed rate lending and deposit taking
- Cash flow hedges, which were used in previous years to manage the foreign exchange and interest rate risk inherent in its currency borrowings. No such hedges were in place during the year

An economic hedge of the interest rate risk in fixed rate lending must also address pipeline exposures, where future lending at a given fixed rate is anticipated. However, such arrangements do not qualify as hedges for accounting purposes.

In addition, the Group utilises currency derivatives to hedge its exposure on the small amount of its lending denominated in foreign currencies. These are not treated as hedges for accounting purposes due to the low level of exposure.

The analysis below splits derivatives between those accounted for within portfolio fair value hedges and those which, despite representing an economic hedge, are not accounted for as hedges. There were no individual interest rate risk hedging arrangements in place either in the year ended 30 September 2022 or the preceding year.

	2022	**2022**	2021	2021
	Assets	**Liabilities**	Assets	Liabilities
	£m	**£m**	£m	£m
Derivatives in hedge accounting relationships				
Fair value hedges				
Interest rate swaps				
Fixed to floating	**652.7**	**-**	35.9	(35.8)
Floating to fixed	**0.3**	**(98.5)**	2.8	(5.9)
Total derivatives in hedge accounting relationships	**653.0**	**(98.5)**	38.7	(41.7)
Other derivatives				
Interest rate swaps	**125.5**	**(3.6)**	5.5	(2.0)
Currency futures	**0.5**	**-**	-	(0.2)
Total recognised derivative assets / (liabilities)	**779.0**	**(102.1)**	44.2	(43.9)

The credit risk inherent in the derivative financial assets shown above is discussed in note 61.

The balances held on the Group's balance sheet relating to the hedging of interest rate risk on its fixed rate customer loan and deposit balances are summarised below.

	Note	**2022**	2021
		£m	£m
Derivative financial instruments			
Assets		**779.0**	44.2
Liabilities		**(102.1)**	(43.9)
		676.9	0.3
Fair value hedging adjustments			
On loans to customers	*17*	**(559.9)**	5.5
On retail deposits	*32*	**99.7**	3.0
		(460.2)	8.5
Net balance sheet position		**216.7**	8.8
Collateral balances			
Posted (in sundry assets)	*26*	**-**	36.6
Received (in sundry liabilities)	*38*	**(388.6)**	(0.2)
		(388.6)	36.4

(a) Fair value hedges

Background and hedging objectives

The Group's fair value hedges of portfolios of interest rate risk ('macro hedges') arise from its management of the interest rate risk inherent in its fixed rate lending and deposit taking activities. These activities would expose the Group to movement in market interest rates if not hedged.

This position arises naturally where fixed rate loans are funded with floating or variable rate borrowings, as in the Group's securitisation transactions, but may also arise where retail deposit funding is used. Where possible the Group takes advantage of natural hedging between fixed rate assets and deposits, but it is unlikely that a precise match for value and tenor of the instruments could be achieved leaving unmatched items on both sides. This is referred to as repricing or duration risk and is controlled within limits under the Group's interest rate risk management process, described in note 63. In order to manage these exposures, they are hedged with financial derivatives and form part of the Group's portfolio hedging arrangements. Duration risk is monitored regularly to ensure mismatches or gaps remain within limits set by policy.

Responsibility to direct and oversee structural interest rate risk management has been delegated by the Board to the Executive Risk Committee ('ERC') and by ERC to the Asset and Liability Committee ('ALCO'). A hedging strategy is developed for each fixed product considering behavioural characteristics, such as whether a customer is likely to prepay before contractual maturity. This is reviewed from time to time with any changes agreed with ALCO.

In order to manage potential exposure to changes in interest rates between the point at which fixed rate products are priced and the advance date, it may be necessary to undertake hedging of assets in the pipeline. Interest rate swaps used to hedge pipeline loan exposures, which are not yet recognised on the balance sheet, can cause unmatched fair value costs or credits to arise until both sides of the hedge can be recognised within the interest rate portfolio hedging arrangement, generally a few months after the inception of the derivative contract.

In managing interest rate exposure, Treasury may use interest rate swaps, forward rate agreements, swaptions or interest rate caps and floors. However, interest rate swaps are the most generally used instruments.

This policy creates two macro hedges:

- The 'loan hedge' matching fixed rate buy-to-let mortgage assets, or other fixed rate assets, with interest rate swaps to convert the interest receivable to a floating rate
- The 'deposit hedge' matching fixed rate deposits with interest rate swaps which operates in the opposite direction, converting the fixed rate interest payable to floating rate amounts

During the year the Group completed the process of changing the principal sterling reference rate used in its interest rate risk management framework from LIBOR to SONIA, with all hedges which referenced LIBOR transitioned to a SONIA basis. However, for administrative purposes, the macro hedges continued to be divided into two sections, one including the transitioned swaps and the other those swaps which referenced SONIA at inception.

Through the year, as assets and deposits matured and were replaced by new business, the formally LIBOR-linked element of the hedges reduced, and the originally SONIA-linked element increased.

All interest rate hedging arrangements for new fixed rate assets or liabilities since 1 February 2020 have been executed with SONIA as a reference rate. In addition, hedging related to fixed rate assets funded in the most recent securitisation transactions, PM26, PM27 and PM28, where the funding rate is SONIA-linked, was also undertaken with reference to SONIA.

As part of an agreement reached with the noteholders of PM25, described in note 34, to transition that transaction to a SONIA-linked basis, all LIBOR-linked derivatives owned by that entity were transitioned to SONIA on an agreed basis by 15 February 2022, with the final reset of each falling in or before December 2021.

The remaining back book of swaps which referenced three-month LIBOR either ran off as the instruments reached maturity, or, where they had a maturity date after December 2021, transitioned to SONIA in accordance with the protocol issued by ISDA, the trade organisation for derivatives, at the point of LIBOR cessation.

During the year the Group has continued to hedge interest rate risk on fixed rate CBILS and BBLS exposures using SONIA-linked basis guarantee swaps, which are included in the loan hedge.

The designation of the four macro hedges is updated, on a month-by-month basis, using software which compares the overall tenor, value and rate positions to match the expected fair value movement of the swaps with the expected interest rate risk related movement in the fair value of the relevant assets or liabilities over the designation period as closely as possible. The software applies regression analysis techniques to the potential impact of changes in expected interest rates over the designation period to maximise expected hedge effectiveness on a prospective basis. The value of the portfolio of loans or deposits selected is then designated, as a monetary amount of interest rate risk, as the hedged item, while the portfolio of swaps selected are designated as the hedging instruments.

Any swaps not selected in this process are disclosed as derivatives not in hedging relationships. These will generally be swaps taken out to hedge the pipeline of fixed rate mortgage offers, which will match with the related loans when they complete.

At the end of each designation period the Group will assess the effectiveness of each hedge retrospectively, based on fair value movements (relating to interest rate risk components only) which have occurred in the period. Movements are compared to pre-determined test thresholds using regression techniques to determine whether the hedge was effective in the period.

Potential sources of ineffectiveness

The Group has identified the following possible sources of hedge ineffectiveness in its portfolio hedges of interest rate risk:

- The maturity profile of the hedging instruments may not exactly match that of the hedged items, particularly where hedged items settle early
- The use of derivatives as a hedge of interest rate risk additionally exposes the Group to the derivative counterparties' credit risk, which is not matched in the hedged item. This risk is minimised by transacting only with high quality counterparties and through collateralisation arrangements (as described in note 61)
- The use of different discounting curves in measuring fair value changes in the hedged items and hedging instruments
- Difference in the timing of interest payments on the hedged items and settlements on the hedging instruments

These sources of ineffectiveness are minimised by the portfolio matching process, which seeks to match the terms of the items as closely as possible.

In addition to the hedging ineffectiveness described above, group profit will also be affected by the fair value movements of interest rate swap agreements which were entered into as part of the Group's interest rate risk hedging strategy but failed to find a match in the hedging portfolio, particularly those relating to the lending pipeline.

Hedging Instruments

The hedging portfolios at 30 September 2022 and 30 September 2021 consist of a large number of sterling denominated swaps. In addition, there are a small number of Balance Guarantee Swaps ('BGS') in place at both dates. Settlement on all swaps is generally quarterly (monthly for BGS) where:

- One payment is calculated based on a fixed rate of interest and the nominal value of the swap
- An opposite payment is calculated based on the same nominal value but using a floating interest rate set at a fixed margin over a reference rate, LIBOR or SONIA (SONIA only at 30 September 2022)

On the BGS the nominal value of the swap is linked to the principal value of a pool of assets and reduces in line with redemptions and repayments until maturity. Other interest rate swaps have a fixed nominal value throughout their lives.

The Group pays fixed rate and receives floating when hedging exposures from fixed rate assets (in the loan hedge). Conversely, the Group pays floating rate and receives fixed rate when hedging fixed rate deposits, in the deposit hedge.

The principal terms of the hedging instruments are set out below, analysed between the two directions of the swap.

	2022		2021	
	Deposit Hedge	**Loan Hedge**	Deposit Hedge	Loan Hedge
Average fixed notional interest rate	**1.45%**	**0.99%**	0.16%	0.69%
Average notional margin over LIBOR	**N/A**	**N/A**	-	-
Average notional margin over SONIA	**-**	**-**	-	-
	£m	**£m**	£m	£m
Notional principal value				
LIBOR swaps	**-**	**-**	471.5	3,121.4
SONIA BGS	**-**	**47.0**	-	62.6
Other SONIA swaps	**4,286.0**	**6,853.1**	2,415.0	2,876.2
	4,286.0	**6,900.1**	2,886.5	6,060.2
Maturing				
Within one year	**3,097.0**	**1,369.9**	2,224.5	920.7
Between one and two years	**987.5**	**1,641.7**	422.0	1,712.7
Between two and five years	**201.5**	**3,886.0**	240.0	3,421.3
More than five years	**-**	**2.5**	-	5.5
	4,286.0	**6,900.1**	2,886.5	6,060.2
Fair value	**(98.2)**	**652.7**	(3.1)	0.1

The values included above for BGS are analysed by their contractual maturity dates although, due to the terms of the instruments, it is likely that the balance outstanding will reduce more quickly.

The increased levels of hedging shown above arise from the growth in both the loan and deposit books. The changes in fair value are a result of moves in market implied interest rates compared to the rates on the fixed legs of the swaps.

Accounting impacts

Movements affecting the portfolio fair value hedges during the year are set out below.

	2022		2021	
	Deposit hedge	**Loan hedge**	Deposit hedge	Loan hedge
	£m	**£m**	£m	£m
Hedging instruments				
Interest rate swaps				
Included in derivative financial assets	**0.3**	**652.7**	2.8	35.9
Included in derivative financial liabilities	**(98.5)**	**-**	(5.9)	(35.8)
	(98.2)	**652.7**	(3.1)	0.1
Notional principal value	**4,286.0**	**6,900.1**	2,886.5	6,060.2
Change in fair value used in calculating hedge ineffectiveness	**(94.8)**	**598.1**	(15.4)	128.6

	2022		2021	
	Deposit hedge	**Loan hedge**	Deposit hedge	Loan hedge
	£m	**£m**	£m	£m
Hedged items				
Fixed rate deposits				
Monetary amount of risk relating to Retail Deposits	**3,986.4**	**-**	2,730.4	-
Fixed rate loans				
Monetary amount of risk relating to Loans to Customers	**-**	**7,168.6**	-	6,120.7
Accumulated amount of fair value hedge adjustments included on balance sheet (notes 32 and 17)*	**99.7**	**(559.9)**	3.0	5.5
Of which: amounts related to discontinued hedging relationships being amortised	**(7.9)**	**73.4**	(1.7)	6.9
Change in fair value used in recognising hedge ineffectiveness	**106.4**	**(583.0)**	15.1	(122.0)
Hedge ineffectiveness recognised				
Included in fair value gains / (losses) in the profit and loss account (note 12)	**11.6**	**15.1**	(0.3)	6.6

*Under the IAS 39 rules relating to fair value hedge accounting for portfolios of interest rate risk, the change in the fair value of the hedged items attributable to the hedged risk is shown as 'fair value adjustments from portfolio hedging' next to the carrying value of the hedged assets or liabilities in the appropriate note.

The Accounts

(b) Cash flow hedging

Background and hedging objectives

The Group has historically entered into cross-currency basis swap agreements which formed part of certain of its securitisation arrangements, providing an economic hedge against financial risks inherent in the deal structures, as described below. The last of these arrangements terminated during the year ended 30 September 2021. These hedging relationships were designated as cash flow hedges for accounting purposes.

In any securitisation where asset backed floating rate notes ('FRNs') are issued in currency (US dollars or Euros ('EUR')), a currency and interest rate mismatch between assets and liabilities would exist, exposing the securitisation and the Group to both foreign exchange and interest basis risk.

This would preclude such a deal from attaining a AAA rating for its senior debt. To address that issue, in each deal a bespoke cross-currency basis swap was written, with the swap being an asset or liability of the relevant SPV company.

The effect of these swaps is to translate the required currency payments, both principal and interest to sterling payments, based on a fixed rate of exchange. They also translate the reference rate of interest on the notes from a dollar LIBOR or Euro Interbank Offered Rate ('EURIBOR') basis to a sterling LIBOR basis. This effectively eliminates the foreign exchange and interest rate basis risks with respect to these instruments.

In order to achieve a AAA rating for the deal, the swaps must themselves be capable of this level of rating. Therefore, the deal conditions specify that only high quality counterparties may be used, and that where there is a deterioration in credit quality of the counterparty, collateral must be posted. The collateral requirement is supervised by the independent third-party rating agencies.

Full details of these arrangements were set out in the Group Accounts for the year ended 30 September 2021, but are not reproduced in these accounts as no balance sheet items were carried in respect of them at either 30 September 2022 or 30 September 2021.

(c) Derivatives not in a hedge accounting relationship

The Group's other derivatives comprise:

- Interest rate swaps which are economically part of the Group's portfolio hedging arrangements but failed to find a match in the hedge designation, particularly including swaps hedging interest rate risk on the new lending pipeline
- Currency futures, economically hedging exposures on lending denominated in currency, where hedge accounting has not been adopted due to the size of the exposure

The principal terms of these derivatives are set out below.

Interest rate swaps

	2022		2021	
	Pay fixed	**Pay floating**	Pay fixed	Pay floating
Average fixed notional interest rate	**2.11%**	**4.31%**	0.49%	0.35%
Average notional margin over LIBOR	**N/A**	**N/A**	-	-
Average notional margin over SONIA	**-**	**-**	-	-
	£m	**£m**	£m	£m
Notional principal value				
LIBOR swaps	**-**	**-**	86.1	98.5
SONIA swaps	**1,578.1**	**377.1**	595.5	585.0
	1,578.1	**377.1**	681.6	683.5
Maturing				
Within one year	**351.6**	**288.0**	83.6	270.5
Between one and two years	**23.5**	**86.0**	85.5	331.0
Between two and five years	**542.5**	**3.1**	265.0	82.0
More than five years	**660.5**	**-**	247.5	-
	1,578.1	**377.1**	681.6	683.5
Fair value	**124.8**	**(2.9)**	4.2	(0.7)

Currency futures

	2022	2021
US dollar futures		
Average future exchange rate	**1.07**	1.36
	£m	**£m**
Notional principal value	**13.4**	11.9
Maturing		
Within one year	**13.4**	11.9
Between one and two years	**-**	-
Between two and five years	**-**	-
	13.4	11.9
Fair value	**0.5**	(0.2)

26. Sundry assets

(a) The Group

	Note	2022	2021	2020
		£m	£m	£m
Current assets				
Accrued interest income		**1.0**	-	0.1
Trade receivables		**1.9**	1.3	3.2
CSA assets		-	36.6	103.5
CRDs		**30.2**	23.7	15.1
Sovereign receivables		**0.3**	0.9	0.2
Other receivables		**2.0**	3.2	3.2
Sundry financial assets	*69*	**35.4**	65.7	125.3
Prepayments		**3.8**	3.5	2.7
Other tax		**-**	-	-
		39.2	69.2	128.0

Cash ratio deposits ('CRDs') are non-interest-bearing deposits lodged with the Bank of England, based on the value of the Bank's eligible liabilities. These are required to comply with regulatory rules.

CSA assets are deposits placed with highly rated banks to act as security for the Group's derivative financial liabilities.

Neither of these balances is accessible by the Group at the balance sheet date. Therefore, they are included in sundry assets rather than cash balances.

Sovereign receivables includes amounts receivable from the UK Government under the CBILS and BBLS schemes.

CRDs, CSA assets, sovereign receivables and accrued interest are considered to be Stage 1 assets for IFRS 9 impairment purposes. The probabilities of default of the obligor institutions (the UK Government, Bank of England and major banks) have been assessed and are considered to be so low as to require no significant impairment provision.

(b) The Company

	2022	2021	2020
	£m	£m	£m
Current assets			
Amounts owed by Group companies	**39.1**	73.0	84.0
Accrued interest income	**0.1**	0.1	0.6
	39.2	73.1	84.6

The amounts owed to the Company by other group entities are considered to be Stage 1 balances for IFRS 9 impairment purposes. The PD of the subsidiaries has been assessed in the context of the Group's overall funding and asset position, and is considered to be so low as to require no significant impairment provision.

27. Current tax assets / liabilities

Current tax in the Group and the Company represents UK corporation tax owed or recoverable.

28. Property, plant and equipment

(a) The Group

	Leased assets	Land and buildings	Plant and machinery	Total
	£m	£m	£m	£m
Cost				
At 30 September 2020	58.1	29.5	12.5	100.1
Additions	13.0	7.1	1.8	21.9
Disposals	(8.2)	(0.8)	(0.9)	(9.9)
At 30 September 2021	62.9	35.8	13.4	112.1
Additions	14.5	1.6	1.1	17.2
Disposals	(5.2)	(1.7)	(0.5)	(7.4)
At 30 September 2022	**72.2**	**35.7**	**14.0**	**121.9**
Accumulated depreciation				
At 30 September 2020	18.6	5.9	9.5	34.0
Charge for the year	8.9	2.7	1.6	13.2
On disposals	(3.9)	(0.8)	(0.8)	(5.5)
At 30 September 2021	23.6	7.8	10.3	41.7
Charge for the year	10.1	2.2	1.3	13.6
On disposals	(3.1)	(1.2)	(0.5)	(4.8)
At 30 September 2022	**30.6**	**8.8**	**11.1**	**50.5**
Net book value				
At 30 September 2022	**41.6**	**26.9**	**2.9**	**71.4**
At 30 September 2021	39.3	28.0	3.1	70.4
At 30 September 2020	39.5	23.6	3.0	66.1

Land and buildings and plant and machinery shown above are used within the Group's business. Leased assets includes £31.4m in respect of assets leased under operating leases (2021: £26.8m) and £10.2m of assets available for hire (2021: £12.5m).

The carrying values of right of use of assets, in respect of leases where the Group is the lessee, included in property, plant and equipment are set out below.

	Land and buildings	Plant and machinery	Total
	£m	£m	£m
Cost			
At 30 September 2020	6.0	1.2	7.2
Additions	6.1	0.9	7.0
Disposals	(0.6)	(0.6)	(1.2)
At 30 September 2021	11.5	1.5	13.0
Additions	1.0	0.4	1.4
Disposals	(0.9)	(0.1)	(1.0)
At 30 September 2022	**11.6**	**1.8**	**13.4**
Accumulated depreciation			
At 30 September 2020	1.4	0.5	1.9
Charge for the year	2.2	0.6	2.8
On disposals	(0.6)	(0.4)	(1.0)
At 30 September 2021	3.0	0.7	3.7
Charge for the year	1.6	0.5	2.1
On disposals	(0.9)	(0.1)	(1.0)
At 30 September 2022	**3.7**	**1.1**	**4.8**
Net book value			
At 30 September 2022	**7.9**	**0.7**	**8.6**
At 30 September 2021	8.5	0.8	9.3
At 30 September 2020	4.6	0.7	5.3

During the year ended 30 September 2018, the Group entered into a transaction with the Paragon Pension Plan, effectively granting a first charge over its freehold head office building as security for its agreed contributions under the recovery plan. The carrying value of the assets subject to this charge was £17.1m (2021: £17.4m).

(b) The Company

The property, plant and equipment balance of the Company represents a right of use asset in respect of a building leased from a fellow group entity. The carrying value of this asset is set out below.

	Land and buildings £m
Cost	
At 30 September 2020	18.8
Additions	-
Disposals	-
At 30 September 2021	18.8
Additions	-
Disposals	-
At 30 September 2022	**18.8**
Accumulated depreciation	
At 30 September 2020	1.4
Charge for the year	1.4
On disposals	-
At 30 September 2021	2.8
Charge for the year	1.4
On disposals	-
At 30 September 2022	**4.2**
Net book value	
At 30 September 2022	**14.6**
At 30 September 2021	16.0
At 30 September 2020	17.4

29. Intangible assets

	Goodwill (note 30)	Computer software	Other intangible assets	Total
	£m	£m	£m	£m
Cost				
At 30 September 2020	170.4	12.4	10.6	193.4
Additions	-	2.4	-	2.4
At 30 September 2021	170.4	14.8	10.6	195.8
Additions	-	1.7	-	1.7
At 30 September 2022	**170.4**	**16.5**	**10.6**	**197.5**
Accumulated amortisation and impairment				
At 30 September 2020	6.0	10.2	7.1	23.3
Amortisation charge for the year	-	1.2	0.8	2.0
At 30 September 2021	6.0	11.4	7.9	25.3
Amortisation charge for the year	-	1.2	0.8	2.0
At 30 September 2022	**6.0**	**12.6**	**8.7**	**27.3**
Net book value				
At 30 September 2022	**164.4**	**3.9**	**1.9**	**170.2**
At 30 September 2021	164.4	3.4	2.7	170.5
At 30 September 2020	164.4	2.2	3.5	170.1

Other intangible assets comprise brands and the benefit of business networks recognised on the acquisition of businesses.

30. Goodwill

The goodwill carried in the accounts is attributable to three cash generating units ('CGU's), which have not changed in the year. These balances are reviewed for impairment annually, in accordance with the requirements of IAS 36 – 'Impairment of Assets'. The balance is as analysed below:

	2022	2021
	£m	£m
CGU		
SME lending	**113.0**	113.0
Development finance	**49.8**	49.8
TBMC	**1.6**	1.6
	164.4	164.4

(a) SME lending

The goodwill carried in the accounts relating to the SME lending CGU was recognised on acquisitions in the years ended 30 September 2016 and 30 September 2018.

An impairment review undertaken at 30 September 2022 indicated that no write down was required.

The recoverable amount of the SME lending CGU used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board in November 2022 covering a five-year period.

The key assumptions underlying the value in use calculation for the SME lending CGU are:

- Level of business activity, based on management expectations. The forecast assumes a compound annual growth rate ('CAGR') for new lending over the five-year period of 10.56%, compared with 13.9% used in the calculation at 30 September 2021. The new lending forecasts are the key driver for the profit and cashflow forecasts. Cash flows beyond the five-year budget are extrapolated using a constant growth rate of 1.54% (2021: 1.6%) which does not exceed the long term average growth rates for the markets in which the business is active

  Management have concluded that the levels of activity assumed for the purpose of this forecast are reasonable, based on past experience and the current economic environment

- Discount rate, which is based on third party estimates of the implied industry cost of capital. The pre-tax discount rate applied to the cash flow projection is 14.8% (2021: 13.4%)

As an illustration of the sensitivity of this impairment test to movements in key assumptions, the Group has calculated that a 0% growth rate combined with a 7.5% reduction in profit levels would eliminate the projected headroom of £43.5m. While such movements are not expected by management, they are considered 'reasonably possible' for the purposes of IAS 36. A 0% growth rate combined with an 11.2% reduction in profit levels would generate a write down of £10.0m.

In the testing carried out at 30 September 2021, a 0% growth rate combined with a 15.0% reduction in profit levels and a 159 basis point increase in the pre-tax discount rate , which were considered 'reasonably possible' movements, would have eliminated the projected headroom at that date of £98.3m. A 0% growth rate combined with a 20.7% reduction in profit levels and a 125 basis point increase in the pre-tax discount rate would have generated a write down of £10.0m.

(b) Development finance

The goodwill carried in the accounts relating to the development finance CGU was first recognised on a business acquisition in the year ended 30 September 2018.

An impairment review undertaken at 30 September 2022 indicated that no write down was required.

The recoverable amount of the development finance CGU used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board in November 2022 covering a five-year period.

The key assumptions underlying the value in use calculation for the development finance CGU are:

- Level of business activity, based on management expectations. The forecast assumes a CAGR for drawdowns over the five-year period of 8.77%, compared with 13.2% used in the calculation at 30 September 2021. Cash flows beyond the five-year budget are extrapolated using a constant growth rate of 1.54% (2021: 1.6%) which does not exceed the long-term average growth rate for the UK economy

  Management have concluded that the levels of activity assumed for the purpose of this forecast are reasonable, based on past experience and the current economic environment

- Discount rate, which is based on third party estimates of the implied industry cost of capital. The pre-tax discount rate applied to the cash flow projection is 14.4% (2021: 13.2%)

Management believes any reasonably possible change in the key assumptions above would not cause the recoverable amount of the development finance CGU to fall below the balance sheet carrying value. This was also the case in the testing carried out at 30 September 2021.

(c) TBMC

The goodwill carried in the accounts relating to the TBMC CGU was recognised on an acquisition in December 2008 and impaired by £6.0m in 2009.

An impairment review was undertaken at 30 September 2022 which indicated no further impairment. The recoverable amount of the TBMC CGU used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board covering a five year period. The pre-tax discount rate applied to the cash flow projection is 7.64% (2021: 4.94%) and cash flows beyond the five year budget are extrapolated using a 1.75% (2021: 1.6%) growth rate, being the average long term growth rate in the UK economy over a twenty year period.

The key assumptions underlying the value in use calculation for the TBMC business are:

- Level of business activity, based on management expectations. Management have concluded that the levels of activity assumed for the purpose of this forecast are reasonable, based on past experience and the current economic environment

- Discount rate, which is based on market rates of interest plus a margin appropriate to the risk profile of the TBMC business as an investment.

The directors believe that no reasonably possible change in any of the key assumptions above would cause the recoverable value of the CGU to fall below its balance sheet carrying value. This was also the case at 30 September 2021.

31. Investment in subsidiary undertakings

	Shares in group companies	Loans to group companies	Loans to ESOP Trusts	Total
	£m	£m	£m	£m
At 30 September 2020	639.6	390.0	0.5	1,030.1
Capital distributions	(0.7)	-	-	(0.7)
Loans advanced	-	256.0	3.9	259.9
Loans repaid	-	(306.5)	-	(306.5)
Provision movements	(0.2)	-	(4.1)	(4.3)
At 30 September 2021	638.7	339.5	0.3	978.5
Capital distributions	-	-	-	-
Loans advanced	-	164.0	13.0	177.0
Loans repaid	-	(246.5)	-	(246.5)
Provision movements	-	-	(11.9)	(11.9)
At 30 September 2022	**638.7**	**257.0**	**1.4**	**897.1**

During the year ended 30 September 2021, the Group carried out capital reductions in various non-trading subsidiaries. Dividends were paid, or capital was distributed to the parent and the investments above were written off as a result of the reduction in these entities' net assets.

During the year ended 30 September 2022 the Company received £152.7m in dividend income from its subsidiaries (2021: £97.8m) and £12.0m of interest on loans to group companies (2021: £22.5m).

The Company's subsidiaries, and the nature of its interest in them, are shown in note 70.

32. Retail deposits

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

	2022	2021	2020
	£m	£m	£m
Fixed rate	**6,201.3**	5,466.0	4,975.9
Variable rates	**4,467.9**	3,834.4	2,880.7
	10,669.2	9,300.4	7,856.6

The weighted average interest rate on retail deposits at 30 September 2022, analysed by charging method, was:

	2022	2021	2020
	%	%	%
Fixed rate	**1.74**	1.25	1.69
Variable rates	**1.55**	0.42	0.72
All deposits	**1.66**	0.91	1.34

The contractual maturity of these deposits is analysed below.

