



Paragon Banking Group PLC

Annual Report 2023

For the year ended 30 September 2023



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; social unrest; 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

Financial and Operating Highlights

Results in brief

- P4** Financial and operating highlights

Strategic Report

The business and its performance in the year

- P8** A1. Chair of the Board's introduction
P10 A2. Business model and strategy
P24 A3. Chief Executive's review
P28 A4. Review of the year
P54 A5. Future prospects
P57 A6. Citizenship and sustainability
P87 A7. Approval of Strategic Report

Corporate Governance

How the business is controlled and how risk is managed

- P90** B1. Chair's statement on corporate governance
P92 B2. Corporate governance statement
P94 B3. Board of Directors and senior management
P102 B4. Governance framework
P120 B5. Nomination Committee
P126 B6. Audit Committee
P136 B7. Remuneration Committee
P168 B8. Risk management
P183 B9. Directors' report
P186 B10. Responsibility statement

Independent Auditor's Report

On the financial statements

- P190** C1. Independent auditor's report to the members of Paragon Banking Group PLC

The Accounts

The financial statements of the Group

- P202** D1. Primary financial statements
P209 D2. Notes to the accounts

Appendices to the Annual Report

Additional financial information

- P336** E1. Appendices to the Annual Report

Glossary

- P342** F1. Glossary

Useful information

- P346** G1. Shareholder information
P347 G2. Other public reporting

Contacts

- P350** H1. Contacts

Financial and operating highlights

Our purpose

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

Find out how we are supporting our customers' ambitions on pages 12 to 13



Strong performance in a dynamic environment

£3.0 billion

(2022: £3.2 billion)

New lending to support people and businesses across the UK

£14.9 billion

(30 September 2022: £14.2 billion)

Total loans and advances to customers

£277.6 million

(2022: £221.4 million)

Underlying profit before tax

20.2%

(2022: 16.0%)

Underlying return on tangible equity

£180.9 million

Total capital returned to shareholders in 2023

Ordinary dividend

37.4 pence per share + 30.8%

Share buy-back

£100.0 million

90%

(2021: 87%)

Employee engagement score in 2023 Employee Survey

4.6/5

Combined Trustpilot rating awarded by savings customers and buy-to-let customers with newly originated loans

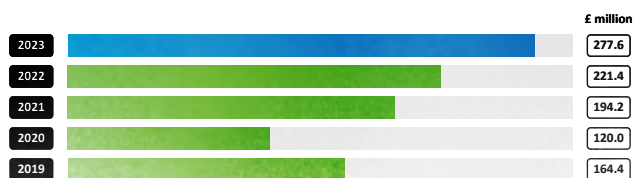
1 May 2023 to 30 September 2023

Trustpilot



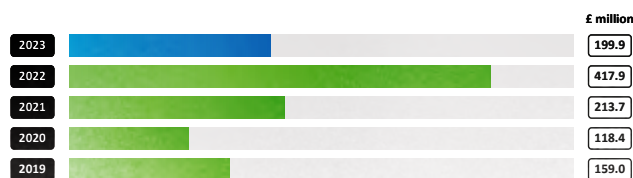
Underlying profit before tax

£277.6 million 25.4% higher (2022: £221.4 million)



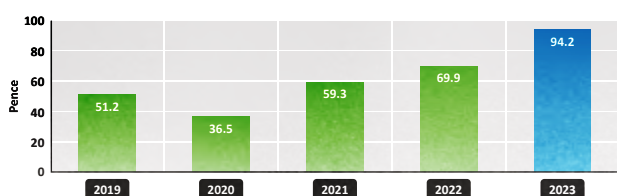
Profit before tax

£199.9 million 52.2% lower (2022: £417.9 million)



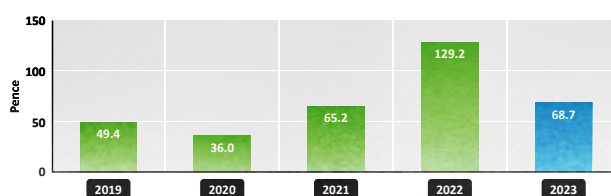
Underlying basic earnings per share

94.2 pence 34.8% higher (2022: 69.9 pence)



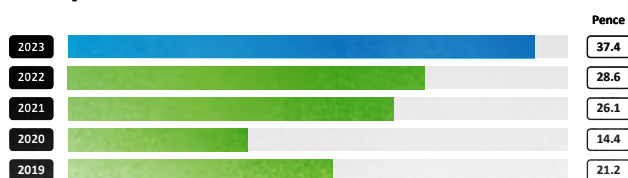
Basic earnings per share

68.7 pence 46.8% lower (2022: 129.2 pence)



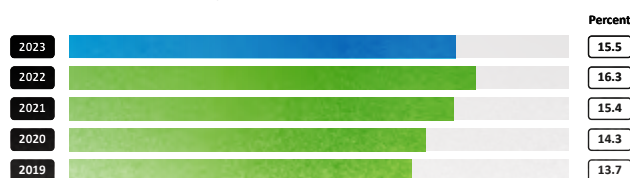
Dividend per share

37.4 pence 30.8% higher (2022: 28.6 pence)



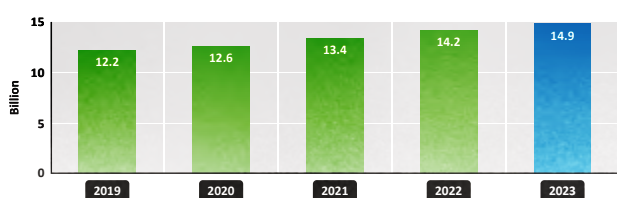
Capital - CET1 Ratio

15.5% Stable in the year (2022: 16.3%)



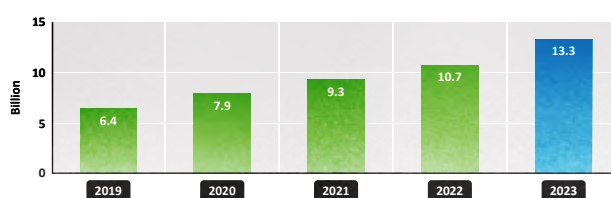
Total loans to customers

£14.9 billion 4.7% higher (2022: £14.2 billion)



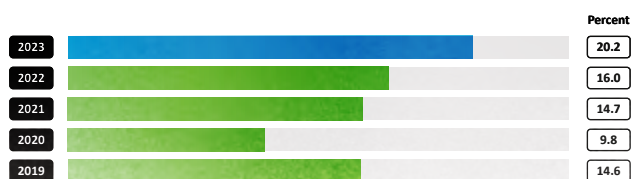
Retail deposits

£13.3 billion 24.3% higher (2022: £10.7 billion)



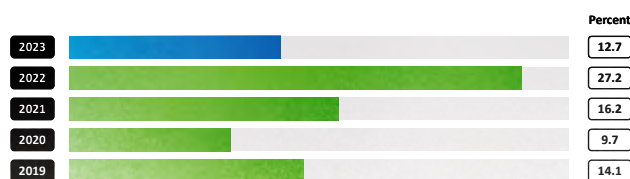
Underlying return on tangible equity

20.2% (2022: 16.0%)



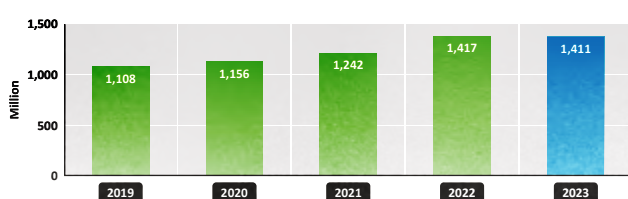
Return on tangible equity ('RoTE')

12.7% (2022: 27.2%)



Equity

£1,410.6 million (2022: £1,417.3m)



Tangible net assets per share

£5.79 (2022: £5.33)



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 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 61b. The derivation of underlying profit before taxation and other underlying measures is described in Appendix A.

A.

Strategic Report

The business and its performance in the year

- P8** **A1. Chair of the Board's introduction**
The year in summary
- P10** **A2. Business model and strategy**
Overview of what the Group does and the significant risks to which it is exposed
- P24** **A3. Chief Executive's review**
Strategic summary of the Group's performance and position
- P28** **A4. Review of the year**
Financial and operational performance of the Group in the year
- P54** **A5. Future prospects**
How the Group is placed looking forward
- P57** **A6. Citizenship and sustainability**
The Group's impact on its employees, the environment and the community, including non-financial reporting
- P87** **A7. Approval of the Strategic Report**
Approval of the Strategic Report





Our values

FAIRNESS

To work together to
ensure good outcomes
for all our customers

A1. Chair of the Board's introduction



Dear Shareholder

My first full year as Chair has been an eventful and challenging one for the UK. We have seen the highest levels of interest rates and inflation for many years, driven by a sharp increase in energy prices caused by the ongoing conflict in Ukraine and political instability in the UK, with a general election probably less than twelve months away. These issues have impacted our customers and challenged us to ensure we provide them with good support while protecting and developing our own businesses.

As I have completed my induction process, visiting all parts of the business, I have been impressed with how the Group's strategy, purpose and culture have effectively shaped our response to these issues and the support we have provided to our customers and business partners.

This annual report sets out the Group's progress in the face of these challenges and the positive results it has delivered for its stakeholders. I hope you will find it an interesting and useful guide to the Group's development and achievements in the year.

The business and its purpose

The Group's purpose, which is to support the ambitions of the people and businesses of the UK by delivering specialist financial services, remains particularly important at a time of economic pressure. The Group's focus on specialist customers and its expert approach to the issues they are facing provides an important alternative to the wider mass-market banking sector, where the specific needs of these businesses and consumers may be less well understood.

This specialist focus means that the Group is able to work effectively with its loan customers, supporting them in the management of their businesses as they respond to the challenging economic environment encountered during the year. In this context I was pleased with the Group's progress in implementing the new FCA Consumer Duty, which I found to be well aligned with the Group's existing culture.

The long-term digitalisation strategy, which is key to the delivery of the Group's purpose continued to make strong progress in the year, and I was gratified to see the elements which have already been delivered are improving customer and intermediary experience and enhancing operational outcomes and efficiencies. With additional major developments in the pipeline, I look forward eagerly to further benefits for the Group's business and stakeholders.

The Group's strategic objectives have remained a constant throughout the recent upheavals in the UK economy and provided a disciplined framework to guide it through the challenges it has faced and to ensure it can continue to deliver positive results for our stakeholders.

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



Results

In the face of a more challenging climate for new lending, I was pleased with how well business levels were maintained during the year. New lending was £3.0 billion, only a little down from the £3.2 billion recorded in 2022, despite the increases in interest rates and the consequent impacts on affordability. The savings deposit base grew to £13.3 billion from the £10.7 billion recorded a year earlier, and the Group's final wholesale funding arrangement which predated the grant of its banking licence in 2014 was repaid. The Group's credit rating remained strong, and I was pleased to receive affirmation of the BBB+ rating in February 2023.

In the face of the challenging environment the Group maintained its focus on high quality credit, disciplined pricing and the careful control of costs, delivering a continued growth in underlying profit for the year, at £277.6 million, despite the Group's careful approach to loss provisioning (2022: £221.4 million). Earnings per share on the underlying basis increased by 34.8% to 94.2 pence (2022: 69.9 pence) and the underlying return on equity at 20.2% continued to strengthen (2022: 16.0%).

Profit before tax on the statutory basis, which also includes fair value accounting losses recorded on hedging, was substantially lower than underlying profit at £199.9 million (2022: £417.9 million). Statutory EPS reduced to 68.7 pence (2022: 129.2 pence) and RoTE on the statutory basis was 12.7% (2022: 27.2%). The level of these measures was driven by the magnitude of interest rate movements in the previous year which affected the Group's derivative positions causing significant gains to be recorded in 2022. These began to unwind in 2023, with substantial fair value losses being recorded in the process. These movements do not reflect the underlying performance of the business and will reverse over the lives of the related hedges, so have been consistently excluded from underlying profit.

Regulatory capital has remained strong and broadly stable in the year, with the small decrease reflecting the fair value effects noted above. The Core Equity Tier 1 ('CET1') ratio closed the year at 15.5% (2022: 16.3%) and the Group's projections show that it is well placed to address the upcoming Basel 3.1 changes, even based on the most adverse of the potential outcomes being consulted upon. Group liquidity was also maintained at a healthy level, growing in the year.

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



Stakeholders

Throughout the year I have continued to be impressed with the Group's focus on all its stakeholder groups and its duties as a corporate citizen.

I have found my engagement with the employee representatives on the Group's People Forum both informative and helpful in understanding how the business puts its values into action, and the levels of satisfaction recorded in the employee engagement survey carried out in the year were very gratifying.

The Group's climate change agenda continued to progress through the year and in this annual report you will find enhanced TCFD disclosures covering a broader range of the Group's activities. You will also see details of how climate-based stress testing has been developed and delivered to the Board, which I found very useful in understanding the Group's impacts.

We understand how important the provision of finance will be to ensuring that our landlord and SME customers are able to make progress on their own journeys to net zero and stand ready to deliver products which will support them. Many of our customers, have, however reported a lack of clarity in the regulatory landscape in this area, and we would urge the authorities to provide some certainty sooner rather than later, so that investment plans can be developed.

I have been impressed during the year with the level of engagement of people from across the Group with industry-led and wider sustainability initiatives, demonstrating how these issues are at the heart of our Group's strategy. I would also like to congratulate the growing number of the Group's people who take up their opportunity for a paid volunteering day in the community.

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



Governance

The year has been one of potential change for the UK's corporate governance regime. Proposals to reform both the legal regime and the UK Corporate Governance Code (the 'Code') have been published, consulted upon, and in some cases withdrawn during the course of the period. I have monitored the developments with the hope that the final outcomes would be proportionate, useful, efficient and effective and the Group has provided its input to the consultation processes. We have yet to see final proposals, but I welcome the movements seen since the year end, which seem to show government and regulators responding positively to the concerns of UK PLC.

The Group continues to operate under the Code, complying with its provisions in the year. During the year I was involved in an externally facilitated evaluation of the Board and the Group's governance, which I found both informative and reassuring.

Zoe Howorth joined the Board as a new non-executive director in June. Her appointment, from a customer-facing and marketing background, has broadened the range of skills and experience available to the Board. My colleague, Hugo Tudor, reached the ninth anniversary of his appointment to the Board in November, and whilst he will continue as a non-executive director he will no longer be considered to be independent from March 2024. In anticipation of this Hugo handed over his responsibilities as Senior Independent Director to Alison Morris in August, and we have announced that Tanvi Davda will succeed Hugo as Chair of the Remuneration Committee from 7 December. I look forward to working with Zoe, Alison and Tanvi as they take on their new roles.

The Group's approach to corporate governance is discussed in Sections B3 and B4



Risk

I am pleased with the continuing development of the Group's risk management framework in the year and with its evolution to manage risks as they emerge. During the year the processes for the management of customers with vulnerabilities was a particular focus, in light of the pressures on household and business incomes. The fast changing landscape of cyber and financial crime risk was also a recurring theme as we considered risk exposures. The Group met the deadlines for the implementation of the FCA Consumer Duty for live products during the year and is on track to meet those for legacy products during 2024. The successful programme to embed the duty has been a major piece of work across the Group, informed by its existing customer service culture. This project has been a significant area of board focus throughout the year and I have been impressed by the way in which it was executed.

The Risk Management report is set out in Section B8



Shareholder returns

The Group's strategic objective is to provide a strong and sustainable return to investors while maintaining a prudent capital position. The consistently strong trading performance of the Group over recent years has enabled it to complete share buy-backs of £100.0 million during the year, in addition to the declaration of an interim dividend. It is, though, frustrating that this performance has not been reflected in the Group's share price. It is our view that a major contributory factor to this is the relatively weak level of valuations in the UK listed market and the consequent investment outflows from the mid-cap sector. In this context, we support the various initiatives underway to encourage greater investment into UK equities.

On the basis of its regular year-end review of the Group's capital position, the Board concluded that a final dividend for the year of 26.4 pence per share can be declared, subject to shareholder approval, giving a total dividend for the year of 37.4 pence per share, and thereby achieving a dividend cover of approximately 2.5 times of earnings excluding fair value losses, in line with policy. It also authorised a further share buy back of up to £50.0 million. I would like to thank all our shareholders for their continuing support during the year, but particularly those who made time to meet with me and share their views of the Group, its businesses and its strategic priorities. I found these interactions very useful in developing my own views.

Conclusion

My first full year as Chair of the Board has been interesting and challenging, with the Group seeing good progress on strategic projects and effective responses to more unexpected changes in the operating environment. Underlying earnings levels have continued to grow, and the capital and funding position remains strong.

Prospects for the future are promising, with the further benefits from the digitalisation strategy due to be delivered, a resilient capital base and strong businesses which are well placed to resist economic headwinds and continue to deliver good outcomes for customers into the new financial year.

Finally I would like to thank my colleagues on the Board and across the Group for their contribution during the year, and the support they provided as I have developed my understanding of the business. I look forward to working with them and all of our other stakeholders as the Group addresses the challenges and opportunities of the coming years.

Robert East

Chair of the Board
6 December 2023

A2. Business model and strategy

Mortgage Lending



Landlord customers **49,000+**

Loan assets **£12.90 billion**
(+4.7%)

New lending **£1.88 billion**
(2022: £1.91 billion)

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. We are headquartered in Solihull and employ more than 1,500 people. Our operations are organised into two lending divisions and lending is funded principally by retail deposits.

We offer buy-to-let mortgage finance for landlords operating in the UK's Private Rented Sector. A pioneer in this area of the mortgage market, we have originated £29.2 billion of buy-to-let lending since 1996.

Our customer-focused approach, combined with our expertise in property valuation and risk management, helps us to support 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.

Commercial Lending



Business customers **40,750+**

Loan assets **£1.97 billion** (+4.8%)

New lending **£1.13 billion**
(2022: £1.30 billion)

Since the introduction of our first commercial lending products for small and medium sized businesses ('SME's') 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

New lending **£0.45 billion** (2022: £0.45 billion)

Supporting customers across construction, transport, manufacturing, agriculture, technology and professional services, our products include hire purchase and finance and operating leases.

► Development finance

New lending **£0.52 billion** (2022 £0.63 billion)

Helping property developers bring their plans to life with competitive and flexible finance, including residential development loans, bridging finance and pre-planning finance, as well as finance for purpose-built student accommodation and build-to-rent developments.

► Structured lending

Total facilities **£0.24 billion** (2022: £0.22 billion)

Delivering finance for non-bank specialist lenders.

► Motor finance

New lending **£0.16 billion** (2022: £0.17 billion)

Providing finance through approved intermediaries and dealers for cars, light commercial vehicles, motorhomes and caravans.



Savings



Direct savings customers	260,000+
Total volume of savings deposits	£13.27 billion (+24.3%)
Trustpilot customer rating	4.3/5 1 October 2022 to 30 September 2023

Our principal source of funding for our lending activities is our range of savings products offered to UK households. We offer a range of safe, simple and transparent Easy Access, Defined Access, Notice and Fixed Term savings accounts, including ISAs. Online and postal distribution is supplemented by distribution through digital banking and wealth management platforms.



Other funding for lending is derived from the efficient use of Bank of England funding schemes, while securitisation continues to fund elements of the lending book and is used tactically. Central funding is provided through corporate and retail bonds.

Our purpose

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

Delivering on our purpose is fundamental to the success of our customers, our employees, the economy and the wider world around us.

By living our purpose, we have developed and continue to evolve an innovative range of mortgage and commercial lending products to support a unique group of customers with a distinctive set of needs, funded predominantly by retail deposits.

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 take. We see specialisation as what makes us different - as our competitive advantage - and it runs through our business model and strategy.

Working together as one team also provides the opportunity for our people to achieve their own ambitions to grow and develop, to enjoy a successful career and to build strong foundations for their lives outside of work.

Our values

We have a strong and unique culture underpinned by eight values that 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.



FAIRNESS



PROFESSIONALISM



INTEGRITY



COMMITMENT



TEAMWORK



RESPECT



HUMOUR



CREATIVITY

Supporting our customers

10 properties

average portfolio size³

17 years

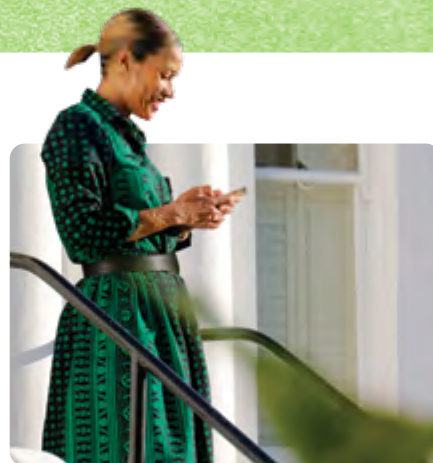
average experience as a landlord³

53.7%

proportion of lending to limited company landlords

Landlords

The Private Rented Sector ('PRS') is an important part of the UK's housing mix, providing a home to approximately one in five households¹. Buy-to-let mortgage finance is estimated to fund 36.7% of PRS properties², with recent regulation encouraging a trend towards more professional landlords. While our landlords span the full spectrum of the market, they are concentrated in the professional landlord segment with larger and more complex property portfolios and higher growth ambitions.



Professional landlords have specialist requirements and this is where our product and service support stands out, carefully designed and constantly evolving to meet their needs:

- Mortgage finance for a wide range of property types
- Limited company lending
- Specialist support from our team of in-house surveyors
- Fixed and discounted interest rate mortgages
- Lower interest rates for properties with higher energy efficiency ratings

10 years of excellence

Awarded Best Professional Buy-to-Let Lender by Your Mortgage for the 10th time



Decades of experience have given Paragon the confidence and specialist expertise to make lending decisions and design products that meet the needs of professional landlords.

Your Mortgage Awards Panel

Residential property developers

The UK's housing shortage provides a huge opportunity for developers with the right skills and funding to bring innovative projects to life, regenerating unused land and brownfield sites. We work with experienced small and mid-sized property developers across the UK on a wide variety of residential projects.

Lending up to **70%**
of Gross Development Value
for residential projects

54.2%
of business outside of
London and the South East

50%+
of business from
repeat customers



Project support from conception
to completion

Working side-by-side with our developer clients, we offer a range of lending products and an outstanding service commitment designed to support each project from inception to marketing:

- Development finance for multi-unit residential new build, conversion and refurbishment projects
- Development finance for purpose-built student accommodation and build-to-rent projects
- Bridging, pre-planning and marketing finance for development projects
- The Green Finance Initiative, offering a 50% reduction on loan exit fees for the most energy efficient developments
- Long-term support from our experienced business development specialists

Paragon has been great in understanding our purpose and assisting with our growth, providing funding to maintain our momentum and the growth of our company and to allow the development of multiple sites simultaneously.

Elevate Property Group

¹English Housing Survey 2021 to 2022: headline report ²Estimated using data from Department for Levelling Up, Housing and Communities, The Scottish Government and The Welsh Government and UK Finance

³Paragon Customer Survey 2023

Small and medium sized business



£92,000

average value of lease agreement

49 months

average term of lease agreement

Small and medium sized businesses are the lifeblood of the UK economy and they need an expert and reliable finance partner to help them innovate, adapt and grow. We support business customers across a wide range of sectors, with a particular emphasis on six focus sectors: construction, transport, manufacturing, agriculture, technology and professional services.

We have built up asset knowledge and expertise in our focus sectors over decades and it is this, coupled with the wide range of finance solutions we offer and our commitment to service, that gives customers the confidence to choose Paragon:

- Finance solutions for asset purchase and refinance
- Working with manufacturers and distributors, together with specialist broker channels
- Support from sector experts with deep and specialist asset knowledge

Savings

Retail savings deposits provide the mainstay of funding for our specialist lending products. In a competitive market, we attract customers by providing a broad range of safe, straightforward and easy-to-use savings accounts across multiple channels and by building a reputation for good value and service.

Direct savings customers

£28,000

average deposit held in direct accounts

58%

of customers try to meet their annual ISA allowance⁴

50:50

new customer application split between fixed and variable interest rate accounts

97%

of customers know the maximum limit on the FSCS guarantee⁵

The sharp rise in interest rates has given savers a bigger incentive to shop around and we have responded with speed to help them make the most of this opportunity. Higher interest rates also mean more savers will be subject to tax on their interest income and that is where our tax-free ISA products come into play:

- Broad range of fixed term, defined access and easy access savings accounts
- Choice of ISA and non-ISA accounts
- Online and postal accounts, backed with UK-based call centre support
- Competitive interest rates
- Tailored accounts for customers of digital banks and wealth platforms

⁴ Paragon Savings Customers, Financial Outcome Survey 2023

⁵ Paragon Savings Customers, New Application Survey 2023



Finance for green assets

For businesses to make the transition to green technology it is essential that they are able to access the funding necessary to do so – and Paragon is committed to supporting businesses in acquiring assets that will be beneficial for both them and our environment in the years ahead.

Reactive Hire



A consistent focus on Cash ISAs

Awarded Cash ISA Provider of The Year by MoneyNet in 2023

Paragon Bank has been a consistently strong performer in the Cash ISA savings market for both easy access and fixed term account options. It has rarely been out of the best buy tables in the last year and thoroughly deserves this title.

Andrew Hagger

Personal Finance Commentator and Chair of the MoneyNet judging panel

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 – we achieve success by...

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.

619 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 charge
£18.0 million

Technology

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

14,500+
landlords have registered on our new service portal

Management expertise

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

Average length of service of the executive management team is
16.5 years

To deliver value to all our stakeholders

Our section 172 statement can be found on pages 107-115

Shareholders

Creating long-term shareholder value by growing profits and dividends.

See page 108

Dividend per share

37.4p

Employees

Helping our people develop their career and reach their potential.

See page 110

Average training per employee in 2023*

3.5 days

Society

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

See page 112

469
paid volunteering days supporting charities and local community groups

* Employer skills survey, UK average 3.3 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



Development finance 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
36.6%

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.

2023 employee engagement score¹
90%

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.

97%
of employees agree Paragon has a clear and consistent set of values that underpin how we operate¹

Strong financial foundations

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

CET1 ratio
15.5%

¹2023 Employee Survey

Customers

Providing specialist lending products and savings accounts to help our customers achieve their ambitions.

See page 109

+62

Net Promoter Score ('NPS') for savings account opening

Environment

Continually reducing our environmental impact and designing products that support positive environmental change.

See page 113

£904.6 million

new lending to EPC A-C properties supported by our mortgage products

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. Our strategy is to focus on specialist customers, delivering 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.

Find out more about the progress we are making on each of our strategic priorities on pages 18-23

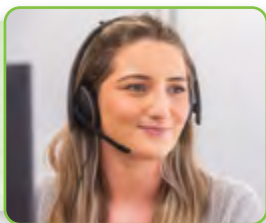


Our strategic priorities

Strategic progress

	<p>Growth Read more on page 18</p>	<p>Delivering consistent growth in loan assets and funding by focusing our expertise in specialist lending markets and building an award-winning savings franchise.</p>
	<p>Diversification Read more on page 19</p>	<p>Developing resilience by diversifying into commercial lending alongside our traditional stronghold in buy-to-let, building on a broader funding base.</p>
	<p>Digitalisation Read more on page 20</p>	<p>Transforming our business using digital, cloud-based technology to enhance customer service, productivity and growth.</p>
	<p>Capital management Read more on page 21</p>	<p>Generating strong levels of core capital to support customers through the economic cycle, provide capacity for growth and shareholder returns.</p>
	<p>Sustainability Read more on pages 22 and 23</p>	<p>Moving towards net zero, building skills and capability to support long-term growth and maintaining strong stewardship.</p>

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

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



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.

Capital

- ▶ Risk of insufficient capital to operate effectively and meet minimum requirements.

Liquidity and funding

- ▶ Risk of insufficient financial resources to enable us to meet our obligations as they fall due.

Market

- ▶ Risk of changes in the net value of, or net income arising from, our assets and liabilities from adverse movements in market prices.

Credit

- ▶ Risk of financial loss arising from a borrower or counterparty failing to meet their financial obligations.

This year's outstanding performance reflects the growing specialist franchise of the Group and continued progress in our strategic development.

Nigel Terrington, Chief Executive

5.2%
five-year compound annual growth rate in new lending

4.2%
five-year compound annual growth rate in the net loan book

37.5%
of new lending now Commercial Lending

81.1%
savings as a proportion of total funding

Digital transformation underway across the Group

new customer-facing applications and capability

enhanced operational infrastructure

£1,188.9 million
Tier 1 equity

20.2%
underlying return on tangible equity

42%
reduction in market-based operational emissions since 2019

95%
of our people are proud to work at Paragon¹

¹2023 Employee Survey



Strong financial foundations

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

Model

- ▶ Risk of making incorrect decisions based on the output of internal models.

Reputational

- ▶ Risk of failing to meet the expectations and standards of our stakeholders.

Strategic

- ▶ Risk that the corporate plan does not fully align to and support strategic priorities or is not executed effectively.

Climate change

- ▶ Risk of financial risks arising through climate change impacting the Group and our strategy.

Conduct

- ▶ Risk of poor behaviours or decision making leading to failure to achieve fair outcomes for customers or to act with integrity.

Operational

- ▶ Risk resulting from inadequate or failed internal procedures, people, systems or external events.



Strategy in action

Growth



We focus 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.

Our approach

- Focus on specialist market segments with underlying growth
- Build market share by launching new products and extending distribution
- Grow retention, encourage repeat business and extend customer lifecycle

Consistent delivery

Loan book growth achieved in the latest reporting period builds upon a long track record of consistent delivery over many years.

£3.01 billion

New lending
12 months ended
30 September 2023

5.2%

Five-year compound
annual growth rate
2018-2023

£14.87 billion

Total loans and advances
to customers at
30 September 2023

4.2%

Five-year compound
annual growth rate
2018-2023

Growth in a challenging mortgage market

In a challenging period for the mortgage market, we continued to concentrate on the needs of our target market of professional landlords. Despite the rising interest rate environment, our focus on three related areas has delivered continued progress in the loan book.

1

Streamlined support at product maturity

Over 80%

of fixed-rate mortgage accounts
maturing in the year retained

Five-year fixed rate products became popular in the buy-to-let market around 2017 and, with high volumes now reaching maturity, we invested to improve our customer proposition. Customers and intermediaries benefit from:

- Notification six months in advance of their mortgage fixed-rate maturity date, with an offer of alternative switch and further advance products
- A fully automated, easy-to-use, online switch and further advance process
- A dedicated customer support team to offer extra help where needed

2

Mortgage product availability and choice



Against a backdrop of rising interest rates and a volatile swap market, maintaining mortgage product availability and choice becomes more challenging for lenders but remains essential for customers. We continued to offer a wide variety of product options for customers and even expanded the range to include an innovative track to fix option. This lets customers navigate the uncertain outlook by starting on a discounted variable rate, then converting to a fixed rate when they choose.

3

Faster, more transparent service



Mortgage applications need expert support to ensure a fast and transparent turnaround. This year, we took a number of steps to improve our effectiveness in converting pipeline applications that meet our criteria into new lending.

These included:

- Pre-referrals on properties, enabling our in-house surveyors to confirm that the property meets our standards ahead of full application
- More comprehensive day one, application checks to close any information gaps
- Weekly publication of current application processing times on our website

These measures helped to boost the average monthly Net Promotor Score from brokers placing new mortgage lending business with Paragon to an all-time high of +60.





Strategy in action

Diversification



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

Our approach

- Build capability in specialist commercial lending markets alongside buy-to-let
- Develop a successful savings franchise, while maintaining access to central bank and capital market funding
- Enhance flexibility to stay resilient in the face of changing market conditions

A versatile lending and funding mix

Since gaining our banking licence in 2014 and embarking on our diversification journey, we have grown successfully in selected commercial lending markets and built a broader funding base.

37.5%

Commercial Lending as a proportion of new lending in 2023

9.7%

New lending, five-year compound annual growth rate 2018-2023

£13.27 billion

retail savings deposits at 30 September 2023 (30 September 2018: £5.30 billion)

£3.09 billion

funding from central bank and wholesale markets (30 September 2018: £7.96 billion)



Adding reach and capability in property development finance

From a stronghold in London and the South East, we have expanded business across the UK, added more capacity to finance purpose-built student accommodation and launched into the build-to-rent market.

Purpose-built student accommodation

This year, we signed an agreement with long-standing client, Tribe, providing £29.6 million to finance a 12-storey, 267-bed student accommodation development in Southwark, South London. The development utilises Paragon's stabilisation facility, which provides finance for an 18-month period post-completion to season the development with student occupancy for up to two academic years.



Applying expertise to help SME customers adapt and grow

SME businesses need finance partners that can help them to adapt and grow. Our asset expertise means we are well-placed to help customers fund new assets or refinance existing ones.

Recycling waste into profit

Greater Manchester-based waste management specialists SED Services expanded its operations with the acquisition of a state-of-the-art composting site with the help of funding from Paragon raised by refinancing existing, unencumbered assets.

Providing competition and choice for UK savers

Since launching into the cash savings market in 2014 and the ISA market in 2016, we now offer a broad range of savings accounts, reaching customers through a range of different channels.



Double and Triple Access savings accounts

In a changing interest rate environment, customers have been attracted to our Double and Triple Access savings accounts, which provide flexibility to make limited withdrawals in 12 months while maintaining an attractive interest rate.



Strategy in action

Digitalisation



The transformation of our technology is focused on implementing digitally-enabled, API-driven, 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.

Our approach

- Implement flexible, cloud-based and digital-first technology
- Utilise API and Open Banking technologies to enhance customer propositions and deliver deeper insight
- Leverage data and emerging technology to enhance experience for customers and employees

A fast-paced digital transformation

We are delivering a fast-paced digital transformation, moving through a carefully planned, stepped programme to bring a better experience for our customers and colleagues.

Over 80%

of Paragon's IT applications are now cloud-based

£24.4 million

2023 IT costs as we invest in digitalisation

New service portal for landlord customers

In May 2023, we launched a new service portal for our existing landlord customers – a key milestone in our end-to-end, buy-to-let digital transformation programme. The new portal gives landlords a clearer view of their mortgage details and introduces a range of self-service features which will be expanded over time.

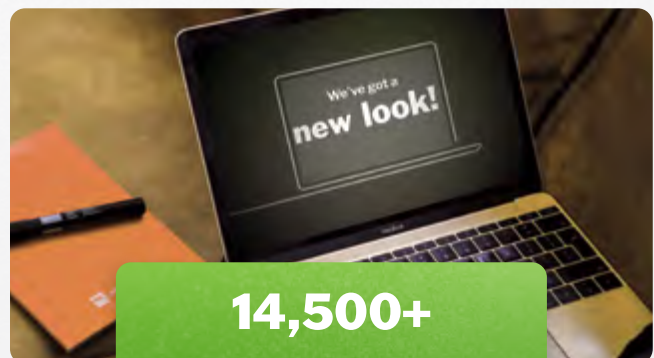
Landlords using the new portal can:

- Access their account and product details
- Update their contact details
- View and download annual statements
- Create custom mortgage statements
- Apply for a product switch or further advance

The next major milestone in our digital transformation in Mortgage Lending will be the launch of the new mortgage application and origination process.

Really easy to navigate. Especially liked the custom mortgage statements.

Landlord customer



14,500+

landlords have registered on our new service portal

SME lending introduce auto-decisioning capability for faster service on standard deals

Some lending decisions are more straightforward than others. Sometimes we know the customer well, we are familiar with the asset and its characteristics and the amount of finance sought is relatively small. In these cases, we want to be able to respond with speed and that's why we have developed an auto-decisioning capability in our SME lending team. As the system evolves and improves, it delivers faster service for customers with standard transactions, giving our specialist team more time to assist customers on more complex deals.





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 of 15-20%.

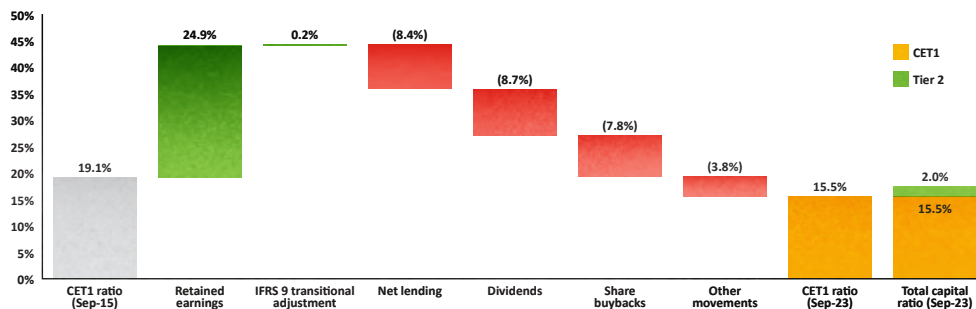
Our approach

- Maintain a cautious risk appetite, operationally and prudentially
- Deliver a sustainable return on tangible equity of 15-20%
- Grow our dividend and return excess capital through a share buy-back programme

Strong capital generation

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 growth and making distributions to shareholders.

Movements in capital 2015-2023



17.5%
Total Capital Ratio
30 September 2023

15.5%
Core Tier 1 Equity Ratio
30 September 2023

£465.5 million

Total dividends declared since 2015

£483.0 million

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

Sustainable shareholder returns

We aim to enhance shareholder returns on a sustainable basis, while protecting the capital base. In ordinary circumstances, we distribute 40% of consolidated earnings to shareholders, achieving a dividend cover ratio of approximately 2.5x. Our share buy-back programmes provide flexibility to return excess capital to shareholders as appropriate.

Moving towards IRB accreditation

We are seeking accreditation to adopt an IRB approach when setting and managing our risk-weighted capital requirements. We continue to work closely with the PRA, as they consider our application, reflecting feedback and enhancing documentation as we progress through the regulator's modular assessment process. As a conservative lender, with a proven through-the-cycle track record, IRB accreditation will allow us to tailor our capital requirements more closely to the credit risks we face.





Strategy in action

Sustainability



Reducing our operational impact

We want to make a positive contribution to the challenge of climate change and one of the main ways of doing this is by reducing the environmental impact of our everyday business activities.

42%
reduction in
market-based emissions¹

92%
of total electricity from
renewable sources

46%
of waste diverted
from landfill

¹ compared to 2019 base line

For Paragon, sustainability means understanding our responsibilities towards the environment and the societies in which we live and work, and focusing our agenda on doing the right thing for all our stakeholders and contributing to a world in which we can all thrive. That includes reducing the impact our operations have on the environment, delivering sustainable lending through products that help our customers achieve their goals, positively impacting our people, customers and communities, and achieving the highest standards of business integrity and professionalism. A commitment to maintaining high environmental, social and governance ('ESG') standards is embedded in the Group's culture and values, influencing every aspect of our business.

Our approach

- Reducing our own emissions to become operationally net zero by 2030
- Financing a greener world by delivering sustainable lending products to help achieve the UK's 2050 net zero goal
- Making a positive difference by supporting the communities in which we live and work

Financing a greener world

£904.6 million

new lending to EPC A-C properties supported by our mortgage products

Achieved

£150 million

allocation of our Tier 2 Green Bond

We will keep working with industry, partners and policymakers to ensure we are playing a proactive part in supporting our customers' transitions to net zero, and that sustainable finance is embedded throughout our business.

Green Homes Initiative funding doubled to

£200 million

4.6 out of 5

Trustpilot trust score
1 May – 30 September for savings
and mortgage customers

95%

of our people are proud
to work at Paragon
(Employee Engagement Survey 2023)

Making a difference

When it comes to social matters, the needs of our people, customers and communities are priorities. We think globally, linking our priorities to the UN's Sustainable Development Goals, and deliver locally across the UK.

Raising and donating **£100,000+** to benefit charities
and contributing **469** volunteering days to good causes across the UK

Progress Together

Progress Together

Paragon is a founding member of Progress Together, an independent membership body, created to drive socio-economic diversity at senior levels across UK financial services.



Green Homes Initiative

Our development finance team supported Ambassador Living with Green Homes Initiative funding of £9.5 million for the completion of its energy efficient Wallace Park project in Wallyford, East Lothian. Each Wallace Park home has maximum energy efficiency and is anticipated to achieve an EPC A rating. The funding will support the project's remaining 67 private homes, which comprise three, four, and five-bedroom bespoke detached properties.





The high interest rate, high inflation economic background has led to both market-wide reductions in demand and challenges on customer affordability. In this environment the Group's focus on specialist products, a robust credit approach, high levels of customer retention and margin maintenance has delivered strong results in 2023 and these strategies will continue into 2024 and beyond.

Nigel Terrington, Chief Executive

A3. Chief Executive's review

Introduction

The Group has reported strong results for 2023, with the loan book growing by 4.7% from its 2022 level and net interest margin widening to over 3%. This growth has been delivered whilst maintaining the strong capital and liquidity that underpins the Group's lending and savings propositions. Gross new lending advances again exceeded £3.0 billion, while the net increase of £2.6 billion in the deposit base supports growth and materially enhances liquidity.

The increasing influence of digitalisation is seen across the business, with our asset finance portal generating material application flows in the year, and the buy-to-let mortgage maturities portal underpinning stronger year-on-year customer retention at product maturity. Most recently, a post-completion portal has been put in place for buy-to-let customers and further functionality is being developed across the business, with delivery planned for 2024. The value of these enhancements is clear both from the response of our customers and from improved operational efficiency.

2023 has seen the Group make further progress with its climate change initiatives, which are discussed in more detail in the third edition of its Responsible Business Report. Developments in the year included enhanced analysis of the Group's lending on a financed emissions basis, a significant step towards the compilation of an associated transition plan, and the completion of a decarbonisation assessment of the head office building, which contributes to over 30% of the Group's operational carbon footprint.

The Group's people have responded extremely well to the effects of the volatile macroeconomic environment seen during 2023, rising to the various challenges, ensuring good outcomes for customers, and continuing to support the extensive change programmes in progress, as the Group develops its hybrid working approach in an increasingly digitalised environment.

The strong financial performance for the year supports a 30.8% increase in the Group's dividend to 37.4 pence per share. The Group completed a £100.0 million share buy-back programme in the financial year and has announced its intention to conduct a further buy-back of up to £50.0 million during the coming financial year. The full details of the PRA's approach to implementing Basel 3.1 in the UK are still not certain, and the regulator has recently delayed implementation to July 2025. Sufficient capital continues to be available to address the potential impacts of the Basel 3.1 regime. The Group also continues to progress its application for IRB accreditation for its buy-to-let mortgage assets.

Financial performance

Underlying operating profits (excluding fair value and gains on asset sales in 2022) increased by 25.4% year-on-year, to £277.6 million. The principal driver remained net interest income, which benefitted from a growing book and wider margins.

The average net loan book in Mortgage Lending rose by 4.4% to £12.6 billion from its 2022 level, with the average value of the Commercial Lending book increasing by 11.5% to £1.9 billion. The net interest margin rose to 309 basis points from the 269 basis points recorded in the previous year. These positive rate and volume influences saw net interest income increase by 20.9% to £448.9 million (2022: £371.2 million).

Interest income recognition follows the EIR approach set out in IFRS 9, which requires management judgments to be made about the future behaviour of customer accounts, in order to spread income over the expected life of a loan. For the Group's buy-to-let portfolio, these judgements centre on the likely behaviour of customers after their fixed rate period ends and the rates of reversionary interest which will apply at that point. The lack of recent historical precedent for the current economic environment makes these judgements complex.

The aggregate EIR debtor position on the Group's balance sheet at 30 September 2023 totalled £20.5 million (including the impact of discounts on acquired loans), representing 14 basis points of the gross loan book.

Other income was little changed year-on-year, at £17.1 million (2022: £17.2 million, excluding the one-off impact of gains on a disposal of loans).

Operating expenses totalled £170.4 million and include costs associated with the closure of a Group subsidiary and an operational restructuring. While these are one-off in nature, they are considered immaterial and therefore no adjustment has been made to underlying results. The 8.4% increase in costs excluding these one-off items reflects the impact of inflationary pressures in the year, particularly in professional services, together with the Group's continued investment in its digitalisation plans.

The underlying cost: income ratio improved from 39.4% for the 2022 financial year to 36.6% in 2023, with cost discipline and the delivery of operational synergies remaining key areas of focus.

Impairment charges rose by £4.0 million to £18.0 million (2022: £14.0 million), reflecting the impact on customers of higher interest rates and the broader inflationary environment. The charge represents a cost of risk of 12 basis points. A more stable economic outlook, together with enhancements to the Group's SME lending impairment models have been the main drivers in supporting the reduction of overlays from £15.0 million at 30 September 2022 to £6.5 million at the year end, with a greater proportion of the expected loss being recognised by the modelled provisions. Impairment coverage ratios at 30 September 2023 stand at 45 basis points before judgemental overlays (2022: 37 basis points) and 49 basis points including the overlays (2022: 44 basis points).

As noted in the 2022 accounts, the rapid increase in interest rate expectations during 2022 generated a material fair value gain on derivatives hedging the new business pipeline. These gains reverse to zero over the lives of the related loan assets, and 2023 saw £77.7 million of this unwind.

The following table details the reconciliation between statutory and underlying profits for the 2022 and 2023 financial years.

Underlying profit reconciliation

	2023 £ million	2022 £ million
Underlying profit before tax	277.6	221.4
Gains on asset sales	-	4.6
Fair value movements	(77.7)	191.9
Statutory profit before tax	199.9	417.9

Trading performance

New business flows for the year were in line with expectations, although the volatile interest rate environment resulted in substantial variations in application flows on an intra-period basis, with the sharp movements in rate expectations influencing demand and customer confidence.

In Mortgage Lending, £1.88 billion of new buy-to-let advances, coupled with stronger customer retention at product maturity, resulted in 4.7% growth in the net loan book across the year. Credit quality remains strong, with buy-to-let three-month plus arrears standing at 34 basis points (2022: 15 basis points), which continues to be significantly better than industry averages, and a weighted average indexed loan-to-value ratio of 62.7% (2022: 57.8%) providing substantial security cover.