	2022	2021	2020
	£m	£m	£m
Amounts repayable			
In less than three months	**929.0**	789.0	565.0
In more than three months, but not more than one year	**3,732.1**	3,105.4	2,725.6
In more than one year, but not more than two years	**1,627.3**	1,580.1	1,541.6
In more than two years, but not more than five years	**421.4**	507.4	664.8
Total term deposits	**6,709.8**	5,981.9	5,497.0
Repayable on demand	**3,959.4**	3,318.5	2,359.6
	10,669.2	9,300.4	7,856.6
Fair value adjustments for portfolio hedging (note 25)	**(99.7)**	(3.0)	10.4
	10,569.5	9,297.4	7,867.0

33. Asset backed loan notes

The Group's Notes are rated and publicly listed and are secured on portfolios comprising variable and fixed rate mortgages. The maturity date of the Notes matches the maturity date of the underlying assets. The Notes can be prepaid in part from time to time, but such prepayments are limited to the net capital received from borrowers in respect of the underlying assets. There is no requirement for the Group to make good any shortfall on the Notes out of general funds. It is likely that a substantial proportion of the Notes will be repaid within five years.

The Group also has an option to repay all the Notes on any issue at an earlier date (the 'call date'), at their outstanding principal amount.

During the year ended 30 September 2022 interest was payable at a fixed margin above:

- LIBOR on Notes issued by Paragon Mortgages (No. 25) PLC until LIBOR transition in December 2021
- The compounded Sterling Overnight Interbank Average Rate ('SONIA') on all other Notes

At 30 September 2021 all notes remaining in issue paid interest at rates referencing SONIA, other than those issued by Paragon Mortgages (No. 25) PLC, where LIBOR was used. An agreement for the transition of this arrangement to a SONIA basis during the current year was completed in the year ended 30 September 2021, and is described below.

In addition, during the year ended 30 September 2021 the Group had outstanding notes denominated in euros, on which interest was based on EURIBOR, and US dollars, on which interest was based on US dollar LIBOR. The last of these notes were paid down during that year.

All payments in respect of the Notes are required to be made in the currency in which they are denominated.

The Group publishes detailed information on the performance of all its note issues on the Bond Investor Reporting section of its website at www.paragonbankinggroup.co.uk. A more detailed description of the securitisation structure under which these Notes are issued is given in note 62.

Notes in issue at 30 September 2022 and 30 September 2021, net of any held by the Group, were:

Issuer	Maturity date	Call date	Principal outstanding		Average interest margin	
			2022	2021	**2022**	2021
Sterling notes			**£m**	£m	**%**	%
Interest based on LIBOR						
Paragon Mortgages (No. 25) PLC	15/05/50	15/05/23	**-**	338.9	**-**	0.73
Interest based on SONIA						
Paragon Mortgages (No. 25) PLC	15/05/50	15/05/23	**302.5**	-	**0.86**	-
Paragon Mortgages (No. 26) PLC	15/05/45	15/08/24	**107.9**	179.2	**1.05**	1.05
Paragon Mortgages (No. 27) PLC†	15/04/47	15/10/25	**-**	-	**-**	-
Paragon Mortgages (No. 28) PLC†	15/12/47	15/12/25	**-**	-	**-**	-

†All notes issued by Paragon Mortgages (No. 27) and Paragon Mortgages (No. 28) were retained by the Group (see note 62).

The details of the assets backing these securities are given in note 17.

On 25 August 2021 an agreement was reached with the senior noteholders of Paragon Mortgages (No. 25) PLC to transition to a SONIA-linked basis for interest charging, effective from the interest payment date on 15 February 2022. From that date the interest on these notes has been calculated by reference to SONIA rather than LIBOR and the note margins increased by 0.12% in line with the ISDA fallback adjustment rate. Other terms of the notes remain unchanged. The agreement also provided for the transition of hedging arrangements in the securitisation to a SONIA basis.

On 26 June 2019, the Group disposed of its beneficial interest in the Paragon Mortgages (No. 12) PLC securitisation. At that point, the FRN liabilities were derecognised by the Group, although the notes remain in issue. The Group's continuing involvement in the transaction is described in note 51.

34. Bank borrowings

New first mortgage loans may be financed by a secured bank loan, referred to as a 'warehouse facility'. The Group's warehouse facilities may also be used to acquire accounts from other group companies to be held on a temporary basis as part of the Group's overall management of funding and liquidity. Such internal transfers are on a no gain / no loss basis.

These facilities are drawn on the completion or acquisition of a mortgage and repayment of the facilities is restricted to the principal cash received in respect of the funded mortgages. Loans held in warehouse facilities are refinanced in the mortgage backed securitisation market when conditions are appropriate or through internal sales to access retail funding. More information on this process is given in note 62 and details of assets held within the warehouse facilities are given in note 17. Details of the Group's bank borrowings are set out below.

		2022			2021		
		Principal value	**Maximum available facility**	**Carrying value**	Principal value	Maximum available facility	Carrying value
		£m	**£m**	**£m**	£m	£m	£m
i)	Paragon Second Funding	**416.0**	**416.0**	**416.0**	529.0	529.0	529.0
ii)	Paragon Seventh Funding	**170.0**	**450.0**	**170.0**	201.0	400.0	201.0
		586.0	**866.0**	**586.0**	730.0	929.0	730.0

i) The Paragon Second Funding warehouse was available for further drawings until 29 February 2008 at which point it converted automatically to a term loan and no further drawings were allowed. This loan is a sterling facility provided to Paragon Second Funding Limited by a consortium of banks and is secured on all the assets of Paragon Second Funding Limited, Paragon Car Finance (1) Limited and Paragon Personal Finance (1) Limited. Its final repayment date is 28 February 2050, but it is likely that substantial repayments will be made within the next five years. Interest on this loan was payable monthly at 0.675% above LIBOR until 26 February 2021 and at 0.704% above SONIA thereafter.

ii) On 14 November 2018, a £200.0m warehouse funding facility was agreed between Paragon Seventh Funding Limited and Bank of America Merrill Lynch. The facility is secured over all the assets of Paragon Seventh Funding Limited, with a 12 month commitment period. This was renewed for 12 months on 24 October 2019 and was increased to £400.0m and renewed for a further 18 month commitment on 25 September 2020. Interest was payable at 0.95% over three month LIBOR up to 25 September 2020, 1.05% over three month LIBOR between that date and 25 March 2021 and 0.60% over three month LIBOR thereafter.

On 8 November 2021, revisions to the facility were agreed extending the commitment period for an initial 13-month period with the ability to extend monthly. The maximum drawing was increased to £450.0m and the interest rate payable was transitioned to 0.5% above SONIA. The facility will expire on 24 July 2023.

35. Retail bonds

On 11 February 2013 the Company inaugurated a £1,000.0m Euro Medium Term Note Programme under which it may issue retail bonds, or other notes, within a twelve-month period. The prospectus has been updated from time to time, most recently renewing the programme for a further twelve-month period on 15 July 2016, but may be further extended in the future.

The terms of issue for each tranche of notes are separately determined. These bonds are listed on the London Stock Exchange and have a fixed term, but are callable at the option of the Company in certain circumstances. A summary of the retail bonds outstanding under this programme, shown with their principal values, is set out below.

Maturity date	Interest terms	Issue price	Currency	2020	2019
				£m	£m
30 January 2022	6.125% p.a. fixed	par	GBP	-	125.0
28 August 2024	6.000% p.a. fixed	par	GBP	**112.5**	112.5
				112.5	237.5

The outstanding notes are rated BBB by Fitch Ratings.

The notes are unsubordinated unsecured liabilities of the Company and the amount included in the accounts of the Group and the Company in respect of these bonds is £112.3m (2021: £237.1m), none of which falls due within one year (2021: £125.0m).

36. Corporate bonds

On 25 March 2021 the Company issued £150.0m of Fixed Rate Callable Subordinated Tier-2 Notes due 2031 at par. These Notes bear interest at a rate of 4.375% per annum until 25 September 2026 after which interest will be payable at a reset rate which is 3.956% over that payable on UK Government bonds of similar duration at that time. These Notes are callable at the option of the Company between 25 June 2026 and 25 September 2026 and may be called at any time in the event of certain tax or regulatory changes. The Notes are unsecured and subordinated to all creditors of the Company. The Notes were originally rated BB+ by Fitch and are currently rated BBB-, following an upgrade on 7 March 2022. The proceeds of the Notes are utilised in accordance with the Group's Green Bond Framework, which is available on its investor website.

The carrying value of corporate bonds in the accounts of the Group and the Company at 30 September 2022 was £149.2m (2021: £149.0m).

37. Central bank facilities

During the year, the Group has utilised facilities provided by the Bank of England including through its Sterling Monetary Framework. These facilities enable either funding or off balance sheet liquidity to be provided to Paragon Bank PLC ('Paragon Bank' or 'the Bank') on the security of eligible collateral, currently in the form of designated pools of the Bank's first mortgage assets and/or the retained Notes described in note 62, with the amount available based on the value of the security given, subject, where appropriate, to a haircut.

Drawings under the Term Funding Scheme for SMEs ('TFSME') have a maturity of four years and bear interest at BBR. The average remaining maturity of the Group's drawings is 37 months (2021: 40 months). As these drawings were provided at rates below those available commercially, by a government agency, they are accounted for under IAS 20.

Drawings under the original Term Funding Scheme ('TFS') had a maturity of four years and bore interest at BBR. The average remaining maturity of the Group's drawings at 30 September 2021 was 4 months and all outstanding drawings were repaid in the year. As these drawings were provided at rates below those available commercially, by a government agency, they were accounted for under IAS 20. The TFS is no longer available for new drawings.

Drawings under the Indexed Long-Term Repo Scheme ('ILTR') have a maturity of six months and a rate of interest set in an auction process. The Group accessed the ILTR during the year, and it retains access to this programme for liquidity purposes.

The amounts drawn under these facilities are set out below.

	2022	2021
	£m	£m
TFSME	**2,750.0**	2,750.0
TFS	**-**	69.0
ILTR	**-**	-
Total central bank facilities	**2,750.0**	2,819.0

All TFSME borrowings fall due after more than one year. At 30 September 2021 £69.0 million of TFS borrowings were due within one year.

During the year all TFSME borrowings were repaid and redrawn, extending the maturity date to 21 October 2025 for the majority of drawings, with £5.2m falling due on 31 March 2027.

Further first mortgage assets of the Bank have been pre-positioned with the Bank of England for future use in such schemes and eligible retained Notes can also be used to support this funding (note 62). The mortgage assets pledged in support of these drawings are set out in note 17.

The balances arising from the TFSME and TFS carried in the Group accounts are shown below.

	2022	**2022**	2021	2021
	£m	**£m**	£m	£m
TFSME at IAS 20 carrying value	**2,700.2**		2,657.8	
Deferred government assistance	**49.8**		92.2	
		2,750.0		2,750.0
TFS at IAS 20 carrying value	**-**		68.7	
Deferred government assistance	**-**		0.3	
		-		69.0
		2,750.0		2,819.0

38. Sundry liabilities

(a) The Group

	2022	2021	2020
	£m	£m	£m
Current liabilities			
Accrued interest	**42.2**	22.2	29.2
Trade creditors	**0.7**	1.4	1.6
CSA liabilities	**388.6**	0.2	-
Purchase of own shares (note 45)	**10.8**	-	-
Other accruals	**35.9**	32.9	29.5
Sundry financial liabilities at amortised cost	**478.2**	56.7	60.3
Contingent consideration (note 39)	**2.2**	4.6	3.2
Sundry financial liabilities	**480.4**	61.3	63.5
Lease payables (note 40)	**2.2**	1.5	1.5
Deferred income	**3.7**	3.3	1.0
Conduct (note 41)	**-**	-	-
Other taxation and social security	**3.7**	2.5	3.3
	490.0	68.6	69.3
Non-current liabilities			
Accrued interest	**13.0**	9.5	14.3
Other accruals	**-**	-	-
Sundry financial liabilities at amortised cost	**13.0**	9.5	14.3
Contingent consideration (note 39)	-	2.9	10.3
Sundry financial liabilities	**13.0**	12.4	24.6
Lease payables (note 40)	**6.8**	8.0	4.1
Deferred income	**3.3**	1.7	2.0
	23.1	22.1	30.7
Total sundry financial liabilities at amortised cost	**491.2**	66.2	74.6
Total sundry financial liabilities at fair value	**2.2**	7.5	13.5
Total other sundry liabilities	**19.7**	17.0	11.9
Total sundry liabilities	**513.1**	90.7	100.0

CSA liabilities represent collateral received in respect of interest rate swap agreements and are described further in notes 25 and 61.

(b) The Company

	2022	2021	2020
	£m	£m	£m
Current liabilities			
Amounts owed to Group companies	**23.2**	22.6	22.7
Accrued interest	**0.7**	2.0	2.9
Purchase of own shares (note 45)	**10.8**	-	-
Other financial liabilities	**1.4**	1.0	-
Sundry financial liabilities at amortised cost	**36.1**	25.6	25.6
Lease payables (note 40)	**1.3**	1.3	1.2
	37.4	26.9	26.8
Non-current liabilities			
Lease payables (note 40)	**13.7**	15.0	16.3
Total sundry liabilities	**51.1**	41.9	43.1

39. Contingent consideration

The contingent consideration represents consideration payable in respect of corporate acquisitions which is dependent on the performance of the acquired businesses. Movements in the balance are set out below.

	2022	2021
	£m	£m
At 1 October 2021	7.5	13.5
Payments	(4.6)	(2.5)
Revaluation	(0.8)	(3.8)
Unwind of discounting (note 5)	0.1	0.3
At 30 September 2022 (note 38)	2.2	7.5

The write downs above are the result of the reconsideration of future business volumes following the impact of Covid, and the impact of the speed of post-Covid recovery on the contingent consideration calculation.

40. Lease payables

The Group's lease liabilities arise under the leasing arrangements described in note 52. Related right of use assets are shown in note 28.

	The Group		The Company	
	2022	2021	2022	2021
	£m	£m	£m	£m
Leasing liabilities falling due:				
In more than five years	1.1	2.3	8.2	9.6
In more than two but less than five years	3.8	3.8	4.2	4.1
In more than one year but less than two years	1.9	1.9	1.3	1.3
In more than one year (note 38)	6.8	8.0	13.7	15.0
In less than one year (note 38)	2.2	1.5	1.3	1.3
	9.0	9.5	15.0	16.3

41. Conduct

The Group, as a participant in the financial services industry, is exposed to a high level of regulatory supervision, which could in the event of conduct failures expose it to financial liabilities. The Group maintains a strong compliance and conduct framework, supervised by the second line compliance function, to mitigate the risk, although it is impossible to eliminate it entirely.

The regulatory environment continues to develop, through regulatory policies, legislative rules and court rulings, and while the Group's assessment is that it currently has no further potential liability for conduct issues, this is based on our current interpretation of requirements and hence further liabilities may arise as these develop over time.

42. Deferred tax

(a) The Group

The net deferred tax liability / (asset) for which provision has been made and the movements in that balance are analysed as follows:

	Opening Balance	Profit and loss Charge / (credit)		Charge / (credit) to equity	Closing balance
		Current	Prior		
	£m	£m	£m	£m	£m
Year ended 30 September 2022					
Accelerated tax depreciation	**(5.9)**	**(2.9)**	**1.9**	**-**	**(6.9)**
Retirement benefit obligations	**(4.4)**	**1.3**	**-**	**3.6**	**0.5**
Interest rate hedging	**(2.2)**	**55.4**	**-**	**-**	**53.2**
Loans and other derivatives	**2.9**	**(0.6)**	**(0.1)**	**-**	**2.2**
Share based payments	**(5.2)**	**0.2**	**(0.5)**	**1.8**	**(3.7)**
Tax losses	**(0.4)**	**0.4**	**(0.1)**	**-**	**(0.1)**
Other timing differences	**0.8**	**(0.3)**	**(1.3)**	**-**	**(0.8)**
Total	**(14.4)**	**53.5**	**(0.1)**	**5.4**	**44.4**
Year ended 30 September 2021					
Accelerated tax depreciation	(2.9)	(2.1)	(0.9)	-	(5.9)
Retirement benefit obligations	(6.7)	1.3	0.1	0.9	(4.4)
Interest rate hedging	0.2	(2.3)	(0.1)	-	(2.2)
Loans and other derivatives	5.0	(1.8)	0.1	(0.4)	2.9
Share based payments	(1.7)	(1.5)	(0.2)	(1.8)	(5.2)
Tax losses	(1.3)	0.9	-	-	(0.4)
Other timing differences	1.2	(0.4)	-	-	0.8
	(6.2)	(5.9)	(1.0)	(1.3)	(14.4)

Balances in respect of interest rate hedging in the table above relate to derivatives hedging interest rate risk in the Group's loan and deposit books and related pipelines, and fair value accounting adjustments.

The temporary differences shown above have been provided at the rate prevailing when the Group anticipates these temporary differences to reverse. In the event that the temporary differences actually reverse in different periods a credit or charge will arise in a future period to reflect the difference. The timing of reversal of temporary differences will be affected by both matters within the Group's control (e.g. the timing and nature of the refinancing of certain portfolios) and matters outside the Group's control (eg the timing of the Group's contributions to the defined benefit pension scheme).

If temporary differences reverse within Paragon Bank PLC in a period in which it is subject to the banking surcharge, then the impact of the reversal will be at an effective tax rate that includes the banking surcharge to some extent.

In addition to the temporary differences, the Group has tax losses of £3.0m (2021: £4.0m) in entities whose current taxable profits are insufficient to support the recognition of a deferred tax asset.

(b) The Company

The net deferred tax liability for which provision has been made, and the movements in that balance are analysed as follows:

	Opening Balance	Profit and loss Charge / (credit)		Charge / (credit) to equity	Closing balance
		Current	Prior		
	£m	£m	£m	£m	£m
Year ended 30 September 2022					
Accelerated tax depreciation	**-**	**0.1**	**-**	**-**	**0.1**
Other timing differences	**1.8**	**-**	**(1.8)**	**-**	**-**
Total	**1.8**	**0.1**	**(1.8)**	**-**	**0.1**
Year ended 30 September 2021					
Accelerated tax depreciation	-	-	-	-	-
Other timing differences	1.8	-	-	-	1.8
	1.8	-	-	-	1.8

43. Called-up share capital

The share capital of the Company consists of a single class of £1 ordinary shares.

Movements in the issued share capital in the year were:

	2022	2021
	Number	Number
Ordinary shares		
At 1 October 2021	**262,495,185**	261,777,972
Shares issued	**386,039**	717,213
Shares cancelled	**(21,471,600)**	-
At 30 September 2022	**241,409,624**	262,495,185

During the year, the Company issued 386,039 shares (2021: 717,213) to satisfy options granted under Sharesave schemes for a consideration of £1,309,525 (2021: £2,196,934).

On 24 November 2021, 12,100,834 shares, held in treasury at 30 September 2021, were cancelled. On 8 September 2022 a further 9,370,766 shares, purchased into treasury during the year were also cancelled.

44. Reserves

(a) The Group

	2022	2021	2020
	£m	£m	£m
Share premium account	**71.1**	70.1	68.7
Capital redemption reserve	**71.8**	50.3	50.3
Merger reserve	**(70.2)**	(70.2)	(70.2)
Cash flow hedging reserve (note 25)	**-**	-	2.5
Profit and loss account	**1,151.2**	1,005.9	880.7
	1,223.9	1,056.1	932.0

(b) The Company

	2022	2021	2020
	£m	£m	£m
Share premium account	**71.1**	70.1	68.7
Capital redemption reserve	**71.8**	50.3	50.3
Merger reserve	**(23.7)**	(23.7)	(23.7)
Profit and loss account	**326.3**	358.9	319.1
	445.5	455.6	414.4

The share premium account and capital redemption reserve are non-distributable reserves which are required by, and operate under the provisions of, UK company law.

The merger reserve arose, due to the provisions of UK company law at the time, on a group restructuring on 12 May 1989 when the Company became the parent entity of the Group.

45. Own shares

	The Group		The Company	
	2022	2021	2022	2021
	£m	£m	£m	£m
Treasury shares				
At 1 October 2021	**60.7**	23.0	**60.7**	23.0
Shares purchased	**66.9**	37.7	**66.9**	37.7
Shares cancelled	**(109.4)**	-	**(109.4)**	-
At 30 September 2022	**18.2**	60.7	**18.2**	60.7
ESOP shares				
At 1 October 2021	**16.0**	14.8	**-**	-
Shares purchased	**12.6**	4.5	**-**	-
Options exercised	**(9.6)**	(3.3)	**-**	-
At 30 September 2022	**19.0**	16.0	**-**	-
Irrevocable authority to purchase				
At 1 October 2021	**-**	-	**-**	-
Given in year	**10.8**	-	**10.8**	-
Expiring / utilised in year	**-**	-	**-**	-
At 30 September 2022	**10.8**	-	**10.8**	-
Balance at 30 September 2022	**48.0**	76.7	**29.0**	60.7
Balance at 1 October 2021	**76.7**	37.8	**60.7**	23.0

At 30 September 2022 the number of the Company's own shares held in treasury was 3,640,519 (2021: 12,100,834). These shares had a nominal value of £3,640,519 (2021: £12,100,834). These shares do not qualify for dividends.

At 30 September 2022 an irrevocable instruction for the purchase of a further £10.8m of shares to be held in treasury was in place. This instruction was completed on 7 November 2022, before the approval date of these financial statements.

The ESOP shares are held in trust for the benefit of employees exercising their options under the Company's share option schemes and awards under the Paragon PSP and Deferred Share Bonus Plan. The trustees' costs are included in the operating expenses of the Group.

At 30 September 2022, the trust held 3,879,160 ordinary shares (2021: 3,732,324) with a nominal value of £3,879,160 (2021: £3,732,324) and a market value of £15,314,924 (2021: £20,359,827). Options, or other share-based awards, were outstanding against all of these shares at 30 September 2022 (2021: all). The dividends on all these shares have been waived (2021: all).

46. Equity dividend

Amounts recognised as distributions to equity shareholders in the Group and the Company in the period:

	2022	2021	**2022**	2021
	Per share	Per share	**£m**	£m
Equity dividends on ordinary shares				
Final dividend for the previous year	**18.9p**	14.4p	**46.6**	36.5
Interim dividend for the current year	**9.4p**	7.2p	**22.3**	18.1
	28.3p	21.6p	**68.9**	54.6

Amounts paid and proposed in respect of the year:

	2022	2021	**2022**	2021
	Per share	Per share	**£m**	£m
Interim dividend for the current year	**9.4p**	7.2p	**22.3**	18.1
Proposed final dividend for the current year	**19.2p**	18.9p	**44.9**	46.6
	28.6p	26.1p	**67.2**	64.7

The proposed final dividend for the year ended 30 September 2022 will be paid on 3 March 2023, subject to approval at the AGM, with a record date of 3 February 2023. The dividend will be recognised in the accounts when it is paid.

47. Net cash flow from operating activities

(a) The Group

	2022	2021
	£m	£m
Profit before tax	**417.9**	213.7
Non-cash items included in profit and other adjustments:		
Depreciation of operating property, plant and equipment	**3.5**	4.3
Profit on disposal of operating property, plant and equipment	**(0.1)**	0.1
Amortisation of intangible assets	**2.0**	2.0
Movements related to asset backed loan notes denominated in currency	**-**	(442.3)
Other non-cash movements on borrowings	**1.9**	2.5
Impairment losses on loans to customers	**14.0**	(4.7)
Charge for share based remuneration	**9.2**	8.9
Net (increase) / decrease in operating assets:		
Assets held for leasing	**(2.3)**	0.2
Loans to customers	**(821.6)**	(766.6)
Derivative financial instruments	**(734.8)**	419.1
Fair value of portfolio hedges	**565.4**	104.2
Other receivables	**22.9**	58.8
Net increase / (decrease) in operating liabilities:		
Retail deposits	**1,368.8**	1,443.8
Derivative financial instruments	**58.2**	(88.5)
Fair value of portfolio hedges	**(96.7)**	(13.4)
Other liabilities	**416.9**	(15.7)
Cash generated by operations	**1,225.2**	926.4
Income taxes (paid)	**(56.5)**	(48.3)
	1,168.7	878.1

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

(b) The Company

	2022	2021
	£m	£m
Profit before tax	**133.6**	84.0
Non-cash items included in profit and other adjustments:		
Depreciation on property, plant and equipment	**1.4**	1.4
Non-cash movements on borrowings	**0.4**	4.3
Impairment provision / (release) on investments in subsidiaries	**11.9**	4.3
Charge for share based remuneration	**9.2**	8.9
Net decrease in operating assets:		
Other receivables	**33.9**	11.5
Net (decrease) in operating liabilities:		
Other liabilities	**(0.3)**	-
Cash generated by operations	**190.1**	114.4
Income taxes received	**1.2**	1.5
	191.3	115.9

48. Net cash flow from investing activities

	The Group		The Company	
	2022	2021	**2022**	2021
	£m	£m	**£m**	£m
Proceeds from sales of operating property, plant and equipment	**0.6**	-	**-**	-
Purchases of operating property, plant and equipment	**(1.3)**	(1.9)	**-**	-
Purchases of intangible assets	**(1.7)**	(2.4)	**-**	-
Advances of loans to subsidiary undertakings	**-**	-	**(177.0)**	(259.9)
Repayment of loans by subsidiary entities	**-**	-	**246.5**	307.2
Net cash (utilised) / generated by investing activities	**(2.4)**	(4.3)	**69.5**	47.3

The presentation of cashflows related to loans to group companies has been revised to correspond to that used in note 31 and the comparative amounts shown for 2021 reanalysed accordingly.

49. Net cash flow from financing activities

	The Group		The Company	
	2022	2021	**2022**	2021
	£m	£m	**£m**	£m
Shares issued (note 43)	**1.4**	2.1	**1.4**	2.1
Dividends paid (note 46)	**(68.9)**	(54.6)	**(68.9)**	(54.6)
Issue of Tier-2 bond	**-**	148.9	**-**	148.9
Repayment of asset backed floating rate notes	**(107.6)**	(2,313.1)	**-**	-
Repayment of Tier-2 bond	**-**	(153.7)	**-**	(153.7)
Repayment of retail bond	**(125.0)**	(60.0)	**(125.0)**	(60.0)
Movement on central bank facilities	**(69.0)**	964.6	**-**	-
Movement on other bank facilities	**(144.6)**	71.9	**-**	-
Capital element of lease payments	**(1.7)**	(2.5)	**(1.3)**	(1.2)
Purchase of shares (note 45)	**(79.5)**	(42.2)	**(66.9)**	(37.7)
Exercise of share awards	**(0.7)**	-	**-**	-
Net cash (utilised) by financing activities	**(595.6)**	(1,438.6)	**(260.7)**	(156.2)

50. Reconciliation of net debt

(a) The Group

		Cash flows		Non-cash movements			
	Opening debt	Debt issued	Other	Recognition	Currency loan notes	Other	Closing debt
	£m	£m	£m	£m	£m	£m	£m
30 September 2022							
Asset backed loan notes	**516.0**	-	**(107.6)**	-	-	**0.9**	**409.3**
Bank borrowings	**730.0**	-	**(144.6)**	-	-	**0.6**	**586.0**
Corporate bonds	**149.0**	-	-	-	-	**0.2**	**149.2**
Retail bonds	**237.1**	-	**(125.0)**	-	-	**0.2**	**112.3**
Central bank borrowings	**2,819.0**	-	**(69.0)**	-	-	-	**2,750.0**
Lease liabilities	**9.5**	-	**(1.7)**	-	-	**1.2**	**9.0**
Bank overdrafts	**0.3**	-	**0.1**	-	-	-	**0.4**
Gross debt	**4,460.9**	-	**(447.8)**	-	-	**3.1**	**4,016.2**
Cash	**(1,360.1)**	-	**(570.8)**	-	-	-	**(1,930.9)**
Net debt	**3,100.8**	-	**(1,018.6)**	-	-	**3.1**	**2,085.3**
30 September 2021							
Asset backed loan notes	3,270.5	-	(2,313.1)	-	(442.3)	0.9	516.0
Bank borrowings	657.8	-	71.9	-	-	0.3	730.0
Corporate bonds	149.8	148.9	(153.7)	-	-	4.0	149.0
Retail bonds	296.8	-	(60.0)	-	-	0.3	237.1
Central bank borrowings	1,854.4	-	964.6	-	-	-	2,819.0
Lease liabilities	5.6	-	(2.5)	-	-	6.4	9.5
Bank overdrafts	0.4	-	(0.1)	-	-	-	0.3
Gross debt	6,235.3	148.9	(1,492.9)	-	(442.3)	11.9	4,460.9
Cash	(1,925.0)	(148.9)	713.8	-	-	-	(1,360.1)
Net debt	4,310.3	-	(779.1)	-	(442.3)	11.9	3,100.8

Other cash movements for the year ended 30 September 2021 relating to currency loan notes shown above relate to the settlement and translation of asset backed loan notes denominated in US dollars and euros (note 33), which are cashflow hedged under the arrangements described in note 25(b). The effect of these borrowings is described further in note 63. None of these notes remained outstanding at 30 September 2021.