The annualised redemption rate for the buy-to-let portfolio as a whole was 9.0% in 2023 (2022: 9.8%) with the legacy variable rate book, which is more impacted by increases in variable rates, amortising at 14.7% and the post-2010 new book seeing redemptions of 7.0%.

The net loan book for the Commercial Lending division grew by 4.8% in the year. Development finance grew by 3.9% to £0.75 billion, motor finance grew by 13.9% to £0.30 billion and SME lending grew 5.0% to £0.76 billion. The structured lending division saw net repayments of 5.4%, taking the year end drawn balance to £0.17 billion.

High interest rates (both spot rates and swap rates) in the final quarter of the financial year resulted in subdued demand for the Group's property-focussed offerings. In the buy-to-let book, these lower flows, coupled with disciplined management of lending margins and a swifter turnaround of offers, resulted in the year end pipeline decreasing to £0.6 billion (2022: £1.3 billion). The development finance pipeline also reduced, to £0.5 billion from £0.7 billion a year before.

Capital and funding

Since the authorisation of Paragon Bank in 2014, the Group has used retail deposits to fund the majority of its lending growth and the systematic refinancing of its legacy wholesale facilities. This process continued through 2023, with the deposit book growing to £13.3 billion. Wholesale funding will continue to be used tactically, when pricing is attractive, and to manage duration. However, savings deposits are expected to provide the principal source for the Group's financing requirements over the coming years, supporting the further growth of its business and the repayment of its £2.75 billion TFSME drawing by October 2025.

Around 94% of our savings deposits are FSCS covered, and the product mix remains skewed to term deposits rather than easy access accounts, with term deposits comprising 65.5% of the portfolio (2022: 58.1%).

The success of the Group's savings growth has seen Paragon Bank's twelve-month average Liquidity Coverage Ratio ('LCR') increasing to 193.8% in 2023, compared to 146.2% during 2022. With savings deposits expected to be the Group's primary source of funds for the planned repayments of its TFSME borrowings, savings inflows and, hence, the LCR are likely to remain at more elevated levels in the near term. Once the TFSME funding is repaid we would expect the LCR to move back towards historic levels.

The CET1 and total capital ratios at the year end were 15.5% and 17.5% respectively and remain comfortably above regulatory requirements (2022: 16.3% and 18.3%). These requirements increased in the year, with the Bank of England increasing the UK CCyB rate to 2.0% (2022: 0.0%).

The Group continues to pursue an IRB accreditation, initially for its buy-to-let portfolio, and has been in active dialogue with the PRA for much of 2023. The Group is currently awaiting feedback regarding its most recent submissions.

Business model developments

The most notable developments seen in 2023 relate to the Group's continued digitalisation plans, which involve a phased re-platforming of its operational systems together with enhancements to customer and intermediary-facing portals, improving the user experience, and helping to drive operational efficiencies.

The buy-to-let mortgage maturities portal introduced in 2022 underpinned a material improvement in customer retention, with over 80% of professional landlords with maturing fixed-rate accounts taking switch products at maturity, up from over 70% in 2022. Similarly, the roll-out of the SME lending broker portal and enhanced automated support for decision-making in that business has been a catalyst for increased application volumes and more effective handling of cases.

The new financial year is scheduled to see further progress on the Group's digitalisation journey, with more systems moving from on-site hardware to cloud-based hosting, and additional functionality being developed for both the lending and savings businesses. The majority of the cost of these developments is included in operating expenses at the point it is incurred, with just £1.6 million of software capitalised in the year and held on the balance sheet (2022: £1.7 million).

The Group's operating model was reviewed during the year – focusing on the implications of hybrid working and critically examining the Group's management structure. The review was facilitated by a third-party consultancy which provided relevant peer and emerging trend insight to inform the Group's analysis of best practice. The process concluded during September 2023, resulting in a restructuring that will see 53 people leaving the business. Costs associated with this exercise totalled £2.6 million and were fully expensed in 2023.

2023 also saw the closure of the Group's mortgage brokerage subsidiary, TBMC, following a review of buy-to-let distribution strategy. This closure resulted in the writing off of goodwill and other intangible assets, together with other costs, totalling £2.0 million.

People

The Group's 1,500 employees are its most important asset. The outcome of the 2023 engagement survey was therefore particularly pleasing, with 88% of employees sharing their views, more than in any previous survey. The overall engagement score of 90% was our highest level for eight years, a result well above the average for the sector. Employees scored the Group particularly well on areas such as delivering good outcomes for customers, risk culture and positively influencing climate, alongside organisational integrity, wellbeing, development opportunities and employee voice.

A formal employee code of conduct has been in place throughout the year, with 100% of the Group's people attesting that they understood the code's expectations during 2023. The Group has a thriving Equality, Diversity and Inclusion ('EDI') network, sponsored at ExCo level, and a strong People Forum, which has regular engagement with the Chair of the Board, and the executive and non-executive directors.

Sustainability

During 2023 the Group joined PCAF (the Partnership for Carbon Accounting Financials) and in its 2023 Annual Report presents a PCAF Scope 3 financed emissions balance sheet, which measures the emissions attributable to its lending on an industry standard basis. Establishing a reliable benchmark forms a key element in planning the Group's transition path to net zero, so this represents an important milestone in that process.

Progress is also represented by work to enhance understanding of the potential impacts, over time, on the Group's buy-to-let portfolio of the UK Government's evolving proposals for Minimum Energy Efficiency Standards ('MEES') for residential property, and by the extension of attributable emissions reporting to include elements of the Group's Commercial Lending operations.

The majority of the emissions included in the Group's operational footprint arise from its thirty-year old head office in Solihull. During the year a full decarbonisation report on this building was completed, with the identified enhancement works planned to be completed over the coming three years, well ahead of the Group's operational net zero target date of 2030.

Outlook

The high interest rate, high inflation economic background has led to both market-wide reductions in demand and challenges on customer affordability. In this environment the Group's focus on specialist products, a robust credit approach, high levels of customer retention and margin maintenance has delivered strong results in 2023 and these strategies will continue into 2024 and beyond.

The Group's buy-to-let business represents its most mature and well-established division. Overall, the buy-to-let market slowed significantly in 2023, but the more specialist sector in which the Group operates has been materially more resilient. Having delivered stable and steady growth for many years, the combination of its strong franchise, longevity of data, planned delivery of IRB in fine-tuning capital requirements and increasingly digitalised operations combine to provide opportunities to maintain and accelerate this progress.

The continuing development of the Group's Commercial Lending division is also being driven by technological initiatives, embedding those recently introduced and rolling-out further elements of the Group's digitalisation plans. Capacity exists for each of the division's existing business lines to grow, and this is also an area where incremental capabilities can be strategically added over time, either organically or through acquisition. Operating at wider margins than the buy-to-let business, future growth in this segment will be a core component in the structure of the Group's margins going forward.

Savings deposits continue to form the core of the Group's funding, with 2023 having seen significant growth at attractive costs. The Group's TFSME drawings begin to mature in October 2025, therefore growth in savings at a greater rate than that for loan balances, potentially together with tactical access to wholesale markets, should be anticipated in the coming year. With a strong retail focus and 94% of deposits covered by the FSCS, the Group's savings proposition delivers a reliable, scalable and cost-effective means of financing the growth of the business.

Overall, the Group remains well placed to continue to support customers in its chosen specialist markets. The strength of the business model provides a strong foundation to capitalise on opportunities and deliver strong returns to shareholders.

Nigel Terrington

Chief Executive Officer

6 December 2023

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

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. 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	
	2023	2022	2023	2022
	£m	£m	£m	£m
Mortgage Lending	1,879.9	1,910.0	12,902.3	12,328.7
Commercial Lending	1,128.7	1,304.7	1,972.0	1,881.6
	3,008.6	3,214.7	14,874.3	14,210.3

The Group's total loan balance increased by 4.7% in the year, as it pursued its strategic objective of managed, targeted growth in challenging market conditions.

Total advances decreased 6.4% year-on-year, although the pattern of movements was not consistent between the Group's specialist markets, with the complex economic situation seen in the year impacting different business lines to varying degrees.

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 of the requirements of the specialist landlords who form its customer base.

During the period the Group also offered a limited volume of loans to non-specialist landlords, although this activity has been increasingly non-core in recent years. The segment also includes legacy assets from discontinued product lines, including residential first and second charge mortgage loans.

The Group's focus on the specialist buy-to-let market facilitates detailed, case-by-case underwriting, where its unique approach to managing property risk and building customer relationships differentiate it from both mass market and other specialist lenders.

Housing and mortgage market

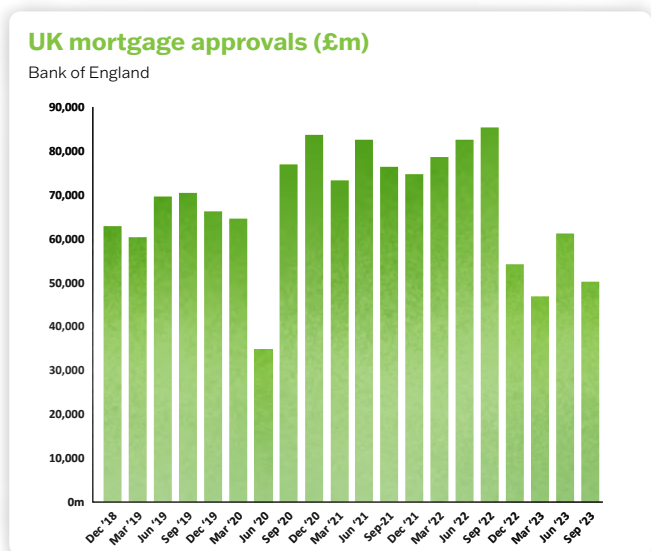
The levels of economic uncertainty in the UK economy over the year, coupled with the higher interest rate environment has significantly impacted the housing market. Activity substantially reduced year-on-year, with transactions for the year ended September 2023 reported by HMRC, at 1,085,000, 11.5% lower than the 1,226,000 in the previous year. In part this reflects a hiatus in the mortgage market in September and October 2022 when many lenders withdrew products as a response to the volatility in financial markets following the September 2022 mini-budget, but subsequent pressure on mortgage affordability has kept business levels depressed.

In its September 2023 Residential Market Survey, RICS reported continuing weak demand, although their members' outlook was less negative than earlier in the year, attributable to the impact of interest rates and more general economic uncertainty on affordability.

This weakening of demand put downward pressure on house prices, with the Nationwide House Price Index recording a year-on-year fall of 5.3% to September 2023 (2022: increase of 9.5%), although prices had broadly stabilised towards the end of the year. This was a smaller fall than some had predicted and returns house prices to February 2022 levels, although the impact of inflation over the period means that in real terms house prices fell by 12.6% in the year. Nationwide predicts the market to remain subdued in the short term, with RICS forecasting further house price falls over a twelve month horizon.

In response to the level of activity in the housing market, new mortgage lending was extremely weak in the year, with volumes in all four quarters less than any in recent years, other than the June 2020 quarter impacted by Covid. The Bank of England reported new approvals of £212.2 billion for the year ended 30 September 2023, a reduction of 33.8% on the record £320.8 billion reported for the previous financial year. Lending for new purchases and for remortgages were equally impacted, with volumes for both transaction types falling by around 18%, although the value of mortgages refinanced with their existing lender increased by 23%.

Quarterly Bank of England UK mortgage approval data for the last four financial years is set out below.



At 30 September 2023 the UK Finance ('UKF') survey of mortgage market arrears and possessions reported arrears levels building, potentially in response to rising interest rates, particularly towards the year end. Possession numbers rose through the year but remain 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 active in the PRS. Such landlords will typically let out four or more properties, or operate with more complex properties. They 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 group of mostly small, specialist lenders addressing this sector, which is underserved by many of the larger banks.

While it is clear that the changing economic environment and regulatory landscape has caused some landlords to step away from the PRS, the Group's experience is that this reaction is concentrated amongst some smaller non-specialist amateur landlords, while its specialist customers remain committed to the sector.

The experience of the Group's 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 impacting them or their tenants.

According to data from the 2021 census carried out in England and Wales, the PRS provides homes for around 20.3% of households in those countries, increased from 16.7% in the 2011 census. Data from the ONS Labour Force Survey suggest that across the UK at 30 June 2023, 22.1% of households were renting privately, a figure that has been gradually rising over recent years. With the economic environment creating constraints on income and mortgage affordability, it is likely that reliance on the sector will increase.

This can be seen in the lettings market data published in the RICS September 2023 UK Residential Market Survey. This reported continuing strong tenant demand coupled with a serious shortage of new instructions from landlords, which was pushing rents upwards, with RICS members expecting rent rises of around 5% in the next twelve months.

Research published by Zoopla suggested that, on average, rents for new tenancies across the UK had increased by 10.3% year-on-year, with the highest increases in Scotland, at 12.8%, despite what is perceived as more restrictive regulation in the Scottish PRS.

The UK Government is proposing reform of the PRS through its Renters (Reform) Bill, which was introduced into Parliament in May 2023. The Group has monitored the development of the legislation to date and is largely comfortable with the reforms, which balance the needs of tenants and landlords. However, there are concerns over the impact of the level of new regulation being applied to landlords. The Group would also urge the UK Government to ensure that the introduction of the new framework is adequately resourced to prevent disruption to both tenants and landlords. Overall, the Group does not believe its business model will be significantly impacted by the new legislation, and considers that its customer base may be better prepared to face these changes than some other parts of the PRS.

Around three quarters of properties in the PRS are funded through buy-to-let mortgages, but buy-to-let mortgage activity in the year was even more subdued than for mortgages more generally, with new advances reported by UKF, at £36.8 billion for the year ended 30 September 2023, being 32.4% lower than for the previous year (2022: £54.5 billion). While this was mostly led by a fall in activity for new house purchases, which were down by 36.6%, remortgaging was also impacted, falling by 30.5%. However, some of the downward pressure on remortgaging will be attributable to the relative unattractiveness of fixed rates available, coupled with the potential for affordability issues.

There is also evidence of increasing numbers of borrowers transferring to new products offered by their existing lender, which are not recorded as new cases in the data. Information published by UKF showed that around two thirds of landlords refinancing their mortgage in the year ended 30 September 2023 switched to a new product with the same lender, rather than remortgaging with a new provider, compared to around half in the preceding year.

This mixed outlook for the sector was borne out by the Group's own independently commissioned research amongst landlords and mortgage intermediaries.

In the Group's quarterly survey of buy-to-let landlords for the quarter ended 30 September 2023, 71% of landlords reported that they were experiencing increased tenant demand, with 48% reporting significant increases. Rental yields also continued to move upwards, with 70% of respondents having made rent increases over the year. Landlord confidence had also increased, year-on-year for rental expectations and for their own businesses, where the survey reported net optimism for the first time in a year. This was particularly the case amongst the larger landlords who form the Group's targeted customer base.

Expectations for capital gains, however, had fallen year-on-year and landlords remained relatively pessimistic generally. Reported confidence, across all metrics measured, covering their own business, the sector and the UK economy more generally, had declined significantly in the last quarter of the financial year.

Amongst specialist mortgage intermediaries, the Group's half-yearly insight survey, published in August 2023, showed that the vast majority of intermediaries were confident or very confident about the prospects for their firms and the mortgage industry. However, over 40% cited a lack of confidence in the outlook for buy-to-let, although this was still an improvement in the year. The principal issues that were concerning the respondents were the level of interest rates, and the impact of the cost of living on affordability.

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 moving upwards, and that trend accelerating towards the end of the period.

Overall, this data indicates that the buy-to-let mortgage market remains generally robust, even in the face of economic pressures, albeit with a degree of caution on its future prospects. It therefore underpins the strength of the Group's proposition, particularly given its focus on the specialist landlord.

The Business Mortgage Company ('TBMC')

During the year the Group conducted a review of its TBMC mortgage brokerage business. This concluded that changes in market dynamics had meant that this operation was no longer contributing materially to the Group's strategic objectives and the decision was taken to close the operation. Costs of £2.0 million relating to the closure, including writing off remaining intangible balances, were expensed in the year.

By the end of the year the closure process had been largely completed, with remaining cases processed in an orderly fashion. The Group thanks TBMC's employees, business partners and customers for their support over the years and wishes them well for the future.

Mortgage Lending activity

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

	2023	2022
	£m	£m
Originated assets		
Specialist buy-to-let	1,857.6	1,869.5
Non-specialist buy-to-let	22.3	39.5
Total buy-to-let	1,879.9	1,909.0
Owner-occupied	-	1.0
	1,879.9	1,910.0

Total mortgage originations in the Group decreased by only 1.6%, despite the constriction seen in the housing and mortgage markets more generally resulting in an increased market share of new lending. This is partly due to the Group's pipeline hedging policy, which enabled the mortgage offers which were in process at the start of the year to be satisfied, at a time when many lenders had to withdraw offers as a result of rising market interest rates. 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 decreased by 0.6%, significantly outperforming the market, with the specialist sector showing itself to be resilient and eager to take advantage of opportunities created by the economic environment. These specialist completions, at £1,857.6 million formed 98.8% of the Group's new mortgage business. 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 those loans are now reaching the end of the five-year period. The Group has well-established retention procedures to address accounts as their fixed rates expire, which were enhanced as part of its digitalisation programme during the previous year. Over 80% of the specialist landlord customers whose products matured in the year remained with the Group at the year end.

In response to the uncertainties over the future of interest rates, the Group launched a new suite of track-to-fixed rate products, allowing customers to delay fixing their interest rate. The early launch of this alternative, compared to the market, helped support both advances and retentions.

The new business pipeline, being the loans passing through the underwriting process, stood at £594.6 million at the year-end, with the reduction from the previous year partly reflecting the tightening of the market in the period, but partly reflecting an enhanced approach to managing the pipeline (2022: £1,256.0 million).

Specialist intermediaries are the principal source of the Group's buy-to-let applications, and it continues to strategically focus on ensuring that the service offered to them is excellent. The Group's regular intermediary insight surveys in the year showed 95% were satisfied with the ease of obtaining a response from the Group (2022: 89%), delivering an NPS at offer stage of +60 (2022: +40). 75% of intermediaries dealing with the Group rated its service as good or better than that provided by other lenders (2022: 67%). Paragon Mortgages was also named as Best Professional Buy-to-Let Lender at the 2022/23 Your Mortgage awards, its tenth victory in that category, highlighting the effectiveness of its service proposition.

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. The value of the work completed to improve the redemption and retention process in the previous period is demonstrated by results in this area in the current year.

The current year saw the completion of another major phase of the project, with the first release of a new landlord portal launched in May 2023. This market-leading new portal offers a better user experience and increased self-serve opportunities, and will continue to be enhanced. The overall project continues and will deliver additional service upgrades and new opportunities for interaction between the Group and its customers and business partners as further phases are rolled out.

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 types of property within the Group's lending criteria. These products offer lower interest rates for energy efficient properties with EPC ratings 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 as the UK Government continues to develop its approach in this area.

The Group's new buy-to-let lending volumes on energy-efficient properties, which have increased by 8.7% in the year, are set out below.

	2023	2022
	£m	£m
EPC rated A or B	184.1	169.0
EPC rated C	720.5	663.2
Total rated A to C	904.6	832.2
Percentage with available data (England and Wales)	99.9%	99.6%

The Group's latest analysis identified EPC grades for 94.6% by value of its mortgage book in England and Wales at 30 September 2023 (2022: 92.8%). Of these 99.2% were graded E or higher (2022: 98.9%) with 41.5% rated A, B or C (2022: 39.3%). The year-on-year movements are principally a result of the balance of new business, with almost half of the Group's advances in the year in England and Wales, 49.5% (2022: 45.1%) 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. In addition, the exposure relating to the current mortgage book is monitored using specialist bureau data. This addresses the risk of flooding from rivers, seas or surface water. This showed that 3.0% of properties securing buy-to-let mortgages, where data was available, were at 'higher' risk (2022: 3.0%).

98% of landlords surveyed in the Group's research said that they were aware of the EPC rules affecting their properties. 79% of landlords stated they had no properties with EPC grades less than E, and 64% confirmed they would upgrade any property not meeting the standard rather than seek to sell it.

The Group's mortgage business is currently working to develop products to support its landlord 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.

	2023	2022
	£m	£m
Post-2010 assets		
First charge buy-to-let	9,679.5	8,536.4
First charge owner-occupied	22.5	28.0
Second charge	75.8	104.4
	9,777.8	8,668.8
Legacy and acquired assets		
First charge buy-to-let	3,040.6	3,549.6
First charge owner-occupied	5.2	8.4
Second charge	78.7	101.9
	12,902.3	12,328.7

At 30 September 2023, the total net mortgage portfolio was 4.7% 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 12.8% and now represents 75.8% of the division's total loan assets (2022: 69.2%).

The annualised redemption rate on buy-to-let mortgage assets, at 9.0% (2022: 9.8%), has continued at a relatively low level. This is despite the potential impact of rising rates on customers whose interest charges are linked to reference rates, and the increasing numbers of five-year products now reaching the end of their fixed rate periods. As described above, the Group has adopted a number of strategic initiatives to retain customers with maturing fixed rate products.

Arrears on the buy-to-let book increased in the year to 0.34% (2022: 0.15%), 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 0.06% (2022: 0.09%). These arrears remain very low compared to the national buy-to-let market, highlighting the strength of the Group's credit standards. UKF reported arrears of 0.69% across the buy-to-let sector at 30 September 2023, sharply increased year-on-year (2022: 0.41%), though still less than the arrears seen in the wider mortgage market.

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 significant security in the face of economic stress.

The loan-to-value coverage in the Group's buy-to-let loan book, at 62.8% (2022: 57.9%), represents significant security, despite the falls in house prices in the year. 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 around £9.0 billion of equity in their mortgaged properties.

Arrears on the closed second charge mortgage lending portfolios increased to 23.48% (2022: 21.33%) as the books continue to run off. These arrears levels remain higher than the average for the sector, which reflects the ageing of the balances, with the continuing upward trend reflecting 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. Credit performance is considered to be in line with expectations and the Group benefits from substantial security on these assets, with an average loan-to-value ratio of 52.3% (2022: 50.6%) providing a significant mitigant to credit risk.

For accounting purposes, 6.5% of the segment's gross balances were considered as having a significant increase in credit risk ('SICR') at the year end (2022: 16.4%), including 1.2% which were credit impaired (2022: 1.1%). This resulted from the more stable economic situation and some fine tuning of ECL models which enabled a more accurate identification of increased credit risk in performing accounts, counterbalanced, to some extent, by an increased number of arrears cases. However, the nature of the cases involved meant that provision coverage was stable, at 33 basis points (2022: 31 basis points), although coverage on fully performing accounts had reduced from 6 basis points at 30 September 2022 to 4 basis points at the year end, a result of the decreased level of overlay required.

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, 564 properties were managed by a receiver on the customer's behalf, an increase of 18.7% over the year (2022: 475 properties), with receivers appointed on a number of additional portfolios during the year, while older cases continue to be resolved. Almost all these cases currently relate to pre-2010 lending, with cases being addressed on a long-term basis to ensure good outcomes for customers and their tenants, as well as for the Group.

Outlook

In the face of a difficult operating environment the division performed strongly in the year and the work carried out in the year to enhance retentions and develop new products means that it enters the new financial year with a robust proposition, with further improvements to its processes and systems progressing towards launch. These will ensure the Group maintains its reputation for providing an effective and responsive service to its customers and their brokers.

The Group's underwriting standards, credit performance and administration policies mean that the division is well placed to deliver value to shareholders whatever direction the UK economy takes, while ensuring that any issues of vulnerability amongst customers or their tenants are appropriately addressed.

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 specialist management 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.

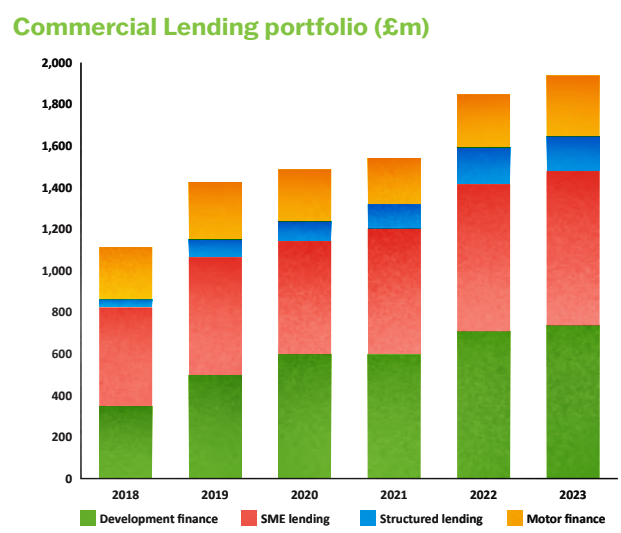
Commercial Lending activity

New lending in the Commercial Lending segment fell by 13.4% in the year as the UK economy slowed and customers felt the impact of the interest rate environment. Performance varied between business lines with development finance, where economic and political uncertainty increased caution amongst developers, particularly affected.

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.

	2023	2022
	£m	£m
Development finance	528.1	632.2
SME lending	447.9	446.4
Structured lending	(9.5)	59.9
Motor finance	162.2	166.2
	1,128.7	1,304.7

Despite this slowdown the overall Commercial Lending portfolio continued to grow, with total exposure increasing by 4.8% in the year to £1,972.0 million (2022: £1,881.6 million). The increase in the portfolio over the last five years, and its impact on the Group's diversification strategy is illustrated by the chart below.



Development finance

Activity levels across the development finance market have been significantly depressed during the year. Political uncertainty at the start of the year, coupled with caution over the future directions of interest rates, build costs and property values over the period, reduced developers' appetite to launch new projects, and led to increased issues arising on those projects which have been progressed.

The Group reported lower levels of enquiries and pipeline at the end of the previous financial year and this trend has largely continued through the year, with advances falling 16.5%. At the 2023 year end developers remained cautious, with undrawn amounts on live facilities at 30 September 2023, at £404.1 million, being 27.3% lower than those a year earlier (2022: £556.0 million), while the post-offer pipeline fell to £97.3 million (2022: £136.8 million).

The business extended its green financing option during the year, with the amount of funding available increased to £200.0 million. This product provides beneficial terms for projects to develop energy-efficient properties, those with an EPC A grade, and by 30 September 2023, £155.0 million of new lending facilities had been agreed under this initiative, with drawings in the year of £51.4 million and the first major project completed. This type of development will be an area of focus for the Group going forward, as customers increasingly factor these discounts into their project planning.

The Group's development finance lending was originally centred on London, but has broadened, year-on-year, with the proportion of the portfolio located in London and South-East England falling to 45.8% from 56.8% at 30 September 2022. Activity increased particularly in South-West England, with funding provided for a number of major projects.

The Group's investment in systems for this business has continued to show benefits during the year, with systems introduced in July 2022 enhancing process efficiency and customer service as they have bedded in. This drive towards digitalisation will continue, providing a solid platform for the future of the business and supporting the transition over time to an IRB approach to capital management.

In spite of the disruption seen in the sector during the year and the consequent impact on new business levels, long-term fundamentals of the business remain sound. The Group has a strong presence in the purpose-built student accommodation market, where evidence suggests there is a significant shortfall in high quality provision and, following the year end, the business expanded its product range to cover 'Build-to-Rent' projects, providing a wider range of options for its developer customers.

There is wide-spread agreement that the UK provides fewer new homes than necessary, offering significant opportunities for smaller developers to expand and for the Group to support them. The Group's proposition is strong and attractive and continues to provide healthy returns for the capital invested and opportunities for growth.

SME lending

The Group's SME lending business has a focus toward construction equipment and similar wheeled plant, and therefore is exposed to UK sentiment around capital investment. The political uncertainties of the period and the rising interest rate environment served to increase levels of caution around committing to major capital projects, so the business has been faced with a testing operating environment for most of the year.

Despite this, asset leasing volumes increased by 3.4% year-on-year to £286.4 million excluding government-backed balances (2022: £276.9 million). While this is less than the 8% increase in new leasing business, excluding cars and high value items, in the year to 30 September 2023 reported by the Finance and Leasing Association ('FLA'), the FLA data has sharp variations between asset classes. The FLA reported no year-on-year increase in new leases of plant and machinery, while new leases of construction plant showed a decline. Investment in operating leases has also continued with £15.3 million of assets acquired in the period (2022: £14.5 million).

Lending under the UK Government-sponsored Recovery Loan Scheme, ('RLS') to support SMEs potentially affected by the Covid pandemic continued in the year. The reduction in the guarantee from December 2021, and the general emergence from Covid saw a marked drop-off in take-up of the scheme. During the year £7.9 million was advanced under the RLS (2022: £32.2 million), of which the majority, £6.9 million, was asset leasing business.

The Group continues to closely monitor the government-guaranteed portfolio for any adverse indications, particularly in view of the performance issues with such loans reported by other lenders, which have principally focussed on Bounce Back Loans Scheme ('BBLs') lending. However, it has not yet encountered such problems in its own portfolio.

Short-term lending to professional services firms outside government supported schemes increased by 9.5% to £137.7 million (2022: £125.8 million). These loans are often used to spread the impact of tax and other significant liabilities, and in previous periods the availability of tax deferrals, and government-guaranteed loans under Covid-related schemes to firms 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 Group's investment in technology within the SME lending operation has continued to deliver improvements in internal efficiency and service to brokers and customers, providing an important point of differentiation against competitors. Agile and modular delivery enables individual improvements to go into the live system as they are completed, providing incremental enhancements, on an ongoing basis. During the year these included enhanced automated support for decisioning, enabling more efficient processing of applications.

The new broker portal launched in the previous financial year continues to provide benefits as its use is rolled out and further product lines added. Take-up has continued to grow with over 70% of standard SME lending applications now being received through the portal. This interface is designed as an additional service to brokers, with the division's business support team remaining fundamental to ensuring brokers and customers receive the standard of service they require.

The portal has facilitated a step-change in the operation's ability to handle smaller value loans efficiently, leading to an increased level of applications for such products, reducing the size of the average advance, which reduces risk in the portfolio.

In a survey conducted by the Group, 75% of users were satisfied with the new portal, with 79% considering it to be as good as or better than other lenders' offerings. Feedback from the survey is being used to drive further enhancements to the portal.

More widely, the division's ongoing broker satisfaction survey reported that 78% of respondents were likely to do further business with the Group (2022: 81%), with 86% reporting that the service they had received was as good or better than that received from other lenders (2022: 88%). The overall NPS amongst brokers for the year was +25, significantly positive. This was also recognised when the Group won the Leasing World 2023 Gold Award as SME Specialist of the Year. The strength of the Group's relationships with the broker community are key to the success of the business going forward.

The Group monitors the potential impact on climate of the industries it does business with, and supports UK SMEs with green propositions, such as the installation of solar power or infrastructure for recycling, as they transition their businesses towards net zero. These types of initiatives are expected to increase going forward as such considerations are prioritised by customers.

The FLA Outlook Survey for the third quarter of 2023, released in November 2023, showed almost all of its members expected a broadly similar economic situation for the coming year, with almost half anticipating some decline in business investment. 82% anticipated a worsening arrears position and 89% expected a higher level of corporate insolvencies, although a majority in both cases felt the increases would be small. Despite these fears, most members had become more optimistic for future business levels, with three quarters expecting at least some increase in lending levels in the next twelve months.

The Group's own quarterly research among SME leaders, conducted towards the end of the financial year, also reported a mixed picture. Just over half of SMEs were confident of the prospects for their own business with the remainder unsure or negative, with similar results for their views on the sector more generally. Substantial numbers reported declining cashflows and turnover in recent months, although a larger number said these had improved, with a majority expecting improvements in the short term. Despite this, the number of SMEs expecting to make capital investments in their business in the near future was far greater than those who had made such investments in the previous six months.

Overall, the outlook for the SME sector remains uncertain, with contradictory data and a real prospect of additional headwinds building going forward. Some SMEs are clearly becoming more confident, especially for the longer term, but significant numbers still have a neutral or more negative outlook.

The prospects for SMEs in the UK are clearly more stable than at the previous year end, although the economic pressures of high interest rates and rising costs continue to present risks. However, the division has robust resources in place to manage any decline in portfolio performance and has enhanced its technology further to support recoveries. The division's investment in systems and its expert team ensure that it is well placed to support those SMEs who feel ready to invest to take advantages of the opportunities that will present themselves.

Structured lending

In response to the challenging economic conditions, activity in the structured lending business was broadly stable in the year. Drawn balances fell marginally from £178.7 million at 30 September 2022 to £169.0 million at the end of September 2023, although the total amount of the outstanding facilities increased by 6.9% to £235.7 million (2022: £220.5 million). All facilities continued to be managed in line with their agreements.

These facilities generally fund non-bank lenders of various kinds, providing the Group with increased product diversification and are constructed to provide a credit buffer in the event of default in the 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. To date the Group has recorded no losses on any of its structured lending facilities.

Further facilities to the value of £40.0 million came on stream after the year end, and the Group continues to examine additional opportunities which would broaden the range of products and industries supported, diluting the concentration risk inherent in this form of lending. In the current economic climate these evaluations have a significant focus on the viability of the underlying customer activity.

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, including static caravans. During the year the business marked the fifth anniversary of its entry into the leisure vehicle market by increasing its maximum lease term for motorhomes. The Group has facilitated over £130 million of motorhome finance since entering this growing market in 2018.

Lending in the year was broadly stable at £162.2 million (2022: £166.2 million). Car finance volumes reported by the FLA fluctuated significantly in the period, with amounts particularly depressed towards the end of the year. The FLA's data showed new business up 4% overall for the year ended 30 September 2023, although the amount of used car business, which represents a significant part of the Group's portfolio, fell by 6%.

The Group's cautious expansion of lending to finance battery-powered electric vehicles ('BEVs'), including light commercial vehicles, continued in the year. £7.8 million of new loans were made in the year, an increase of 30.0% (2022: £6.0 million), reflecting the continuing growth in this market. With the business focusing on used vehicles, the proportion of BEV lending will lag the growth in new registrations, however progress continues to be made, with almost 5% of new lending relating to such vehicles. The Group is well placed to support the green aspirations of its customers, as electric vehicles become a more widely viable and popular option and increasing numbers enter the used car market.

Performance

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

	2023	2022
	£m	£m
Asset leasing	586.0	532.5
Professions finance	52.2	60.9
CBILS, BBLS and RLS	67.2	88.0
Invoice finance	31.7	25.7
Unsecured business lending	20.4	14.6
Total SME lending	757.5	721.7
Development finance	747.8	719.9
Structured lending	169.0	178.7
Motor finance	297.7	261.3
	1,972.0	1,881.6

The economic pressures in the UK had generated an increased number of issues on development finance projects by the year end, mostly relating to increased build costs or delays. Accounts are regularly monitored and graded on a case-by-case basis by the Credit Risk function and by 30 September 2023 there were twelve accounts identified as being at risk (2022: none) with one additional long-standing legacy case (2022: one).

These accounts have been carefully examined and projections stressed for the purposes of the Group's IFRS 9 provisioning, generating an additional impairment charge. Security across the portfolio more generally remains strong. The average loan to gross development value for the portfolio at the year end was 63.1% (2022: 62.1%), which gives the Group a substantial buffer if any project encounters problems. No write-offs were recognised on projects completed in the year.

Credit performance in the division's originated finance leasing portfolios has been generally strong, despite the adverse headwinds in the UK economy. Arrears in asset leasing at 0.23% remained minimal (2022: 0.08%) and motor finance arrears improved to 1.08% (2022: 1.58%). Despite this, the Group has reviewed its potential responses to credit issues across the operation and is ready to support any customers encountering problems.

Whilst some lenders have reported significant issues with their CBILS, BBLs and RLS lending related to either credit quality or fraud, with over 10% of loans under these schemes resulting in default, the Group has not yet seen any serious impacts on its lending on such products. These portfolios contained only £3.3 million of Stage 2 accounts at gross carrying value at 30 September 2023, and only £1.1 million of credit impaired cases. The Group's total claims made up to 30 September 2023 under the government guarantee were £3.4 million, only 2.6% of the £131.1 million advanced since the schemes began, with £3.3 million of this balance already recovered at the year end. The majority of the Group's government-backed lending was to its existing customers, which contributed to the credit quality of this lending and has enabled it to avoid the issues seen elsewhere.

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 broadly in line with expectations, with generally improved metrics across the book and all but one account classified in IFRS 9 Stage 1 at the year end.

In terms of the Group's impairments procedures, 9.5% of the segment's gross balances were considered as having an SICR (2022: 4.7%) including 3.3% which were credit impaired (2022: 0.7%). The increase in credit impaired cases related mostly to the development finance projects noted above.

Provision coverage increased to 156 basis points (2022: 134 basis points), principally as a result of the greater number of credit impaired cases. Coverage on fully performing accounts reduced from 108 basis points at 30 September 2022 to 82 basis points at the year end as some of the potential issues identified at the beginning of the year were clarified in the period, or the relevant accounts moved to Stage 2.

Outlook

All business lines within the Commercial Lending segment have been subject to increasing economic pressure over the last year, particularly towards the end of the period, with finance and other costs impacting on the cash flows of the majority of UK enterprises. This environment seems likely to continue for the near future with clear consequences for volumes.

However, all the division's businesses remain strong and the efficient and effective processes which have been rolled out through the Group's digitalisation programme so far, coupled with strong customer relationship management and the high standards of credit management applied over time, will both protect the value in the business and enable it to grow in the longer term.

A4.2 Funding

The Group's retail deposit-taking operation, which operates under the Paragon Bank branding is central to its funding strategy. This is supplemented with a variety of other sources of central bank and wholesale funding and liquidity sources, creating an adaptable and sustainable funding position which can respond to developments in the business, its operating environment and the economic landscape.

The Group's debt has an investment grade credit rating, confirmed by Fitch in February 2023, which supports its status as a debt issuer. The Group is therefore able to access cost-effective funding, as well as raising finance for strategic initiatives on a timely basis.

During the year the Group was able to expand its retail deposit portfolio, both to support new lending and to repay more expensive wholesale borrowings, despite the continuing pressures on household savings resulting from increasing costs of living, which were mitigated by the increasing attractiveness of term deposits for customers, compared to other forms of saving. This growth in term deposits has generated a flow of funds from clearing banks to smaller deposit takers, such as the Group, whose market focus has historically been on this type of product.

The Group's funding at 30 September 2023 is summarised as follows:

	2023	2022	2021
	£m	£m	£m
Retail deposit balances	13,265.3	10,669.2	9,300.4
Securitised and warehouse funding	28.0	995.3	1,246.0
Central bank facilities	2,750.0	2,750.0	2,819.0
Tier 2 and retail bonds	258.2	261.5	386.1
Sale and repurchase agreements	50.0		
Total on balance sheet funding	16,351.5	14,676.0	13,751.5
Off balance sheet liquidity facilities	150.0	150.0	150.0
	16,501.5	14,826.0	13,901.5

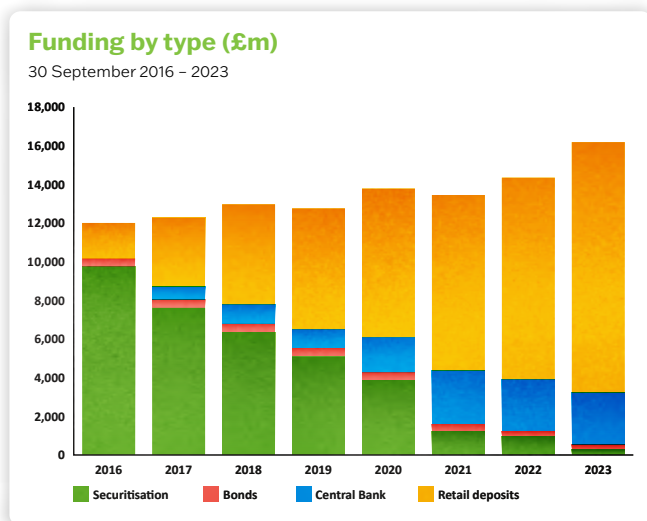
The Group's retail deposit balance grew by 24.3% in the year to £13,265.3 million (2022: £10,669.2 million), representing 81.1% of balance sheet funding (2022: 72.7%). Wholesale borrowings were also considerably reduced during the year.

At 30 September 2023 the proportion of easy access deposits, which are repayable on demand, was 25.7% of total on-balance sheet funding (2022: 27.0%). This reduction is a result, in part, of the market sentiment in favour of fixed-rate savings, especially towards the end of the year, with some savers anticipating little further increase in interest rates. The Group's proportion of easy access deposits remains low compared to the rest of the banking sector and can be expected to increase in the future.

The Group has built cash reserves during the period, applying them to repay wholesale borrowings, including the repayment of the last remaining funding structure from the period before Paragon Bank received its banking licence.

At the end of the year the Group had £2,907.7 million of cash available for liquidity and other purposes (2022: £1,689.1 million). This included operational liquidity and cash resources assembled in order to repay part of the Group's central bank exposures in the early part of the 2024 financial year. The appropriate level of cash reserves is monitored on an ongoing basis as part of the Group's capital and liquidity strategy, which continues to be based on a conservative view of the economic outlook and allows for the developing needs of the business.

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, accessing 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 2016, the outstanding funding balance by type.



The Group continues to adopt hedging strategies, including those using derivative financial instruments, to protect its income and operating model from adverse fluctuation in market interest rates. This activity was enhanced in the year in response to the higher interest-rate environment which developed during the period.

A4.2.1 Retail funding

The UK savings market is a reliable, scalable and cost-effective source of funding, with the Group's strategy centred on offering sterling deposit products to UK households through a streamlined online presence, supported by an outsourced administration function, with additional routes to market provided by third party platforms.

Products include cash ISAs, where the Group has a significant market presence, term and notice deposits and easy access accounts. 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 protection provided to depositors by the FSCS both incentivises larger savers to divide their deposits between several institutions and reduces the perceived risk for customers in using less familiar institutions, providing market opportunities for the Group's offering. At 30 September 2023, this FSCS protection covered around 95% of the Group's deposit balances.

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



During the year, UK deposit balances from individuals reported by the Bank of England remained relatively stable, despite increasing pressures on living costs, with balances at 30 September 2023 reaching £1.67 trillion (2022: £1.65 trillion), a year-on-year increase of 1.3%. Given that recent data shows a trend of household incomes diminishing in real terms, it is possible that overall UK savings balances may contract in the coming year, before returning to growth thereafter.

Against this relatively static background the Group's customer deposits increased much faster than the overall market, with a 24.3% increase in balances over the year. This reflects both the attractiveness of the Group's proposition and its continuing programme of business and systems development, which continued in the year. This was achieved despite the complexities inherent in more volatile market pricing as different deposit-takers responded to base rate increases in different ways and over differing time frames, and customers' savings preferences adapted to the higher rate environment.

Within the savings market there was a strong move towards fixed-term and notice deposits, with the Bank of England reporting a 60.8% (£88.9 billion) increase in such deposits from individuals during the year, despite the stable position of the overall savings base. National Savings deposits, which fulfil a similar function for consumers, also increased by 8.0% (£17.0 billion) in the period. These increases are attributable to the increasing opportunity cost to consumers of leaving excess savings in current accounts or low yielding deposit accounts as rates rise.

As many of these fixed-term products are offered on a fixed-rate basis, this market shift also increased the proportion of the market represented by these products.

The Group benefitted from this market shift, with increasing demand for its core products. Specialist savings providers, such as the Group, typically have stronger product offerings in the fixed term, notice and ISA markets, with the current account and easy access markets dominated by the major clearing banks. Therefore, a market where fixed-term products are more attractive offers opportunities for the Group, evidenced by the increased proportion of the savings book represented by fixed rate products.

Increasing diversification and the FSCS guarantee are likely to reduce the potential for liquidity impacts and the Group's profiling of its target customers suggests they may be more resilient than average in the event of future economic stresses.

Savings accounts at the financial year end are analysed below.

	Average interest rate		Proportion of deposits	
	2023	2022	2023	2022
	%	%	%	%
Fixed rate deposits	4.07%	1.74%	65.5%	58.8%
Variable rate deposits	3.74%	1.55%	34.5%	41.2%
All balances	3.95%	1.66%	100.0%	100.0%

The increase in the Group's absolute funding costs is driven by market movements, where, following the rises in the Bank of England base rate during the year, saving rates have also moved sharply upwards. The Bank of England has reported average interest rates at 30 September 2023 for new 2-year fixed rate deposits at 5.50% (2022: 2.63%), and at 2.68% for instant access balances (2022: 0.60%), with similar rises across other product types.

This rise in market savings rates was, however, not as large as that seen for market benchmark rates. During the year the SONIA benchmark increased from 2.19% at 30 September 2022 to 5.18% at 30 September 2023, meaning the average variable rate paid by the Group represented a 144 basis point discount to SONIA (2022: 64 basis points) continuing the widening trend seen in the previous financial year. This represented a general realignment of borrowing and lending rates across the sector and increased the attractiveness of deposit funding compared to wholesale funds, which are generally priced at a margin above SONIA.

The average initial term of fixed rate deposits was 20 months (2022: 22 months), with such products representing a greater percentage of the portfolio, reflecting the market trends discussed above.

The Group's presence on third party investment platforms and digital banks' savings marketplaces provides an important alternative route to market for the savings operation. These channels provide access to a different customer demographic to the Group's mainstream customers, with the more diversified sourcing offering enhanced opportunities to manage inflows and costs. The difference in profile of the platform customers is highlighted by their average account balance, which is far lower than that seen on direct business. The Group now has nine such relationships, compared to eight at 30 September 2022. These channels represent around 22% of the total deposit base (2022: 13%) and the Group has the systems and control framework in place to further increase its reach through these channels, if appropriate and cost-effective.