Other non-cash changes shown above represent:

- EIR adjustments relating to the spreading of initial costs of the facilities concerned
- Premiums on redemptions of corporate bonds
- Inception of new lease assets under IFRS 16

(b) The Company

		Cash flows			
	Opening debt	Debt issued	Other	Non-cash movements	Closing debt
	£m	£m	£m	£m	£m
30 September 2022					
Corporate bonds	**149.0**	-	-	**0.2**	**149.2**
Retail bonds	**237.1**	-	**(125.0)**	**0.2**	**112.3**
Lease liabilities	**16.3**	-	**(1.3)**	-	**15.0**
Gross debt	**402.4**	-	**(126.3)**	**0.4**	**276.5**
Cash	**(19.6)**	-	**(0.1)**	-	**(19.7)**
Net debt	**382.8**	-	**(126.4)**	**0.4**	**256.8**
30 September 2021					
Corporate bonds	149.8	148.9	(153.7)	4.0	149.0
Retail bonds	296.8	-	(60.0)	0.3	237.1
Lease liabilities	17.5	-	(1.2)	-	16.3
Gross debt	464.1	148.9	(214.9)	4.3	402.4
Cash	(12.6)	(148.9)	141.9	-	(19.6)
Net debt	451.5	-	(73.0)	4.3	382.8

Non-cash changes shown above represent EIR adjustments relating to the spreading of initial costs of the bonds and premium paid on redemption.

51. Unconsolidated structured entities

Following the Group's disposal of its residual interest in the Paragon Mortgages (No. 12) PLC securitisation in June 2019, it ceased to consolidate the assets and liabilities of the entity. The external securitisation borrowings remain in place with their terms unchanged and the Group continues to act as administrator, for which it charges a fee. It has no other exposure to the profitability of the deal, no exposure to credit risk, other than on the recoverability of its quarterly fee, and no obligation to make further contribution to the entity.

Fee income from servicing arrangements of £1.4m is included in third party servicing fees (note 8) (2021: £1.6m) and £0.2m is included in other debtors in respect of unpaid fees at the year end (2021: £0.3m). Outstanding collection monies due to the structured entity of £0.1m are included in other creditors at 30 September 2022 (2021: £0.3m).

52. Leasing arrangements

(a) As Lessor

The Group, through its motor finance and asset finance businesses, leases assets under both finance and operating leases. In respect of certain of these assets, the Group also provides maintenance services to the lessee.

Disclosures in respect of these balances are set out in these financial statements as follows

Disclosure	Note
Investment in finance leases	18
Finance income on net investment in finance leases	4
Assets leased under operating leases	28
Operating lease income	6

The undiscounted future minimum lease payments receivable by the Group under operating lease arrangements may be analysed as follows:

	2022	2021
	£m	£m
Amounts falling due:		
Within one year	**14.0**	11.4
Within one to two years	**8.1**	6.8
Within two to three years	**5.8**	4.8
Within three to four years	**3.6**	3.3
Within four to five years	**1.7**	1.9
After more than five years	**0.8**	1.0
	34.0	29.2

(b) As Lessee

The Group's use of leases as a lessee relates to the rental of office buildings and company cars. Under IFRS 16 these have been accounted for as right of use assets and corresponding lease liabilities.

The average term of the current building leases from inception or acquisition is 8 years (2021: 9 years) with rents subject to review every five years, while the average term of the vehicle leases is 3 years (2021: 3 years).

The Company's use of leases as lessee is limited to the rental of an office building from a subsidiary entity. The lease term from inception is 15 years.

Disclosures relating to these leases are set out in these financial statements as follows.

Disclosure	Note
Depreciation on right of use assets	28
Interest expense on lease liabilities	5
Expense relating to short-term leases	9
Additions to right of use assets	28
Carrying amount of right of use assets	28
Maturity analysis of lease liabilities	62

There was no subleasing of any right of use asset and the total cash flows relating to leasing as a lessee were £1.9m (2021: £2.0m).

53. Related party transactions

(a) The Group

During the year, certain directors of the Group were beneficially interested in savings deposits made with Paragon Bank, on the same terms as were available to members of the public. Deposits of £779,000 were outstanding at the year-end (2021: £16,000), and the maximum amounts outstanding during the year totalled £793,000 (2021: £301,000).

The Paragon Pension Plan (the 'Plan') is a related party of the Group. Transactions with the Plan are described in note 58.

The Group had no other transactions with related parties other than the key management compensation disclosed in note 56.

(b) The Company

During the year, the parent company entered into transactions with its subsidiaries, which are related parties. Management services were provided to the Company by one of its subsidiaries and the Company granted awards to employees of subsidiary undertakings under the share based payment arrangements described in note 57.

Details of the Company's investments in subsidiaries and the income derived from them are shown in notes 31 and 70.

Outstanding current account balances with subsidiaries are shown in notes 26 and 38.

During the year the Company incurred interest costs of £1.0m in respect of borrowings from its subsidiaries (2021: £0.8m).

The Company leased an office building from a subsidiary entity (note 52(b)). Finance charges recognised in respect of this lease were £0.4m (2021: £0.5m).

54. Country-by-country reporting

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 came into effect on 1 January 2014 and place certain reporting obligations on financial institutions that are within the scope of CRD IV. The objective of the country-by-country reporting requirements is to provide increased transparency regarding the source of the financial institution's income and the locations of its operations.

Paragon Banking Group PLC is a UK registered entity. Details of its subsidiaries are given in note 70 and the activities of the Group are described in Section A2.

The activities of the Group, described as required by the Regulations for the year ended 30 September 2022 were:

	United Kingdom £m
Year ended 30 September 2022	
Total operating income	**393.0**
Profit before tax	**417.9**
Corporation tax paid	**56.5**
Public subsidies received	-
Average number of full time equivalent employees	**1,397**

	United Kingdom £m
Year ended 30 September 2021	
Total operating income	324.9
Profit before tax	213.7
Corporation tax paid	48.3
Public subsidies received	-
Average number of full time equivalent employees	1,327

The Group's participation in Bank of England funding schemes is set out in note 37.

D2.2 Notes to the Accounts - Employment costs

For the year ended 30 September 2022

The notes set out below give information on the Group's employment costs, including the disclosures on share based payments and pension schemes required by accounting standards.

55. Employees

The average number of persons (including directors) employed by the Group during the year was 1,498 (2021: 1,426). The number of employees at the end of the year was 1,503 (2021: 1,441).

Costs incurred during the year in respect of these employees were:

	2022	**2022**	2021	2021
	£m	**£m**	£m	£m
Share based remuneration	**9.2**		8.9	
Other wages and salaries	**81.9**		65.1	
Total wages and salaries		**91.1**		74.0
National Insurance on share based remuneration	**0.5**		2.4	
Other social security costs	**9.7**		8.3	
Total social security costs		**10.2**		10.7
Defined benefit pension cost	**0.9**		1.8	
Other pension costs	**4.1**		3.7	
Total pension costs		**5.0**		5.5
Total employment costs		**106.3**		90.2
Of which				
Included in operating expenses (note 9)		**103.6**		87.9
Included in maintenance costs (note 6)		**2.7**		2.3
		106.3		90.2

The charge in respect of National Insurance on share based costs is partly a function of movements in the Group's share price. The reduction in the current year is generated by a year-on-year fall in the share price and a reduction in the rate at which National Insurance is expected to be charged.

Details of the pension schemes operated by the Group are given in note 58.

The Company has no employees. Details of the directors' remuneration are given in note 56.

56. Key management remuneration

Key Management

As part of the ongoing development of its governance framework, the Group has revised its definition of key management personnel of the Group and the Company, as defined by IAS24 – Related Party Transactions', to include members of its Executive Committee as well as members of the Board of Directors of the Company.

The details of key management remuneration required by IAS 24 are set out below. Disclosures for the year ended 30 September 2021 are provided in accordance with the new definition for ease of comparison.

	2022	**2022**	2021 *(Revised definition)*	2021 *(Revised definition)*
	£m	**£m**	£m	£m
Salaries and fees	**4.4**		4.2	
Cash amount of bonus	**3.1**		2.4	
Social security costs	**1.1**		0.9	
Short-term employee benefits		**8.6**		7.5
Post-employment benefits		**0.6**		0.5
IFRS 2 cost in respect of key management	**4.0**		2.8	
National Insurance thereon	**1.0**		0.5	
Share based payment		**5.0**		3.3
		14.2		11.3

Post-employment benefits shown above include pension allowances, contributions to defined contribution pension schemes or costs of accrual under the Group's defined benefit pension plan.

Social security costs paid in respect of key management are required to be included in this note by IAS 24, but do not fall within the scope of the disclosures in the Annual Report on Remuneration.

Costs in respect of share awards shown in the Annual Report on Remuneration are determined on a different basis to the IFRS 2 charge shown above.

Directors

The information in respect of the remuneration of the directors of the Company required to be disclosed in the notes to the Company's accounts by Schedule 5 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, as applicable to quoted companies, is set out below.

	2022	2021
	£m	£m
Aggregate amount of remuneration	**3.5**	2.7
Pension allowances	**0.2**	0.2
Gains on exercise of share options	**5.6**	0.1

In the table above remuneration includes the cash amount of bonuses and the value of benefits in kind. It excludes any amounts receivable in shares.

No director accrued benefits under either a defined benefit or defined contribution pension scheme in the year, nor did any director receive benefits under long-term incentive schemes, other than in the form of share awards.

Further information about the remuneration of individual directors is provided in the Annual Report on Remuneration in Section B7.2.2.

57. Share based remuneration

During the year, the Group had various share based payment arrangements with employees. They are accounted for by the Group and the Company as shown below.

The effect of the share based payment arrangements on the Group's profit is shown in note 55.

Further details of share based payment arrangements are given in the Annual Report on Remuneration in Section B7.2.2.

A summary of the number of share awards outstanding under each scheme at 30 September 2022 and at 30 September 2021 is set out below.

	2022	2021
	Number	Number
(a) Sharesave Plan	**3,613,777**	3,561,675
(b) Performance Share Plan	**4,834,871**	5,375,494
(c) Company Share Option Plan	**87,716**	241,574
(d) Deferred Bonus Plan	**1,155,638**	1,387,137
(e) Restricted Stock Units	**616,709**	273,193
	10,308,711	10,839,073

(a) Sharesave plan

The Group operates an All Employee Share Option ('Sharesave') plan. Grants under this scheme vest, in the normal course, after the completion of the appropriate service period and subject to a savings requirement.

A reconciliation of movements in the number and weighted average exercise price of Sharesave options over £1 ordinary shares during the year ended 30 September 2022 and the year ended 30 September 2021 is shown below.

	2022	**2022**	2021	2021
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
		p		p
Options outstanding				
At 1 October 2021	**3,561,675**	**306.89**	4,134,577	295.40
Granted in the year	**737,978**	**391.20**	432,095	424.00
Exercised or surrendered in the year	**(386,039)**	**339.22**	(717,213)	306.32
Lapsed during the year	**(299,837)**	**333.10**	(287,784)	319.15
At 30 September 2022	**3,613,777**	**318.46**	3,561,675	306.89
Options exercisable	**109,654**	**359.92**	105,945	303.07

The weighted average remaining contractual life of options outstanding at 30 September 2022 was 27.0 months (2021: 32.4 months). The weighted average market price at exercise for share options exercised in the year was 507.07p (2021: 526.83p).

Options are outstanding under the Sharesave plans to purchase ordinary shares as follows:

Grant date	Period exercisable	Exercise price	Number 2022	Number 2021
20/06/2016	01/08/2021 to 01/02/2022	249.44p	-	68,546
28/07/2017	01/09/2020 to 01/03/2021	341.76p	-	2,633
28/07/2017	01/09/2022 to 01/03/2023	341.76p	**1,403**	20,971
31/07/2018	01/09/2021 to 01/03/2022	408.80p	-	34,766
31/07/2018	01/09/2023 to 01/03/2024	408.80p	**20,391**	21,124
30/07/2019	01/09/2022 to 01/03/2023	360.16p	**108,251**	379,915
30/07/2019	01/09/2024 to 01/03/2025	360.16p	**4,577**	5,409
29/07/2020	01/09/2023 to 01/03/2024	278.56p	**1,925,599**	2,078,709
29/07/2020	01/09/2025 to 01/03/2026	278.56p	**478,876**	518,610
28/07/2021	01/09/2024 to 01/03/2025	424.00p	**278,279**	350,345
28/07/2021	01/09/2026 to 01/03/2027	424.00p	**63,315**	80,647
27/07/2022	01/09/2025 to 01/03/2026	391.20p	**622,064**	-
27/07/2022	01/09/2027 to 01/03/2028	391.20p	**111,022**	-
			3,613,777	3,561,675

An option holder has the legal right to a payment holiday of up to twelve months without forfeiting their rights. In such cases the exercise period would be deferred for an equivalent period of time and therefore options might be exercised later than the date shown above.

In the event of the death or redundancy of the employee options may be exercised early and the exercise period may also start or end later than stated above (options may be exercised up to twelve months after the holder's decease). Awards lapse on cessation of employment, other than in 'good leaver' circumstances.

The fair value of options granted is determined using a trinomial model. Details of the awards made in the year ended 30 September 2022 and the year ended 30 September 2021, are shown below.

Grant date	27/07/22	27/07/22	27/07/21	27/07/21
Number of awards granted	**623,122**	**114,856**	351,448	80,647
Market price at date of grant	**527.0p**	**527.0p**	554.5p	554.5p
Contractual life (years)	**3.5**	**5.5**	3.5	5.5
Fair value per share at date of grant (£)	**1.34**	**1.06**	1.41	1.17
Inputs to valuation model				
Expected volatility	**39.36%**	**33.75%**	38.77%	33.10%
Expected life at grant date (years)	**3.42**	**5.43**	3.42	5.43
Risk-free interest rate	**1.69%**	**1.74%**	0.19%	0.31%
Expected annual dividend yield	**5.37%**	**5.37%**	3.90%	3.90%
Expected annual departures	**5.00%**	**5.00%**	5.00%	5.00%

The expected volatility of the share price used in determining the fair value for the three-year schemes is based on the annualised standard deviation of daily changes in price over the three years preceding the grant date. The five-year schemes use share price data for the preceding five years.

(b) Paragon Performance Share Plan ('PSP')

PSP awards are made annually to executive directors and other senior employees as part of their variable remuneration. The grantees, and the values of their grants, are approved by the Remuneration Committee.

Awards under this plan comprise a right to acquire ordinary shares in the Company for nil or nominal payment and normally vest in the third financial year after the date of grant, to the extent that the applicable performance criteria have been satisfied, if the holder is still employed by the Group.

Awards vest on the date on which the Remuneration Committee determines the extent to which the performance conditions have been satisfied. For employees, other than the executive directors, awards may be exercised from the vesting date to the day before the tenth anniversary of the grant date. Executive directors' awards made in 2020 and subsequently are exercisable from the time of the Group's fifth results announcement after the date of the grant to the day before the tenth anniversary of the grant date. Where performance conditions are not met in full, awards lapse at this point. Awards will also lapse on cessation of employment, other than in 'good leaver' circumstances. Malus and clawback provisions apply to awards granted under the PSP as detailed in the Directors' Remuneration Policy.

The conditional entitlements outstanding under this scheme at 30 September 2022 and 30 September 2021 were:

Grant date	Period exercisable	Number 2022	Number 2021
21/12/2011	21/12/2014 to 20/12/2021†	-	5,093
28/02/2013	28/02/2016 to 27/02/2023†	**4,578**	4,578
10/12/2013	10/12/2016 to 09/12/2023†	**2,132**	2,132
18/12/2014	18/12/2017 to 17/12/2024†	**5,005**	5,366
22/12/2015	22/12/2018 to 21/12/2025†	**10,473**	14,927
01/12/2016	01/12/2019 to 30/11/2026†	**34,894**	341,168
08/12/2017	03/12/2020 to 07/12/2027†	**50,268**	347,715
14/12/2018	14/12/2021 to 13/12/2028ψ	**155,092**	1,477,203
06/07/2020	07/12/2022* to 05/07/2030ϕ	**1,144,820**	1,153,178
06/07/2020	07/12/2024* to 05/07/2030ϕ	**509,192**	509,192
11/12/2020	07/12/2023* to 10/12/2030δ	**1,122,904**	1,129,235
11/12/2020	07/12/2025* to 10/12/2030δ	**385,707**	385,707
15/12/2021	07/12/2024* to 14/12/2031λ	**1,069,870**	-
15/12/2021	07/12/2026* to 14/12/2031λ	**339,936**	-
		4,834,871	5,375,494

*Estimated date.

†These awards, which were conditional on the achievement of performance-based criteria, vested before the start of the financial year. Any reduction in entitlements resulting from the application of those criteria is reflected in the numbers above.

ψThese awards are (or were) subject to performance criteria, assessed over a period of three financial years, starting with the year of grant.

- 50% to a Total Shareholder Return ('TSR') test based on a ranking of the Company's TSR against those of a comparator group of UK listed financial services companies, determined at the date of grant. This tranche vests in full for upper quartile performance, 25% vests for median performance and vesting between those points is determined on a straight line basis
- 25% to an EPS test. This tranche vests in full if basic EPS for the third year of the test period is at least 68p, 25% vesting if EPS in this year is 60p and vesting between those points on a straight line basis
- 25% to a risk test. The risk test is based on an internal scorecard of the Group's performance against its principal risk metrics

An 'underpin' condition also operates, such that the Remuneration Committee has to be satisfied with the Group's underlying financial performance over the performance period. An individual performance condition relating to the grantee's performance in the final financial year of the vesting period also applies.

At the point of exercise, the gross number of awards vesting will be reduced so that the gain to the recipient from the PSP and the CSOP described below, evaluated at that point, is equal to the gain from the gross PSP vesting.

ϕThese awards are subject to performance criteria, similar to those described at ψ above, except that:

- The TSR condition related to 25% of the grant, not 50%
- Under the EPS condition full vesting occurs if basic EPS for the third year of the test period is at least 67p, 25% vesting if EPS in this year is 60p and vesting between those points on a straight line basis
- The risk condition comprises two components. 50% of the risk element is based on an assessment by the CRO of the six key measures of the Group's risk appetite: regulatory breaches; customer service performance; conduct; operational risk incidents; capital and liquidity; and credit losses. The remaining 50% is based on a strategic risk assessment reflecting the management of risk as it impacts on the delivery of the Group's medium term strategy. Following the Remuneration Committees assessment the tranche will vest between 0% and 100%
- 12.5% of the grant is determined based on a customer service condition. This condition is based on the performance of the Group against its most significant customer service metrics including insight feedback on key product lines and complaint levels. 50% of this tranche will vest for on-target performance
- 12.5% of the grant is determined based on a people test. The people test is based on the performance of the Group against its most significant employment metrics including employee engagement, voluntary attrition and gender diversity levels. 50% of this tranche will vest for on-target performance
- Due to the volatility of the share price at the time of grant, the Remuneration Committee may adjust the vesting levels at the vesting date if it believes that the use of this share price has created a potential windfall gain
- No CSOP grants were made in conjunction with this award, therefore no adjustment on vesting will take place

δThese awards are subject to performance criteria, similar to those described at ϕ above, except that:

- Under the EPS condition full vesting occurs if EPS for the third year of the test period is at least 66p, 25% vesting if EPS in this year is 58p and vesting between those points on a straight line basis
- The ability of the Remuneration Committee to adjust specifically for windfall gains was not a condition of this grant

λThese awards are subject to performance criteria, similar to those described at δ above except that:

- Under the EPS condition full vesting occurs if EPS for the third year of the test period is at least 72p, 25% vesting if EPS in this year is 63p and vesting between those points on a straight line basis

For each of the customer and people tests set out above, the Remuneration Committee will determine the extent to which this condition has been met, between 0% and 100%, and vesting for the relevant tranche will occur at that level, subject to a 25% threshold, below which no awards in the tranche will vest.

On exercise, holders of awards granted in February 2013 and thereafter receive a payment equivalent to the dividends accruing on the vested shares during the vesting period.

The fair value of awards granted under the PSP is determined using a Monte Carlo simulation model, to take account of the effect of the market based condition. Details of the awards over £1 ordinary shares made in the year ended 30 September 2022 and the year ended 30 September 2021 are shown below:

Grant date	**15/12/21**	11/12/20
Number of awards granted	**1,411,533**	1,539,645
Market price at date of grant	**549.0p**	446.8p
Contractual life (years)	**3.0**	3.0
Fair value per share at date of grant	**504.50p**	407.50p
Inputs to valuation model		
Expected volatility	**38.13%**	37.85%
Expected life (years)	**3.0**	3.0
Risk-free interest rate	**0.53%**	(0.12)%

For all the above grants no departures are expected. The expected volatility is based on the annualised standard deviation of daily changes in price over the three years preceding the grant date.

The effect of the CSOPs is not allowed for in the IFRS 2 market values of the 2016, 2017 and 2018 grants.

(c) Company Share Option Plan ('CSOP')

The PSP includes a tax advantaged element under which CSOP options can be granted. The CSOPs may be exercised alongside their accompanying PSPs based upon the exercise price that was set at the grant date. Each employee may be granted up to a maximum total value of £30,000 of tax benefitted options. No new CSOP awards were made in the years ended 30 September 2022 or 30 September 2021.

A reconciliation of movements in the number and weighted average exercise price of CSOP options over £1 ordinary shares during the year ended 30 September 2022 and the year ended 30 September 2021 is shown below.

	2022	**2022**	2021	2021
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
		p		p
Options outstanding				
At 1 October 2021	**241,574**	**403.66**	444,771	419.97
Exercised or surrendered in the year	**(148,680)**	**402.14**	(87,377)	397.33
Lapsed during the year	**(5,178)**	**402.37**	(115,820)	471.06
At 30 September 2022	**87,716**	**406.31**	241,574	403.66
Options exercisable	**87,716**	**406.31**	62,049	425.70

The weighted average remaining contractual life of options outstanding at 30 September 2022 was 66.2 months (2021: 81.5 months). The weighted average market price at exercise for share options exercised in the year was 466.70p.

The conditional entitlements outstanding under this scheme at 30 September 2022 and 30 September 2021 were:

Grant date	Period exercisable	Exercise price	Number 2022	Number 2021
01/12/2016	01/12/2019 to 30/11/2026†	361.88p	**22,802**	27,875
08/12/2017	08/12/2020 to 07/12/2027†	477.76p	**20,557**	34,174
14/12/2018	14/12/2021 to 13/12/2028β	396.04p	**44,357**	179,525
			87,716	241,574

†These awards, which were conditional on the achievement of performance-based criteria, vested before the start of the financial year. Any reduction in entitlements resulting from the application of those criteria is reflected in the numbers above.

β66.7% of these awards are (or were) subject to a TSR test and 33.3% are subject to an EPS test. These tests operate in the same manner and with the same conditions as those for the PSP grant of the same date.

To the extent that the CSOP awards vest, the vesting of the PSP award granted at the same time will be abated on exercise so that the overall gain to the grantee is the same as would be received on the related PSP award had the CSOP not been in place.

No separate fair value has been attributed to the CSOP options for IFRS 2 purposes as the IFRS 2 market values for the CSOP and PSP combined will equate to that calculated for the PSP without allowing for the CSOP. The benefit from the CSOP is in relation to the employees' tax position, which does not affect the IFRS 2 charge.

(d) Deferred Bonus awards

These plans are generally used for the deferral in shares of annual bonus awards made to executive directors and certain other senior managers ('executive awards'). Additionally in 2020 a one-off award was made on an all-employee basis.

Awards under these plans comprise a right to acquire ordinary shares in the Company for nil or nominal payment. The conditional entitlements outstanding under these plans at 30 September 2022 and 30 September 2021 were:

Grant date	Period exercisable	Number 2022	Number 2021
10/12/2013	10/12/2016 to 09/12/2023	**55,302**	55,302
18/12/2014	18/12/2017 to 17/12/2024	**52,888**	52,888
22/12/2015	22/12/2018 to 21/12/2025	**60,042**	60,042
01/12/2016	01/12/2019 to 30/11/2026	**-**	71,235
08/12/2017	08/12/2020 to 07/12/2027	**-**	67,572
14/12/2018	14/12/2021 to 13/12/2028	**26,437**	334,498
12/12/2019	12/12/2022 to 11/12/2029	**108,701**	108,701
11/12/2020	11/12/2023 to 10/12/2030	**382,334**	382,334
11/12/2020*	11/12/2023 to 01/06/2024	**224,981**	254,565
15/12/2021	15/12/2024 to 10/12/2031	**244,953**	-
		1,155,638	1,387,137

*All-employee award

The Deferred Bonus shares granted under the executive awards can be exercised from the third anniversary of the award date until the day before the tenth anniversary of the date of grant.

The all-employee awards will vest on the third anniversary of the grant date and the shares will be automatically transferred to the participants as soon as reasonably practicable thereafter. The period exercisable shown above therefore illustrates the latest date by which it is anticipated that these transfers will have been made.

In the event of death or redundancy the all-employee awards may vest early. Awards lapse on the cessation of employment, other than in 'good leaver' circumstances. Except in these regards the all-employee awards operate in the same way as the executive awards.

The Deferred Bonus shares granted in December 2016 and thereafter accrue dividends only over the vesting period, unlike earlier grants which accrued dividends until the point of exercise. The fair value of Deferred Bonus awards issued in the year was determined using a Black-Scholes Merton model.

Details of the awards made in the year ended 30 September 2022 and the year ended 30 September 2021 are shown below.

Grant date	15/12/21 Executive	11/12/20 All employee	11/12/20 Executive
Number of awards granted	**244,953**	**275,029**	**382,334**
Market price at date of grant	**549.0p**	**446.80p**	**446.80p**
Fair value per share at date of grant	**549.0p**	**353.62p**	**446.80p**

No departures are expected for grantees under this plan, except for grants under the all-employee grant in 2020, where a departure rate of 7.5% per annum is expected.

(e) Restricted Stock Units ('RSUs')

Since 2016, the Company has permitted certain employees to elect to receive RSU awards instead of PSP awards. For RSU awards to vest, the grantee's personal performance must be satisfactory during the financial year preceding the vesting date. In addition, a risk based performance condition, assessed against the Group's risk management metrics and, for the July 2020 grant only, against its strategic management of risk for the medium term, considered over the vesting period, must also be met. The level to which this condition is met will be determined by the Remuneration Committee and vesting levels scaled back as appropriate.

In addition, in the financial year ended 30 September 2022, a one-off RSU grant with a four-year vesting period was made to certain employees designated as Material Risk Takers ('MRT').

The conditional entitlements outstanding under this scheme at 30 September 2022 and 30 September 2021 were:

Grant date	Period exercisable	Number 2022	Number 2021
14/12/2018	14/12/2021 to 13/12/2028	**-**	52,040
06/07/2020	07/12/2022* to 05/07/2030	**190,960**	190,960
11/12/2020	11/12/2023* to 10/12/2030	**30,193**	30,193
15/12/2021	07/12/2024* to 15/12/2031	**26,603**	-
15/12/2021	07/12/2025* to 15/12/2031	**368,953**	-
		616,709	273,193

*Estimated date

The fair value of RSU awards issued in the year was determined using a Black-Scholes Merton model. Details of the awards made in the year ended 30 September 2022 and the year ended 30 September 2021 are shown below.

Grant date	15/12/21	15/12/21	11/12/20
Number of awards granted	**368,953**	**26,603**	**30,193**
Market price at date of grant	**549.0p**	**549.0p**	**446.80p**
Contractual life (years)	**4.0**	**3.0**	**3.0**
Fair value per share at date of grant	**549.0p**	**549.0p**	**446.80p**

For all of these grants no departures are expected.

58. Retirement benefit obligations

(a) Defined benefit plan - description

The Group operates a funded defined benefit pension scheme in the UK, the Paragon Pension Plan (the 'Plan'). The Plan assets are held in a separate fund, administered by a corporate trustee, to meet long-term pension liabilities to past and present employees. The Trustee of the Plan is required by law to act in the best interests of the Plan's beneficiaries and is responsible for the investment policy adopted in respect of the Plan's assets. The appointment of directors to the Trustee is determined by the Plan's trust documentation. The Group has a policy that one third of all directors of the Trustee should be nominated by active and pensioner members of the Plan.

Scheme benefit changes

During the year ended 30 September 2021, following consultation with the active members of the Plan, changes were made affecting the accrual of benefits by members after 1 July 2021. The principal changes were:

- The earliest age that members can access benefits building up after 1 July 2021 without any reduction for early payment is 65, rather than 60
- The rate of salary increase counting towards benefits and contributions in the Plan is capped at 2.5% per annum
- Members were allowed to elect to either contribute 8% of capped salary to accrue benefits at the rate of 1/70 of capped final salary per year or continue to contribute 5% of capped salary to accrue benefits at the rate of 1/75 of capped final salary per year

The changes did not affect benefits already accrued to that date.

Employee contributions and benefits

The scheme was closed to new entrants in February 2002. Employees who are members of the Plan are entitled to receive a pension of 1/60 of their final basic annual salary per year of service up to 30 June 2021. After that date further accrual is at a rate of 1/70 or 1/75 of capped final salary depending on the level of contributions. After 1 July 2021 employee contributions were either 5% or 8% of capped salary. Before that date all active members contributed at a rate of 5% of salary.

Dependants of Plan members are eligible for a dependant's pension and the payment of a lump sum in the event of death in service.

Actuarial risks

The principal actuarial risks to which the Plan is exposed are:

- **Investment risk** – The present value of the defined benefit liabilities is calculated using a discount rate set by reference to high quality corporate bond yields. If plan assets underperform corporate bonds, this will reduce the surplus. The strategic allocation of assets under the Plan is currently weighted towards equity assets and diversified growth funds as its liability profile is relatively immature, and it is expected that these asset classes will, over the long term, outperform gilts and corporate bonds. In consultation with the Company, the Trustee keeps the allocation of the Plan's investments under review to manage this risk on a long-term basis
- **Interest risk** – A fall in corporate bond yields would reduce the discount rate used in valuing the Plan liabilities and increase the value of the Plan liabilities. The Plan assets would also be expected to increase, to the extent that bond assets are held, but this would not be expected to fully match the increase in liabilities, given the weighting towards equity assets and diversified growth funds noted above
- **Inflation risk** – Pensions in payment are increased annually in line with the RPI or the Consumer Price Index ('CPI') for Guaranteed Minimum Pensions built up since 1988. Pensions built up since 5 April 2006 are capped at 2.5% and pensions built up before 6 April 2006 are capped at 5%. For employees who have left the Company but have deferred pensions, these also revalue over the period to retirement predominantly in line with RPI. Therefore, an increase in inflation would also increase the value of the pension liabilities. The Plan assets would also be expected to increase, to the extent that they are linked to inflation, but this may not fully match the increase in liabilities
- **Longevity risk** – The value of the Plan surplus is calculated by reference to the best estimate of the mortality rate among Plan members both during and after employment. An increase in the life expectancy of the members would reduce the surplus in the Plan
- **Salary risk** – The valuation of the Plan assumes a level of future salary increases based on the expected rate of inflation. Should the salaries of Plan members increase at a higher rate, then the surplus will be lower. For service from 1 July 2021, a 2.5% cap on individual pensionable salary applies, mitigating this risk

The risks relating to death in service payments are insured with an external insurance company.

As a result of the Plan having been closed to new entrants since February 2002, the service cost as a percentage of pensionable salaries is expected to increase as the average age of active members rises over time. However, the membership is expected to reduce so that the service cost in monetary terms will gradually reduce. The changes referred to above will also reduce this cost going forward.

Actuarial valuation and recovery plan

The most recent full actuarial valuation of the Plan's liabilities, obtained by the Trustee, was carried out at 31 March 2019, by Aon Solutions UK Limited, the Plan's independent actuary. This showed that the value of the Plan's liabilities on a buy-out basis in accordance with section 224 of the Pensions Act 2004, the level of assets which would be required to buy insurance policies for benefits earned to the valuation date, was £203.6m, with a shortfall against the assets of £85.0m (2016: £118.4m). The deficit on the Technical Basis, the basis agreed by the Trustee as being appropriate to meet member benefits, assuming the plan continues as a going concern, was £18.2m (2016: £18.0m). This valuation forms the basis of the IAS 19 valuation.

Following the agreement of the 2019 actuarial valuation, the Trustee put in place a revised recovery plan. On current forecasts the Trustee's recovery plan would meet the statutory funding objective by 31 July 2025. The revised recovery plan continues to include a Pension Funding Partnership ('PFP') arrangement effectively granting the Plan a first charge over the Group's head office building as security for payments under the plan (note 28). No amount is included in the Plan assets in respect of the building, which remains within the Group's Property, Plant and Equipment balance (note 28) but this arrangement provides the Plan with additional security in a stress event.

A new actuarial valuation, as at 31 March 2022, is currently in progress. While the draft outputs of this process have been used as the basis for the Group's accounting at 30 September 2022, the process is incomplete and the final position will be reflected in the accounts for the year ending 30 September 2023.

(b) Defined benefit plan – financial impact

For accounting purposes, the draft valuation at 31 March 2022 was updated to 30 September 2022 in accordance with the requirements of IAS 19 (revised) by Mercer, the Group's independent consulting actuary.

The major categories of assets in the Plan at 30 September 2022, 30 September 2021 and 30 September 2020 and their fair values were:

	2022	2021	2020
	£m	£m	£m
Cash and cash equivalents	**0.7**	17.1	28.6
Equity instruments	**56.6**	73.4	60.7
Debt instruments	**47.4**	54.8	34.9
Real estate funds	**-**	-	10.3
Total fair value of Plan assets	**104.7**	145.3	134.5
Present value of Plan liabilities	**(97.6)**	(155.6)	(154.9)
Surplus / (deficit) in the Plan	**7.1**	(10.3)	(20.4)

The Group has recognised the surplus as an asset at the balance sheet date as it anticipates being able to access economic benefits at least as great as the carrying value. However such assets are eliminated from capital for regulatory purposes (note 59).

At 30 September 2022 the Plan assets were invested in a diversified portfolio that consisted primarily of equity and debt investments. The majority of the equities held by the Plan are in developed markets.

The Plan also has a benchmark allocation of 28% of total assets to Liability Driven Investments ('LDI'). These investments are used to hedge 60% of the interest and inflation risks faced by the Plan. During the recent market turmoil the assets of the Plan proved themselves to be robust in protecting the members' interests, with no requirement to either divest from LDI nor to reduce the hedge ratio in place.

Towards the end of the year ended 30 September 2021 the Plan disposed of its holdings in real estate funds, following a review of its investment strategy. At the 2021 year end these were in the process of reinvestment in other asset classes, with part of the proceeds held in cash at the balance sheet date.

During October 2018, the High Court made a ruling in the Lloyds Banking Group Pension Scheme GMP (Guaranteed Minimum Pension) equalisation case, which effectively directs defined benefit pension schemes to change their rules to equalise the benefits of male and female members for the effects of GMPs for employees who were, at one time, contracted out of state schemes. The Court did not specify a single method which schemes should employ and hence the impact of this on the Plan will not be certain until the Trustee has determined which method should be adopted and detailed calculations have been performed to evaluate the impact, as the impact on members will vary from person to person.

The estimated effect of this ruling was accounted for in the accounts of the Group for the year ended 30 September 2019 as a 'past service cost'. However, this estimate is based on one permissible method, method C2, and therefore the actual amount may vary due to the method which the Trustee chooses to apply, which is yet to be finalised, idiosyncratic impacts on individual members and the development of a wider legal and accounting consensus on the proper interpretation of the courts' requirements as further cases are determined.

A further judgement relating to GMP equalisation within historic transfer values was handed down in November 2020. The impact was allowed for in employment cost for the year ended 30 September 2021, but is not significant.

The movement in the fair value of the Plan assets during the year was as follows:

	2022	2021
	£m	£m
At 1 October 2021	**145.3**	134.5
Interest on Plan assets	**2.9**	2.4
Cash flows		
Contributions by the Group	**4.0**	4.8
Contributions by Plan members	**0.2**	0.2
Benefits paid	**(3.8)**	(6.8)
Administration expenses paid	**(0.8)**	(0.8)
Remeasurement (loss) / gain		
Return on Plan assets (excluding amounts included in interest)	**(43.1)**	11.0
At 30 September 2022	**104.7**	145.3

The actual return on Plan assets in the year ended 30 September 2022 was a loss of £40.2m (2021: gain of £13.4m).

The movement in the present value of the Plan liabilities during the year was as follows:

	2022	2021
	£m	£m
At 1 October 2021	**155.6**	154.9
Current service cost	**0.9**	1.8
Past service cost	**-**	-
Funding cost	**3.1**	2.7
Cash flows		
Contributions by Plan members	**0.2**	0.2
Benefits paid	**(3.8)**	(6.8)
Remeasurement loss / (gain)		
Arising from demographic assumptions	**2.2**	1.1
Arising from financial assumptions	**(61.9)**	1.7
Arising from experience adjustments	**1.3**	-
At 30 September 2022	**97.6**	155.6

The liabilities of the Plan are measured by discounting the best estimate of future cash flows to be paid out by the Plan using the Projected Unit method. This amount is reflected in the liability in the balance sheet. The Projected Unit method is an accrued benefits valuation method in which the Plan liabilities are calculated based on service up until the valuation date allowing for future salary growth until the date of retirement, withdrawal or death, as appropriate. The future service rate is then calculated as the contribution rate required to fund the service accruing over the next year again allowing for future salary growth.

Following the changes in the plan described above, liabilities for benefits accruing for service up to 1 July 2021 are calculated separately from those accruing in respect of service after that date.

The major weighted average assumptions used by the actuary were (in nominal terms):

	2022	2021	2020
In determining net pension cost for the year			
Discount rate	**2.00%**	1.75%	1.85%
Rate of compensation increase:			
Pre July 2021 accrual	**3.40%**	2.95%	3.20%
Post 1 July 2021 accrual	**2.50%**	2.50%	n/a
Rate of price inflation	**3.40%**	2.95%	2.70%
Rate of increase of pensions	**3.15%**	2.85%	2.65%
In determining benefit obligations			
Discount rate	**5.00%**	2.00%	1.75%
Rate of compensation increase:			
Pre 1 July 2021 accrual	**3.55%**	3.40%	2.95%
Post 1 July 2021 accrual	**2.50%**	2.50%	2.50%
Rate of price inflation	**3.55%**	3.40%	2.95%
Rate of increase of pensions	**3.25%**	3.15%	2.85%
Further life expectancy at age 60			
Male member aged 60	**27**	28	28
Female member aged 60	**29**	29	29
Male member aged 40	**29**	29	30
Female member aged 40	**31**	31	31

In the 2022 valuation the base mortality table used was the standard S3PMA/S3PFA_M (All) Year of Birth table, with future improvements projected by the CMI 2021 projection model with a 1.5% per annum long-term improvement rate.

In the 2021 valuation the base mortality table used was the standard S3 PA (All) Year of Birth table, with future improvements projected using the CMI 2020 projection model with a 1.5% per annum long-term improvement rate.

The amounts charged in the consolidated income statement in respect of the Plan are:

	Note	**2022**	2021
		£m	£m
Current service cost		**0.9**	1.8
Past service cost		**-**	-
Total service cost	*55*	**0.9**	1.8
Administration expenses		**0.8**	0.8
Included within operating expenses		**1.7**	2.6
Funding cost of Plan liabilities		**3.1**	2.7
Interest on Plan assets		**(2.9)**	(2.4)
Net interest expense	*5*	**0.2**	0.3
Components of defined benefit costs recognised in profit or loss		**1.9**	2.9

The amounts recognised in the consolidated statement of comprehensive income in respect of the Plan are:

	2022	2021
	£m	£m
Return on Plan assets (excluding amounts included in interest)	**(43.1)**	11.0
Actuarial gains / (losses)		
Arising from demographic assumptions	**(2.2)**	(1.1)
Arising from financial assumptions	**61.9**	(1.7)
Arising from experience adjustments	**(1.3)**	-
Total actuarial gain / (loss)	**15.3**	8.2
Tax thereon	**(3.7)**	(0.9)
Net actuarial gain / (loss)	**11.6**	7.3

Of the remeasurement movements reflected above:

- The return on plan assets to 30 September 2022 reflects the impact of generally falling global investment values over the year, including the effect on the Group's portfolio of its LDI hedging strategy, whereas the result for the year ended 30 September 2021 included an element of recovery from low points experienced during the Covid pandemic
- The change in demographic assumptions in the year ended 30 September 2022 resulted from the adoption of new mortality tables which included an adjustment for the impact of Covid as well as a change in the tables used; included an allowance for updated commutation factors; updated the assumed age difference between members and their partners; and adopted different proportion-married assumptions, all to follow the Trustee's assumptions for the 2022 triennial valuation

  In the year ended 30 September 2021 the change predominantly reflected the adoption of new commutation factors by the Trustee from January 2021, which increased liabilities in respect of non-retired members
- The change in financial assumptions in the year ended 30 September 2022 reflects principally the sharp increase in corporate bond yields, which are used to determine the discount applied in the calculation of the pension liability. The difference between Fixed Interest and Indexed-Linked Gilt yields, which is used to forecast market-implied inflation, increased far less and so only partially mitigated this movement

  The movement in the year ended 30 September 2021 mostly represented the impact of market implied inflation expectations increasing the value of Plan liabilities, although this was partially offset by higher discount rates, which are derived from market bond yields
- The experience adjustments in 2022 arose on the adoption of the draft 2022 Plan valuation as the basis of the IAS 19 valuation. This means that the actual pay rises, resignations, retirements and deaths of members since March 2019 are accurately represented rather than projected. This exercise takes place triennially

(c) Defined benefit plan – future cash flows

The sensitivity of the valuation of the defined benefit obligation to the principal assumptions disclosed above at 30 September 2022, calculating the obligation on the same basis as used in determining the IAS 19 value, is as follows:

Assumption	**Increase in assumption**	**Impact on scheme liabilities**	
		2022	2021
Discount rate	0.1% per annum	**(1.7)%**	(2.2)%
Rate of inflation*	0.1% per annum	**1.7%**	2.0%
Rate of salary growth	0.1% per annum	**0.4%**	0.4%
Rates of mortality	1 year of life expectancy	**2.9%**	3.0%

*maintaining a 0.0% assumption for real salary growth

The sensitivity analysis presented above may not be representative of an actual future change in the defined benefit obligation as it is unlikely that changes in assumptions would occur in isolation, as some of the assumptions will be correlated. There has been no change in the method of preparing the analysis from that adopted in previous years. The impacts of equivalent decreases in assumptions are broadly equal and opposite to the effects of the increases shown above.

In conjunction with the Trustee, the Group has continued to conduct asset-liability reviews of the Plan. These studies are used to assist the Trustee and the Group to determine the optimal long-term asset allocation with regard to the structure of liabilities within the Plan. The results of the studies are used to assist the Trustee in managing the volatility in the underlying investment performance and risk of a significant increase in the scheme deficit by providing information used to determine the investment strategy of the Plan. There have been no changes in the processes by which the Plan manages its risks from previous periods.

Following a review of the Plan's investment strategy, the current target asset allocations for the year ending 30 September 2023 are 60% growth assets (primarily equities), and 40% matching assets (primarily bonds) which includes LDI balances.

Following the finalisation of the March 2019 valuation, the agreed rate of employer contributions in respect of future service increased to 43.8% from 32.0% with effect from 1 July 2020. Additional contributions of £2.5m per annum for deficit reduction, including amounts payable under the PFP, and £0.4m per annum in respect of costs, each payable monthly, were also agreed. An additional contribution of £20.0m was made by the Group in June 2020. With effect from 1 July 2021, when the changes in the Plan benefits described above were implemented, the level of employer contributions for future service reduced to 25.0% of capped salary.

The present best estimate of the contributions to be made to the Plan by the Group in the year ending 30 September 2023 is £3.9m.

The average durations of the discounted benefit obligations in the Plan at the year end are shown in the table below:

	2022	2021
	Years	Years
Category of member		
Active members	**21**	24
Deferred pensioners	**21**	23
Current pensioners	**12**	15
All members	**18**	22

The principal cause of the variations in the period is the significant increase in the discount rate year-on-year.

(d) Defined contribution arrangements

The Group sponsors a defined contribution (Worksave) pension scheme, open to all employees who are not members of the Plan. The Group successfully completed the auto-enrolment process mandated by the UK Government in November 2013, using this scheme. During the year ended 30 September 2020 the Group increased its contribution to the scheme for those employees making the maximum 6% contribution to 10% of salary from 6%, generating an increase in the amounts being saved by employees.

The Group also sponsors a number of other defined contribution pension plans relating to acquired entities and makes contributions to these schemes in respect of employees.

The assets of these schemes are not Group assets and are held separately from those of the Group, under the control of independent trustees. Contributions made by the Group to these schemes in the year ended 30 September 2022, which represent the total cost charged against income, were £4.1m (2021: £3.7m) (note 55).

The notes below describe the processes and measurements which the Group and the Company use to manage their capital position and their exposure to financial risks including credit, liquidity, interest rate and foreign exchange risk. It should be noted that certain capital measures, which are presented to illustrate the Group's position, are not subject to audit. Where this is the case, the relevant disclosures are marked as such.

59. 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 protection of the Group's capital base and its long-term viability are key strategic priorities.

The Group sets its target 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) Regulatory capital

The Group is subject to supervision by the PRA on a consolidated basis, as a group containing an authorised bank. For regulatory purposes the Company is designated as a CRR consolidation entity, as defined by the PRA rulebook. As part of this supervision the regulator will issue a Total Capital Requirement ('TCR') setting the amount of regulatory capital which the Group is required to hold at all times, in order to safeguard depositors from loss in the event of severe losses being incurred by the Group. This requirement is set in accordance with the international Basel III rules, issued by the Basel Committee on Banking Supervision ('BCBS'), which, following the implementation of the Financial Services Act 2021 on 1 January 2022, are implemented through the PRA Rulebook.

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

The Group has elected to take advantage of the IFRS 9 transitional arrangements set out in Article 473a of the CRR, which allow the capital impact of expected credit losses to be phased in over a five-year period. The phase-in factors applying to transition adjustments will allow for a 95% add back to CET1 capital and Risk Weighted Assets ('RWA') in the financial year ended 30 September 2019, reducing to 85%, 70%, 50% and 25% for the financial years ending in 2020 to 2023, with full recognition of the impact on CET1 capital in the 2024 financial year.

As part of the regulatory response to Covid, Article 473a was revised to extend the transitional arrangements for Stage 1 and Stage 2 impairment provisions created in the financial year ended 30 September 2020 and the financial year ended 30 September 2021, while maintaining the transitional arrangements for impairment provisions created before those years. In order to increase institutions lending capacity in the short term, the EU determined that these additional provisions should be phased into capital over the financial years ending 30 September 2022 to 30 September 2024, rather than recognising the reduction in capital immediately.

Where these reliefs are taken, firms are also required to disclose their capital positions calculated as if the reliefs were not available (the 'fully loaded' basis).

The tables below demonstrate that at 30 September 2022 the Group's total regulatory capital of £1,371.8m (2021: £1,205.8m) exceeded the amounts required by the regulator, including £660.6m (2021: £604.2m) in respect of its TCR, which is comprised of fixed and variable elements (amounts not subject to audit).

The total regulatory capital at 30 September 2022 on the fully loaded basis of £1,346.0m (2021: £1,176.1m) was in excess of the TCR of £658.4m (2021: £601.8m) on the same basis (amounts not subject to audit).

At 30 September 2022, the Group's TCR represented 8.8% of the total risk exposure ('TRE') (2021: 8.8%).

The CRR also requires firms to hold additional capital buffers, including a Capital Conservation Buffer ('CCoB') of 2.5% of risk weighted assets (at 30 September 2022) (2021: 2.5%) and a Counter-cyclical Capital Buffer ('CCyB'), currently 0.0% of risk weighted assets (2021: 0.0%). The UK CCyB will increase to 1.0% of TRE from December 2022 and to 2.0% of TRE from July 2023, which is expected to be its long-term rate in a standard risk environment. Firm specific buffers may also be required.

The Group's regulatory capital differs from its equity as certain adjustments are required by the PRA Rulebook or the regulator. A reconciliation of the Group's equity to its regulatory capital determined in accordance with the PRA Rulebook at 30 September 2022 is set out below.

		Regulatory basis		Fully loaded basis	
	Note	**2022**	2021	**2022**	2021
		£m	£m	**£m**	£m
Total equity		**1,417.3**	1,241.9	**1,417.3**	1,241.9
Deductions					
Proposed final dividend	*46*	**(44.9)**	(46.6)	**(44.9)**	(46.6)
IFRS 9 transitional relief	*	**25.8**	29.7	**-**	-
Intangible assets	*29*	**(170.2)**	(170.5)	**(170.2)**	(170.5)
Pension surplus net of deferred tax	*58*	**(5.3)**	-	**(5.3)**	-
Software relief	†	**-**	1.4	-	1.4
Prudent valuation adjustments	§	**(0.9)**	(0.1)	**(0.9)**	(0.1)
Insufficient coverage	ψ	**(0.0)**	-	**(0.0)**	-
Common Equity Tier 1 ('CET1') capital		**1,221.8**	1,055.8	**1,196.0**	1,026.1
Other tier 1 capital		**-**	-	**-**	-
Total Tier 1 capital		**1,221.8**	1,055.8	**1,196.0**	1,026.1
Corporate bond	*36*	**150.0**	150.0	**150.0**	150.0
Eligibility cap	Φ	**-**	-	**-**	-
Total Tier 2 capital		**150.0**	150.0	**150.0**	150.0
Total regulatory capital ('TRC')		**1,371.8**	1,205.8	**1,346.0**	1,176.1

*Firms are permitted to phase in the impact of IFRS 9 transition as described above.

†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 was calculated in accordance with Article 36 (1) (b) of the CRR. This relief was rescinded for UK firms from 1 January 2022

§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 PRA Rulebook.

ψRegulatory deduction where there is insufficient coverage for non-performing exposures required under Article 47(c) of the CRR which remains in force in the UK for the time being under the Brexit arrangements. The amount required at 30 September 2022 was less than £0.1m.

ΦThe PRA Rulebook restricts the amount of tier 2 capital which is eligible for regulatory purposes to 25% of TCR.

The total risk exposure amount calculated under the PRA Rulebook framework against which this capital is held, and the proportion of these assets it represents, are calculated as shown below.

	Regulatory basis		Fully loaded basis	
	2022	2021	**2022**	2021
	£m	£m	**£m**	£m
Credit risk				
Balance sheet assets	**6,652.1**	6,073.5	**6,652.1**	6,073.5
Off balance sheet	**85.4**	143.9	**85.4**	143.9
IFRS 9 transitional relief	**25.8**	29.7	**-**	-
Total credit risk	**6,763.3**	6,247.1	**6,737.5**	6,217.4
Operational risk	**633.1**	576.0	**633.1**	576.0
Market risk	**-**	-	**-**	-
Other	**118.6**	13.7	**118.6**	13.7
Total risk exposure amount ('TRE')	**7,515.0**	6,836.8	**7,489.2**	6,807.1
Solvency ratios	**%**	%	**%**	%
CET1	**16.3**	15.4	**16.0**	15.1
TRC	**18.3**	17.6	**18.0**	17.3

This table is not subject to audit

The risk weightings for credit risk exposures are currently calculated using the Standardised Approach ('SA'). The Basic Indicator Approach is used for operational risk.

Leverage ratio

The table below shows the calculation of the UK leverage ratio, based on the consolidated balance sheet assets adjusted as shown. The PRA has proposed a minimum UK leverage ratio of 3.25% for UK firms, with retail deposits of over £50.0 billion. In addition, in October 2021 the PRA stated its expectation that all other UK firms should manage their leverage risk so that this ratio does not ordinarily fall below 3.25%.

	Note	**2022**	2021
		£m	£m
Total balance sheet assets		**16,653.6**	15,137.0
Add: Credit fair value adjustments on loans to customers	*17*	**559.9**	-
Debit fair value adjustments on retail deposits	*32*	**99.7**	3.0
Adjusted balance sheet assets		**17,313.2**	15,140.0
Less: Derivative assets	*25*	**(779.0)**	(44.2)
Central bank deposits	*16*	**(1,612.5)**	(1,142.0)
CRDs	*26*	**(30.2)**	(23.7)
Accrued interest on sovereign exposures		**(1.0)**	-
On-balance sheet items		**14,890.5**	13,930.1
Less: Intangible assets	*29*	**(170.2)**	(170.5)
Pension surplus	*58*	**(7.1)**	-
Add back: Software relief		**-**	1.4
Total on balance sheet exposures		**14,713.2**	13,761.0
Regulatory exposure for derivatives		**434.7**	-
Derivative assets	*25*	**-**	44.2
Potential future exposure on derivatives		**-**	36.3
Total derivative exposures		**434.7**	80.5
Post offer pipeline at gross notional amount		**1,307.9**	1,380.3
Adjustment to convert to credit equivalent amounts		**(1,094.1)**	(1,128.3)
Off balance sheet items		**213.8**	252.0
Tier 1 capital		**1,221.8**	1,055.8
Total leverage exposure before IFRS 9 relief		**15,361.7**	14,093.5
IFRS 9 relief		**25.8**	29.7
Total leverage exposure		**15,387.5**	14,123.2
UK leverage ratio		**7.9%**	7.5%

This table is not subject to audit

The fully loaded leverage ratio is calculated as follows

	2022	2021
	£m	£m
Fully loaded Tier 1 capital	**1,196.0**	1,026.1
Total leverage exposure before IFRS 9 relief	**15,361.7**	14,093.5
Fully loaded UK leverage exposure	**7.8%**	7.3%

This table is not subject to audit.

Following regulatory changes introduced from 1 January 2022, the Group calculates regulatory exposure on derivatives using the Standardised Approach for Counterparty Credit Risk ('SA-CCR'), which includes elements based on the market value of derivative assets adjusted for collateral, amongst other things, and based on potential future exposure in respect of all derivatives held. In previous years the Mark-to-Market approach was used, however this is no longer available.

The UK leverage ratio is prescribed by the PRA and differs from the leverage ratio defined by Basel due to the exclusion of central bank balances from exposures.

Capital requirements in subsidiary entities

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

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

RoTE is a measure of an entity's profitability used by investors. RoTE is defined by the Group by comparing the profit after tax for the year, adjusted for amortisation charged on intangible assets, to the average of the opening and closing equity positions, excluding intangible assets and goodwill.