The Group's strategy in the savings market relies on providing a high-quality customer offering and it conducts insight surveys throughout the customer journey. The results of this research in the period maintained the strongly positive position previously reported, demonstrating that the Group's customer interactions infrastructure positions it well to retain customers and develop customers in the active and competitive market it serves.

For customers opening a savings account with the Group in the year, 88% of those who provided data stated that they would 'probably' or 'definitely' take a second product (2022: 88%). The NPS in the same survey was +62, similar to that in the previous year (2022: +59).

When customers with maturing savings balances in the year were surveyed, 88% stated that they would 'probably' or 'definitely' consider taking out a replacement product with the Group (2022: 87%) with an NPS at maturity of +59, an increase from that seen in the 2022 financial year (2022: +52).

The Group's savings offering continues to win recognition from industry experts. Paragon Bank was named 'Best Multi-Channel Savings Provider' at the 2023 Savings Champion awards and 'Cash ISA Provider of the Year' at the 2023 Moneynet awards, endorsing the Group's diversified approach as well as one of its key products.

The Group's retail deposit base continues to provide a stable foundation for its funding strategy, allowing volumes and rates to be effectively and flexibly managed. It is an important objective for the Group to develop its savings business further, broadening its product range, addressing wider demographics and expanding its presence on third party platforms. It will also continue to develop its systems and routes to market to ensure it is able to address the increasingly sophisticated needs of savers and meet the Group's funding requirements into the future.

A4.2.2 Central bank facilities

The Group's wholesale funding balance at the year end mostly comprises Bank of England facilities, principally those introduced to support SME lending during the Covid pandemic. The Group also has access to other facilities offered by the Bank, which it utilises from time to time as part of its overall funding strategy.

The Term Funding scheme for SMEs ('TFSME') provides the largest part of this funding, with borrowings at 30 September 2023 of £2,750.0 million (2022: £2,750.0 million). Interest is payable on these drawings at the Bank of England base rate, which is currently less attractive than rates available on retail deposits and the Group is seeking to strategically reduce this balance, with £300.0 million repaid early after the year end.

The Group has access to other Bank of England funding channels, including the Indexed Long-Term Repo ('ILTR') scheme, for liquidity purposes but has made no drawings in the period.

The Group expects to make use of 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 2023 of up to £1,715.4 million (2022: £1,776.0 million). Additionally, the Group's retained asset backed notes can be used to access Bank of England funding arrangements.

A4.2.3 Wholesale funding

The Group's wholesale funding options include securitisation funding, warehouse bank debt and retail and Tier 2 corporate bonds, which can be accessed from time to time as appropriate. The Group's Long-Term Issuer Default Rating was confirmed at BBB+ by Fitch in February 2023 with a stable outlook, enhancing the Group's funding capability.

During the year the Group reduced its wholesale funding significantly. The Paragon Mortgages (No. 25) PLC securitisation was redeemed in the year, at its expected date, while the Paragon Seventh Funding warehouse was repaid and termed out.

In September 2023, the Paragon Second Funding warehouse structure, which had been in run-off since 2008 was redeemed in full, closing out the Group's final legacy funding liability from the period prior to the licencing of Paragon Bank.

This leaves the proportion of the Group's funding represented by wholesale borrowings at its lowest level since it received its banking licence. The relative attractiveness of retail funding has led to the Group's focus on that channel, although it retains the capacity to raise wholesale debt as required, where appropriate. The Group also entered into sale and repurchase transactions on a short term basis from time to time, to ensure it retains access to this channel for liquidity purposes, and balances of £50.0 million were outstanding at the year end (2022: £nil).

Capital markets have remained active in the period for most classes of debt, but the number of transactions coming to market has been lower than average, with firms which have access to retail funds finding wholesale pricing generally unattractive.

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 retained internally to support wider liquidity options, rather than being issued in the market. This was the case with the Paragon Mortgages (No. 29) PLC securitisation, completed after the year end, on 1 November 2023, where the £855.0 million of notes issued can be used to access central bank and third party facilities.

The Group's wholesale funding position now satisfies only a small part of its overall requirements, but remains available on a tactical basis when rates and conditions are attractive, and to provide contingent funding and support liquidity.

A4.2.4 Derivatives and hedging

Derivative assets and liabilities continue to be used to hedge interest rate risk arising from fixed rate loans and deposits. The Group pre-hedges a proportion of its lending pipeline, which results in derivative positions being established before loans are completed.

While this strategy has not materially changed in the period, the movements in interest rate expectations over the most recent financial periods have resulted in large derivative asset balances being carried on the balance sheet at fair value, although the 30 September 2023 position was reduced from the previous financial year end. The size of these balances and the volatility in rates has also led to significant profit and loss account impacts. However, any such gains or losses, which tend to zero over time, are ancillary to the Group's lending and deposit-taking activities and it undertakes no trading in derivatives.

The Group's hedging strategy has been enhanced in the year to protect profit margins from the impact of future falls in interest rates on fixed rate borrowings and equity, which otherwise would cause a fixed / floating mismatch between the asset and liability sides of the balance sheet. A one-to-one interest rate hedge has been arranged for the Group's Tier 2 bond and accounted for as a micro hedge of interest rate risk (note 26).

An amount of the Group's fixed rate mortgage lending is also being attributed to provide natural equity hedging. At the end of the year £313.0 million had been attributed in this way, and it is the Group's intention to extend this balance to around £1,200.0 million, covering the majority of the equity balance. However, this form of hedging has no direct accounting impact.

A4.2.5 Funding outlook

The year ended 30 September 2023 saw the continuing growth of the Group's savings proposition, with total balances reaching £13,265.3 million, 24.3% higher than a year earlier. The wholesale part of the funding base continued to reduce, a trend expected to continue into the new financial year. However, little refinancing is required 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 34 to 39



A4.3 Capital

The Group's strong financial foundations form one of its three strategic pillars, with building and maintaining strong levels of core capital through the economic cycle a key strategic priority. The Group manages its balance sheet to maintain capital strength, 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.

The year has seen considerable fluctuation in UK economic metrics, coupled with changes in political priorities for the country, while the Basel 3.1 process to reform the regulatory capital regime has continued to progress. In the face of the uncertainties generated by this environment the Group has remained focussed on ensuring that its capital strength remains sufficient to withstand the potential pressures and address future changes in requirements.

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 2023 Annual General Meeting ('AGM'), which will be proposed for renewal at the 2024 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 sets a Total Capital Requirement ('TCR') for the Group, the minimum amount of regulatory capital which it must hold. This is defined under the international Basel 3 rules, implemented through the PRA Rulebook.

The TCR is held in order to safeguard depositors in the event of severe losses being incurred by the Group and includes elements determined based on the Group's Total Risk Exposure ('TRE'), together with fixed elements. The TCR is specific to the Group and is set on the basis of periodic supervisory reviews carried out by the regulator, the most recent of which took place in 2021.

Strong capital and leverage ratios are fundamental to the Group's strategy. In 2019, along with most other UK banks, it was granted transitional relief for the capital impacts of the adoption of the IFRS 9 impairment regime, with additional relief granted in 2020 for the impact of provisions created in response to the Covid pandemic. This relief is being phased out, year-by-year, and with any reversal of Covid-related provisions also generating a corresponding reduction in relief, the impact on the Group's capital position of these reliefs is no longer significant.

The PRA requires firms to disclose capital measures both on the regulatory basis and as if these reliefs had not been given, referred to as the 'fully loaded' basis. The value of the reliefs tapers over time, and the difference between measures on the regulatory and fully loaded bases has significantly narrowed and will 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	
	2023	2022	2023	2022
	£m	£m	£m	£m
Capital				
CET1 capital	1,188.9	1,221.8	1,175.4	1,196.0
Total Regulatory Capital ('TRC')	1,338.9	1,371.8	1,325.4	1,346.0
Exposure				
TRE	7,668.7	7,515.0	7,665.3	7,489.2
Requirements				
TCR	673.4	660.6	672.2	658.4
Capital buffers	345.1	187.9	344.9	187.2

The Group's CET1 capital comprises its equity shareholders' funds, adjusted as required by the 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 decrease in capital in the period has arisen because distributions, in the form of dividends and share buy-backs, have exceeded accounting profit for the year. This however is principally a result of the fair value losses on hedge accounting reported in the year, which themselves represent an unwinding of gains reported in the previous year. Such gains and losses, which reverse over time, are disregarded for the purposes of long-term capital planning. The small 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, although the increase is less than might have been expected due to the relative risk weightings of the assets involved.

At 30 September 2023, the Group's TCR was 8.8% (2022: 8.8%), compared to the minimum TCR allowed under the Basel 3 framework of 8.0%. This low level gives it 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.

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 (2022: 2.5%), while the UK CCyB was increased to 2.0% in July 2023 (2022: 0.0%), generating the increase in the buffer amount shown above.

The Financial Policy Committee of the Bank of England has stated that it expects 2.0% to be the long-term standard level of the UK CCyB. 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, but excluding the effect of future share buy-backs, are set out below.

	Basic		Fully loaded	
	2023	2022	2023	2022
CET1 ratio	15.5%	16.3%	15.4%	16.0%
Total capital ratio	17.5%	18.3%	17.3%	18.0%
UK leverage ratio	7.6%	7.9%	7.6%	7.8%

All the Group's capital ratios show a reversion to more normal levels over the year. This reflects the inclusion in trading profits of the unwind of fair value gains on hedge accounting recognised in the year ended 30 September 2022, which temporarily inflated capital at the previous year end. As the IFRS 9 reliefs are phased out the fully loaded and regulatory bases are automatically converging.

The PRA has announced that it intends to implement changes in its Rulebook to reflect the impact of the revisions to the Basel 3 framework made by the Basel Committee on Banking Supervision ('BCBS') from 1 July 2025. These changes, referred to as Basel 3.1, remain under consultation, and changes would affect both firms applying Internal Ratings Based ('IRB') approaches to capital and those using the Standardised Approach. The new requirements are likely to be phased in over a five-year period.

The Group has evaluated the initial PRA proposals and engaged with the regulator on its results. Certain of the proposals might adversely affect buy-to-let lending and lending to small business, notwithstanding the PRA's stated intention that the overall impact of the reforms should be broadly neutral. However, the Group's capital planning has allowed for a range of potential outcomes, and sufficient capital is being held to address the most negative scenarios, which would reduce the Group's CET 1 ratio by 2.2 percentage points.

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 continues to refine its IRB submission with close engagement with the PRA. In addition to the submission for its buy-to-let approach, which is currently being processed, the Group has also prepared much of the documentation to support an IRB approach for development finance, which represents the next stage in the Group's IRB roadmap.

A4.3.2 Liquidity

Liquid assets are held in the Group's 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. It continues to be the Group's policy to maintain strong levels of liquidity cover, and this policy impacts 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 193.7% compared to 146.2% during the 2022 financial year. This increase, which was particularly marked towards the end of the year, represents a build-up of retail funding in advance of settlement of wholesale borrowings just before the year-end, and in anticipation of payment of TFSME indebtedness in the early part of the new financial year described above. It also includes the impact of £383.4 million of swap collateral held in cash (2022: £388.6 million).

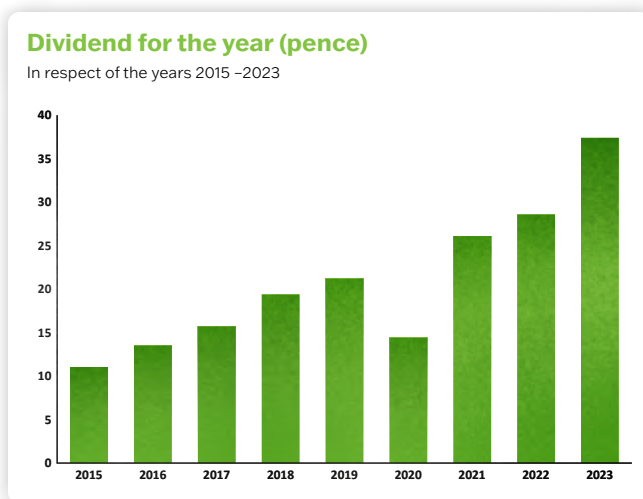
The NSFR is a longer-term measure of liquidity with a one-year horizon, supporting the management of balance sheet maturities. At 30 September 2023 the Bank's NSFR stood at 123.4% (30 September 2022: 122.3%), broadly comparable to its position twelve months earlier, and reflective of the strength of the overall funding and capital position.

A4.3.3 Dividends and distribution policy

A fundamental part of the Group's capital strategy has been to enhance shareholder returns on a sustainable basis, while protecting the capital base. In order to achieve this, it has adopted a dividend policy of distributing 40% of consolidated underlying 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, addressing the expectations and requirements of different types of investor.

An interim dividend for the year of 11.0 pence per share (2022: 9.4 pence per share) was paid in July 2023 and the Board is proposing, subject to approval at the AGM on 6 March 2024, a final dividend for the year of 26.4 pence per share (2022: 19.2 pence per share). This would give a total dividend of 37.4 pence per share (2022: 28.6 pence per share). During the year ended 30 September 2022 substantial fair value gains on hedge accounting were included in profit. As these gains were considered to be essentially timing differences it was decided to exclude them from the calculation of last year's dividend. During the year these gains reversed, in part, and the decision was made to exclude the fair value losses recorded from the current year's dividend calculation, for consistency. The dividend proposed therefore represents approximately 40% of the profit before fair value losses, giving a dividend cover on the adjusted basis of 2.52 times (2022: 2.50 times) (Appendix D).

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



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

At the beginning of the financial year, the previous year's share buy-back programme was completed under an irrevocable authority. In December 2022 the Board authorised a buy-back programme for the year of £50.0 million, which was extended to £100.0 million in June 2023, and completed in September 2023. £111.5 million, including costs, was expended during the year (Note 47).

As part of the review of capital management described above, the Board decided that it was appropriate to authorise a further share buy-back programme of up to £50.0 million for the 2024 financial year. This will commence shortly after the announcement of the Group's 2023 year-end results.

The Group has the general authority to make such purchases, granted at the AGM on 1 March 2023. Any purchases made under these programmes will be announced through the Regulatory News Service ('RNS') of the London Stock Exchange and the shares will initially be held in treasury.

During November 2023, the Board affirmed the existing dividend policy going forward, subject to an assessment of prevailing conditions at the time, including future operational and regulatory capital requirements, business strategy and external economic risks.

A4.3.4 Capital outlook

The Group's strategy is based on the quality of its capital position which it keeps under regular review as part of its management reporting and more formally through the annual Internal Capital Adequacy Assessment Process ('ICAAP'). Impacts of economic, strategic and regulatory factors on both the current and forecast position are considered and subjected to stress testing, examining the effect of a range of severe scenarios. The results of this testing confirm that the Group's capital position remains strong at the year end, even allowing for the potential effects of economic headwinds and the increase in the rate of the UK CCyB in the year.

As the Group enters 2024 it is well capitalised, even after allowing for forecast levels of distributions, and will remain so following the phasing out of IFRS 9 relief and the introduction of the Basel 3.1 reforms. Meanwhile, the Group continues to progress towards IRB accreditation, which will refine its capital requirements.

Despite the forecasts of a protracted high interest rate, low growth period for the UK economy, the Group's capital position is both prudent and sustainable, supporting the overall viability of the business for the benefit of all stakeholders.

A4.4 Financial results

The financial year ended 30 September 2023 has seen the Group continue to deliver strong profit and margin growth at the underlying level (Appendix A), making progress on its strategic aims despite the economic and political uncertainties in the UK during the year. Underlying profit (Appendix A), which excludes fair value gains, again increased in the year, reaching £277.6 million, an increase of 25.4% (2022: £221.4 million). This, together with the impact of the Group's share buy-back programme, drove growth in underlying earnings per share, which rose by 34.8%, reaching 94.2 pence per share (2022: 69.9 pence per share).

As in the previous period, the Group's statutory results for the year have been significantly affected by the accounting treatment required for pipeline hedging. The Group's policy is 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, such as that of the 2022 financial year, 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 current year has seen the beginning of the unwinding process, combined with a scaling back of expectations for future interest rates, resulting in fair value losses being recorded. The level of these unwinding losses decreased profit before tax on the statutory basis to £199.9 million (2022: £417.9 million), with earnings per share at 68.7 pence per share (2022: 129.2 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.

4.4.1 Consolidated results

For the year ended 30 September 2023

	2023	2022
	£m	£m
Interest receivable	1,010.6	545.7
Interest payable and similar charges	(561.7)	(174.5)
Net interest income	448.9	371.2
Net leasing income	5.6	4.6
Gain on disposal of loan assets	-	4.6
Other income	11.5	12.6
Total operating income	466.0	393.0
Operating expenses	(170.4)	(153.0)
Provisions for losses	(18.0)	(14.0)
	277.6	226.0
Fair value net (losses) / gains	(77.7)	191.9
Operating profit being profit on ordinary activities before taxation	199.9	417.9
Tax charge on profit on ordinary activities	(46.0)	(104.3)
Profit on ordinary activities after taxation	153.9	313.6
	2023	2022
Dividend – rate per share for the year	37.4p	28.6p
Basic earnings per share	68.7p	129.2p
Diluted earnings per share	66.3p	125.9p

Income

The Group's total operating income increased by 18.6% in the year, reaching £466.0 million, compared to the £393.0 million recorded in the previous year, which also included a £4.6 million one-off gain on the sale of the Group's unsecured lending portfolio.

Net interest on lending assets continues to be the principal element of the Group's income. This increased from £371.2 million in 2022 to £448.9 million in 2023, a growth rate of 20.9%. This was driven by both net growth in the loan books, where the average outstanding balance increased by 5.3% to £14,542.3 million (2022: £13,806.5 million) (Appendix B), and by continuing net interest margin ('NIM') improvements in both of its divisions, with overall NIM increased by 40 basis points.

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

	Total basis points
Year ended 30 September	
2023	309
2022	269
2021	239
2020	224
2019	229

This improving trend demonstrates the benefits of both the Group's hedging strategy in managing interest rate risk on fixed rate lending, particularly in the buy-to-let business, together with the careful long-term management of yields across all divisions. It is also a result of the enhancements to the cost of funds delivered by the Group's targeted funding strategy.

Interest income from the Group's loan assets is accounted for using the effective interest rate method set out in IFRS 9. This spreads the impact of initial and terminal fees received from the customer or paid to third parties through the life of the account and, where an account has different interest charging bases during its life, such as the majority of the Group's buy-to-let mortgage accounts which have a fixed initial rate, attempts to spread this effect. The pattern of income recognition is therefore based on estimates of customer settlement behaviour and future charging rates, and where the economic environment is likely to cause these to vary, as in the current year, the rates at which income is included in profit are adjusted.

The Group's other operating income (excluding the one-off gain in 2022) remained stable at £17.1 million (2022: £17.2 million), continuing to represent a combination of operating lease income and other sundry fees.

Costs

Operating expenses increased by 11.4% in the year to £170.4 million (2022: £153.0 million). The largest item within costs continues to be employment costs, forming 63.6% of the total at £108.3 million (2022: £103.6 million). The increase of 4.5% in the year is attributable to an increase in staff numbers, with average headcount increasing by 1.9% to 1,527, and to the 5% pay increase granted to most employees below senior management level at the beginning of the year.

During the year, a strategic review of the Group's operating structure took place, particularly focussed on the higher management levels, to ensure that the arrangements in place were appropriate to meet its strategic aspirations moving forward. As a result of this exercise a number of roles were identified as redundant, with people leaving the business shortly after the year end. Costs of £2.6 million related to this exercise are included in expenses for the year.

The closure of TBMC, the Group's mortgage brokerage business was also announced in the year. Costs of £2.0 million, mostly relating to the write-off of goodwill, are included in operating expenses.

Costs not related to employment, excluding these one-off costs, at £57.5 million were 16.4% higher than those experienced in the previous year (2022: £49.4 million). Part of this represents the impact of inflation in the UK, which has been particularly severe for professional services, but also partly relates to the continued spend on the Group's digitalisation programme, with non-employment related IT costs increased by 28.7% in the period to £13.0 million (2022: £10.1 million). The digitalisation programme continues to deliver new systems and enhancements across the Group's businesses, forming a fundamental part of its strategy going forward.

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

	Underlying %	Statutory %
Year ended 30 September		
2023	36.6	36.6
2022	39.4	38.9
2021	41.7	41.7
2020	43.0	43.0
2019	42.1	40.7

The Group's cost:income ratio continued to reduce in the year, primarily as a result of margins 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. A sustainably lower cost:income ratio is therefore a long-term aspiration, rather than a short-term priority, particularly in the face of continued expectations for inflation levels in the UK.

Impairment provisions

In the accounts for the year ended 30 September 2023 the Group has recognised a charge for impairment of £18.0 million (2022: £14.0 million), an increase of 28.6%. This results partly from experience in the year, where a number of portfolios have seen some increased evidence of delinquency, but also from management's view of the potential impact of the current high interest rate environment on its customers. The increases in the cost of living and of doing business, both those experienced over the last twelve months, and the further increases expected in the near term, being the main drivers for this behaviour.

The current year has seen both inflation and interest rates in the UK reach their highest levels for several years, with interest rates at the year end reaching their highest level since April 2008 and cost pressures on both consumers and businesses increasing. It is considered likely by most commentators that this will have a serious short to medium-term impact on credit quality, but the Group, in common with many lenders has seen only relatively minor impacts in the period up to the year end.

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'). Where the economic outlook is complex, or where there is little relevant historical data to base loss predictions upon, this can be a challenging exercise.

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

	Charge / (release) £m	Cost of risk %
Year ended 30 September		
2023	18.0	0.12
2022	14.0	0.10
2021	(4.7)	(0.04)
2020	48.3	0.39
2019	8.0	0.07

The movements shown above demonstrate the impact of the various economic and political developments affecting the UK in recent years as they appear and then resolve over time. The high charge in 2020 represented the initial onset of the Covid pandemic, whilst in 2021 the position appeared to have become a little more stable. However, 2022 saw the transition into a period of much higher rates of interest and building economic headwinds which have continued into the current year.

The application of provisions in writing off accounts has generally remained more stable across the period. This highlights both the Group's careful approach to provisioning and the resilient nature of its assets.

Multiple economic scenarios and impacts

The Group has developed models in order to support management's estimation of ECLs, which it keeps under review and regularly updates. These project losses for 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. In the current period this applied particularly to the Group's development finance portfolio where the potential impacts of increased input costs and falling property prices were factored into ECL estimates.

At 30 September 2023, there is considerably more consensus on the UK's economic outlook than at the previous year end, which was dominated by the potential consequences of the mini-budget in September 2022. The dominant theme of these forecasts is generally pessimistic, with a significant potential for relatively high inflation rates and low growth to continue for some time, an opinion endorsed by the Bank of England's own predictions. This, however, is an unfamiliar position for the UK economy, and the consequences for longer-term prospects remain an area of significant disagreement amongst experts.

The Group has constructed the scenarios required 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 this.