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

The Group's consolidated RoTE for the year ended 30 September 2022 is derived as follows:

	Note	**2022**	2021
		£m	£m
Profit for the year after tax		**313.6**	164.5
Amortisation of intangible assets	*29*	**2.0**	2.0
Adjusted profit		**315.6**	166.5
Divided by			
Opening equity		**1,241.9**	1,156.0
Opening intangible assets	*29*	**(170.5)**	(170.1)
Opening tangible equity		**1,071.4**	985.9
Closing equity		**1,417.3**	1,241.9
Closing intangible assets	*29*	**(170.2)**	(170.5)
Closing tangible equity		**1,247.1**	1,071.4
Average tangible equity		**1,159.3**	1,028.7
Return on Tangible Equity		**27.2%**	16.2%

This table is not subject to audit

(c) Dividend and distribution policy

The Company is committed to a long-term sustainable dividend policy. Ordinarily, dividends will increase in line with earnings, subject to the requirements of the business and the availability of cash resources. The Board reviews the policy at least twice a year in advance of announcing its results, taking into account the Group's strategy, capital requirements, principal risks and the objective of enhancing shareholder value.

In determining the level of dividend for any year, the Board expects to follow the dividend policy, but will also take into account the level of available retained earnings in the Company, its cash resources and the cash and capital requirements inherent in its business plans. In addition to the payment of dividends, the Board may also consider whether it is appropriate to apply excess capital in the market purchase of the Group's shares.

The distributable reserves of the Company comprise its profit and loss account balance (note 44) and, other than the regulatory requirement to retain an appropriate level of capital in Paragon Bank PLC, there are no restrictions preventing profits elsewhere in the Group from being distributed to the parent.

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

To provide greater transparency, the Board also adopted a policy of paying an interim dividend in each year equivalent to half of the preceding final dividend in the absence of any factors which might make such a distribution inappropriate. After consideration of the Group's capital position an interim dividend for the year of 9.4p per share was declared, in line with this policy (2021: 7.2p).

The appropriate level of final dividend for the current year was considered by the Board in light of economic and regulatory developments in the year, and the various potential paths for the UK economy. In particular the levels of provision in the Group's loan portfolios and the potential for further provision under stress in the event of a worsening UK economic position were considered by the Board. These were compared to the regulatory capital position at the year end along with the capital impacts of stress testing carried out as part of the ICAAP and forecasting processes, discounting the effects of the current temporary reduction in regulatory buffers.

The Board particularly considered the appropriateness of including net gains relating to fair value adjustments from hedging in the calculation of any dividend or distribution, as these will reverse over time. Given the size of such adjustments in the period, the Board concluded that their inclusion was not consistent with its overarching aim of delivering a sustainable dividend which grows with the earnings of the business.

On the basis of this analysis the Board concluded that a dividend of around 40% of earnings excluding fair value items could be paid.

The Board will therefore propose a final dividend for the year of 19.2p per share (2021: 18.9p per share) for approval at the 2023 AGM, making a total dividend for the year of 28.6p per share (2021: 26.1p per share).

The Board authorised share buy-backs in the year: firstly the completion of the buy-back announced in 2021 and incomplete at that year end; and secondly a new buy-back, originally of £50.0m, which was extended to £75.0m in June 2022. The amount expended in these programmes in the year was £66.9m (note 45) and £10.8 million remained to be completed at the year end. An irrevocable instruction to undertake the remaining purchases was given to the Group's brokers before the year end, and the buy-back was completed on 7 November 2022.

As part of its consideration of capital described above the Board of Directors authorised a new buy-back of up to £50.0m to commence shortly after the announcement of the 2022 results. All shares acquired in buy-back programmes are initially held in treasury.

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

The most recent policy review, in November 2022, also confirmed the existing dividend policy would continue to apply for future periods, subject to the impact of any future events, and the Board will consider the appropriateness and scale of any interim dividend in the context of the Group's results and the operating and economic environment at the time. Share buy-backs will be considered where excess capital has arisen, either operationally or as a result of changed regulatory requirements.

60. Financial risk management

The principal risks arising from the Group's exposure to financial instruments are credit risk, liquidity risk and market risk (particularly interest rate risk and a limited amount of currency risk). The nature and extent of these risks are discussed in notes 61 to 63 respectively.

The Board has a Risk and Compliance Committee, consisting of the Chair of the Board and the non-executive directors which is responsible for providing oversight and challenge to the Group's risk management arrangements. Executive responsibility for the oversight and operation of the Group's risk management framework is delegated to the ERC. ERC discharges its duties through a number of sub-committees and escalates issues of concern to the Risk and Compliance Committee where appropriate.

The Credit Committee and ALCO are sub-committees of the ERC which monitor performance against the risk appetites set by the Board and make recommendations for changes in risk appetite where appropriate. They also review and, where authorised to do so, agree or amend policies for managing each of these risks, which are summarised in the relevant note. The Corporate Governance Statement in Section B3 (which is not subject to audit) provides further detail on the operations of these committees.

The financial risk management policies have remained unchanged throughout the year and since the year end. The position discussed in notes 61 to 63 is materially similar to that existing throughout the year.

61. Credit risk

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

		The Group		The Company	
	Note	**2022**	2021	**2022**	2021
		£m	£m	**£m**	£m
Financial assets at amortised cost					
Loans to customers	*17*	**14,210.3**	13,402.7	**-**	-
Trade receivables	*26*	**1.9**	1.3	**-**	-
Amounts owed by Group companies	*26*	**-**	-	**39.1**	73.0
Cash	*16*	**1,930.9**	1,360.1	**19.7**	19.6
CSA assets	*26*	**-**	36.6	**-**	-
CRDs	*26*	**30.2**	23.7	**-**	-
Accrued interest income	*26*	**1.0**	-	**0.1**	0.1
		16,174.3	14,824.4	**58.9**	92.7
Financial assets at fair value					
Derivative financial assets	*25*	**779.0**	44.2	**-**	-
Maximum exposure to credit risk		**16,953.3**	14,868.6	**58.9**	92.7

While this maximum exposure represents the potential loss which might have to be accounted for by the Group, the terms on which a significant proportion of the Group's loan assets are funded, described under Liquidity Risk in note 62, limit the amount of principal repayments on the Group's securitised and warehouse borrowings in cases of capital losses on assets, considerably reducing the effective shareholder value at risk.

All financial assets at amortised cost are subject to the requirements of IFRS 9 relating to impairment.

Further information on the Group's exposure to credit risk by asset type, including the credit quality of assets and any potential concentrations of credit risk, is set out below for:

- Loans to customers
- Cash balances (including CSA assets, CRDs and accrued interest)
- Trade receivables
- Derivative financial assets

Loans to customers

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

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

The Group's underwriting philosophy is based on sophisticated individual credit assessment supported by the automated efficiencies of statistically-based evaluation models. Information on each applicant is combined with data taken from credit reference agencies and other external sources to provide a complete credit picture of the applicant and the borrowing requested. Key information is validated through a combination of documentation and statistical data which collectively provides evidence of the applicant's ability and willingness to pay the amount contracted under the loan agreement. Similarly, where assets form part of the security to support the loan, robust asset valuation processes ensure appropriate risk mitigation is in place. Even so, in assessing credit risk an applicant's ability and propensity to repay the loan remain the principal factors in the decision to lend, even where the Group would have security on the proposed loan.

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

This section sets out information relevant to assessing the credit risk inherent in the Group's loans to customers balances. It is set out in the following subsections:

- Types of lending and related security
- Overall credit grading
- Credit characteristics of particular portfolios
- Arrears performance
- Acquired assets

Types of lending

The Group's balance sheet loan assets at 30 September 2022 are analysed as follows:

	2022	**2022**	2021	2021
	£m	**%**	£m	%
Buy-to-let mortgages	**12,086.0**	**85.1%**	11,413.2	85.2%
Owner-occupied mortgages	**36.4**	**0.2%**	47.4	0.3%
Total first charge residential mortgages	**12,122.4**	**85.3%**	11,460.6	85.5%
Second charge mortgage loans	**206.3**	**1.4%**	281.7	2.1%
Loans secured on residential property	**12,328.7**	**86.7%**	11,742.3	87.6%
Development finance	**719.9**	**5.1%**	608.2	4.5%
Loans secured on property	**13,048.6**	**91.8%**	12,350.5	92.1%
Asset finance loans	**498.8**	**3.5%**	440.5	3.3%
Motor finance loans	**261.3**	**1.8%**	229.2	1.7%
Aircraft mortgages	**33.7**	**0.3%**	28.2	0.2%
Structured lending	**178.7**	**1.3%**	118.9	0.9%
Invoice finance	**25.7**	**0.2%**	20.9	0.2%
Total secured loans	**14,046.8**	**98.9%**	13,188.2	98.4%
Professions finance	**60.9**	**0.4%**	33.1	0.3%
RLS, CBILS and BBLS	**88.0**	**0.6%**	83.8	0.6%
Other unsecured commercial loans	**14.6**	**0.1%**	10.3	0.1%
Unsecured consumer loans	**-**	**-**	87.3	0.6%
Total loans to customers	**14,210.3**	**100.0%**	13,402.7	100.0%

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

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

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

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

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

Loans made under the Recovery Loan Scheme ('RLS'), the Coronavirus Business Interruption Loan Scheme ('CBILS') and the Bounce Back Loan Scheme ('BBLS') have the benefit of a guarantee underwritten by the UK Government.

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

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

	2022	2021
	£m	£m
Buy-to-let mortgages	**151.9**	163.3
Development finance	**306.9**	217.9
Structured lending	**179.4**	108.7
Asset finance	-	10.4
	638.2	500.3

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

Credit grading

An analysis of the Group's loans to customers by absolute level of credit risk at 30 September 2022 is set out below. The analysed amount represents gross carrying amount.

	Stage 1	Stage 2	Stage 3	POCI	Total
	£m	£m	£m	£m	£m
30 September 2022					
Very low risk	**10,270.3**	**846.7**	**1.1**	**9.2**	**11,127.3**
Low risk	**1,563.9**	**932.0**	**63.6**	**1.9**	**2,561.4**
Moderate risk	**118.6**	**114.1**	**4.3**	**2.5**	**239.5**
High risk	**35.0**	**34.6**	**9.7**	**4.1**	**83.4**
Very high risk	**44.4**	**35.1**	**42.2**	**9.3**	**131.0**
Not graded	**124.8**	**1.1**	**3.5**	**1.8**	**131.2**
Total gross carrying amount	**12,157.0**	**1,963.6**	**124.4**	**28.8**	**14,273.8**
Impairment	**(25.5)**	**(8.0)**	**(28.5)**	**(1.5)**	**(63.5)**
Total loans to customers	**12,131.5**	**1,955.6**	**95.9**	**27.3**	**14,210.3**
30 September 2021					
Very low risk	9,834.5	563.8	1.3	41.9	10,441.5
Low risk	1,716.9	532.2	78.5	16.3	2,343.9
Moderate risk	149.2	130.2	3.8	22.4	305.6
High risk	42.0	23.7	11.6	21.7	99.0
Very high risk	42.0	27.5	62.0	17.4	148.9
Not graded	115.8	1.7	7.1	4.6	129.2
Total gross carrying amount	11,900.4	1,279.1	164.3	124.3	13,468.1
Impairment	(15.0)	(11.3)	(38.9)	(0.2)	(65.4)
Total loans to customers	11,885.4	1,267.8	125.4	124.1	13,402.7

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 20, other than those shown as 'realisations'.

Examples of lower risk cases in higher IFRS 9 stages include fully up-to-date receiver of rent cases; accounts where the customer is in arrears on their account with the Group but up to date on accounts with other lenders, creating an overall positive credit rating; and accounts where the default on the Group's loan has yet to impact on the external credit score.

A small proportion of the loan book (2022: 0.9%, 2021: 1.0%) is classed as 'not graded' above. This rating generally relates to loans that have been fully underwritten at origination but where the customer falls outside the automated assessment techniques used post-completion.

Credit characteristics by portfolio

Loans secured on residential property

First mortgage loans have a contractual term of up to thirty years and second charge mortgage loans up to twenty five years. In all cases the customer is entitled to settle the loan at any point and in most cases early settlement does take place. All customers on these accounts are required to make monthly payments.

An analysis of the indexed Loan-to-Value ('LTV') ratio for those loan accounts secured on residential property by value at 30 September 2022 is set out below. LTVs for second charge mortgages are calculated allowing for the interest of the first charge holder, based on the most recent first charge amount held by the Group, while for acquired accounts the effect of any discount on purchase is allowed for.

	First charge mortgages		Second charge mortgages	
	2022	2021	**2022**	2021
	%	%	**%**	%
Loan to value ratio				
Less than 70%	**89.2**	83.8	**95.6**	88.4
70% to 80%	**9.4**	14.3	**2.4**	8.5
80% to 90%	**0.4**	0.5	**0.8**	1.5
90% to 100%	**0.3**	0.3	**0.2**	0.6
Over 100%	**0.7**	1.1	**1.0**	1.0
	100.0	100.0	**100.0**	100.0
Average LTV ratio	**57.8**	61.1	**50.6**	56.1
Of which:				
Buy-to-let	**57.9**	61.2		
Owner-occupied	**37.6**	42.0		

The regionally indexed LTVs shown above are affected by changes in house prices, with the Nationwide house price index, for the UK as a whole, registering an annual increase of 9.5% in the year ended 30 September 2022 (2021: 10.0%).

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

	First charge		Second charge	
	2022	2021	**2022**	2021
	%	%	**%**	%
East Anglia	**3.3**	3.3	**3.3**	3.3
East Midlands	**5.7**	5.5	**6.2**	6.3
Greater London	**18.2**	18.5	**7.8**	7.8
North	**3.3**	3.1	**4.1**	4.0
North West	**10.3**	10.3	**7.7**	7.4
South East	**31.2**	31.8	**38.2**	39.3
South West	**8.8**	8.7	**8.4**	8.3
West Midlands	**5.9**	5.5	**7.4**	7.1
Yorkshire and Humberside	**7.8**	8.1	**6.1**	6.0
Total England	**94.5**	94.8	**89.2**	89.5
Northern Ireland	**0.1**	0.1	**2.0**	1.8
Scotland	**2.3**	2.0	**5.4**	5.2
Wales	**3.1**	3.1	**3.4**	3.5
	100.0	100.0	**100.0**	100.0

Development finance

Development finance loans have an average term of 24 months (2021: 21 months). Settlement of principal and accrued interest takes place either on the sale of the development, or units within it, where appropriate, or on the refinancing of the property following its completion. The customer is not normally required to make payments during the term of the loan. The loans are secured by a legal charge over the site and / or property together with other charges and warranties related to the build.

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

	2022	**2022**	2021	2021
	By value	**By number**	By value	By number
	%	**%**	%	%
LTGDV				
50% or less	**7.9**	**5.1**	2.9	5.3
50% to 60%	**17.0**	**21.7**	27.3	20.6
60% to 65%	**45.0**	**39.1**	44.3	49.4
65% to 70%	**22.2**	**27.2**	22.8	21.9
70% to 75%	**5.8**	**6.2**	1.4	1.6
Over 75%	**2.1**	**0.7**	1.3	1.2
	100.0	**100.0**	100.0	100.0

The average LTGDV cover at the year end was 62.1% (2021: 61.7%).

LTGDV is calculated by comparing the current expected end of term exposure with the latest estimate of the value of the completed development based on surveyors' reports. The focus on residential property development within the portfolio means that asset values will generally move in line with the UK residential property market.

At 30 September 2022, the development finance portfolio comprised 276 accounts (2021: 247) with a total carrying value of £719.9m (2021: £608.2m). Of these accounts only nine were included in Stage 2 at 30 September 2022 (2021: ten), with no accounts classified as Stage 3 (2021: nil). In addition, one acquired account had been classified as POCI (2021: one). An allowance for this loss was made in the IFRS 3 fair value calculation.

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

	2022	2021
	%	%
East Anglia	**2.8**	3.6
East Midlands	**11.7**	6.3
Greater London	**10.5**	6.1
North	**1.2**	2.4
North West	**0.1**	1.1
South East	**46.3**	57.5
South West	**13.0**	13.5
West Midlands	**7.1**	4.8
Yorkshire and Humberside	**6.0**	3.5
Total England	**98.7**	98.8
Northern Ireland	**-**	-
Scotland	**1.3**	1.2
Wales	**-**	-
	100.0	100.0

Asset finance and motor finance

Asset and motor finance lending includes finance lease and hire purchase arrangements, which are accounted for as finance leases under IFRS 16. The average contractual life of the asset finance loans was 52 months (2021: 51 months) while that of the motor finance loans was 67 months (2021: 64 months), but historical behaviour suggests that a significant proportion of customers will choose to settle their obligations early.

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

	2022	2021
	%	%
Commercial vehicles	**37.4**	33.4
Construction plant	**33.2**	34.2
Manufacturing	**6.1**	6.2
Technology	**4.9**	7.0
Other vehicles	**4.7**	4.3
Refuse disposal vehicles	**3.7**	4.3
Agriculture	**2.4**	3.1
Print and paper	**1.3**	2.3
Other	**6.3**	5.2
	100.0	100.0

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

Structured lending

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

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

	2022	2021
Number of active facilities	**8**	8
Total facilities (£m)	**220.5**	185.5
Carrying value (£m)	**178.7**	118.9

The maximum advance under these facilities was generally 80% of the underlying assets, except where loans secured by residential property form the security for the facility, where 90% is admissible.

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

At 30 September 2022, all of these facilities were identified as Stage 1. At 30 September 2021 one of these facilities was identified as Stage 2 with the remainder in Stage 1.

RLS, CBILS and BBLS

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

CBILS and BBLS were launched in 2020 and remained open for new applications until March 2021. RLS was launched in April 2021 as a successor scheme and has subsequently been extended twice. It is currently expected to be available for new lending until June 2024.

The Group offered term loans and asset finance loans under the CBIL scheme. Interest and fees were paid by the UK Government for the first twelve months and the government guarantee covers up to 80% of the lender's principal loss after the application of any proceeds from the asset financed (if applicable).

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

The Group offers term loans and asset finance loans under the RLS. Interest and fees are payable by the customer from inception. The Government guarantee covers up to 80% of the lender's principal loss, after the application of any proceeds from the asset financed (if applicable), on applications received before 1 January 2022 and up to 70% for applications received thereafter.

The Group's outstanding RLS, CBILS and BBLS loans at 30 September 2022 were:

	2022	2021
	£m	£m
RLS		
Term loans	**0.6**	0.1
Asset finance	**41.5**	20.7
Total RLS	**42.1**	20.8
CBILS		
Term loans	**18.3**	28.1
Asset finance	**23.6**	29.9
Total CBILS	**41.9**	58.0
BBLS	**4.0**	5.0
	88.0	83.8
Total term loans	**22.9**	33.2
Total asset finance (note 18)	**65.1**	50.6
	88.0	83.8

At 30 September 2022, £0.6m of this balance was considered to be non-performing (2021: £0.2m).

Unsecured consumer loans

The Group disposed of almost all its unsecured consumer loan portfolio during the year (note 7). It retains an interest only in a limited number of unsecured accounts excluded from the sale.

Almost all the Group's unsecured consumer loan assets were part of purchased debt portfolios where the consideration paid was based on the credit quality and performance of the loans at the point of the transaction. Collections on purchased accounts remained in excess of those implicit in the purchase prices until the point of sale in June 2022.

Arrears performance

The number of accounts in arrears by asset class, based on the most commonly quoted definition of arrears for the type of asset, at 30 September 2022 and 30 September 2021, compared to the industry averages at those dates published by UK Finance ('UKF') and the FLA, was:

	2022	2021
	%	%
First mortgages		
Accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	**0.15**	0.21
Buy-to-let accounts excluding receiver of rent cases	**0.11**	0.14
Owner-occupied accounts	**2.79**	4.48
UKF data for mortgage accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	**0.41**	0.47
Buy-to-let accounts excluding receiver of rent cases	**0.39**	0.45
Owner-occupied accounts	**0.80**	0.94
All mortgages	**0.72**	0.85
Second charge mortgage loans		
Accounts more than 2 months in arrears		
All accounts	**21.33**	19.08
Post-2010 originations	**1.88**	1.18
Legacy cases (pre-2010 originations)	**24.45**	23.12
Purchased assets	**27.71**	24.76
FLA data for secured loans	**7.50**	8.60
Motor finance loans		
Accounts more than 2 months in arrears		
All accounts	**2.07**	4.15
Originated cases	**1.58**	2.30
Purchased assets	**8.94**	14.07
FLA data for point of sale hire purchase	**3.40**	3.40
Asset finance loans		
Accounts more than 2 months in arrears	**0.08**	0.27
FLA data for business lease / hire purchase loans	**0.80**	0.70

No published industry data for asset classes comparable to the Group's other books has been identified. Where revised data at 30 September 2021 has been published by the FLA or UKF, the comparative industry figures above have been amended.

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

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

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

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

Acquired assets

A significant proportion of the Group' second charge mortgage balances and, historically, almost all its unsecured consumer loan assets are, or were, part of purchased debt portfolios, where the consideration paid was based on the credit quality and performance of the loans at the point of the transaction. No additional loans to customers treated as POCI were acquired in the year ended 30 September 2021 or the year ended 30 September 2022

Collections on purchased accounts have been comfortably in excess of those implicit in the purchase prices.

In the debt purchase industry, Estimated Remaining Collections ('ERC') is commonly used as a measure of the value of a portfolio. This is defined as the sum of the undiscounted cash flows expected to be received over a specified future period. In the Group's view, this measure may be suitable for heavily discounted, unsecured, distressed portfolios (which will be treated as POCI under IFRS 9), but is less applicable for the types of portfolio in which the Group has invested, where cash flows are higher on acquisition, loans may be secured on property and customers may not be in default. In such cases, the IFRS 9 amortised cost balance, at which these assets are carried in the Group balance sheet, provides a better indication of value.

However, to aid comparability, the 84 and 120 month ERCs value for the Group's purchased consumer loan assets, are set out below. These are derived using the same models and assumptions used in the EIR calculations. ERCs are set out both for all purchased consumer portfolios and for those classified as POCI under IFRS 9.

	2022	2021	2020
	£m	£m	£m
All purchased consumer assets			
Carrying value	**75.3**	185.2	235.3
84 month ERC	**88.6**	221.2	277.8
120 month ERC	**94.2**	245.2	313.7
POCI assets only			
Carrying value	**21.4**	113.2	139.8
84 month ERC	**29.9**	143.9	176.9
120 month ERC	**33.0**	163.4	203.7

Amounts shown above are disclosed as loans to customers (note 17). They include first mortgages, second charge mortgage loans and, in the amounts shown for 2021 and 2020, unsecured consumer loans.

The reduction in the year primarily reflects the disposal of the Group's unsecured consumer lending assets (note 7).

Cash balances

The credit risk inherent in the cash positions of the Group and the Company is controlled by ALCO, which determines which institutions deposits may be placed with. The Group has formal risk appetites, policies and limits, approved by the Risk and Compliance Committee. These include limitations on large exposures to mitigate any concentration risk in respect of its investments.

For cash deposits within the Group's securitisation structures, the scheme documents will set out criteria for allowable investments, including rating thresholds.

The Group's cash balances are held in sterling at the Bank of England and at highly rated banks in current and call accounts. Cash is also invested in UK government securities and as short fixed-term money market deposits from time to time.

The carrying value of the Group's and the Company's cash balances analysed by their long-term credit rating as determined by Fitch is set out below.

	2022	2021
	£m	£m
The Group		
Cash with central banks rated:		
AA-	**1,612.5**	1,142.0
	1,612.5	1,142.0
Cash with retail banks rated:		
AA-	**46.9**	50.5
A+	**271.5**	167.6
	318.4	218.1
Total exposure	**1,930.9**	1,360.1
The Company		
Cash with retail banks rated:		
A+	**19.7**	19.6

CRDs are exposures to the Bank of England and thus share the central bank rating noted above while CSA assets, placed with retail banks, have similar ratings to those shown above for retail bank deposits

Credit risk on all these balances, and any interest accrued thereon, is considered to be minimal. These balances are considered as Stage 1 for IFRS 9 impairment purposes with a PD such that any provision required would be immaterial.

Trade debtors

The Group's trade debtors balance represents principally amounts outstanding on unpaid operating lease obligations in the asset finance business, where similar acceptance criteria to those used for finance lease cases apply.

Financial assets at fair value

The Group's financial assets held at fair value comprise solely derivative financial instruments used for hedging purposes (note 25).

In order to control credit risk relating to counterparties to the Group's derivative financial instruments, ALCO reviews which counterparties the Group will deal with, establishes limits for each counterparty and monitors compliance with those limits. Any changes necessary are proposed to ERC for approval. The Group's counterparties are typically highly rated banks and, for all derivative positions held within securitisation structures, must comply with criteria set out in the financing arrangements, which are monitored externally.

Since June 2019, the Group has been centrally clearing certain eligible derivatives with a Central Clearing Counterparty ('CCP') which removes credit risk between bilateral counterparties and ensures timely settlement and / or porting of derivative contracts in the event of the failure of a counterparty.

The Group uses the ISDA Master Agreement and Credit Support Annex ('CSA') for documenting uncleared derivative activity. Under a CSA, collateral is passed between counterparties to mitigate the market contingent counterparty risk inherent in the outstanding positions. Collateral pledged to such counterparties by the Group is shown in note 26, while collateral pledged to the Group is shown in note 38.

The Group's exposure to credit risk in respect of the counterparties to its derivative financial assets, analysed by their long-term credit rating as determined by Fitch is set out below.

	2022	2021
	£m	£m
Carrying value of derivative financial assets		
Counterparties rated		
AA	**7.0**	0.1
AA-	**0.5**	0.4
A+	**757.0**	43.1
A	**14.5**	0.6
Gross exposure (note 25)	**779.0**	44.2
Collateral amounts posted		
CSA collateral amounts (note 38)	**(388.3)**	-
Total collateral	**(388.3)**	-
Net exposure	**390.7**	44.2

62. Liquidity risk

Liquidity risk is the risk that the Group might be unable to meet its liabilities as they fall due.

The Group's principal source of liquidity risk is from its retail deposit funding. Deposit balances raised are typically used to support lending activities where maturity is over a longer period than that of the deposits. This maturity transformation exposes the Group to liquidity risk.

Further liquidity risk arises:

- In the medium term from the Group's corporate and retail bonds which are used to support its general operations and from its participation in central bank funding schemes
- From the Group's derivatives portfolio which gives rise to liquidity risk due to the collateral requirements to cover adverse changes in valuation
- From the Group's participation in wholesale funding, including SPVs, where sufficient funding must be available

Liquidity is also required to provide capital support for new loans and working capital for the Group.

Where assets are funded by non-recourse arrangements, through the securitisation process, liquidity risk is effectively eliminated.

As an authorised deposit taker, the liquidity position of Paragon Bank PLC, the Group's banking subsidiary, is also managed on a stand-alone basis.

Set out below is a summary of the contractual cash flows expected to arise from the Group's financial and leasing liabilities, based on the earliest date at which repayment can be demanded.

	Amounts payable				
	In one year or less, or on demand	In more than one year, but not more than two years	In more than two years but not more than five years	In more than five years	Total
	£m	£m	£m	£m	£m
30 September 2022					
Retail deposits	**8,703.4**	**1,697.8**	**452.0**	**32.0**	**10,885.2**
Borrowings	**119.0**	**251.3**	**2,928.2**	**178.1**	**3,476.6**
Total non-derivative liabilities	**8,822.4**	**1,949.1**	**3,380.2**	**210.1**	**14,361.8**
Derivative liabilities	**88.8**	**24.0**	**3.6**	**0.1**	**116.5**
	8,911.2	**1,973.1**	**3,383.8**	**210.2**	**14,478.3**
30 September 2021					
Retail deposits	7,306.3	1,626.9	540.1	12.3	9,485.6
Borrowings	220.3	25.0	2,913.7	185.6	3,344.6
Total non-derivative liabilities	7,526.6	1,651.9	3,453.8	197.9	12,830.2
Derivative liabilities	1.8	11.7	28.9	0.4	42.8
	7,528.4	1,663.6	3,482.7	198.3	12,873.0

Non-recourse balances are payable only to the extent that funds are available, as described further below, and do not expose the Group to any material liquidity risk. They are therefore not included in the table above.

As the amounts set out above include all expected future cash flows, including principal and interest, they will not agree to amortised cost or fair value amounts reported in the balance sheet.

Further information on the liquidity exposure arising from the Group's retail deposits, securitisation and other borrowings is set out below.

The liquidity exposures of the Company arise only from its borrowings, and are set out below.