As in previous years, the severe downside scenario is based on the most recent 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 interest rate expectations continuing at historically high levels, a decline in property values, especially in the short term, minimal growth and inflation generally falling, although remaining at high levels compared to recent history.

Given the potential range of longer-term outcomes, the Group has maintained the weightings attributable to each scenario in its modelling at the levels used at the previous year end. The forecast economic assumptions within each scenario, and the weightings applied, are set out in more detail in note 24.

To illustrate the impact of these scenarios on the Group's IFRS 9 modelling, the impairment provisions before judgemental adjustments are set out below on the weighted average basis, and also shown on a single scenario basis for both the central and severe scenarios.

	2023		2022	
	Unadjusted provision £m	Cover ratio	Unadjusted provision £m	Cover ratio
Weighted average	67.1	0.44%	48.5	0.34%
Central scenario	60.9	0.41%	38.3	0.27%
Severe scenario	89.3	0.60%	85.3	0.60%

Calculated provisions have increased in the year, but remain somewhat lower than might be expected, given the nature of the economic outlook, some of which will relate to the ability of the Group's models to respond to the present economic circumstances, although the resilience of the loan book as a whole will also be a significant factor.

There is little recent historical evidence of the impact of a sustained period of high interest rates and inflation on customer credit, and both products and regulatory expectations have evolved significantly since interest rates last reached current levels. This means the Group's models will have been derived from datasets which include very few observations representative of this type of economic environment.

The distribution of gross balances by IFRS 9 stage (defined in note 22) produced by the Group's impairment methodology at the two most recent year ends is set out below.

	2023	2022
Stage 1	93.5%	85.2%
Stage 2	5.0%	13.7%
Stage 3	1.3%	0.9%
POCI	0.2%	0.2%
Total	100.0%	100.0%

This demonstrates an increased number of Stage 3 cases, although from a very low base, as problem accounts react to economic conditions. It also shows the impact on the number of accounts identified as Stage 2 of the assumption of future stable or slowly declining interest rates and inflation, and the current low level of arrears. This reduces the calculated provision and management must assess whether the result is appropriate, given the economic outlook.

Judgemental adjustments

The fundamental requirement of any provisioning methodology is that the accounts present fairly the assets of the business. Therefore, it is vital to the process to challenge all mechanical outputs, 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.

Impairment models are constructed by analysing the historically observed linkage between actual indicators of credit performance, whether internal, such as arrears metrics, or external, such as credit bureau information and economic indicators. The predictive power of any such model will, therefore, depend on the reliability of that linkage in the circumstances at the balance sheet date.

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.

The major issues addressed by management in considering the needs for judgemental overlays at 30 September 2023 can be summarised as follows:

- How far can impairment models be relied upon in a situation where the absolute magnitudes of economic indicators such as bank base rates and inflation, both currently and in the forecast period, lie significantly outside recent historical levels?
- How well can the models be relied on to reflect the credit impacts of a rapid movement in economic variables followed by a forecast period of stability or gradual recovery in a timely manner?
- To what extent will modelling in the buy-to-let book address the impact of payment shocks caused by customers reaching the end of a fixed-rate period?
- How may the negative outlook expressed by commentators on credit over the past year be reconciled with the generally mild impacts seen to date?
- What continuing impacts might there be from the Covid pandemic in terms of either corporate weakness or inflated cash balances, which might delay or change the responses to economic stimuli which might normally be anticipated?

The Group also considered whether some sectors served by the SME business, particularly those related to the construction industry, might be more vulnerable in the specific economic situations forecast.

Following consideration of the available internal and external evidence, the Group determined that judgemental overlays to its SME leasing and motor finance portfolios and to its buy-to-let mortgage book were required at the year end. The judgemental adjustments generated by this process, analysed by division are set out below.

	2023	2022
	£m	£m
Mortgage Lending	3.0	5.0
Commercial Lending	3.5	10.0
	6.5	15.0

The reduction in the mortgage lending segment is principally a result of more at risk cases being identified by the model and of increased levels of default cases in the year, which resulted in the first upward movement in the number of receiver of rent cases seen for some years. However, the potential for further impacts, as customers move off fixed rates, remains a real concern and it was not felt appropriate to reduce the level of the overlay to zero.

The reduction in overlay in the SME lending book relates partly to the introduction of a new impairment model, incorporating a wider dataset and more up-to-date information, which removes some uncertainty from the modelling process. However, the sector has been impacted by a series of adverse situations over recent years, which may have impacted on resilience, while there is evidence that cash balances in the sector remain elevated, which may serve to delay credit impacts.

There are also parts of the Group's SME portfolio which are connected directly or indirectly to the capital projects sector, where timescales for impacts may be longer. Overall management determined that the overlay in this sector should be reduced, but not eliminated and it stands at £2.5 million at the year end (2022: £10.0 million).

An additional overlay has been provided in the motor finance business. The provisioning model for this business, one of the Group's oldest, shows the lowest probability of default in some years, a function of the downward trend of inflation in the input scenarios. This is seriously at odds with market sentiment and an additional overlay of £1.0 million has been created to allow for this (2022: £ nil).

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 each of these overlays 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 results of the Group's ECL modelling, including the impact of the economic scenarios described above, together with the judgemental adjustments adopted to address uncertainties over the future performance of accounts, has resulted in the overall provision amounts and coverage ratios set out below.

	2023	2022	2021
	£m	£m	£m
Calculated provision	67.1	48.5	46.0
Judgemental adjustments	6.5	15.0	19.4
Total	73.6	63.5	65.4
Cover ratio			
Mortgage Lending	0.33%	0.31%	0.32%
Commercial Lending	1.56%	1.34%	1.74%
Total	0.49%	0.44%	0.49%

Following the judgemental adjustments, these ratios remain broadly in line with those seen in recent periods, although a greater proportion of the provision is generated by modelled approaches than in previous years. These levels remain higher than the 0.34% coverage ratio observed in September 2019, before the outbreak of the pandemic, and in a lower interest rate environment. This level was also recorded despite the level of security cover in the buy-to-let loan book being lower, with the average loan-to-value ratio being 67.4% at that time, higher than the 62.8% recorded at 30 September 2023 (2022: 57.9%).

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, which reverse over the life of the hedging arrangement and the Group regards such movements as essentially representing the anticipation of gains belonging economically to later accounting periods and their subsequent unwinding. They are therefore excluded from underlying results.

During the 2022 financial year, particularly during the second half, there was a significant level of volatility in UK benchmark interest rate expectations, resulting in a fair value gain of £191.9 million being recorded in the year. This impact has been amplified by the Group's approach to pipeline hedging and the retention strategy applied to maturing five-year fixed rate loans, which meant that the pipeline was larger and of longer duration (and hence more exposed to movements in rates) than in earlier periods.

In the year ended 30 September 2023 the levels of volatility in market rates reduced, with longer term market rate expectations moderating, which, coupled with the conversion of loans which had been part of the hedged pipeline at the start of the year, and the consequent commencement of the run-off of hedging gains related to those loans, resulted in much of the previous period's gain being unwound and a fair value loss of £77.7 million being reported.

The Group has a net derivative position of £14.6 million (at notional value) at 30 September 2023, which is unmatched for hedge accounting, although forming part of the economic hedging position (2022: £1,201.0 million). Therefore, the Group is less exposed to value fluctuations on the pipeline going into the new financial year. There are, however, substantial gains from 2022 which are still to unwind.

Tax

The effective tax rate applied to the Group's profits has decreased from 25.0% in 2022 to 23.0% during 2023, principally as a result of the unwinding of deferred tax on fair value gains, described above. The Group operates only in the UK and materially all its profit falls within the scope of UK taxation. The standard rate of corporation tax applicable to it in the year was 22.0% (2022: 19.0%), with the surcharge applicable to the profits of Paragon Bank at 5.5% (2022: 8.0%). The increase in the standard rate was offset, to some extent, by the cut in the surcharge as well as the increase in the profit threshold from which it applies (note 14).

As the bulk of the fair value loss arose in Paragon Bank, the banking surcharge means that 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 23.9% (2022: 23.4%), broadly similar to that in the previous year (Appendix A).

Results

The Group's profit before tax for the year on the statutory basis was £199.9 million (2022: £417.9 million), with the increase in profit at the underlying level reversed by a £269.6 million swing in fair value items. Profit after tax was £153.9 million (2022: £313.6 million). In addition, other comprehensive income of £1.6 million was recorded, relating to valuation gains on the Group's defined benefit pension scheme (the 'Plan').

Consolidated accounting equity at the year end, after dividends and share buy-backs was £1,410.6 million (2022: £1,417.3 million), and consolidated tangible equity was £1,242.4 million (2022: £1,247.1 million), representing a tangible net asset value of £5.79 per share (2022: £5.33 per share) and a net asset value on the statutory basis of £6.57 per share (2022: £6.06 per share) (Appendix E).

A4.4.2 Assets and liabilities

The main driver of movements in the Group's balance sheet is the size and composition of its loan book. This, together with its policies on capital and liquidity, determines its funding requirements and hence the level of its liabilities.

The Group's loan portfolio grew by 4.7% during 2023, with growth in both Mortgage Lending and Commercial Lending. More detail on these movements is given in Section A4.1.

The Group's assets and liabilities at the end of the financial year are summarised below.

Summary balance sheet 30 September 2023

	2023	2022	2021
	£m	£m	£m
Investment in customer loans			
Mortgage Lending	12,902.3	12,328.7	11,829.6
Commercial Lending	1,972.0	1,881.6	1,573.1
	14,874.3	14,210.3	13,402.7
Hedging adjustments	(379.3)	(559.9)	5.5
Derivative financial assets	615.4	779.0	44.2
Cash	2,994.3	1,930.9	1,360.1
Pension surplus	12.7	7.1	-
Intangible assets	168.2	170.2	170.5
Other assets	134.6	116.0	154.0
Total assets	18,420.2	16,653.6	15,137.0
Equity	1,410.6	1,417.3	1,241.9
Retail deposits	13,265.3	10,669.2	9,300.4
Hedging adjustments	(30.9)	(99.7)	(3.0)
Other borrowings	3,086.4	4,007.2	4,451.4
Derivative financial liabilities	39.9	102.1	43.9
Pension deficit	-	-	10.3
Other liabilities	648.9	557.5	92.1
Total equity and liabilities	18,420.2	16,653.6	15,137.0

Funding structure and cash resources

The Group's funding balance increased by 11.4% during the year, exceeding the growth in the loan book as cash balances increased in order to build liquidity and enable the repayment of wholesale borrowings in the early months of the new financial year. Cash balances consequently increased by 55.1%.

The proportion represented by retail deposits increased to 81.1% in accordance with the Group's long-term funding strategy (2022: 72.7%), with wholesale borrowings paid down, including the only remaining funding which pre-dated the licensing of Paragon Bank in 2014. 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 arrangements for hedging interest rate risk on fixed rate mortgage and savings products. These assets and liabilities are held at fair value, with the valuation based on future expectations of interest rates. The size of the balances is driven by the difference between current expectations for variable rates and the fixed rates applicable to the hedged items, set at the point of origination, meaning that where market rates have moved sharply, large balances will be carried.

During the year, expectations of future interest rate increases moderated, resulting in a reduction in the derivative valuation in the balance sheet, with swap assets falling by 21.0% in the year to £615.4 million (2022: £779.0 million) and swap liabilities decreasing by 60.9% to £39.9 million (2022: £102.1 million). While these movements do contribute to the fair value differences in the profit and loss account described above, they are mainly offset by fair value accounting adjustments to loan assets and deposit liabilities, with the adjustment in assets reducing by £180.6 million in the year and that in liabilities by £68.8 million.

Pension obligations

The IAS 19 valuation surplus on the Group's defined benefit pension scheme increased from £7.1 million at the start of the year to £12.7 million at the year end. The assumptions for this valuation are based on market-derived interest and bond rates and can be subject to fluctuation where market rates do not move in parallel.

The changes in inputs between the valuations at the beginning and end of the year are smaller than those seen in some recent periods, with the principal differences being the increase in the discount rate used in evaluating scheme liabilities, based on long-term corporate bond yields, from 5.00% to 5.55%, and the assumed rate of RPI inflation, based on gilt yields, decreasing from 3.55% to 3.25%. These movements led to a pre-tax valuation gain of £2.4 million being booked in other comprehensive income (2022: £15.3 million).

While the valuation under IAS 19 is that which is required to be disclosed in the accounts, pension trustees generally use the technical provisions basis as provided in the Pensions Act 2004 to measure scheme liabilities. On this basis, the surplus at 30 September 2023 was estimated at £11.9 million, an increase of £7.6 million in the period (2022: surplus of £4.3 million).

Other assets and liabilities

Sundry assets increased from £116.0 million to £134.6 million in the year, largely a result of increased cash ratio deposits, which grew by £7.8 million as a consequence of the increased retail deposit balance, and a higher level of accrued interest income, which increased by £3.6 million as a result of higher interest rates.

Sundry liabilities grew from £557.5 million to £648.9 million at 30 September 2023. This was principally a result of the impact of the increasing interest rate environment, with accrued interest payable increasing by £133.0 million. This was offset by a fall of £26.7 million in deferred tax, a result of the reversal of fair value movements.

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.

	2023	2022 (restated)
	£m	£m
Segmental profit		
Mortgage Lending	246.6	229.6
Commercial Lending	113.2	86.7
	359.8	316.3
Unallocated central costs and other one-off items	(82.2)	(90.3)
	277.6	226.0

The Group's central administration and funding costs, principally the costs of service areas, establishment costs and bond interest have not been allocated. For the current financial year, the Group's internal cost allocation processes have been updated to recharge items relating to certain treasury activities to the segments, as described in note 2. Comparative amounts have been restated accordingly.

Mortgage Lending

The Mortgage Lending division continues to perform well and grow its NIM, with margin on fixed rate accounts protected by the Group's hedging arrangements. Net interest grew by 10.5% in the year to £277.6 million (2022: £251.2 million) with the average net loan balance growing by 4.4% to £12,615.5 million (2022: £12,079.2 million) as NIM increased to 220 basis points (2022: 208 basis points).

Credit performance in the period remained good, but an increased level of arrears and defaults through the year was noted. The charge for impairment increased to £10.4 million in the year (2022: £4.6 million) with the cost of risk at 8 basis points (Appendix B). IFRS 9 Stage 3 cases increased from £119.3 million to £142.2 million, with increases in both current three-month arrears accounts and realisation cases, although these continue to form a very small part of the portfolio.

Overall contribution from the division increased by 7.4% to £246.6 million (2022: £229.6 million).

Commercial Lending

Average balances in the Commercial Lending division grew by 11.5% to £1,926.8 million (2022: £1,727.3 million), which, together with an increase in NIM from 644 basis points to 704 basis points, generated an increase of 22.0% in net interest to £135.7 million (2022: £111.2 million). This reflected the continuing focus on yield management, together with changes in product mix and tighter funding costs.

Impairment charges for the period, at £7.6 million, had reduced a little from the 2022 financial year (2022: £9.4 million). Credit performance in the year has remained largely stable in the motor finance and SME lending elements of the portfolio, with low arrears and relatively few defaulted cases, although the Group maintains a cautious attitude towards credit prospects for the sector. An increasing number of watchlist cases have been recorded in the development finance business, contributing £56.8 million of the £58.7 million increase in IFRS 9 Stage 3 balances in the year.

These factors led to an increase in segmental profit of 30.7% to £113.3 million (2022: £86.7 million).

A4.5 Operations

The Group's strategic pillars include a customer-focused culture and a dedicated team, highlighting the importance of its experienced, skilled and engaged workforce facilitated by systems and analytics in delivering its purpose. The Group's strategy relies on sector knowledge, specialist systems and the careful management of risk across all its operations to meet its goals.

In the year the Group has continued to invest in its people, progress its long-term programme to enhance processes and technology, addressing both internal systems and those facing its customers and business partners, and enhance its risk management framework to support the digitalised vision of its future operating model.

This continuing prioritisation ensures that the Group maintains a firm foundation on which to build its business and deliver its strategy in the future.

A4.5.1 Operations

The Group operates primarily on a centralised basis, with a workforce which exceeded 1,500 people at the year end. The majority of these people are attached to one of the Group's office sites in Solihull, Southampton and London, but work on a hybrid basis. During the year the hybrid working approach has continued to be refined to ensure both the most effective use of the Group's people and the optimal working experience for them, as well as the best possible interactions with customers and business partners.

The Group recognises that its strategy of tailoring its operational approach to the specialist needs of its customers and markets implies that there is unlikely to be a single preferred approach to service delivery, and business areas are tasked with establishing working methods to suit the needs of their operations and customers, with the Group investing in appropriate system enhancements as required.

The year saw continuing progress with the Group's digitalisation agenda, which includes major projects to improve systems and procedures in the Group's main lending areas. A new customer portal in buy-to-let mortgages was a significant deliverable during the year, while improved system-based support for decisioning was rolled out in SME lending. Significant enhancements made to systems in both development finance and SME lending towards the end of the previous year also continued to be rolled out, enabling more customers and business partners to benefit.

The digitalisation programme also includes a variety of other enhancements to the Group's infrastructure and operational systems, including enhancement to the resilience of the hardware supporting the Group's loan administration systems, improvements to telephony for motor finance and a new system to improve supplier management, enabling better management of ESG considerations in the supply chain.

Towards the end of the year considerable progress had been made on a project which will see 28 of the Group's 30 major operational systems transferred from on-site mainframe computers into the cloud in the early part of the new financial year, opening the way to further developments and efficiencies.

The Group's offices remain valuable as hubs for the growth of its culture and identity, where collaboration can be fostered, communication facilitated, and learning promoted. During the period initiatives continued to ensure they remain fit for purpose as working practices evolve. These included a decarbonisation review of the Group's head office building, initiatives to improve energy efficiency, and the expansion of on-site charging capabilities for electric vehicles across the Group's estate.

The operational resilience of the business remains an important area of focus for the Group and its regulators. During the period the second formal self-assessment required by regulators was successfully completed, providing an opportunity to evaluate developments in this area since the exercise was first completed.

A significant part of the Group's operational infrastructure exists to drive its focus on high quality customer service. Regular surveys are conducted with customers and business introducers to monitor satisfaction, which have remained positive in the period.

The first phase of the introduction of the new FCA Consumer Duty in July 2023 required significant attention across all operational teams to ensure that the regulator's expectations were embedded in systems and processes, meeting the deadlines for the first phase of implementation. While the new duty is a significant change in the way the regulator approaches firms' responsibilities, the Group considers that its culture and values have always aligned with its underlying philosophy.

The rising interest rate climate in the year, coupled with the impacts of inflation on customers' incomes, meant that a significant focus for the Group's customer service teams was identifying the potential impact on customers who are, or may become, vulnerable and ensuring that they receive good outcomes. The Group monitors customer complaints as a metric of customer outcomes and it was pleasing that these levels remained low by industry standards, despite the economic pressures.

A4.5.2 Governance

The Group believes that high standards of corporate governance are fundamental to the effective execution of its strategy. It is subject to the UK Corporate Governance Code (the 'Code') and the Group has continued to comply with the Code's principles and provisions throughout the period.

The Group continues to adopt a 'comply and explain' approach to Provision 21 of the Code. Having deferred the external board evaluation, which had been due in 2022, until the new Chair had been in post for a sufficient time to make such an assessment more meaningful, relevant and useful, this evaluation was completed in the year.

More details on the Group's corporate governance arrangements and of the board evaluation are set out in Section B.

Board of directors and senior management

A review of the skills and experience of the non-executive directors determined that the Board would benefit from additional experience in the fields of sustainability and customer experience, and it was agreed to recruit an additional non-executive director with particular strength in these areas.

Following an extensive search and assessment process, Zoe Howorth was appointed to the Board on 1 June 2023. Zoe's breadth of knowledge, which includes branding, digital and sustainability understanding, and her strong focus on the customer will enhance the diversity of perspective on the Board. Her executive experience includes 16 years with the Coca-Cola Company across a variety of roles, culminating in her role as UK Marketing Director. Zoe is a non-executive director, chair of the ESG committee and a member of the remuneration committee at AG Barr PLC, a FTSE-250 consumer goods business. In 2021, Zoe joined the board of International Schools Partnership Limited, a global education business, where she has board responsibility for ESG and brand. Zoe is also a director of the Water Babies Group Limited.

Hugo Tudor, who was the Company's senior independent director and chair of its remuneration committee reached the ninth anniversary of his appointment to the Board in November 2023. During the year the Board and the Nomination Committee undertook a process to identify a successor to Hugo in each of his roles, which resulted in the appointment of Alison Morris, the Chair of the Audit Committee as Senior Independent Director from August 2023 and the announcement, on 27 October 2023, that Tanvi Davda, a non-executive director, would become Chair of the Remuneration Committee on 7 December 2023. Hugo will remain on the Board, but will be considered to be a non-independent non-executive director from the conclusion of the 2024 AGM.

Following the announcement that Pam Rowland intended to retire as the Group's Chief Operating Officer at the end of March 2023, the Group was pleased to announce the appointment of Zish Khan to the position in December 2022. Zish brings a wealth of experience in technology, change and operations having over 20 years' experience across the financial services sector. A smooth transition and handover of responsibilities was completed during the year.

The Group continues to be conscious of the need to ensure that the Board contains an appropriate balance and diverse set of skills and experience. It has noted statements on diversity and governance from the PRA and the FCA, as well as in the corporate world more generally, setting out enhanced expectations and new regulatory requirements in this area. With effect from 1 June 2023 the Group now complies with the new FCA Listing Rules requirements on diversity, which apply to it for the first time for this financial year.

As at 30 September 2023, the Board had four female directors out of a total of ten board members, forming 40.0% of the Board, with one senior board position, that of Senior Independent Director, held by a female director.

Remuneration policy

The Group's triennial review of the Directors' Remuneration policy was approved at the 2023 Annual General Meeting ('AGM') following extensive consultation with shareholders, investor bodies and other stakeholder groups and we thank them for their feedback and support. The Directors' Remuneration Report was passed with 69.19% of votes cast in favour, which represents a "significant vote against" the report as defined by the Code. Accordingly, the Remuneration Committee considered carefully the points raised by those shareholders who were not supportive of the report seeking additional input as appropriate. As required by the Code, the Company published an update on its position within six months of the meeting.

A4.5.3 Management and people

At 30 September 2023 the Group employed 1,522 people, an increase of 1.3% year-on-year. The majority are based at its Solihull Head Office but with hybrid working arrangements. People are the Group's most important asset, and it is accredited as a platinum status employer under the Investors in People programme. The Group focusses on providing people with opportunities for varied and rewarding careers, offering extensive training and coaching opportunities to meet their own ambitions whilst delivering on the strategic objectives of the business.

Conditions and culture

During the period the Group undertook an exercise to look at its operating model and as a result it has made some changes to streamline and simplify its organisational structure, making sure it is best positioned to continue its focus on providing good outcomes for customers, while protecting and developing specialist skills. While the business continues to be financially strong it was considered that there was a need to examine the resource requirements of potential future challenges and opportunities, while ensuring the Group operates in the most cost-efficient way possible.