The overall responsibility for the management of liquidity risk rests with ALCO which makes recommendations for the Group's liquidity policy for board approval. ALCO monitors liquidity risk metrics within limits set by the Board or regulators and uses detailed cash flow projections to ensure that an adequate level of liquidity is available at all times.

The Group's and the Bank's liquidity position is managed on a day to day basis by the treasury function, under the supervision of ALCO.

Retail deposits

The Group's retail funding strategy is focussed on building a stable mix of deposit products. A high proportion of balances, around 95%, are protected by the FSCS which mitigates against the possibility of a retail run.

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

	2022	2021
	£m	£m
Payable on demand	**3,934.6**	3,308.7
Payable in less than three months	**955.1**	808.1
Payable in less than one year but more than three months	**3,813.7**	3,189.5
Payable in less than one year or on demand	**8,703.4**	7,306.3
Payable in one to two years	**1,697.8**	1,626.9
Payable in two to five years	**452.0**	540.1
Payable after more than five years	**32.0**	12.3
	10,885.2	9,485.6

In order to reduce the liquidity risk inherent in the Group's retail deposit balances, the PRA requires that the Bank, like other regulated banks, maintains a buffer of liquid assets to ensure it has sufficient available funds at all times to protect against unforeseen circumstances. The amount of this buffer is calculated using Individual Liquidity Guidance ('ILG') set by the PRA based on the Internal Liquidity Adequacy Assessment Process ('ILAAP') undertaken by the Bank. The ILAAP determines the liquid resources that must be maintained in the Bank to meet the Overall Liquidity Adequacy Rule ('OLAR') and to ensure that it can meet its liabilities as they fall due. It is based on an analysis of its business as usual forecast cash requirements but also considers their predicted behaviour in stressed conditions.

At 30 September 2022 the liquidity buffer comprised the following on and off balance sheet assets. All these assets are held within the Bank and are readily realisable.

	2022	2021
	£m	£m
Balances with central banks	**1,505.5**	942.7
Total on balance sheet liquidity	**1,505.5**	942.7
Long/ short repo transaction	**150.0**	150.0
	1,655.5	1,092.7

Balances with central banks above exclude group cash balances placed on deposit at the Bank of England through Paragon Bank.

Paragon Bank manages its Liquidity Coverage Ratio ('LCR'), the level of its High Quality Liquid Assets ('HQLA') relative to its short-term forecast net cash outflows. A minimum level of LCR is set through regulation for all regulated financial institutions. As at 30 September 2022, the Bank's LCR was comfortably above the required minimum regulatory standard. The Bank also monitors its Net Stable Funding Ratio ('NSFR') which measures the stability of the funding profile in relation to the composition of its assets and off balance sheet activities.

Liquidity is not regulated at Group level.

Borrowings

Set out below is the contractual maturity profile of the Group's and the Company's borrowings at 30 September 2022 and 30 September 2021 based on their carrying values. These are analysed between non-recourse (securitisation) and other funding, with the liquidity position arising principally from the other funding.

The Group

	Financial liabilities falling due:				
	In one year or less, or on demand	In more than one year, but not more than two years	In more than two years but not more than five years	In more than five years	Total
	£m	£m	£m	£m	£m
30 September 2022					
Secured bank borrowings	**-**	**170.0**	**-**	**416.0**	**586.0**
Asset backed loan notes	**-**	**-**	**-**	**409.3**	**409.3**
Total non-recourse funding	**-**	**170.0**	**-**	**825.3**	**995.3**
Bank overdrafts	**0.4**	**-**	**-**	**-**	**0.4**
Retail bonds	**-**	**112.3**	**-**	**-**	**112.3**
Corporate bond	**-**	**-**	**-**	**149.2**	**149.2**
Central bank facilities	**-**	**-**	**2,750.0**	**-**	**2,750.0**
Lease liabilities	**2.2**	**1.9**	**3.8**	**1.1**	**9.0**
	2.6	**284.2**	**2,753.8**	**975.6**	**4,016.2**
30 September 2021					
Secured bank borrowings	201.0	-	-	529.0	730.0
Asset backed loan notes	-	-	-	516.0	516.0
Total non-recourse funding	201.0	-	-	1,045.0	1,246.0
Bank overdrafts	0.3	-	-	-	0.3
Retail bonds	125.0	-	112.1	-	237.1
Corporate bond	-	-	-	149.0	149.0
Central bank facilities	69.0	-	2,750.0	-	2,819.0
Lease liabilities	1.5	1.9	3.8	2.3	9.5
	396.8	1.9	2,865.9	1,196.3	4,460.9

The Company

	Financial liabilities falling due:				
	In one year or less, or on demand	In more than one year, but not more than two years	In more than two years but not more than five years	In more than five years	Total
	£m	£m	£m	£m	£m
30 September 2022					
Retail bonds	**-**	**112.3**	**-**	**-**	**112.3**
Corporate bond	**-**	**-**	**-**	**149.2**	**149.2**
Lease liabilities	**1.3**	**1.3**	**4.2**	**8.2**	**15.0**
	1.3	**113.6**	**4.2**	**157.4**	**276.5**
30 September 2021					
Retail bonds	125.0	-	112.1	-	237.1
Corporate Bond	-	-	-	149.0	149.0
Lease liabilities	1.3	1.3	4.1	9.6	16.3
	126.3	1.3	116.2	158.6	402.4

IFRS 7 requires the disclosure of future contractual cash flows (including interest) on these borrowings, and these are described and set out on the following pages.

Non-recourse funding

The Group has historically used securitisation as a principal source of funding, but currently only accesses this market on a strategic basis. In a securitisation an SPV company within the Group will issue asset backed loan notes ('Notes') secured on a pool of mortgage or other loan assets beneficially owned by the SPV in a public offer. The Notes have a maturity date later than the final repayment date for any asset in the pool, typically over thirty years from the issue date. The noteholders are entitled to receive repayment of the Note principal from principal funds generated by the loan assets from time to time, but their right to the repayment of principal is limited to the cash available in the SPV. Similarly, payment of accrued interest to the noteholders is limited to cash generated within the SPV. There is no requirement for any Group company other than the issuing SPV to make principal or interest payments in respect of the Notes. This matching of the maturities of the assets and the related funding substantially reduces the Group's exposure to liquidity risk. Details of Notes in issue are given in note 33 and the assets backing the Notes are shown in note 17.

In each case the Group provides funding to the SPV at inception, subordinated to the Notes, which means that the primary credit risk on the pool assets is retained within the Group. The Group receives the residual income generated by the assets. These factors mean that the risks and rewards of ownership of the assets remain with the Group, and hence the loans remain on the Group's balance sheet.

Cash received from time to time in each SPV is held until the next interest payment date when, following payment of principal, interest and the associated costs of the SPV, the remaining balances become available to the Group. Cash balances are also held within each SPV to provide credit enhancement for the particular securitisation, allowing interest and principal payments to be made even if some of the loans default. The cash balances of the SPV companies are included within the restricted cash balances disclosed in note 16 as 'securitisation cash'.

Newly originated mortgage loans may be initially funded by a revolving loan facility or 'warehouse' from the point of their origination until their inclusion in a securitisation transaction or other refinancing. A warehouse may also be used to hold acquired loans or to refinance group loans on a short-term basis. A warehouse company functions in a similar way to an SPV, except that funds are drawn down as advances are made or loans are sold in, repaid when loans are securitised or refinanced by an internal asset sale and may subsequently be redrawn up to the end of a commitment period. The Group's Paragon Second Funding facility was initiated as a warehouse, but is no longer available for new drawings.

Repayment of the principal amount of the facilities is not required unless amounts are realised from the secured assets either through repayment, securitisation or asset sales, even after the end of the commitment period. There is no further recourse to other assets of the Group in respect of either interest or principal on the borrowings.

As with the SPVs, the Group provides subordinated funding to active warehouse companies and restricted cash balances are held within them. Contributions to the subordinated funding are made each time a drawing on the facility concerned is made. These amounts provide credit enhancement to the warehouse and cover certain fees. This funding is repaid when assets are securitised or refinanced by an internal asset sale. Credit enhancement in the active warehouse at 30 September 2022 was £23.2m (2021: £27.4m) and undrawn facilities of £280.0m were available at the year-end (2021: £199.0m).

Further details of the warehouse facilities are given in note 34 and details of the loan assets within the warehouses are given in note 17.

The final repayment date for all of the securitisation borrowings and the Paragon Second Funding warehouse borrowing is more than five years from the balance sheet date, the earliest falling due in 2045 and the latest in 2050.

The sterling principal amount outstanding at 30 September 2022 under the SPV and warehouse arrangement was £996.5m (2021: £1,248.1m). The total sterling amount payable under these arrangements, were these principal amounts to remain outstanding until the final repayment date, would be £1,912.3m (2021: £1,886.9m). As the principal will, as discussed above, reduce as customers repay or redeem their accounts, the cash flow will be far less than this amount in practice

Corporate debt

In February 2013, the Company initiated a Euro Medium Term Note issuance programme, with a maximum issuance of £1,000.0m. The Company had the ability to issue further notes under the programme and has issued three fixed rate bonds for a total of £297.5m, with interest rates ranging from 6.000% to 6.125% and maturities ranging from December 2020 to August 2024, the most recent issue of £112.5m being made in August 2015. Following redemptions in the year, only the most recent bond remains outstanding.

The Group issued £150.0m of green tier-2 debt in March 2021. This bond is optionally callable between 25 June 2026 and 25 September 2026 and has a final maturity date of 25 September 2031.

The Group's ability to issue debt is supported by its credit rating issued by Fitch which was upgraded from BBB to BBB+ in March 2022.

None of the Group's corporate and retail bond issuance falls due for payment in the next twelve months.

Central bank facilities

The Group has accessed term credit facilities under the central bank schemes described in note 37. The Group has prepositioned further assets with the Bank of England which can be used to release more funds for liquidity or other purposes. At 30 September 2022 the amount of drawings available in respect of prepositioned assets was £1,776.0m (2021: £1,424.2m).

Additional Liquidity

The Group holds certain of its own listed, externally rated, asset backed securities which may be used as security to access term credit and other facilities, including those offered by the Bank of England. The principal value of these notes is analysed by credit grade and utilisation status below.

	2022			2021		
	Utilised	**Available**	**Total**	Utilised	Available	Total
	£m	**£m**	**£m**	£m	£m	£m
Rating						
AAA	**1,212.7**	**213.0**	**1,425.7**	1,276.1	287.0	1,563.1
AA+ / AA / AA-	**5.3**	**100.9**	**106.2**	5.3	100.9	106.2
A+ / A / A-	**4.6**	**59.9**	**64.5**	4.6	59.9	64.5
BBB+ / BBB / BBB-	**4.3**	**81.4**	**85.7**	4.3	81.4	85.7
	1,226.9	**455.2**	**1,682.1**	1,290.3	529.2	1,819.5

As these notes are held internally, they are not included in balance sheet liabilities. Mortgage assets backing these securities remain on the Group's balance sheet and are included in amounts pledged as collateral in note 17.

Utilised notes includes those which the Group is obliged to hold under regulations governing securitisation issuance.

The available AAA notes would give access to £171.6m (2021: £149.3m) if used to secure drawings on Bank of England facilities.

During the year ended 30 September 2020, the Group entered into a back-to-back long / short sale and repurchase ('repo') transaction with a UK bank which continued throughout the current year. This provides £150.0m of liquidity (2021: £150.0m), utilising £26.8m of the loan notes shown above, but does not appear on the Group's balance sheet.

The Group has also entered into short-term repo transactions from time-to-time, most recently in the year ended 30 September 2021, and maintains the capability to access the repo market for liquidity purposes.

Contractual cash flows

The total undiscounted amounts, inclusive of estimated interest, which would be payable in respect of the non-securitisation borrowings of the Group and the Company, should those balances remain outstanding until the contracted repayment date, or the earliest date on which repayment can be required, are set out below.

	Contingent consideration	Corporate bonds	Retail bonds	Central bank facilities	Lease liabilities	Total
	£m	£m	£m		£m	£m
a) The Group						
30 September 2022						
Payable in:						
Less than one year	**2.2**	**6.6**	**6.8**	**101.4**	**2.0**	**119.0**
One to two years	-	**6.6**	**119.2**	**123.8**	**1.7**	**251.3**
Two to five years	-	**19.7**	-	**2,905.0**	**3.5**	**2,928.2**
Over five years	-	**176.2**	-	-	**1.9**	**178.1**
	2.2	**209.1**	**126.0**	**3,130.2**	**9.1**	**3,476.6**
30 September 2021						
Payable in:						
Less than one year	4.6	6.6	135.6	71.8	1.7	220.3
One to two years	3.0	6.6	6.8	6.7	1.9	25.0
Two to five years	-	19.7	119.2	2,770.9	3.9	2,913.7
Over five years	-	182.7	-	-	2.9	185.6
	7.6	215.6	261.6	2,849.4	10.4	3,344.6

	Corporate bonds	Retail bonds	Lease liabilities	Total
	£m	£m	£m	£m
b) The Company				
30 September 2022				
Payable in:				
Less than one year	**6.6**	**6.8**	**1.7**	**15.1**
One to two years	**6.6**	**119.2**	**1.7**	**127.5**
Two to five years	**19.7**	-	**5.0**	**24.7**
Over five years	**176.2**	-	**8.7**	**184.9**
	209.1	**126.0**	**17.1**	**352.2**
30 September 2021				
Payable in:				
Less than one year	6.6	135.6	1.7	143.9
One to two years	6.6	6.8	1.7	15.1
Two to five years	19.7	119.2	5.0	143.9
Over five years	182.7	-	10.3	193.0
	215.6	261.6	18.7	495.9

Amounts payable in respect of the 'other accruals' and 'trade creditors' shown in note 38 fall due within one year. The cash flows described above will include those for interest on borrowings accrued at 30 September 2022 disclosed in note 38.

The cash flows which are expected to arise from derivative contracts in place at the year end, estimating future floating rate payments and receipts on the basis of the yield curve at the balance sheet date are as follows:

	2022	2021
	Total cash outflow / (inflow)	Total cash outflow / (inflow)
	£m	£m
On derivative liabilities		
Payable in less than one year	**88.8**	1.8
Payable in one to two years	**24.0**	11.7
Payable in two to five years	**3.6**	28.9
Payable in over five years	**0.1**	0.4
	116.5	42.8
On derivative assets		
Payable in less than one year	**(253.1)**	(25.1)
Payable in one to two years	**(246.2)**	(13.6)
Payable in two to five years	**(342.0)**	(3.8)
Payable in over five years	**(2.7)**	-
	(844.0)	(42.5)
	(727.5)	0.3

63. Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. The Group's exposure to market risk is mainly through interest rate risk, though there is some minor exposure to currency risk. These exposures arise solely through the Group's lending and deposit taking business – no speculative trading in financial instruments is undertaken.

Interest rate risk

Interest rate risk is the current or prospective risk to capital or earnings arising from adverse movements in interest rates.
The Group's exposure to this risk is a natural consequence of its lending, deposit-taking and other borrowing activities, as some of its financial assets and liabilities bear interest at rates which float with various market rates while others are fixed, either for a term or for their whole lives. Such risk is referred to as Interest Rate Risk in the Banking Book ('IRRBB'). The Group does not seek to generate income from taking interest rate risk and aims to minimise exposures that occur as a natural consequence of carrying out its normal business activities.

The principal market-set interest rate used by the Group has historically been LIBOR, which has been used to set rates for certain loan assets and borrowings. However, the Group completed its transition to the use of alternative reference rates, principally SONIA, during the year. All new wholesale debt and interest rate swaps recognised since that point have referenced SONIA, while existing LIBOR linked instruments have been transitioned.

The Group's risk management framework for IRRBB continues to evolve in line with updates in regulatory guidance on methods expected to be used by banks measuring, managing, monitoring and controlling such risks. The Group will continue to develop these processes as interpretation of these standards becomes clearer as they become more widely implemented.

IRRBB is managed through board approved risk appetite limits and policies. The Group seeks to match the structure of assets and liabilities naturally where possible or by using appropriate financial instruments, such as interest rate swaps. Day-to-day management of interest rate risk is the responsibility of the Group's Treasury function, with control and oversight provided by ALCO.

IRRBB exposures

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

- Duration or re-pricing risk. The risk created when interest rates on assets, liabilities and off-balance sheet items reprice at different times causing them to move by different amounts
- Basis risk. The risk arising where assets and liabilities re-price with reference to different reference interest rates, for example rates set by the Group and market rates, such as Bank of England base rate, SONIA and, before its withdrawal, LIBOR. Relative changes in the difference between the reference rates over time may impact earnings
- Optionality or prepayment risk. The risk that settlement of asset and liability balances at different times from those forecast due to economic conditions or customer behaviour may create a mismatch in future periods

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

The Group measures these risks through a combination of economic value and earnings-based measures considering prepayment risk:

- Economic Value ('EV') – a range of parallel and non-parallel interest rate stresses are applied to assess the change in market value from assets, liabilities and off balance sheet items re-pricing at different times
- Net Interest Income ('NII') - impact on earnings from a range of interest rate stresses

The Group's use of financial derivatives for hedging interest rate risk is discussed further in note 25.

IBOR transition

In July 2017 the FCA announced that by the end of 2021 it would no longer compel banks to make submissions to the LIBOR setting process. As a result of this, LIBOR was discontinued in the early part of the financial year. The UK Working Group on Sterling Risk-Free Interest Rates recommended SONIA as its replacement and this recommendation was adopted by the Group where appropriate.

LIBOR was historically used in setting interest rates on significant amounts of the Group's loan assets and borrowings and an internal working group was established to identify the impact on the business and ensure an orderly transition from LIBOR to other reference rates across all classes of financial instrument. This process was completed ahead of the required date.

The current balances of the Group's loans to customers where the interest rate or the reversionary interest rate is set by reference to IBOR rates are set out below.

	2022	2021
	£m	£m
Development finance facilities	-	63.3
Second charge mortgages	-	45.0
Structured lending	-	43.4
Aviation mortgages	-	12.1
	-	163.8

All these loans referenced sterling LIBOR, except certain aviation mortgages denominated in US dollars which referenced US dollar LIBOR.

The Group's development finance operation ceased to lend on a LIBOR-linked basis from 1 April 2020. A programme to transition the remaining LIBOR-linked facilities to the Group's Commercial Variable Rate ('CVR') commenced in that year. Of the balance shown above, £21.0m transitioned with effect from 1 October 2021 and the remaining balances were repaid before 31 December 2021.

The second charge mortgages shown above were moved to LIBOR as a temporary measure following the withdrawal of the Finance House Base Rate in 2020. They were transitioned to a basis calculated based on movements in the Bank Base Rate ('BBR') in December 2021.

Structured finance facilities agreed since 22 February 2021 have interest rates linked to Daily Compounded SONIA. The majority of extant LIBOR loans were transitioned to the SONIA basis during that year with the remainder transitioned before the end of December 2021.

No new aviation mortgages referencing sterling LIBOR have been written since 1 October 2020. All extant LIBOR linked loans were transitioned to BBR-linked arrangements during the year ended 30 September 2021.

Aviation mortgages referencing US Dollar LIBOR were transitioned to reference the US Fed Funds (upper bound) rate during the year.

Borrowings where interest rates had been based on LIBOR and other IBOR rates are shown in notes 33 and 34. All such arrangements have either expired or transitioned to SONIA during the year.

Derivative financial assets and liabilities where cash flows are based on IBOR rates are shown in note 25. All remaining LIBOR linked derivatives at 30 September 2021 transitioned to SONIA in line with ISDA protocols at the LIBOR withdrawal date.

Interest rate sensitivity

To provide a broad indication of the Group's exposure to interest rate movements, the notional impact of a 1.0% change in UK interest rates on the equity of the Group at 30 September 2022, and the notional annualised impact of such a change on the operating profit of the Group, based on the year-end balance sheet have been calculated.

As a simplification this calculation assumes that all relevant UK interest rates move by the same amount in parallel and that all repricing takes place at the balance sheet date.

On this basis, a 1.0% increase in UK interest rates would increase profit before tax by £21.7m (2021: increase by £16.7m).

The principal direct point in time impact on the Group's equity would result from the revaluation of derivative assets and liabilities which are not part of fair value hedges at the balance sheet date. A 1.0% increase in rate expectations would increase equity by £34.6m (2021: increase by £13.4m). For this illustration no ineffectiveness in hedging relationships is assumed.

These calculations allow only for the direct effects of any change in UK interest rates. In practice, such a change might have wider economic consequences which would themselves potentially affect the Group's business and results.

It should be noted that these sensitivities are illustrative only, and much simplified from those used to manage IRRBB in practice.

The Company

All the borrowings of the Company have fixed interest rates. The Company's investments in loans to subsidiary companies include a Tier-2 Bond issued by Paragon Bank PLC, with terms matching the Tier-2 Bond issued by the Company. Its intercompany balance with Paragon Bank also includes £257.0m which is placed on deposit with the Bank of England. Interest is received on this balance at the same rate as that paid by the Bank of England. Other assets and liabilities with group entities bore interest at rates based on LIBOR up to 30 September 2021, after which they were transitioned to a SONIA basis. All other balances in the Company balance sheet are non-interest bearing.

Currency risk

Currency risk, also referred to as foreign exchange or forex risk, is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The Group has little appetite for material amounts of exposure to currency risk and applies a hedging strategy for any material open positions through the use of spot or forward contracts or derivatives.

All the Group's significant assets and liabilities at 30 September 2022 and 30 September 2021 are denominated in sterling.

The SME lending business has a limited amount of lending denominated in US dollars and may contract to purchase assets for leasing in currency. These balances are hedged by the purchase of currency derivatives and / or appropriate currency balances.

As a result of these arrangements the Group has no material exposure to foreign currency risk, and no sensitivity analysis is presented for currency risk.

The Group's use of financial derivatives to manage currency risk is described further in note 25.

None of the assets or liabilities of the Company are denominated in foreign currencies.

D2.4 Notes to the Accounts - Basis of preparation

For the year ended 30 September 2022

The notes set out below describe the accounting basis on which the Group and the Company prepare their accounts, the particular accounting policies adopted by the Group and the principal judgements and estimates which were required in the preparation of the financial statements.

They also include other information describing how the accounts have been prepared required by legislation and accounting standards.

64. Basis of preparation

The Group is required, by the Companies Act 2006 and the Listing Rules of the FCA, to prepare its financial statements for the year ended 30 September 2022 in accordance with UK-adopted international accounting standards. In the financial years reported on this also means, in the Group's circumstances, that the financial statements also accord with IFRS as approved by the International Accounting Standards Board.

In previous periods financial statements had been prepared under EU endorsed IFRS, however the change of framework does not change the substance of the requirements applying to the Group and no prior-year restatement of the financial statements is required.

The particular accounting policies adopted have been set out in note 65 and the critical accounting judgements and estimates which have been required in preparing these financial statements are described in notes 66 and 67 respectively.

The Group has historically chosen to present an additional comparative balance sheet.

Adoption of new and revised reporting standards

In the preparation of these financial statements, no accounting standards are being applied for the first time.

Standards not yet adopted

There are no standards and interpretations in issue but not effective which address matters relevant to the Group's accounting and reporting.

Restatement of segments

Following the scale of a substantial part of the assets of the former Idem Capital segment (note 7) the remaining segment represented a disproportionately small part of the Group compared to the other two segments. The directors determined it was appropriate to adopt a new segmental analysis, described in note 2 and comparative amounts have been restated.

This restatement has no impact on the overall profit, assets and liabilities, equity, capital, or cash flows of the Group.

The segmental results of the Idem Capital segment reported in 2021 (a profit of £17.1m) and the loan assets of the segment (£225.2m) have been subsumed into the two ongoing segments in the comparative disclosures.

65. Accounting policies

The particular policies applied by the Group in preparing these financial statements in accordance with the IFRS regime as adopted in the UK are described below.

(a) Accounting convention

The financial statements have been prepared under the historical cost convention, except as required in the valuation of certain financial instruments which are carried at fair value.

(b) Basis of consolidation

The consolidated financial statements deal with the accounts of the Company and its subsidiaries made up to 30 September 2022. Subsidiaries comprise all those entities over which the Group has control, as defined by IFRS 10 – 'Consolidated Financial Statements'.

In addition to legal subsidiaries, where the Company owns shares in the entity, directly or indirectly, in accordance with IFRS 10, companies owned by charitable trusts into which loans originated by group companies were sold as part of its warehouse and securitisation funding arrangements, where the Group enjoys the benefits of ownership and which, therefore, it is considered to control, are treated as subsidiaries.

Similarly, trusts set up to hold shares in conjunction with the Group's employee share ownership arrangements are also treated as subsidiaries.

A full list of the Group's subsidiaries is set out in note 70, together with further information on the basis on which they are considered to be controlled by the Company. The results of businesses acquired are dealt with in the consolidated accounts from the date of acquisition.

(c) Going concern

The consolidated financial statements have been prepared on the going concern basis.

The directors have adopted this basis following a going concern assessment for the Group and the Company covering a period of at least twelve months following the date of approval of these financial statements. Details of this assessment are set out in note 68.

(d) Acquisitions and goodwill

Goodwill arising from the purchase of subsidiary undertakings, representing the excess of the fair value of the purchase consideration over the fair values of acquired assets, including intangible assets, is held on the balance sheet and reviewed annually to determine whether any impairment has occurred.

As permitted by IFRS 1, the Group has elected not to apply IFRS 3 – 'Business Combinations' to combinations taking place before its transition date to IFRS (1 October 2004). Therefore any goodwill which was written off to reserves under UK GAAP will not be charged or credited to the profit and loss account on any future disposal of the business to which it relates.

Contingent consideration arising on acquisitions is first recognised in the accounts at its fair value at the acquisition date and subsequently revalued at each accounting date until it falls due for payment or the final amount is otherwise determined.

(e) Cash and cash equivalents

Balances shown as cash and cash equivalents in the balance sheet comprise demand deposits and short-term deposits with banks with initial maturities of not more than 90 days.

(f) Leases

For leases where the Group is the lessee a right of use asset is recognised in property, plant and equipment on the inception of the lease based on the discounted value of the minimum lease payments at inception. A lease liability of the same amount is recognised at inception, with the unwinding of the discount included in interest payable.

Leases where the Group is lessor are accounted for as operating or finance leases in accordance with IFRS 16 – 'Leases'. A finance lease is one which transfers substantially all of the risks and rewards of the ownership of the asset concerned. Any other lease is an operating lease.

Finance lease receivables are accounted for as loans to customers, with impairment provisions determined in accordance with IFRS 9.

Rental income and costs on operating leases are charged or credited to the profit and loss account on a straight-line basis over the lease term. The associated assets are included within property, plant and equipment.

(g) Loans to customers

Loans to customers includes assets accounted for as financial assets and finance leases. The Group assesses the classification and measurement of a financial asset based on the contractual cash flow characteristics of the asset and its business model for managing the asset. The Group has concluded that its business model for its customer loan assets is of the type defined as 'Held to collect' by IFRS 9 and the contractual terms of the asset should give rise to cash flows that are solely payments of principal and interest ('SPPI'). Such loans are therefore accounted for on the amortised cost basis.

Loans advanced are valued at inception at the initial advance amount, which is the fair value at that time, inclusive of procuration fees paid to brokers or other business providers and less initial fees paid by the customer. Loans acquired from third parties are initially valued at the purchase consideration paid or payable. Thereafter, all loans to customers are valued at this initial amount less the cumulative amortisation calculated using the Effective Interest Rate ('EIR') method. The loan balances are then reduced where necessary by an impairment provision.

The EIR method spreads the expected net income arising from a loan over its expected life. The EIR is that rate of interest which, at inception, exactly discounts the future cash payments and receipts arising from the loan to the initial carrying amount.

Where financial assets are credit-impaired at initial recognition the EIR is calculated on the basis of expected future cash receipts allowing for the effect of credit risk. In other cases, the expected contractual cash flows are used.

(h) Finance lease receivables

Finance lease receivables are included within 'Loans to Customers' at the total amount receivable less interest not yet accrued, unamortised commissions and provision for impairment.

Income from finance lease contracts is governed by IFRS 16 – 'Leases' and accounted for on the actuarial basis.

(i) Impairment of loans to customers

The carrying values of all loans to customers, whether accounted for under IFRS 9 or IFRS 16, are reduced by an impairment provision based on their ECL, determined in accordance with IFRS 9. These estimates are reviewed throughout the year and at each balance sheet date.

With the exception of POCI financial assets (which are discussed separately below), all assets are assessed to determine whether there has been a significant increase in credit risk ('SICR') since the point of first recognition (origination or acquisition). Assets are also reviewed to identify any which are 'Credit Impaired'. SICR and credit impairment are identified on the basis of pre-determined metrics including qualitative and quantitative factors relevant to each portfolio, with a management review to ensure appropriate allocation.

Assets which have not experienced an SICR are referred to as 'Stage 1' accounts, assets which have experienced an SICR but are not credit impaired are referred to as 'Stage 2' accounts, while credit impaired assets are referred to as 'Stage 3' accounts.

An impairment allowance is provided on an account by account basis:

- For Stage 1, at an amount equal to 12-month ECL, the total ECL that results from those default events that are possible within 12 months of the reporting date, weighted by the probability of those events occurring
- For Stage 2 and 3 accounts, at an amount equal to lifetime ECL, the total ECL that results from any future default events, weighted by the probability of those events occurring

In establishing an ECL allowance, the Group assesses its PD, LGD and exposure at default for each reporting period, discounted to give a net present value. The estimates used in these assessments must be unbiased and take into account reasonable and supportable information including forward-looking economic inputs.

While the Group uses statistical models as the basis for its calculation of ECLs where appropriate, expert judgement will always be used to assess the adequacy of any calculated amount and additional provision made if required.

Within its buy-to-let portfolio the Group utilises a receiver of rent process, whereby the receiver stands between the landlord and tenant and will determine an appropriate strategy for dealing with any delinquency. This strategy may involve the immediate sale of any underlying security or the short or long term letting of the property to cover arrears and principal shortfalls. Such cases are automatically considered to have an SICR, but where a letting strategy is adopted by the receiver and a tenant is in place, arrears may be reduced or cleared. Properties in receivership are eventually either returned to their landlord owners or sold.

For loan portfolios acquired at a discount, the discounts take account of future expected impairments and such assets are treated as POCI. For these assets, the Group recognises all changes in future cash flows arising from changes in credit quality since initial recognition as a loss allowance with any changes recognised in profit or loss.

For financial accounting purposes, provisions for impairments of loans to customers are held in an impairment allowance account from the point at which they are first recognised. These balances are released to offset against the gross value of the loan when it is written off for accounting purposes. This occurs when standard enforcement processes have been completed, subject to any amount retained in respect of expected salvage receipts. Any further gains from post-write off salvage activity are reported as impairment gains.

(j) Amounts owed by or to group companies

In the accounts of the Company, balances owed by or to other group companies are carried at the current amount outstanding less any provision. Where balances owing between group companies fall within the definition of either financial assets or financial liabilities given in IAS 32 – 'Financial Instruments: Presentation' they are classified as assets or liabilities at amortised cost, as defined by IFRS 9.

(k) Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation.

Assets held for letting under operating leases are depreciated in equal annual instalments to their estimated residual value over the life of the related lease. Vehicles held for short term hire are depreciated in equal annual instalments to their estimated residual value over their expected useful life. This depreciation is deducted in arriving at net lease income and is shown in note 6.

The assets' residual values and useful lives are reviewed by management and adjusted, if appropriate, at each balance sheet date.

Depreciation on operating assets is provided on cost in equal annual instalments over the lives of the assets. Land is not depreciated. The rates of depreciation are as follows:

Freehold premises	Short leasehold premises	Computer hardware	Furniture, fixtures and office equipment	Company motor vehicles
2% per annum	over the term of the lease	25% per annum	15% per annum	25% per annum

Depreciation on right of use assets recognised in accordance with IFRS 16 is provided on a straight line basis over the term of the lease.

(l) Intangible assets

Intangible assets comprise purchased computer software and other intangible assets acquired in business combinations.

Purchased computer software is capitalised where it has a sufficiently enduring nature and is stated at cost less accumulated amortisation. Amortisation is provided in equal instalments at a rate of 25% per annum.

Other intangible assets acquired in business combinations include brands and business networks and are capitalised in accordance with the requirements of IFRS 3 – 'Business Combinations'. Such assets are stated at attributed cost less accumulated amortisation. Amortisation is provided in equal instalments at a rate determined at the point of acquisition.

(m) Investments in subsidiaries

The Company's investments in subsidiary undertakings are valued at cost less provision for impairment.

(n) Own shares

Shares in Paragon Banking Group PLC held in treasury or by the trustee of the Group's employee share ownership plan are shown on the balance sheet as a deduction in arriving at total equity. Own shares are stated at cost.

Where an irrevocable instruction for the purchase of such shares has been given, it is treated as a reduction in capital from the point at which the instruction becomes irrevocable.

(o) Retail deposits

Retail deposits are carried in the balance sheet on the amortised cost basis. The initial fair value recognised represents the cash amount received from the customer.

Interest payable to the customer is expensed to the income statement as interest payable over the deposit term on an EIR basis.

(p) Borrowings

Borrowings are carried in the balance sheet on the amortised cost basis. The initial value recognised includes the principal amount received less any discount on issue or costs of issuance.

Interest and all other costs of the funding are expensed to the income statement as interest payable over the term of the borrowing on an EIR basis.

(q) Central bank facilities

Where central bank facilities are provided at a below market rate of interest, and therefore fall within the definition of government assistance as defined by IAS 20 – 'Accounting for Government Grants and Disclosure of Government Assistance', the liability is initially recognised at the value of its expected cash flows discounted at a market rate of interest for a comparable commercial borrowing. Interest is recognised on this liability on an EIR basis, using the imputed market rate to determine the EIR.

The remaining amount of the advance is recognised as deferred government assistance and released to the profit and loss account through interest payable over the periods during which the arrangement affects profit.

(r) Derivative financial instruments

All derivative financial instruments are carried in the balance sheet at fair value, as assets where the value is positive or as liabilities where the value is negative. Fair value is based on market prices, where a market exists. If there is no active market, fair value is calculated using present value models which incorporate assumptions based on market conditions and are consistent with accepted economic methodologies for pricing financial instruments. Changes in the fair value of derivatives are recognised in the income statement, except where such amounts are permitted to be taken to equity as part of the accounting for a cash flow hedge.

(s) Hedging

IFRS 9 paragraph 7.2.21 permits an entity to elect, as a matter of accounting policy, to continue to apply the hedge accounting requirements of IAS 39 in place of those set out in Chapter 6 of IFRS 9. The Group has made this election and the accounting policy below has been determined in accordance with IAS 39.

For all hedges, the Group documents the relationship between the hedging instruments and the hedged items at inception, as well as its risk management strategy and objectives for undertaking the transaction. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the hedging arrangements put in place are considered to be 'highly effective' as defined by IAS 39.

For a fair value hedge, as long as the hedging relationship is deemed 'highly effective' and meets the hedging requirements of IAS 39, any gain or loss on the hedging instrument recognised in income can be offset against the fair value loss or gain arising from the hedged item for the hedged risk. For macro hedges (hedges of interest rate risk for a portfolio of loan assets or retail deposit liabilities) this fair value adjustment is disclosed in the balance sheet alongside the hedged item, for other hedges the adjustment is made to the carrying value of the hedged asset or liability. Only the net ineffectiveness of the hedge is charged or credited to income. Where a fair value hedge relationship is terminated, or deemed ineffective, the fair value adjustment is amortised over the remaining term of the underlying item.

Where a derivative is used to hedge the variability of cash flows of an asset or liability, it may be designated as a cash flow hedge so long as this relationship meets the hedging requirements of IAS 39. For such an instrument the effective portion of the change in the fair value of the derivative is taken initially to equity, with the ineffective part taken to profit or loss. The amount taken to equity is released to the income statement at the same time as the hedged item affects the income statement. Where a cash flow hedge relationship is terminated, or deemed ineffective, the amount taken to equity will remain there until the hedged transaction occurs, or is no longer expected to take place.

(t) Taxation

The charge for taxation represents the expected UK corporation tax (including the Bank Corporation Tax Surcharge where applicable) and other income taxes arising from the Group's profit for the year. This consists of the current tax which will be shown in tax returns for the year and tax deferred because of temporary differences. This in general, represents the tax impact of items recorded in the current year but which will impact tax returns for periods other than the one in which they are included in the financial statements.

The Group will hold a provision for any uncertain tax positions at the balance sheet date based on a global assessment of the expected amount that will ultimately be payable.

Tax relating to items taken directly to equity is also taken directly to equity.

(u) Deferred taxation

Deferred taxation is provided in full on temporary differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Deferred tax assets are recognised to the extent that it is regarded as probable that they will be recovered. As required by IAS 12 – 'Income Taxes', deferred tax assets and liabilities are not discounted to take account of the expected timing of realisation.

(v) Retirement benefit obligations

The expected cost of providing pensions within the funded defined benefit scheme, determined on the basis of annual valuations by professionally qualified actuaries using the projected unit method, is charged to the income statement. Actuarial gains and losses are recognised in full in the period in which they occur and do not form part of the result for the period, being recognised in the Statement of Comprehensive Income.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation, as reduced by the fair value of scheme assets at the balance sheet date.

The expected financing cost of the deficit, as estimated at the beginning of the period is recognised in the result for the period within interest payable. Any variances against the estimated amount in the year form part of the actuarial gain or loss.

The charge to the income statement for providing pensions under defined contribution pension schemes is equal to the contributions payable to such schemes for the year.

(w) Revenue

The revenue of the Group comprises interest receivable and similar charges, operating lease income and other income. The accounting policy for the recognition of each element of revenue is described separately within these accounting policies.

(x) Other income

Other income, which is accounted for in accordance with IFRS 15, includes:

- Event-based administration fees charged to borrowers (other than the initial fees included in amortised cost), which are credited when the related service is performed
- Fees charged to third parties for account administration services, which are credited as those services are performed
- Commissions receivable on the sale of insurances, as agent of the third-party insurer, which are taken to profit at the point at which the Group becomes unconditionally entitled to the income
- Maintenance income charged as part of the Group's contract hire arrangements which is recognised as the services are provided. Costs of these services are deducted in other income
- Broker fees receivable on the arrangement of loans funded by third parties, on an agency basis, which are taken to profit at the point of completion of the related loan

(y) Share based payments

In accordance with IFRS 2 – 'Share-based Payments', the fair value at the date of grant of awards to be made in respect of options and shares granted under the terms of the Group's various share based employee incentive arrangements is charged to the profit and loss account over the period between the date of grant and the vesting date.

National Insurance on share based payments is accrued over the vesting period, based on the share price at the balance sheet date.

Where the allowable cost of share based awards for tax purposes is greater than the cost determined in accordance with IFRS 2, the tax effect of the excess is taken to reserves.

(z) Dividends

In accordance with IAS 10 – 'Events after the balance sheet date', dividends payable on ordinary shares are recognised in equity once they are appropriately authorised and are no longer at the discretion of the Company. Dividends declared after the balance sheet date, but before the authorisation of the financial statements remain within shareholders' funds.

However, such dividends are deducted from regulatory capital from the point at which they are announced, and capital disclosures are prepared on this basis.

(aa) Foreign currency

Foreign currency transactions, assets and liabilities are accounted for in accordance with IAS 21 – 'The Effects of Changes in Foreign Exchange Rates'. The functional currency of the Company and all of the other entities in the Group is the pound sterling. Transactions which are not denominated in sterling are translated into sterling at the spot rate of exchange on the date of transaction. Monetary assets and liabilities which are not denominated in sterling are translated at the closing rate on the balance sheet date.

Gains and losses on retranslation are included in interest payable or interest receivable depending on whether the underlying instrument is an asset or a liability, except where deferred in equity in accordance with the cash flow hedging provisions of IAS 39.

(bb) Segmental reporting

The accounting policies of the segments are the same as those described above for the Group as a whole. Interest payable by each segment includes directly attributable funding and the allocated cost of retail deposit funds utilised. Costs attributed to each segment represent the direct costs incurred by the segment operations.

66. Critical accounting judgements

The most significant judgements which the directors have made in the application of the accounting policies set out in note 65 relate to:

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

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

As part of its consideration of the adequacy of its impairment provisioning, management have considered whether there are any factors not reflected in its normal approach which indicate that a group, or groups of accounts should be considered as having an SICR. No such accounts were identified.

If additional accounts were determined to have an SICR, these balances would attract additional impairment provision, as such cases are provided on the basis of lifetime expected loss, rather the 12-month expected loss, and the overall provision charge would be higher. Conversely, if cases are incorrectly identified as SICR, impairment provisions will be overstated. Furthermore, adjustments to current PD estimates in the Group's models may also have the effect of identifying more or less accounts as having an SICR.

More information on the definition of SICR adopted is given in note 20.

(b) Definition of default

In applying the impairment provisions of IFRS 9, the directors have used models to derive the probabilities of default. In order to derive and apply such models, it is required to define 'default' for this purpose. The Group's definition of default is aligned to its internal operational procedures. IFRS 9 provides a rebuttable presumption of default when an account is 90 days overdue and this was used as the starting point for this exercise. Other factors include account management activities such as appointment of a receiver or enforcement procedures.

A combination of qualitative and quantitative measures was considered in developing the definition of default.

If a different definition of default had been adopted the expected loss amounts derived might differ from those shown in the accounts.

More information on the Group's definition of default adopted is given in note 20.

(c) Classification of financial assets

The classification of financial assets under IFRS 9 is based on two factors:

- The company's 'business model' – how it intends to generate cash and profit from the assets
- The nature of the contractual cash flows inherent in the assets

Financial assets are classified as held at amortised cost, at fair value through OCI, or at fair value through profit and loss.

For an asset to be held at amortised cost, the cash flows received from it must comprise solely payments of principal and interest ('SPPI'). In effect, this restricts this classification to 'normal' lending activities, excluding arrangements where the lender may have a contingent return or profit share from the activities funded. The Group has considered its products and concluded that, as standard lending products, they fall within the SPPI criteria.

This is because all the Group's lending arrangements involve the advancing of amounts to customers, either as loans or finance lease products and the receipt of repayments of principal and charges, where those charges are calculated based on the amount loaned. There are no 'success fee' or other compensation arrangements not linked to the loan principal.

The use of amortised cost accounting is also restricted to assets which a company holds within a business model whose object is to collect cash flows arising from them, rather than seek to profit by disposing of them (a 'Held to Collect' model). The Group's strategy is to hold loan assets until they are repaid or written off. Loan disposals are rare, and the Group does not manage its assets in order to generate profits on sale. On this basis, it has categorised its business model as Held to Collect.

Therefore, the Group has classified its customer loan assets as carried at amortised cost. There were no significant changes in the nature of the Group's products, nor in the business models in which they are held, during the year.

67. Critical accounting estimates

Certain balances reported in the financial statements are based wholly or in part on estimates or assumptions made by the directors. There is, therefore, a potential risk that they may be subject to change in future periods. The most important of these, those which could, if revised significantly in the next financial year, have a material impact on the carrying amounts of assets or liabilities are:

(a) Impairment losses on loans to customers

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

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

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

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

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

In evaluating the potential impact of the economic situation at 30 September 2022 this process is made more complex by both the elevated level of uncertainties and the lack of recent experience of similar situations against which to benchmark. At the same time, the level to which Covid-related 'scarring' has yet to manifest itself in credit metrics is still unclear.

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

In order to provide forward looking economic inputs to the modelling of the ECL, the Group must derive a set of scenarios which are internally coherent. The Group addresses these requirements using four distinct economic scenarios chosen to represent the range of possible outcomes. These scenarios at 30 September 2022 have been derived in light of the current economic situation, at that date, modelling a variety of possible outcomes as described in note 23. It should be noted, however, that there remains a significant range of different opinions amongst economists about the longer-term prospects for the UK, which have diverged again over the period since September 2021, with both UK economic and geopolitical uncertainties building.

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 is considered that the current forecast scenarios, which include higher rates of interest and inflation than in the historically observed data, represent situations where its models may not be able to fully allow for potential economic impacts on its loan portfolios. It therefore assessed, for each class of asset, whether any adjustment to the normal approach was required to ensure sufficient provision was created and also reviewed other available data, both from account performance and customer feedback to form a view of the underlying reasons for observed customer behaviours and of their future intentions and prospects.

As a result of this exercise additional requirements for provision were identified, to compensate for potential model weakness and to allow for economic pressures in the wider economy which cannot be identified by a modelled approach. By their nature such adjustments are less systematic and therefore subject to a wider range of outturns. The nature and amounts of these judgemental adjustments are set out in note 20.

The position after considering all these matters is set out in notes 20 to 22, together with further information on the Group's approach. The economic scenarios described above and their impact on the overall provision are set out in note 23, while sensitivity analyses on impairment provisioning are set out in note 24.

(b) Effective interest rates

In order to determine the EIR applicable to loans and borrowings an estimate must be made of the expected life of each asset or liability and hence the cash flows relating thereto, including those relating to early redemption charges. For purchased loan accounts this will involve estimating the likely future credit performance of the accounts at the time of acquisition. For each portfolio a model is in place to ensure that income is appropriately spread.

The underlying estimates are based on historical data and reviewed regularly. For purchased accounts historical data obtained from the vendor will be examined. The accuracy of the EIR applied would therefore be compromised by any differences between actual repayment profiles and those predicted, which in turn would depend directly or indirectly (in the case of borrowings) on customer behaviour.

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

- A reduction of the assumed average lives of loans secured on residential property by three months would reduce balance sheet assets by £13.3m (2021: £12.0m), while an increase of the assumed asset lives of such assets by three months would increase balance sheet assets by £13.3m (2021: £12.1m)
- 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 £8.8m (2021: £11.2m)
- A reduction (or increase) in estimated cash flows from purchased loan assets of 5% would reduce (or increase) balance sheet assets by £2.0m (2021: £7.1m)

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

(c) Impairment of goodwill

The carrying value of goodwill recognised on acquisitions is verified by use of an impairment test based on the projected cash flows for the CGU, based on management forecasts and other assumptions described in note 30, including a discount factor.

The accuracy of this impairment calculation would therefore be compromised by any differences between these forecasts and the levels of business activity that the CGU is able to achieve in practice. As the Group forecasts are based on the Group's central economic scenario, any variance from this will potentially impact on the valuation. This test will also be affected by the accuracy of the discount factor used.

The sensitivity of the impairment test to reasonably possible movements in these assumptions is discussed in note 30.

(d) Retirement benefits

The present value of the retirement benefit obligation is derived from an actuarial calculation which rests on a number of assumptions relating to inflation, long-term return on investments and mortality. These are listed in note 58. Where actual conditions differ from those assumed the ultimate value of the obligation would be different.

Information on the sensitivity of the valuation to the various assumptions is given in note 58.

68. Going concern

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

Particular focus is given to the Group's financial forecasts to ensure the adequacy of resources available for the Group to meet its business objectives on both a short-term and strategic basis. The guidance requires that this assessment covers a period of at least twelve months from the date of approval of these financial statements.

Financial and capital forecasting

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

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

- Higher buy-to-let volumes – This scenario allows the Board to see what impact higher buy-to-let volumes at a reduced yield has on the profitability of the business. The higher volumes also allow the Board to determine whether capital resources and liquidity would be stretched due to the higher cash and capital requirements
- Higher funding costs – This scenario allows the Board to see the impact of a significant prolonged margin squeeze on profitability and whether this would cause significant impacts on any capital, liquidity or encumbrance ratios
- Lower development finance volume and yield – This scenario replicates a significant increase in competition within the sector (potentially from market shrinkage), reducing yields and impacting the Group's market share. Since development finance is the highest yielding product, its reduction shows the Board the impact of a lower mix on the contribution to costs and what other ratios may be affected from such a drop in volume
- Higher buy-to-let redemptions – This scenario highlights to the Board the potential risk that is inherent in the currently held buy-to-let EIR debtor and invites discussion as to what mitigating action could be taken to avoid such an impact
- Bad debt stress – This scenario simulates a significant short-term capital and profitability shock with prolonged house price deflation across the plan horizon. To ensure that it is a worst-case stress point and also to avoid replicating the ICAAP process, only bad debt rates are altered in these scenarios – all new business and other assumptions remain with no management actions included
- Combined downside stress – This presents a plausible set of adverse factors to the business model that allows the Board to see how this impacts the strategy across the five-year horizon

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

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

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

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 £10,669.2m (note 32), raised through Paragon Bank, are repayable within five years, with 80.8% of this balance (£8,620.5m) payable within twelve months of the balance sheet date. The liquidity exposure represented by these deposits is closely monitored; a process supervised by the Asset and Liability Committee. The Group is required to hold liquid assets in Paragon Bank to mitigate this liquidity risk. At 30 September 2022 Paragon Bank held £1,505.5m of balance sheet assets for liquidity purposes, in the form of central bank deposits (note 62). A further £150.0m of liquidity was provided by an off balance sheet swap arrangement (note 62), bringing the total to £1,655.5m.

Paragon Bank manages its liquidity in line with the Board's risk appetite and the requirements of the PRA, which are formally documented in the Board's approved ILAAP, updated annually. The Bank maintains a liquidity framework that includes a short to medium term cash flow requirement analysis, a longer-term funding plan and access to the Bank of England's liquidity insurance facilities, where pre-positioned assets would support drawings of £1,776.0m. Holdings of the Group's own externally rated mortgage backed loan notes can also be used to access the Bank of England's liquidity facilities or other funding arrangements. At 30 September 2022 the Group had £455.2m of such notes available for use, of which £213.0m were rated AAA. The available AAA notes would give access to £171.6m if used to support drawings on Bank of England facilities.

The Group's securitisation funding structures, described in note 62, provide match funding for part of the asset base. Repayment of the securitisation borrowings is restricted to funds generated by the underlying assets and there is limited recourse to the Group's general funds. Recent and current loan originations are financed through retail deposits and may be refinanced through securitisation where this is appropriate and cost-effective. While the Group has not accessed the public securitisation market in the year, the market remains active with strong levels of demand and the Group maintains the infrastructure required to access it.

The earliest maturity of any of the Group's bond debt is the £112.5m retail bond, due August 2024. No central bank debt is payable until 2025.

The Group's access to debt is enhanced by its corporate BBB+ rating, upgraded by Fitch Ratings in March 2022, and its status as an issuer is evidenced by the BBB- investment grade rating of its £150.0m Tier-2 bond. It has regularly accessed the capital markets for warehouse funding and corporate and retail bonds over recent years and continues to be able to access these markets.

The Group has access to the short-term repo market for liquidity purposes which it uses from time to time.

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

As described in note 59 the Group's capital base is subject to consolidated supervision by the PRA. The most recent review of the Group's capital position and management systems, during the year ended 30 September 2021, resulted in a reduction of the minimum capital level. Its capital at 30 September 2022 was in excess of regulatory requirements and its forecasts indicate this will continue 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.

After performing this assessment, the directors concluded that there was no material uncertainty as to whether the Group and the Company would be able to maintain adequate capital and liquidity for at least twelve months following the date of approval of these financial statements and consequently that it was appropriate for them to continue to adopt the going concern basis in preparing the financial statements of the Group and the Company.

69. Financial assets and financial liabilities

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

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

IFRS 7 – 'Financial Instruments: Disclosures' requires that where assets are measured at fair value these measurements should be classified using the fair value hierarchy set out in IFRS 13 – 'Fair Value Measurement'. This hierarchy reflects the inputs used and defines three levels:

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

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

The Group had no financial assets or liabilities in the year ended 30 September 2022 or the year ended 30 September 2021 carried at fair value and valued using level 3 measurements, other than contingent consideration amounts (note 39).

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

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

(a) Assets and liabilities carried at fair value

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

	Note	**2022**	2021
		£m	£m
Financial assets			
Derivative financial assets	*25*	**779.0**	44.2
		779.0	44.2
Financial liabilities			
Derivative financial liabilities	*25*	**102.1**	43.9
Contingent consideration	*39*	**2.2**	7.5
		104.3	51.4

All of these financial assets and financial liabilities are required to be carried at fair value by IFRS 9.

The Company has no financial assets or liabilities carried at fair value.

Derivative financial assets and liabilities

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

The principal inputs to these valuation models are SONIA (and formally LIBOR) benchmark interest rates for the currencies in which the instruments are denominated, being sterling, EUR and dollars. The cross-currency basis swaps, which were terminated during 2021, had a notional principal related to the outstanding currency borrowings and therefore the estimated rate of repayment of these notes also affected the valuation of the swaps. However, variability in this input does not have a significant impact on the valuation, compared to other inputs.

In order to determine the fair values, the management applies valuation adjustments to observed data where that data would not fully reflect the attributes of the instrument being valued, such as particular contractual features or the identity of the counterparty. The management reviews the models used on an ongoing basis to ensure that the valuations produced are reasonable and reflect all relevant factors. These valuations are based on market information, and they are therefore classified as level 2 measurements. Details of these assets are given in note 25.

Contingent consideration

The value of the contingent consideration balances shown in note 39 are required to be stated at fair value in the accounts. These amounts are valued based on the expected outcomes of the performance tests set out in the respective sale and purchase agreements, discounted as appropriate. The most significant inputs to these valuations are the Group's forecasts on future activity relating to business generated by operational units acquired, business derived as a result of the vendor's contacts or other goodwill and any other new business flows which are or might be attributable to the acquisition agreement, which are drawn from the overall Group forecasting model. As such, these are classified as unobservable inputs and the valuations classified as level 3 measurements.

(b) Assets and liabilities carried at amortised cost

The fair values for financial assets and financial liabilities held at amortised cost, determined in accordance with the methodologies set out below are summarised below.

	Note	**2022 Carrying amount £m**	**2022 Fair value £m**	2021 Carrying amount £m	2021 Fair value £m
The Group					
Financial assets					
Cash	*16*	**1,930.9**	**1,930.9**	1,360.1	1,360.1
Loans to customers	*17*	**14,210.3**	**13,898.4**	13,402.7	13,470.6
Sundry financial assets	*26*	**35.4**	**35.4**	65.7	65.7
		16,176.6	**15,864.7**	14,828.5	14,896.4
Financial liabilities					
Short-term bank borrowings		**0.4**	**0.4**	0.3	0.3
Asset backed loan notes		**409.3**	**409.3**	516.0	516.0
Secured bank borrowings		**586.0**	**586.0**	730.0	730.0
Retail deposits	*32*	**10,669.2**	**10,592.9**	9,300.4	9,308.5
Corporate and retail bonds		**261.5**	**254.4**	386.1	411.9
Other financial liabilities	*38*	**491.2**	**491.2**	66.2	66.2
		12,417.6	**12,334.2**	10,999.0	11,032.9

	Note	**2022 Carrying amount £m**	**2022 Fair value £m**	2021 Carrying amount £m	2021 Fair value £m
The Company					
Financial assets					
Cash	*16*	**19.7**	**19.7**	19.6	19.6
Loans to group companies	*26*	**39.1**	**39.1**	73.0	73.0
Sundry financial assets	*26*	**0.1**	**0.1**	0.1	0.1
		58.9	**58.9**	92.7	92.7
Financial liabilities					
Corporate and retail bonds		**261.5**	**254.4**	386.1	411.9
Amounts owed to group companies	*38*	**23.2**	**23.2**	22.6	22.6
Other financial liabilities	*38*	**12.9**	**12.9**	3.0	3.0
		297.6	**290.5**	411.7	437.5

The fair values of retail deposits and corporate and retail bonds shown above will include amounts for the related accrued interest.

Cash, bank loans and securitisation borrowings

The fair values of cash and cash equivalents, bank loans and overdrafts and asset backed loan notes, which are carried at amortised cost are considered to be not materially different from their book values. In arriving at that conclusion market inputs have been considered but because all the assets mature within three months of the year end and the interest rates charged on financial liabilities reset to market rates on a quarterly basis, little difference arises. This also applies to the parent company's loans to its subsidiaries. While the Group's asset backed loan notes are listed, the quoted prices for an individual note may not be indicative of the fair value of the issue as a whole, due to the specialised nature of the market in such instruments and the limited number of investors participating in it.