As part of this process the Group has realigned non-core origination activities and reviewed all origination activities, reducing management layers from eight to six across most areas, right-sizing teams, consolidating operational teams, and restructuring its mortgage lending, SME lending and external relations areas. This was in addition to the closure of the Group's non-core TBMC mortgage brokerage operation (Section A4.1.1).

Whilst the Group seeks to avoid compulsory redundancies wherever possible, it entered into a consultation period with a number of employees in September 2023. Some of the affected employees secured alternative roles in the Group, and others were made redundant, both on a voluntary and compulsory basis. The exercise, along with reduced recruitment resulted in a headcount reduction of around 5%, subsequent to the year end.

In May 2023 the Group conducted its first full employee engagement survey since 2021, with 88% of employees sharing their views (2021: 86%). The survey produced a strong set of positive indicators, with an overall engagement score of 90%; 5% above the industry average. The survey asked for employees' feedback on topics such as organisational integrity, leadership, wellbeing, management, development and employee voice, and the results remained either static or improved across all themes.

With a total employee attrition rate of 12.6% (2022: 15.7%) the Group continues to track below the national average. These high levels of retention are further bolstered by 56% of employees achieving over 5 years' service, 11.5% achieving over 20 years with the Group 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 that the Group continued to meet the needs of its customers.

The Group maintains its accreditation from the UK Living Wage Foundation and minimum pay exceeds the levels set by the Foundation. During the period the Group made the decision to align apprentice rates to the Living Wage Foundation. The Group increased its minimum wage to £12.00 per hour, in line with the Foundation's recommendations, from 1 November 2023.

During the year employees were supported through the cost of living crisis by the Group's profit related pay scheme, which, as a result of the 2022 profit, provided an additional £3,300 to all full time employees below senior management level. Many employees also benefitted in the year from the Group's maturing sharesave scheme, being able to buy shares with a market value in the region of £5.00, each for an option price of £2.79.

On 11 December 2020, all eligible employees were granted a one-off award of £1,000 worth of shares to recognise the contribution that they had made to the business during the Covid pandemic. This award will mature in December 2023 with employees being given the choice to retain or sell their shares.

Equality and diversity

The Group continued to make progress on its equality, diversity and inclusion ('EDI') agenda during the year. The Group's EDI Network, launched in October 2020, continues to have an important impact and has been involved in the launch of several initiatives and offerings to all employees during the year.

The campaign to capture diversity data for all employees continues and by September 2023, 76.8% (2022: 73.1%) of employees had completed a diversity profile on the HR management system. The collation of this data from employees provides the Group with an enhanced ability to monitor and improve the diversity of the workforce going forward.

The Group continues to be committed to improving the diversity of its workforce and ensuring that talented people from all backgrounds can reach their full potential by breaking down barriers to progression. During the year the Group launched Ignite, an internal development programme for employees in underrepresented groups.

The Group continues to make progress towards its Women in Finance target of 40.0% female representation in senior management roles by December 2025, having achieved 38.6% female representation at 30 September 2023 (2022: 38.1%).

To support its efforts to improve gender equality the Group has continued to participate in the Mission Gender Equity cross-company mentoring scheme, sponsored by the 30% Club. This programme has proven popular with both mentors and mentees and a similar scheme is being piloted for employees from ethnic minorities and other underrepresented groups 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 offerings through the design of products and the choices of sectors in which to operate

Sustainability issues are coordinated on a group-wide basis by the Sustainability Committee, which reports directly to the Executive Committee. This ensures that information on initiatives within business areas is shared across the Group and facilitates the development of a coordinated and proactive approach.

During the year the Committee has overseen mapping the Group's strategic priorities against the United Nations Sustainable Development Goals, a framework agreed by world leaders which aims to end poverty, fight inequality and address the urgency of climate change. It is also responsible for driving the Group's initiatives on climate change and progressing other projects in the field of sustainability.

In December 2023 the Group will publish its third annual sustainability report, the Responsible Business Report. This provides more detailed information on sustainability initiatives and demonstrates how sustainability is embedded throughout the Group. It is published on the Group's corporate website at www.paragonbankinggroup.co.uk, alongside other information and documentation relevant to ESG issues.

Climate change

The Group has made a commitment to achieve net zero in line with, and in support of, UK Government commitments. In doing so the Group recognises that net zero cannot be achieved by any entity in isolation and therefore this commitment is dependent on appropriate government and industry support and action. As members of Bankers for Net Zero ('B4NZ') the Group aims to provide input into the wider efforts of the financial services industry in creating a clear pathway for the decarbonisation of the UK economy.

Climate change has been designated as a principal risk within the Group's Enterprise Risk Management Framework. As a result, the Group's responses to climate change 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)

Information and measures on climate-related risks and opportunities are considered at board level through the CEO's monthly reports. Developments in sustainable products and climate-related exposures are considered for each business line as part of strategy deep dives which feed into the annual board strategy event and into the Corporate Plan.

During the year, in-depth risk reviews have been carried out with input from key business areas and credit risk, which identified no new material risks. The findings have been used to inform the Group's climate change scenario analysis exercise and identify the key drivers of its climate change risk profile and opportunities. The exercise was conducted in line with the outputs of the Climate Financial Risk Forum ('CFRF') scenario analysis working group, of which the Group is a member, and incorporated within the 2023 ICAAP.

As part of the ongoing development of its reporting in line with the recommendations of the Taskforce on Climate-related Financial Disclosures, the Group has enhanced its analysis of financed emissions and a more detailed emissions balance sheet is being presented in the 2023 Annual Report and Accounts.

Developments within business lines which contribute towards the Group's climate risk strategy are set out in the relevant business reviews.

As a financial services provider the direct environmental impact of the Group's operations is considered low. However, the Group recognises the importance of reducing the impact these operations have on the environment. The Group has committed to reduce its operational footprint to net zero by 2030 and now reports its operational footprint on a quarterly basis at the Sustainability Committee with a summary report escalated to the Board.

In support of the Group's net zero operational footprint target, for the 2023 financial year the Group purchased certified carbon offsets equivalent to its operational footprint for the twelve months, following the precedent set in the 2022 financial year. It intends to repeat this for each year going forward, however, it acknowledges that reducing impacts is preferable to offsetting, where possible.

Group initiatives to reduce operational environmental impacts during the year include:

- Decarbonisation assessment of the Group's head office building, which is responsible for around 30% of its operational footprint, and the identification of actions to further reduce emissions
- Enhanced support for essential car users following the 2022 update to the company car policy which aims to eliminate diesel and petrol vehicles from its company car fleet by 2025. Electric vehicle users now receive a subsidy to source an appropriate charging unit at their home address
- Appointment of a new waste contractor for the Group's head office building, from May 2023, leading to improvements in both waste management and reporting
- Completion of the LED lighting roll-out at the Group's head office by April 2023, which is reducing overall energy consumption
- Development of a supplier survey, which was rolled out across a sample of suppliers in the second half of the year, aimed at identifying climate and other sustainability risks in those business relationships

Social engagement

The Group's Charity Committee raised £45,000 for Newlife, the charity chosen by employees for the financial year, which supports children who have cancer, birth defects, diseases and infections, and their parents. For the next financial year, ending 30 September 2024, employees have selected Molly Ollys as the beneficiary of the committee's fundraising activities. Molly Ollys supports children with life-threatening illnesses and their families and helps with their emotional wellbeing.

The Group's employee volunteering initiative also expanded during the year. Employees are entitled to an annual paid volunteering day, and the year saw an increasing number of people taking advantage of this, with more opportunities becoming available and teams and departments joining together to address bigger projects. The number of days used increased by 64.0% from 286 in 2022 to 469. Opportunities were focussed on the areas of poverty, education and the environment, and the Group is 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

Over the last year the principal challenges facing the Group have shifted from those related to the direct consequences of the Covid pandemic and the immediate post-pandemic period, to ones arising from increasing global economic and geopolitical threats. This shift in the risk landscape is presenting its own unique challenges with wide ranging consequences such as the rising costs of living and doing business in the UK, global economic uncertainty and potential instability in the banking sector earlier in the year.

The Group's response to this changing risk environment requires it to remain agile and resilient in its risk management capability, and to monitor impacts on its operations and risk profile on an ongoing basis. The Group's Enterprise-wide Risk Management Framework ('ERMF') provides a robust mechanism ensuring that new risks are promptly identified, assessed, managed, and appropriately overseen from a risk governance perspective.

The risk agenda has been dominated over the last year by economic threats, precipitated by the global impacts of the conflict in Ukraine and exacerbated in the UK by the impacts of the mini-budget of September 2022, which continued to be felt through the early part of the year. Consequences in the UK included rising energy, utility and commodity prices and higher interest rates, impacting the Group's customers. Based on current economic forecasts, these strategic issues are expected to continue to pose challenges for the foreseeable future:

- In an environment of rising interest rates and cost pressures for both new and existing loan customers 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 and loan products to ensure loan repayments are sustainable for customers and will continue to be so
- The Group takes its responsibilities in respect of customers in vulnerable circumstances extremely seriously and continues to ensure that, where appropriate forbearance solutions are necessary, these are tailored to individual customer circumstances and aligned to regulatory guidance and expectations
- The welfare of its employees is a key priority for the Group, and it will continue to ensure that individuals feel fully supported during this period of economic uncertainty. Financial and wellbeing initiatives are in place to ensure that people have access to information and resources to assist in navigating cost of living challenges

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

Risk management

The need for a robust risk management framework as a mechanism for identifying, mitigating and managing new and emerging risks is a core priority, and the Group has successfully continued to enhance and embed its ERMF to meet this need. This ongoing process has enabled it to manage all categories of risk and further mature its overall risk approach ensuring that risk considerations remain central to day-to-day and strategic decision making.

Key to the Group's approach is the evolution of the ERMF to ensure that the framework continues to remain effective and proportionate, in line with the Group's strategic aspirations. This approach has been enabled during the period by increasing capability in the risk function, ensuring that appropriately skilled resource is available to provide appropriate oversight and assurance around the management of all categories of risk.

Good progress continues to be made in enhancing the suite of policies that underpin the management of each of the Group's identified principal risks. This, in turn, has resulted in the refinement of associated risk appetites and better articulation of the control environment for each risk type. The Group continues to promote a risk aware culture as being at the heart of its values, ensuring that each individual fully understands their accountabilities and responsibilities in respect of risk.

The Group remains committed to the further development of the ERMF as necessary to ensure it remains relevant and in line with regulatory expectations. Key to this vision will be investment in the implementation of an enhanced risk management system over the next 18 months, which will further improve the analysis and reporting of risk-related data, giving better insight into the risk profile at all levels within the Group.

Despite the pervasive impact of the rising interest rate environment in the year coupled with inflationary challenges which have been a significant risk focus in the year, the Group has identified and addressed a number of additional strategic risk issues including:

- **Consumer Duty** – Successfully delivering the first phase of the FCA Consumer Duty, meeting the regulatory deadlines for those products and services in scope, ensuring that the Group's culture is driving good outcomes for its customers
- **Resilience** – Further enhancing the operational resilience framework and resilience capabilities ensuring the Group can demonstrate it can consistently remain within stated impact tolerances to meet the 2025 regulatory deadline. The Group continues to refine its overarching approach, using its programme of self-assessment and testing to ensure that operational resilience remains a central objective during its transformation programme, which increasingly relies on third parties to deliver core services
- **Climate** – Addressing the impact of climate change on managing financial risks and considering this as part of the wider ESG agenda across the Group, with clear commitments made to drive net zero ambitions in line with wider governmental strategy
- **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 IRB application process
- **Stress testing** – Enhancing stress testing procedures to ensure the robustness of capital and liquidity positions
- **Cyber-security** – Ensuring effective cyber-security controls and a robust data protection approach are in place, particularly with the evolving and increasingly sophisticated nature of cyber threats

The Group continues to review its exposure to emerging developments in the Brexit process as further clarity is received as to future dealings with the EU; however it is clear this will take time to manifest itself fully and the long-term impact 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 have caused shortages in a number of sectors. Whilst this has eased in recent months, and the Group was not directly affected by these issues earlier in the year, the Board continues to keep the situation under ongoing review as future supply issues in areas such as building materials and IT equipment could impact the Group's operations or those of its customers.

Risk outlook

The principal significant and emerging risk areas expected to impact the Group during the coming year ending 30 September 2024 and beyond include:

- **Costs of living and doing business** – Management of risks associated with the wider economic landscape and the impacts this has already had, and will continue to have, on the financial position of people and corporates in the UK. Consecutive interest rate rises, and the continuing inflationary pressures pose an ongoing challenge to the Group's customers. The Group remains committed to ensuring 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
- **Compliance expectations** – 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 year has been on ensuring the Group was able to meet regulatory requirements in respect of the new FCA Consumer Duty rules for those products in scope for the July 2023 deadline. The priority for the Group is to continue to embed the Consumer Duty within its business lines ensuring that good customer outcomes and deep understanding of these remain at the forefront of all customer interactions
- **Financial crime** – Ensuring continuous improvement in the Group's capability to combat the risks of financial crime. Significant work has been undertaken during the previous financial year to ensure that regulatory expectations in respect of anti-money laundering and wider financial crime control frameworks are met, and the Group continues to invest in this area
- **Climate** – Risks associated with climate change remain an ever-present challenge. The UK Government confirmed its goal of net zero carbon by 2050 in November 2020, and the Group, together with the rest of the financial services industry, has a vital role to play in that commitment. As global strategies continue to be refined, the Group is seeking to ensure that the impact of climate change is considered as a core driver for both its operational activities and its lending strategies

A4.5.6 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. All 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, as expected, increased during the year with particular focus 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** – The FCA Consumer Duty sets higher expectations for the standard of support provided to customers, and challenges firms to evidence the customer outcomes they are delivering. Implementation of the new rules is staged (with the requirement for existing products to be compliant by July 2023, and closed products by July 2024). This has been a priority area for the Group during the year with activity being championed by the Board, and a non-executive director assigned responsibility for oversight of the programme. The areas targeted for implementation during 2023 were delivered as planned, with the focus now on implementation for the Group's closed products by July 2024
- **Basel 3.1** – The PRA published a Consultation Paper on Basel 3.1 implementation in November 2022 (CP16/22). The consultation closed on 31 March 2023 and the final policy outcome has yet to be published. The expected implementation date for Basel 3.1 is 1 July 2025. The Group proactively monitors and manages its capital, assessing the implications of a range of different possible impacts including potential worse case scenarios as part of its capital planning activities
- **Regulatory framework** – The PRA has continued to develop its thinking on the Strong and Simple approach for small firms with a consultation on liquidity and disclosure requirements (CP4/23) and expansion of the definition of a simpler firm in the Basel 3.1 consultation paper to include firms with total assets of up to £20 billion. While the current proposals are unlikely to apply to the Group, developments are being monitored closely given the potential impact of future proposals for mid-tier banks
- **Recovery and resolution planning** – The PRA has commenced consultations on new requirements for 'non-systemic' firms, which would include the Group, to undertake 'solvent wind down' planning – the process through which a firm could transfer or repay all deposits and exit the deposit market while remaining solvent throughout. Firms would be expected to undertake such planning in addition to the Recovery Plan. Whilst implementation of this requirement is not expected until the third quarter of 2025, the Group is actively engaged in the consultation process

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.



- **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, as well as its Consumer Duty rules and guidance. 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
- **Borrowers in financial difficulties** – The FCA issued findings from their 'Borrowers in Financial Difficulties' project, setting out clear expectations on the level of support that firms should provide to their customers. The regulator is also consulting on proposals to implement the additional consumer protections put in place during the pandemic as permanent requirements. Considerable work has already been undertaken in this area by the Group and therefore it considers itself well-positioned to meet any future requirements
- **Operational resilience** – Having successfully met the March 2022 policy implementation requirements, the Group has continued to embed its resilience approach to ensure it is well positioned to meet the 2025 regulatory deadline. By this time the Group will need to demonstrate an embedded resilience framework and the ability to stay consistently within impact tolerances for important business services

The 2023 self-assessment set clear objectives for the next assessment period and clearly demonstrates the Group's ongoing commitment to continuous improvement in respect of its resilience capability. It also provides evidence of compliance with regulatory requirements which require that 'Important Business Services' are mapped and tested using severe but plausible scenarios to test the boundaries of the ability of infrastructure, key dependencies and third parties to recover from disruption

- **Climate change** – As approaches to managing climate-related financial risks mature across the industry the Group continues to evolve its own approach, described in Section A6.4. The Sustainability Committee, alongside the executive-level risk committees, ensures comprehensive consideration of climate change across all aspects of the business and ensures the Group is well-positioned to address the emerging challenges

A deep dive review of the Group's climate change risk and opportunities by business area is performed on a regular basis to ensure risks and opportunities are captured where material. 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

- **Regulatory reform** – The Financial Services and Markets Act 2023 is a key piece of post-Brexit legislation that came into force in June 2023. The Act formalises new secondary objectives for the PRA and FCA covering long-term growth and international competitiveness. The Group continues to closely monitor 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
- **MREL** – 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 including regular engagement with regulators

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 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 Introduction 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 61 to the accounts includes an analysis of the Group's working and regulatory capital position and policies, while notes 63 to 65 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 68 and 69.

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 2023 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 2023.

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:

- An increase in buy-to-let volumes. This examined the impact of higher volumes at a reduced yield on profitability and illustrated the extent to which capital resources and liquidity would be stretched due to the higher cash and capital requirements
- Higher funding costs. Higher cost on all new savings deposits, both front book and back book throughout the forecast horizon. This scenario illustrates the impact of a significant, prolonged margin squeeze on profitability, and whether this would cause significant impacts on any capital, liquidity or encumbrance ratios
- Higher buy-to-let redemption rates for buy-to-let mortgages reaching the end of their fixed rate period. This illustrates the potential risk inherent in the five-year fixed rate business
- Increased economic stress on customers. As well as modelling the impact of each of the economic scenarios set out in note 24 across the forecast horizon, the severe economic scenario was also modelled over the five-year horizon. To ensure this represented a worst-case scenario all other assumptions were held steady, although in reality adjustments to new business appetite and other factors would be made
- Combined downside stress. The IFRS 9 downside economic scenario described in note 24 was modelled out for the plan horizon along with a plausible set of other adverse factors to the business model, creating a prolonged tail-risk

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 Group also undertook analysis of the potential impact of climate change on the business, including an assessment leveraging the Bank of England Climate Biennial Exploratory Scenario. More details of these analyses are set out in Section A6.4.

The outputs from these exercises 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.

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 developing economic situation in the UK, in particular the impact on its customers of the level of interest rates and their rate of change, high inflation levels, falling property prices and increased costs of doing business 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 been fed into the Group's forecasting and risk assessment.

In addition, the directors held 'deep dive' sessions into key areas of risk focus including the impact of the collapse of Silicon Valley Bank and Credit Suisse, the unprecedented level of UK energy prices from late 2022 into 2023, and reviewing specific scenarios on the impact of rising interest rates following the Bank of England's increases in the base rate.

Focussed reviews of the principal risks continued throughout the year, including credit risk, capital risk, liquidity and market risk, climate change risk, conduct risk, strategic risk, reputational risk, model risk and across the different categories of operational risk.

The directors also received briefings and training to ensure these impacts could be fully understood and placed in context. 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, the emerging long-term effects of the Covid pandemic, and the consequences for the UK economy of developing global geopolitical issues.

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'), completed after the year end, 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 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.

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 £13,265.3 million (note 33), raised through Paragon Bank, are repayable within five years, with 82.9% of this balance (£10,990.5 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 2023 Paragon Bank held £2,589.7 million of balance sheet assets for liquidity purposes, in the form of central bank deposits (note 64). A further £150.0 million of liquidity was provided by the off balance sheet long / short transaction described in note 66, bringing the total to £2,739.7 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 £1,715.4 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 2023 the Group had £1,205.6 million of such notes available for use, of which £986.9 million were rated AAA. The available AAA notes would give access to £769.8 million if used to support drawings on Bank of England facilities.

The Group's securitisation funding structures, described in note 64, 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 during 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 BBB+ rating, confirmed by Fitch Ratings in February 2023, and its status as an issuer is evidenced by the BBB-, investment grade, 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 61 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 2023 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 2023. 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 2023.

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 2028 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.

During the year the Group formalised this approach by mapping its strategic priorities against the United Nations Sustainable Development Goals, a framework agreed by world leaders which aims to end poverty, fight inequality and address the urgency of climate change.

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.

During the year the Committee launched a group-wide Sustainability Charter, supported by an internal communication campaign and on-line training provided to all employees, aimed at raising awareness of a broad range of sustainability issues.

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 and sustainability 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 this 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

The climate-related financial disclosures required by the Act are presented in Section A6.4 in accordance with the approach set out by the Taskforce on Climate-related Financial Disclosures ('TCFD'). This approach covers all matters set out in Section 2A of Paragraph 414CB of the Act.

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).

The disclosures made by the Group in the current year reflect amendments made to the Act's requirements by The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022, which apply to the Group for the first time in this period.

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 (2022: 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 aligning and embedding the new FCA Consumer Duty principles. While the Consumer Duty does not cover all of the Group's customers, with some Commercial Lending activities outside its scope, the principles of the Consumer Duty inform the Group's approach to all its customers.

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 and, as a specialist bank, it uses its expertise to provide financial products and support to help them achieve their ambitions. The Group is committed to delivering good customer outcomes, offering its customers extra support when they need it and listening to their feedback.

The fair treatment of customers and the delivery of good 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 good outcomes for customers.

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

A cross-functional working group addresses the needs of those customers in vulnerable circumstances, considering their needs and any additional support 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 always to provide excellent service, 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 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. This has ensured that the target dates for implementation in July 2023 were achieved and the Group remains on target to meet the remaining implementation deadlines in 2024.

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 are 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
- The Group's standards will protect consumers and deliver good customer outcomes

This pro-active approach accords with the FCA's Principles for Business, particularly regarding 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 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 good 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

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 as appropriate, where customers are invited to provide feedback on the way in which they feel their complaints have been dealt with. The results 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 shared with all business units concerned with complaint handling.

The Group focusses on FOS complaints data as a high-level satisfaction metric, and incident rates remained low throughout the year. Consolidated information for the two Group companies required to report to FOS, for the four most recent FOS reporting periods, is set out below. In the most recent period only one of the companies met the threshold number of cases for the publication of its data by FOS, with neither company meeting the threshold in the preceding period.

	Six months ended			
	30 June 2023	31 December 2022	30 June 2022	31 December 2021
Cases reported	57	44	46	35
Uphold rate	36.2%	15.2%	34.4%	34.2%

The upward movement in the number of cases reported is principally a function of the increased number of savings accounts, while the uphold rate in the second half of the year reverted to around its long-run normal level, which is consistent with industry averages.

The overall industry uphold rate reported by FOS for the six months ended 30 June 2023 was 37% compared to 34% in the six months ended 31 December 2022 and 37% in the six months ended 30 June 2022. FOS data across the financial services industry is published on the ombudsman's website at www.financial-ombudsman.org.uk.