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

Loans to customers

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

Corporate debt

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

Retail deposits

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

Sundry assets and liabilities

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

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

70. Details of subsidiary undertakings

Subsidiary undertakings of the Group at 30 September 2022, where the share capital is held within the Group are shown below. The holdings shown are those held within the Group. The shareholdings of the Company in the direct subsidiaries listed below are the same as those held by the Group, except that for the shareholdings marked * the Company holds only 74% of the share capital. In these cases, the remainder is held by other group companies.

The issued share capital of all subsidiaries consists of ordinary share capital, except those companies marked § which have additional preference share capital held within the Group.

Company	Holding	Principal activity
Direct subsidiaries of Paragon Banking Group PLC		
Paragon Bank PLC	100%	Deposit taking, residential mortgages and loan and vehicle finance
Paragon Car Finance Limited	100%	Vehicle finance
Idem Capital Holdings Limited	100%	Intermediate holding company
Moorgate Servicing Limited	100%	Intermediate holding company
The Business Mortgage Company Limited	100%	Mortgage broker
Paragon Mortgages (No. 11) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 12) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 13) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 14) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 15) PLC	100% *	Residential mortgages
Colonial Finance (UK) Limited	100%	Non-trading
Earlswood Finance Limited	100%	Non-trading
Herbert (1) PLC	100%	Non-trading
Herbert (2) PLC	100%	Non-trading
Herbert (4) PLC	100%	Non-trading
Herbert (5) PLC	100%	Non-trading
Herbert (6) PLC	100%	Non-trading
Herbert (7) PLC	100%	Non-trading
Herbert (8) PLC	100%	Non-trading
Herbert (9) PLC	100%	Non-trading
Herbert (10) PLC	100%	Non-trading
Paragon Car Finance (1) Limited	100%	Non-trading
Paragon Dealer Finance Limited	100%	Non-trading
Paragon Loan Finance (No. 3) Limited	100%	Non-trading
Paragon Mortgages (No. 5) PLC	100%	Non-trading
Paragon Pension Investments GP Limited	100%	Non-trading
Paragon Pension Plan Trustees Limited	100%	Non-trading
Paragon Personal Finance (1) Limited	100%	Non-trading
Paragon Third Funding Limited	100%	Non-trading
Paragon Vehicle Contracts Limited	100%	Non-trading
Plymouth Funding Limited	100%	Non-trading
Universal Credit Limited	100%	Non-trading
Yorkshire Freeholds Limited	100%	Non-trading
Yorkshire Leaseholds Limited	100%	Non-trading
Direct and indirect subsidiaries of Paragon Bank PLC		
Paragon Finance PLC	100%	Residential mortgages and asset administration
Mortgage Trust Limited	100%	Residential mortgages
Paragon Mortgages Limited	100%	Residential mortgages
Paragon Mortgages (2010) Limited	100%	Residential mortgages
Mortgage Trust Services PLC	100%	Residential mortgages and asset administration
Paragon Second Funding Limited	100%	Residential mortgages and loan and vehicle finance

Paragon Asset Finance Limited	100%	Holding company and portfolio administration
Paragon Business Finance PLC	100%	Asset finance
Paragon Commercial Finance Limited	100%	Asset finance
Paragon Development Finance Limited	100%	Development Finance
Paragon Development Finance Services Limited	100%	Development Finance
Paragon Technology Finance Limited	100%	Asset finance
PBAF Acquisitions Limited	100%	Residential mortgages and loan finance
PBAF (No.1) Limited	100%	Holding Company
Premier Asset Finance Limited	100%	Asset finance broker
Specialist Fleet Services Limited	100%	Asset finance and contract hire
City Business Finance Limited	100%	Non-trading
Collett Transport Services Limited	100%	Non-trading
Fineline Holdings Limited	100%	Non-trading
Fineline Media Finance Limited	100%	Non-trading
Homer Management Limited	100%	Non-trading
Lease Portfolio Management Limited	100%	Non-trading
Paragon Options PLC	100%	Non-trading
State Securities Holdings Limited	100%	Non-trading
State Security Limited	100%	Non-trading

Other indirect subsidiary undertakings		
Moorgate Loan Servicing Limited	100%	Asset administration
Idem Capital Securities Limited	100%	Asset investment
Paragon Personal Finance Limited	100%	Consumer loan finance
Redbrick Survey and Valuation Limited	100%	Surveyors and property consulting
Buy to Let Direct Limited	100%	Non-trading
Moorgate Asset Administration Limited	100%	Non-trading
TBMC Group Limited	100%	Non-trading
The Business Mortgage Company Services Limited	100%	Non-trading

The financial year end of all the Group's subsidiary companies is 30 September. They are all registered in England and Wales and operate in the UK except Paragon Pension Investments GP Limited, which is registered in Scotland and operates in the UK.

As part of the Group's financing arrangements certain mortgage and consumer loans originated by Paragon Mortgages (2010) Limited and Mortgage Trust Limited have been sold to special purpose entity companies, referred to as orphan SPEs, which had raised non-recourse finance to fund these purchases. The shares of these companies are ultimately beneficially owned through independent trusts, but they are considered to be controlled by the Group, as defined by IFRS 10, due to the Group's exposures to the variable returns from the assets of each entity and its ability to direct their activities, within the constraints imposed by the lending documents. Hence, they are considered to be subsidiaries of the Group.

The principal companies party to these arrangements at 30 September 2022 comprise:

Company	Principal activity
Paragon Seventh Funding Limited	Residential mortgages
Paragon Mortgages (No. 25) Holdings Limited	Holding company
Paragon Mortgages (No. 25) PLC	Residential mortgages
Paragon Mortgages (No. 26) Holdings Limited	Holding company
Paragon Mortgages (No. 26) PLC	Residential mortgages
Paragon Mortgages (No. 27) Holdings Limited	Holding company
Paragon Mortgages (No. 27) PLC	Residential mortgages
Paragon Mortgages (No. 28) Holdings Limited	Holding company
Paragon Mortgages (No. 28) PLC	Residential mortgages
Arianty Holdings Limited	Holding company
Arianty No. 1 PLC	Non-trading

Paragon Fifth Funding Limited	Non-trading
Paragon Sixth Funding Limited	Non-trading
Paragon Mortgages (No. 18) Holdings Limited	Non-trading
Paragon Mortgages (No. 19) Holdings Limited	Non-trading
Paragon Mortgages (No. 20) Holdings Limited	Non-trading
Paragon Mortgages (No. 21) Holdings Limited	Non-trading
Paragon Mortgages (No. 22) Holdings Limited	Non-trading
Paragon Mortgages (No. 23) Holdings Limited	Non-trading
Paragon Mortgages (No. 24) Holdings Limited	Non-trading

All these companies are registered and operate in the UK.

Earlswood Finance (No. 3) Limited, a company limited by guarantee, is registered in England and Wales and operates in the UK. It is included in the consolidation as it is ultimately controlled by the parent company.

The Paragon Pension Partnership LP is a limited partnership established under Scots law, in which control is vested in members which are group companies. It is therefore considered to be a subsidiary entity. The outside member is the Group's Pension Plan and the Plan's rights to income from the partnership are set out in the partnership agreement. Therefore, no minority interest arises. The partnership is registered in Scotland and operates in the UK.

The registered office of each of the entities listed in this note is the same as that of the Company (note 1), except that:

- The registered office of The Business Mortgage Company Limited, Buy to Let Direct Limited, TBMC Group Limited, and The Business Mortgage Company Services Limited is Regus House, Malthouse Avenue, Cardiff Gate Business Park, Cardiff CF23 8RU
- The registered office of the Scottish entities is Citypoint, 65 Haymarket Terrace, Edinburgh EH12 5HD

All the entities listed above are included in the consolidated accounts of the Group.

Companies in liquidation

The following legal subsidiaries of the Group were in liquidation at 30 September 2022. They do not form part of the consolidation as they are considered to be controlled by the liquidator. All of these companies were dissolved after the year end.

Company	Holding	Principal activity
Direct subsidiaries of Paragon Banking Group PLC		
First Flexible (No.7) PLC	100%*	Non-trading
Paragon Fourth Funding Limited	100%	Non-trading
Paragon Loan Finance (No. 1) Limited	100% §	Non-trading
Paragon Loan Finance (No. 2) Limited	100% §	Non-trading
Paragon Mortgages (No. 9) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 10) PLC	100% *	Residential mortgages
Paragon Secured Finance (No. 1) PLC	100%	Non-trading
Indirect subsidiaries		
First Flexible No.6 PLC	100% §	Residential Mortgages
Idem (No.3) Limited	100%	Asset investment

The shareholdings of the Company in each of the direct subsidiaries shown above is the same as that of the Group, except for companies marked * where the shareholding of the company is 74%. The issued share capital of each of the companies listed above consists of ordinary shares only, except for companies marked § which have additional preference share capital held within the Group.

The following orphan SPE companies were also in liquidation at 30 September 2022.

Company	Principal activity
First Flexible No.5 PLC	Non-trading
Paragon Mortgages (No. 18) PLC	Non-trading
Paragon Mortgages (No. 19) PLC	Non-trading
Paragon Mortgages (No. 20) PLC	Non-trading
Paragon Mortgages (No. 21) PLC	Non-trading
Paragon Mortgages (No. 22) PLC	Non-trading
Paragon Mortgages (No. 23) PLC	Non-trading
Paragon Mortgages (No. 24) PLC	Non-trading

First Flexible No.5 PLC was dissolved after the year end.

All the companies in liquidation listed in this section are registered and operated in the UK.

E.

Appendices to the Annual Report

Additional financial information supporting amounts shown in the Strategic Report (Section A), but not forming part of the statutory accounts or subject to audit.

RESPECT

To treat people as individuals and listen to their views

> **Respect means listening to our people and our customers, and incorporating their viewpoint into our thinking. If I think of my own team, they're the ones who are closest to our customers so it's essential I listen to what they're telling me, take their ideas on board and explore them fully.**

Liz, New Business Process

E1. Appendices to the Annual Report

For the year ended 30 September 2022

A. Underlying results

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

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

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

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

	2022	2021
	£m	£m
Profit on ordinary activities before tax	**417.9**	213.7
Add back: Fair value adjustments	**(191.9)**	(19.5)
Profit on disposal of loans	**(4.6)**	-
Underlying profit	**221.4**	194.2

Underlying basic earnings per share, calculated on the basis of underlying profit adjusted for tax, is derived as follows.

	2022	2021
	£m	£m
Underlying profit	**221.4**	194.2
Tax on underlying result	**(51.8)**	(44.7)
Underlying earnings	**169.6**	149.5
Basic weighted average number of shares (note 15)	**242.7**	252.3
Underlying earnings per share	**69.9p**	59.3p

In the year ended 30 September 2022 tax has been charged on the underlying profit at 23.4%, being the effective rate at which would result from the exclusion of the adjusting items from the corporation tax calculation. In 2021 tax on underlying profit was allowed for at 23.0%, the overall effective rate for the year, due to the much smaller impact of the adjustments in that year.

Underlying return on tangible equity is derived using underlying earnings calculated on the same basis shown above. Tangible equity is calculated excluding the impacts of fair value hedging. This approach has been adopted in 2022 for the first time, due to the materiality of the balance sheet effect of the hedges. While this effect was not significant in previous years the underlying RoTE for 2021 has been restated on the new basis.

	Note	**2022**	2021
		£m	£m
Underlying earnings		**169.6**	149.5
Amortisation of intangible assets (note 9)		**2.0**	2.0
Adjusted underlying earnings		**171.6**	151.5
Opening underlying tangible equity			
Equity		**1,241.9**	1,156.0
Intangible assets	*29*	**(170.5)**	(170.1)
Balance sheet impact of fair values	*25*	**(8.8)**	15.1
Deferred tax thereon	*42*	**(2.2)**	0.2
		1,060.4	1,001.2
Closing underlying tangible equity			
Equity		**1,417.3**	1,241.9
Intangible assets	*29*	**(170.2)**	(170.5)
Balance sheet impact of fair values	*25*	**(216.7)**	(8.8)
Deferred tax thereon	*42*	**53.2**	(2.2)
		1,083.6	1,060.4
Average underlying tangible equity		**1,072.0**	1,030.8
Underlying RoTE		**16.0%**	14.7%

Appendices

B. Income statement ratios

NIM and cost of risk (impairment charge as a percentage of average loan balance) for the Group are calculated as follows:

Year ended 30 September 2022

	Note	**Mortgage Lending £m**	**Commercial Lending £m**	**Total £m**
Opening loans to customers	*17*	**11,829.6**	**1,573.1**	**13,402.7**
Closing loans to customers	*17*	**12,328.7**	**1,881.6**	**14,210.3**
Average loans to customers		**12,079.2**	**1,727.3**	**13,806.5**
Net interest	*2*	**261.5**	**113.1**	**371.2**
NIM		**2.16%**	**6.55%**	**2.69%**
Impairment provision charge	*11*	**4.6**	**9.4**	**14.0**
Cost of risk		**0.04%**	**0.54%**	**0.10%**

Year ended 30 September 2021 (restated)

	Note	Mortgage Lending £m	Commercial Lending £m	Total £m
Opening loans to customers	*17*	11,101.1	1,530.3	12,631.4
Closing loans to customers	*17*	11,829.6	1,573.1	13,402.7
Average loans to customers		11,465.3	1,551.7	13,017.0
Net interest	*2*	238.7	95.2	310.5
NIM		2.08%	6.14%	2.39%
Impairment provision (release) / charge	*11*	(7.6)	2.9	(4.7)
Cost of risk		(0.07)%	0.19%	(0.04)%

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

C. Cost:income ratio

Cost:income ratio is derived as follows:

	Note	2022	2021
		£m	£m
Cost – operating expenses	*9*	**153.0**	135.4
Total operating income		**393.0**	324.9
Cost / Income		**38.9%**	41.7%

Underlying cost: income ratio is derived as follows:

	2022	2021
	£m	£m
Cost – as above	**153.0**	135.4
Income – as above	**393.0**	324.9
Less: profit on disposal of loans	**(4.6)**	-
	388.4	324.9
Underlying cost: income ratio	**39.4%**	41.7%

D. Dividend cover

For the purposes of dividend policy, the Group defines dividend cover based on basic earnings per share, adjusted where considered appropriate, and dividend per share. This is the most common measure used by financial analysts.

For the current year the Board has determined that is appropriate to exclude the post-tax impact of fair value gains from its calculation. The dividend cover for the year, subject to the approval of the 2022 final dividend at the AGM in March 2023 is therefore as set out below.

	Note	2022	2021
Earnings per share (p)	*15*	**129.2**	65.2
Attributable fair value gains (p)		**(79.1)**	-
Attributable tax thereon (p)		**21.4**	-
Adjusted earnings (p)		**71.5**	65.2
Proposed dividend per share in respect of the year (p)	*46*	**28.6**	26.1
Dividend cover (times)		**2.50**	2.50

E. Net asset value

	Note	2022	2021
Total equity (£m)		**1,417.3**	1,241.9
Outstanding issued shares (m)	*43*	**241.4**	262.5
Treasury shares (m)	*45*	**(3.6)**	(12.1)
Shares held by ESOP schemes (m)	*45*	**(3.9)**	(3.7)
		233.9	246.7
Net asset value per £1 ordinary share		**£6.06**	£5.03
Tangible equity (£m)	*59*	**1,247.1**	1,071.4
Tangible net asset value per £1 ordinary share		**£5.33**	£4.34

F.

Glossary

HUMOUR

To ensure we have fun while achieving success!

"Whatever you do and wherever you work, if you can find a way of having fun together and bringing some humour into your work, you can break down barriers between people and make work feel less like work.

Kaz, Collections

F1. Glossary

Act	The Companies Act 2006
AGM	Annual General Meeting
ALCO	Asset and Liability Committee
AQR	Audit Quality Review
Articles	The Articles of Association of the Company
ASHE	Annual Survey of Hours and Earnings
AT1	Additional Tier 1
Paragon Bank or The Bank	Paragon Bank PLC
BBLS	Bounce Back Loan Scheme
BBR	Bank Base Rate
BCBS	Basel Committee on Banking Supervision
BEIS	Department for Business, Energy and Industrial Strategy
BEPS	Base Erosion and Profit Shifting
BEVs	Battery Powered Electric Vehicles
BGS	Balance Guarantee Swaps
B4NZ	Bankers For Net Zero
CAGR	Compound Annual Growth Rate
CBES	Climate Biennial Exploratory Scenario
CBI	Confederation of British Industry
CBILS	Coronavirus Business Interruption Loan Scheme
CCC	Customer and Conduct Committee
CCoB	Capital Conservation Buffer
CCP	Central Clearing Counterparty
CCyB	Counter-Cyclical Capital Buffer
CEO	Chief Executive Officer
CET1	Core Equity Tier 1
CFO	Chief Financial Officer
CFRF	Climate Financial Risk Forum
CGU	Cash Generating Unit
CIB	Chartered Institute of Bankers
CML	Council of Mortgage Lenders
Code	UK Corporate Governance Code
CO_2e	CO_2 Equivalent
COO	Chief Operating Officer
Company	Paragon Banking Group PLC
CP	Consultation Paper
CPI	Consumer Price Index
CRD IV	The EU Capital Requirements Regulation and Directive Regime
CRDs	Cash Ratio Deposits
CRO	Chief Risk Officer
CRR	Capital Requirements Regulation – EU Regulation 575/2013
CSA	Credit Support Annex
CVR	Commercial Variable Rate
CSOP	Company Share Option Plan
DECL	Task Force on Disclosures about Expected Credit Loss
DEFRA	Department for Environment, Food and Rural Affairs
DISP	FCA's Dispute Resolution: Complaints Sourcebook
DSBP	Deferred Share Bonus Plan
DTR	Disclosure and Transparency Rule
EA	Early Action
EAD	Exposures At Default
ECL	Expected Credit Loss
EDI	Equality, Diversity and Inclusion
EIR	Effective Interest Rate
EPC	Energy Performance Certificate
EPS	Earnings per Share
EQA	External Quality Assessment
ERC	Executive Risk Committee
ERMF	Enterprise Risk Management Framework
ESG	Environmental, Social and Governance
ESOP	Employee Share Ownership Plan
ESOS	Energy Savings and Opportunities Scheme
EU	European Union
EUR	Euro
EURIBOR	Euro Interbank Offered Rate
EV	Economic Value
ExCo	Executive Performance Committee
FCA	Financial Conduct Authority
FLA	Finance and Leasing Association
FOS	Financial Ombudsman Service
Framework	The Group Corporate Governance Policy Framework
FRC	Financial Reporting Council
FRF	Future Regulatory Framework
FRN	Floating Rate Note
FSCS	Financial Services Compensation Scheme
FVTPL	Fair Value Through Profit and Loss
GDP	Gross Domestic Product
GHG	Greenhouse Gases
GMP	Guaranteed Minimum Pension
Group	The Company and all of its subsidiary undertakings
HMRC	His Majesty's Revenue and Customs
HPI	House Price Index
HQLA	High Quality Liquid Assets
IAP	Internal Audit Plan
IAS	International Accounting Standard(s)
IASB	International Accounting Standards Board
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standard(s)
IiP	Investors In People
ILAAP	Internal Liquidity Adequacy Assessment Process
ILG	Individual Liquidity Guidance
ILTR	Indexed Long Term Repo Scheme
IMLA	Intermediary Mortgage Lenders Association
IRB	Internal Ratings Based
IRRBB	Interest Rate Risk in the Banking Book
ISAs	International Standards on Auditing

ISDA	International Swaps and Derivatives Association
ISO14001:2015	ISO 14001:2015, 'Environmental Management Systems'
ISO45001:2018	ISO 45001:2018, 'Management Systems of Occupational Health and Safety'
KPMG	KPMG LLP, the Group's auditor
LA	Late Action
LCR	Liquidity Coverage Ratio
LDI	Liability Driven Investments
LGD	Loss Given Default
LIBOR	London Interbank Offered Rate
LTGDV	Loan to Gross Development Value
LTV	Loan to Value
M&A	Mergers and Acquisitions
MES	Multiple Economic Scenarios
MLRO	Money Laundering Reporting Officer
MRC	Model Risk Committee
MREL	Minimum Requirement for own funds and Eligible Liabilities
MRT	Material Risk Taker
MWh	Mega-Watt Hours
NI	National Insurance
NII	Net Interest Income
NIM	Net Interest Margin
Notes	Asset backed loan notes
NPS	Net Promoter Score
NSFR	Net Stable Funding Ratio
OBR	Office of Budget Responsibility
OCI	Other Comprehensive Income
OFGEM	Office of Gas and Electricity Markets
OHSMS	Occupational Health and Safety Management System
OLAR	Overall Liquidity Adequacy Requirement
ONS	Office for National Statistics
ORC	Operational Risk Committee
Order	The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014
PAYE	Pay As You Earn
PCAF	Partnership for Carbon Accounting Financials
PD	Probability of Default
Performance Exco	Executive Performance Committee
PFP	Pension Funding Partnership
PIDA	Public Interest Disclosure Act 1998
PIEs	Public Interest Entities
Plan	The Paragon Pension Plan
PLC	Public Limited Company
PMA	Post-Model Adjustments
POCI	Purchased or Originated Credit Impaired (assets)
PPC	Prompt Payment Code
PRA	Prudential Regulation Authority (of the Bank of England)
PRP	Profit Related Pay
PRS	Private Rented Sector
PSP	Performance Share Plan
PwC	PricewaterhouseCoopers LLP
RBA	Role Based Allowance
RCV	Refuse Collection Vehicles
RIBA	Royal Institute of British Architects
RICS	Royal Institution of Chartered Surveyors
RIDDOR	Reporting of Incidents, Disease and Dangerous Occurrences Regulation 2013
RLS	Recovery Loan Scheme
RMBS	Residential Mortgage Backed Securities
RNS	Regulatory News Service
RoR	Receiver of Rent
RoTE	Return on Tangible Equity
ROU	Right of Use
RPI	Retail Price Index
RSU	Restricted Stock Unit
RWA	Risk Weighted Assets
SA	Standardised Approach
SAWG	Scenario Analysis industrial Working Group
Schedule 7	Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008
SFS	Specialist Fleet Services Limited
SIC	Standard Industrial Classification
SICR	Significant Increase in Credit Risk
Sharesave	All Employee Share Option scheme
SME	Small and / or Medium-sized Enterprise(s)
SMF	Senior Management Function
SMCR	Senior Managers and Certification Regime
SONIA	Sterling Overnight Interbank Average
SPPI	Solely Payments of Principal and Interest
SPV	Special Purpose Vehicle
TBMC	The Business Mortgage Company
TCFD	Taskforce on Climate-related Financial Disclosures
TCR	Total Capital Requirement
TFS	Term Funding Scheme
TFSME	Term Funding Scheme with additional incentives for SMEs
TRC	Total Regulatory Capital
TRE	Total Risk Exposure
TSR	Total Shareholder Return
TVR	Total Voting Rights
UK	United Kingdom
UKF	UK Finance
VCS	Verified Carbon Standard

G.

Useful information

Information which may be helpful to shareholders and other users of the Annual Report and Accounts

TEAMWORK

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

> **Teamwork matters because we rely on each other to serve our customers effectively and deliver on our objectives as a business. It's more enjoyable to get things done together. We all have different skills and expertise and everything we do needs the support of a team.**

Millie, Operational Risk

G1. Shareholder information

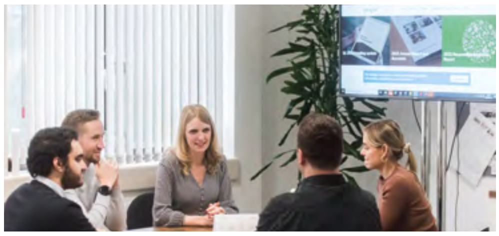
Want more information or help?

The Company's share register is maintained by our Registrars, Computershare. Please contact them directly if you have questions about your shareholding or wish to update your address details.

Computershare Investor Services PLC
The Pavilions
Bridgwater Road
Bristol BS99 6ZZ
Telephone: 0370 707 1244*
and outside the UK +44 (0)370 707 1244

Online: www.investorcentre.co.uk

*Calls are charged at the standard geographic rate and will vary by provider. Calls outside the UK will be charged at the applicable international rate. Lines are open 8:30am to 5:30pm, Monday to Friday, excluding UK public holidays.



Electronic communications

You can view and manage your shareholding online by registering with Computershare's Investor Centre service. To register:

- **Visit www.investorcentre.co.uk**
- **Go to 'Manage my shareholdings'**
- **Register using your Shareholder Reference Number and your postcode**

We actively encourage our shareholders to receive communications via email and view documents electronically on our website, including our Annual Report and Accounts, as this has significant environmental and cost benefits. If you wish to receive electronic documents please contact Computershare by telephone or online.

Website

You can find further useful information on our website, **www.paragonbankinggroup.co.uk**, including:

- **Regular updates about our business**
- **Comprehensive share price information**
- **Financial results and reports**
- **Historic dividend dates and amounts**

Shareholder fraud warning

Shareholders are advised to be very wary of any suspicious or unsolicited advice or offers, whether over the telephone, through the post or by email. If you receive any such unsolicited communication, please check the company or person contacting you is properly authorised by the FCA before getting involved. You can check at **www.fca.org.uk/consumers/protect-yourself** and can report calls from unauthorised firms to the FCA by calling 0800 111 6768.

Duplicate documents and communications

If you receive more than one copy of shareholder documents, it is likely that you have multiple shareholding accounts on the share register, perhaps with a slightly different name or address. To combine your shareholdings, please contact Computershare and provide your Shareholder Reference Number.

Financial calendar

January 2023	June 2023	July 2023	December 2023
Quarter 1 trading update	Half-year results	Quarter 3 trading update	Full-year results

Dividend calendar

2 February 2023 Ex-dividend date for 2022 final dividend	**3 February 2023** Record date for 2022 final dividend	**3 March 2023** Payment date for 2022 final dividend
6 July 2023 Ex-dividend date for 2023 interim dividend	**7 July 2023** Record date for 2023 interim dividend	**28 July 2023** Payment date for 2023 interim dividend

Annual General Meeting

1 March 2023

G2. Other Public Reporting

In addition to its annual financial reporting the Group has published, or will publish, the following documents in respect of the year ended 30 September 2022, as required by legislation or regulation, relating to the Group or its constituent entities.

- Annual and half-year Pillar 3 disclosures required by the PRA Rulebook
- Tax Strategy Statement
- Modern Slavery Statement
- Gender pay gap information

These documents are made available on the Group's website at **www.paragonbankinggroup.co.uk**.

All these statements are required to be published annually. In addition, for the year ended 30 September 2022, the Group has had to publish bi-annual statements on supplier payments under the Reporting on Payment Practices and Performance Regulations 2017. It also made its sixth report against its Women in Finance charter commitments in September 2022.

All this reporting will be continued in the financial year ending 30 September 2023.

The Group publishes an annual sustainability report, the Responsible Business Report. This gives additional information on ESG issues and illustrates the application of the Group's ESG strategy in practice. The 2022 Responsible Business Report will be published in December 2022.

The Group also publishes on its website a statement setting out how it has applied the PRA / FCA dual regulated firms Remuneration Code, as required by the Rule 7.5 of the Remuneration part of the PRA Rulebook and FCA standard SYSC19D.3.13R.

H.

Contacts

CREATIVITY

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

> **Creativity is about simplifying things, making information easy to understand and fostering interactions that are engaging, memorable and enjoyable. It's a great value because it means you're constantly asking yourself how you can make things better for our customers and our colleagues.**

Laura, E-Learning

H1. Contacts

Registered and head office

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Telephone: 0121 712 2323

Investor Relations

(institutional investors)
investor.relations@paragonbank.co.uk

Company Secretariat

(retail investors)
company.secretary@paragonbank.co.uk

Corporate website

www.paragonbankinggroup.co.uk

Customer website

www.paragonbank.co.uk

Auditor

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Solicitors

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London EC1Y 8YY

Registrars

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