The Group routinely assesses its complaints performance against the FCA bi-annual complaints submissions, comparing key complaint metrics to our peers and against the industry. 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 over 1,500 people in the UK with the majority based at its Solihull Head Office but working in a hybrid way. The Group's people are its most important asset, and its focus is on providing them with opportunities for varied and rewarding careers, offering extensive training and coaching opportunities to meet their own ambitions whilst delivering the strategic objectives of the business.

Employee engagement

The Group conducted a full employee engagement survey in May 2023 and 88% of employees shared their views, an increase of 2% on the previous survey carried out in 2021 (2021: 86%). The survey produced a strong set of positive indicators, with an overall engagement score of 90%; 5% above the industry norm and the Group's highest engagement score in eight years (2021: 87%). The survey sought views on topics such as organisational integrity, leadership, wellbeing, management, development and employee voice, with results remaining either static or improved across all themes.

Questions relating to the treatment of the Group's customers demonstrated that 99% of employees believe that the Group is committed to delivering good outcomes to customers (2021: 89%), with 93% of employees believing that the Group is taking action to positively influence climate change (2021: 84%). The Group continues to use the survey as a means of monitoring its risk culture, gathering employee opinion on its approach to being a responsible business and the progress it is making to becoming a more inclusive employer.

Employment conditions

All the Group's employees are based in the UK, and it 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 2023, employees on temporary or short-term contracts accounted for 1.2% of the workforce (2022: 2.0%) and no use was made of zero-hours contracts. The Group usually only employs persons over the age of 18, except in connection with apprenticeship or other training arrangements.

The Group has seen the voluntary employee turnover reduce during the period to 9.6% (2022: 12.2%), while the total turnover was 12.6% (2022: 15.7%). The attrition rate remains lower than the 18.6% average rate in the banking and finance sector published by Reward Gateway in 2022, their most recent data, and the 31 December 2022 figure for voluntary attrition in the financial services sector of 16.4%, the most recent to be published by XpertHR.

The Group benefits from the extensive experience of a significant number of long-serving employees at all levels. 31.4% of the workforce at 30 September 2023 had served for over ten years with 11.5% having been with the Group for over twenty years.

The Group operates a hybrid working model with over 40% of people 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 22.3% of employees (2022: 22.6%), with 78.5% of these working part-time (2022: 74.0%). 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 26 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 granted an additional 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.

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 Foundation employer, the Group pays at least the Real Living Wage (£10.90 per hour at 30 September 2023, rising to £12.00 in November 2023) to all employees and also ensures that wages paid by contractors and suppliers meet the same threshold. In January 2023 the Group made the decision to align apprentice hourly rates to the Living Wage Foundation, this being over and above the UK's minimum apprentice rates. From 1 November 2023 the Group will pay a minimum of rate of £12.00 to all employees, equivalent to a full time equivalent annual wage of £23,400. For employees based in London, the Foundation's London Living Wage is paid.

On the closure of the Group's TBMC mortgage brokerage in the year (Section A4.1.1) all 17 affected employees were either offered alternative roles within the Group, gained employment externally, or chose to retire.

During the year the Group undertook an exercise, supported by external consultants, to analyse its current operating model and identify the future requirements inherent in its business strategy. As a result, changes have been made to streamline and simplify its organisational structure, ensuring that it is optimally positioned to continue its focus on providing good outcomes for customers and to maintain and protect its specialist base. Overall, the steps already taken, through a review of recruitment strategy and a reduction in existing roles, have led to a reduction in the Group's planned future headcount of around 5%.

Whilst the Group seeks to avoid compulsory redundancies wherever possible, aiming to redeploy affected employees elsewhere, it entered into a consultation period with 88 employees in affected roles. 14 people chose to take voluntary redundancy and a further 39 redundancies were made. The Group was able to retain 35 people in affected roles.

All affected employees qualifying for annual bonuses in respect of 2023 were assessed in the normal way and any of these people who would have normally qualified for the Group's PRP scheme, or who were granted post-Covid three-year share awards in 2020, will still receive these benefits, in addition to their normal redundancy arrangements.

The Group runs a Worksave defined contribution pension scheme and complies with the Government's auto-enrolment requirements; 89.4% 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 96.1% of its people.

Culture

Following the launch of the Group's Code of Conduct in 2022, all employees are required to attest annually that they understand the expectations set out in the code, and as at 30 September 2023 100% of employees had done so. The Code of Conduct provides additional guidance to employees on the behaviours expected of them when dealing with each other, with customers, and with other stakeholders, and is a central component of continuing to build and embed a strong risk culture.

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 focus on raising awareness and understanding of creating an inclusive culture and diverse workforce through varied internal communication campaigns, including internal podcasts. Celebrations in the period included Black History Month, International Youth Day, Disability History Month, International Women's Day and Pride at Paragon.

Collecting diversity monitoring data

During the year the Group has continued to ask employees to complete diversity monitoring profiles in CoreHR, the central HR system. Data is requested about gender identity, sexual orientation, ethnicity and race, religion, socio-economic background, disabilities, and caring responsibilities outside of work. As at 30 September 2023 76.8% of employees had completed their profile (2022: 73.1%), and the Group maintains its focus on increasing this figure.

Socio-economic diversity

As a Founding Member of 'Progress Together' the Group recognises the importance of improving socio-economic diversity at senior levels across the UK financial services industry and has been working alongside other members to understand and to improve socio-economic diversity across the sector.

The Group has continued to form working relationships with inner-city colleges and schools as a means of attracting talent from more diverse backgrounds in the year. 12.8% of employee volunteering days were completed in seven local schools.

The Good Youth Employment Charter

The Group recognises the benefits of early careers, and the diversity of skills that young employees bring to a company, and consequently has signed up to the Good Youth Employment Charter. In joining the Charter, the Group has formalised its status as a youth-friendly employer, creating opportunities for young people, which help them to gain the skills and experiences they need for their future careers, through meaningful and good-quality experiences of the world of work that raise their aspirations, and enhance their skills and personal networks.

The Charter links to the Group's continued involvement in the Smart Futures Programme, 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. It also ensures that young people from Black, Asian and ethnic minority groups, as well as those young people from lower socio-economic backgrounds or those with additional needs or barriers are not unfairly excluded.

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 Launch of 'Mission INCLUDE', a mentoring scheme for employees from under-represented groups.

The programme provides high-potential employees from these groups with a mentor from another organisation who is a member of an under-represented group or an ally.

During the year 'Ignite' an internal development programme was launched, following feedback gathered through employee listening circles. The programme focuses on providing greater career support to employees in under-represented groups and addressing personal development needs such as making an impact, building personal brand and networking.

Disability Confident

Employees identifying as having a disability comprise 5.6% of those completing their diversity profile (2022: 4.7%). 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

The Group is accredited to level two of the scheme and is working towards level three – 'Disability Confident Leader'.

The Group makes every effort to retrain and support employees who are affected by disability during their employment, including the provision of flexible working to assist their return to work, and ensuring 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. The Group's project has a designated executive committee sponsor, and progress against 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. These were all surpassed before the target date of January 2022. The Group is in the next phase of its charter journey and has committed to achieve 40% female representation in senior management by 31 December 2025. At 30 September 2023, the Group had achieved 38.6% female representation in senior management (2022: 38.1%).

The definition of senior management used in the Group's 'Women in Finance' target is the same as that used by the FTSE Women Leaders initiative. When that review published its most recent report in February 2023, the Group's level of female representation in senior management was seventh highest out of the thirteen banks and similar institutions covered by the initiative, and above average for the sector.

Gender Pay

As required by legislation, the Group has calculated its gender pay gap as at April 2023. The results will be published on the UK Government website and on the Group's own website and are summarised below.

	April 2023	April 2022
Median gender pay gap	33.5%	32.5%
Mean gender pay gap	35.0%	36.3%
Median bonus pay gap	0.5%	1.9%
Mean bonus pay gap	70.5%	84.4%

This year's gender pay measures, are broadly similar to those for 2022 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 the median figure of 34.3% for the financial services sector reported by the Office of National Statistics in their 2023 Annual Survey of Hours and Earnings ('ASHE') (2022: 36.6%). The mean pay gap for the industry reported by the ASHE, which is more influenced by operational structures, was 25.2% (2022: 30.8%).

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 (87%) 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 (34% 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 male.

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 1.3% to 1,522 employees (2022: 1,503). Information on the composition of the workforce at the year end is summarised below:

	2023	2023	2022	2022
	Females	Males	Females	Males
Employees				
Number	774	748	764	739
Percentage	50.9%	49.1%	50.8%	49.2%
Managers				
Number	119	171	126	176
Percentage	41.1%	58.9%	41.7%	58.3%
Senior managers				
Number	12	36	9	36
Percentage	25.0%	75.0%	20.0%	80.0%
Directors				
Number	4	6	3	6
Percentage	40.0%	60.0%	33.3%	66.7%

In this table managers include all employees with management responsibilities. 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:

- 17.7% of employees (2022: 19.4%)
- 11.6% of managers (2022: 13.0%)
- 17.7% of senior managers (2022: 12.2%)

This is based on the 72.6% of employees who declared their ethnicity (2022: 68.0%). For the purposes of this analysis, ethnic minority employees comprise all those not identifying as a member of a 'White' group.

Health and wellbeing

The Group continues to focus on supporting the wellbeing of employees, providing support with emotional, physical, financial, and social wellbeing issues. Anne Barnett, Chief People Officer, the Executive Sponsor for Wellbeing, ensures that this focus goes to the highest levels of the Group's management.

With the continued cost-of-living challenges facing employees, the Group has increased its 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 remains committed to providing employees with access to trained mental health first aiders. Eight members of the Wellbeing team have undertaken mental health training in the period, with additional training available to all team members on grief and bereavement, trauma and suicide awareness from external specialists. As well as the Wellbeing team being available to provide support, employees also have access to a dedicated Wellbeing Hub where specialist support services providing help with issues such as domestic violence or bereavement are signposted, as well as numerous resources to help with a wide range of wellbeing issues.

In the year the Group signed the Pregnancy Loss Pledge, encouraging a supportive environment where people feel able to discuss and disclose pregnancy or loss without fear of being disadvantaged or discriminated against.

Since the Group introduced The Vitality Health programme, 98% of employees have signed up to the service which gives employees access to an extensive range of physical wellbeing products and services, including personalised health reviews, online GP services and access to Vitality Wellbeing Coaches. Free exercise classes continue to be available in office locations as part of the Group's ongoing commitment to improving employees' physical wellbeing.

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 3.5 days training each in the year (2022: 5.2 days). This is in line with the average figure of 3.6 days per person reported by the 2022 Employer Skills Survey, published by the UK Department for Education in September 2023, the most recent national survey of training provision. This included online training undertaken by all employees on various topics including regulatory requirements.

This year has seen the implementation of the FCA Consumer Duty, which has required a comprehensive learning and development approach across the Group to ensure that the required changes in behaviours are encouraged and embedded. Learning support has ranged from podcasts with the leadership community, interactive 'Achieving Customer Excellence' sessions delivered to over 350 people within operational areas, the update of many of our pre-existing learning materials and the review of training and competency frameworks.

Ensuring all employees understand how to support those of the Group's customers in vulnerable circumstances continues to be an important focus of the development agenda. During the year an interactive e-learning solution was rolled out to all employees, supplemented with bespoke courses for all customer-facing employees.

Digital learning has played a key role in ensuring that major transformation projects undertaken by the Group are introduced effectively and are well supported through easily accessible development. The Group's in-house consultants have also delivered a rich variety of support through video creation, online sessions and classroom interactions to ensure that the learning available is fit-for-purpose, effective and engaging.

To help develop employees careers with the Group 'Purpose and Performance Profiles' are being introduced. These link an employee's role to the Group Purpose and demonstrate and how it contributes towards the delivery of the Group's strategic priorities. The profiles will be used for talent attraction and recruitment, and as a tool for ongoing performance monitoring, development and 'top talent' identification.

Employees and managers are encouraged to regularly discuss performance and purpose throughout the year, which 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 has continued to focus on developing female talent during the year to support its diversity strategy. 53% of employees receiving management development in the year were female, and the Group continues to support the Mission Gender Equity cross-company mentoring programme run by Moving Ahead in conjunction with the 30% Club campaign. It was particularly pleasing that during the year Moving Ahead named the Group as its 'Most Dynamic Mentoring Organisation' for 2023 in recognition of the excellent support and commitment given to the programme.

Feedback from participating mentors and mentees continues to be favourable, with 20% of participants having progressed their careers within the Group. In comparison, research conducted for the 30% Club showed an average promotion rate of 10% for female managers. The sixth cohort of employees started their programme just before the year end.

In response to the success of the Mission Gender Equity Programme, mentoring support was broadened in the year, with the Group joining the Mission Include programme. This programme has the objective of encouraging career development in under-represented groups, and the Group has initially supported four individuals in the cross-company mentoring programme. In addition, the internal 'Ignite' programme was launched, supporting the careers of individuals in under-represented groups with focussed training and mentoring.

For the past year the Group has been a member of 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 set a target that early-careers roles would comprise at least 5% of its workforce by September 2027. This target has already been reached and, in recognition, the Group has been appointed as a gold member of the 5% Club. At 30 September 2023 the Group had 77 such employees (2022: 74), comprising 5.1% 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 70 apprentices (2022: 44), 4.5% of employees (2022: 2.9%) 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 increased to 50% (2022: 31%). It has also pledged 10% of its levy entitlement towards funding apprenticeships in smaller SMEs.

There are currently 75 individuals completing professional qualifications across the Group (2022: 101), including 35 undertaking their CeMap mortgage qualification (2022: 40). Of these 53% are female (2022: 55%) contributing towards the Group's diversity agenda.

Employees' involvement

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 share 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 representatives met with Robert East, the Chair, and with non-executive directors to discuss topics such as, pay and benefits, flexibility and hybrid working and communication and visibility.

The directors recognise the benefit of keeping all employees informed about the progress of the business. Executive directors provide biannual updates on business progress to the entire workforce which continue to be delivered through video messages. ExCo members also use the Group's intranet to deliver updates on important initiatives within the business. During the year 'Network News' launched, regularly providing all employees with the latest news and information from across the People Forum, Wellbeing Team, EDI Network and Charity Committee.

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 2023, 63% of the Group's employees were members of one or more ShareSave scheme and 87% were eligible for profit related pay in respect of the 2023 financial year.

On 11 December 2020, all eligible employees were granted a one-off award of £1,000 worth of Paragon shares to recognise the contribution that they had made to the business during the Covid pandemic. The award will mature in December 2023 with employees being given the choice to either keep or sell their shares.

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. It is committed to the provision of a healthy and safe working environment for all employees, contractors and visitors to its premises, and those affected 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.

With the Group's hybrid working model, the communication of key policies and procedures remains central to its safety and wellbeing initiatives. To enable employees to work effectively and safely, whichever location they may be working in, access to appropriate equipment has been reviewed and procedures developed to ensure a healthy working environment is maintained.

The Group's head office is in central Solihull, therefore exposed to indirect impacts from neighbouring properties. An annual testing programme addresses fire evacuation, network grid failures and physical security as a minimum. This programme's focus is on ensuring that the key processes needed to mitigate any disruption are simulated, to ensure the Group's operations remain resilient, and that adequate appropriate resources would be available in case of an incident.

A programme of periodic inspections and audits is also conducted across the Group's premises, to identify specific health and safety issues and highlight any emerging trends. As well as actioning any individual hazards identified, action will be taken to mitigate any recurrence. This may include targeted safety training or specific safety communications.

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.

Training and awareness

During the year 395 employees in key roles with exposure to specific health and safety risks were provided with specific training relevant to their role. This included employees in the Surveyors, Group Systems, Group Property, Maintenance and Development Finance teams, amongst others, as part of a program to enhance employee awareness of key role-related safety messages.

All employees have been provided with intranet communications on key 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. Group policies, also set out appropriate levels of information, instruction, training and supervision, to empower employees 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 each year, to ensure awareness of the specific issues inherent in their duties and working environment to mitigate the inherent heightened risk.

Management and systems

The Group has a dedicated health, safety and environmental team which 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) continues to be certified to ISO45001:2018 for its Occupational Health and Safety Management System ('OHSMS') which is subject to regular audit, by the Group's Internal Audit function and subject to external verification 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 retains 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.

During this period resources for health and safety have been reviewed and remain sufficient to ensure appropriate standards of Health and Safety management are 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 2023 there were no prosecutions or any enforcement action from visits by the authorities for non-compliance in respect of health and safety matters (2022: None).

Premises occupied by the Group continue to comply with all health and safety regulations, with the required number of fire marshals, first aiders and other qualified personnel continuing to be appropriate. This is regularly monitored across all sites, using a risk-based approach based on the occupancy levels. During the year a change in approach to the Group's fire marshal procedures increased the number of qualified employees, better suiting the approach to the hybrid working environment.

During the year, the Group reported 27 minor incidents classified as relating to work activity or the building environment (2022: 20). There was one lost-time incident, with no notifiable reports required under the Reporting of Incidents, Disease and Dangerous Occurrences Regulations 2013 ('RIDDOR') (2022: 1).

The incident was minor and resulted in three lost days (2022: 8 days). Reported 'near-miss' incidents remain at low levels, with only seven events raised in the course of the year (2022: 28).

To identify the root cause of any incident, all reports are investigated with the co-operation of employees to identify any influence relating to the workplace / unknown work activity hazards, systems or behavioural error. Corrective and preventative measures are then implemented.

A6.4 Environmental impact

Climate change is one of the biggest challenges faced by the world today and the Group continues to take an active role in the transition. The Group has committed to achieve net zero, across all attributable greenhouse gas emissions, including financed emissions, 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.

Through its membership of numerous industry initiatives including Bankers for Net Zero ('B4NZ'), the Partnership for Carbon Accounting Financials ('PCAF') and the Green Finance Institute ('GFI'), the Group supports 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	<ul style="list-style-type: none"> Climate change designated as a principal risk
2021	<ul style="list-style-type: none"> Sustainability Committee established to monitor progress on climate, ESG and sustainability focus areas Financed emissions of the mortgage portfolio reported for the first time
2022	<ul style="list-style-type: none"> Became a member of B4NZ Began offsetting operational footprint emissions 2019 year end set as baseline to track commitment to net zero emissions operational footprint by 2030
2023	<ul style="list-style-type: none"> Became a member of PCAF Enhanced climate change scenario analysis to consider the implications of the UK Government's original proposals for Minimum Energy Efficiency Standards ('MEES') in the PRS. Science-based target pathway analysis undertaken for the mortgage portfolio Expanded the financed emissions balance sheet to include elements of the Group's Commercial Lending division Decarbonisation assessment of the Group's head office building, which contributes to over 30% of operational footprint emissions
2030	<ul style="list-style-type: none"> Net zero across the Green House Gas ('GHG') emissions associated with the Group's operational footprint
2050	<ul style="list-style-type: none"> The Group has committed to net zero across all greenhouse gas 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 internal impacts (or operational footprint) and the impact of its lending activities (the external or downstream impacts). The Group is mainly engaged in the financial services industry in the UK and therefore its operations are considered to have a low impact on the environment and climate change.

The Group has offset the emissions attributable to its operational footprint in the year ended 30 September 2023 through the purchase of carbon credits certified under the Gold and VCS Standard programmes, two of the most widely accepted international certification systems. More detail on the Group's approach to managing the environmental impact of its own activities and operations is provided under '(f) Operational impacts'.

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. The TCFD framework provides guidance (using a principles-based framework) for companies to use for disclosure on climate-related risks and opportunities.

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 2022 and 2023 Thematic Review of climate-related 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
<p>a) Describe the Board's oversight of climate-related risks and opportunities</p> <ul style="list-style-type: none"> • As a principal risk within the Group's ERMF, climate change is considered alongside all other principal risks in all major capital expenditure, acquisition and divesture decisions • During the year the Board approved the Group's climate change scenario analysis module which was incorporated in the 2023 ICAAP • The CFO has been designated as the director responsible for climate change matters • Performance against the Group's net zero operational footprint commitment is monitored by the Sustainability Committee and escalated to the Board through the CEO's monthly report • Through the CEO's monthly report and other regular engagement the Board provides oversight of the sustainability matters most relevant to the Group • The Risk and Compliance Committee is engaged on a quarterly basis through the CRO's Report 	<p>(a) Governance</p> <ul style="list-style-type: none"> – Board oversight – Sustainability Committee and Climate change working groups
<p>b) Describe management's role in assessing and managing climate-related risks and opportunities</p> <ul style="list-style-type: none"> • The Sustainability Committee is a dedicated sustainability governance forum and reports to ExCo and the Board • The terms of reference of key executive risk sub-committees incorporate the consideration of climate change 	<p>(a) Governance</p> <ul style="list-style-type: none"> – 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	<p>As part of the 2023 ICAAP the following have been delivered:</p> <ul style="list-style-type: none"> • 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 the Mortgage Lending and Commercial Lending divisions, considering the key climate-related risks and opportunities <p>The climate risk and opportunity assessment is an integral process for assessing the impact of climate-related risks and opportunities across the Group and their materiality</p> <p>Although no significant vulnerabilities were identified, the impact of current and emerging regulation, particularly the tightening of energy efficiency regulations in the private rented sector, was recognised as a potential risk. Controls are in place to reduce the impact of this risk.</p> <p>Other potential risk drivers identified include technology risk, reputational risk and physical risk from flooding which are all currently deemed to have a low overall impact on the Group's business model.</p>	<p>(b) Strategy</p> <ul style="list-style-type: none"> – Climate-related opportunities – Use of scenario analysis <p>(c) Risk management</p> <ul style="list-style-type: none"> – 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	<ul style="list-style-type: none"> • The Group continues to incentivise customers to be more sustainable by offering discounted rates or reduced fees across its sustainable products • The climate change scenario analysis module continues to enhance the Group's process for embedding and considering climate change within planning and strategy • The Group continues to assess and improve the efficiency of its supply chain. A pilot sustainability survey was shared with the Group's property suppliers with the results now being considered 	<p>(b) Strategy</p> <ul style="list-style-type: none"> – Climate-related opportunities – Use of scenario analysis <p>(f) Operational impact</p> <ul style="list-style-type: none"> – Supply chain and procurement – Environmental initiatives
c) Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario	<ul style="list-style-type: none"> • During the year, the climate change scenario analysis exercise was updated. The approach focused on the shorter-term risks which could materialise within the residual life of the assets across the portfolio. The timescales considered varied from one to six years across the Commercial Lending portfolio to up to and beyond seven years across the Mortgage Lending portfolio. The assessment did not identify any significant vulnerabilities • The quantitative analysis assessed the impact of a divergent transition and a short-term implementation of the MEES across the PRS in the UK. The results indicated that climate-related risks do not significantly impact provision or asset value calculations 	<p>(b) Strategy</p> <ul style="list-style-type: none"> – Use of scenario analysis <p>(g) Future developments</p>

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 climate change principal risk policy continues to incorporate climate risk considerations within the ERMF, 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 have enhanced the approach for identifying and managing climate-related risks
- The climate risk and opportunity assessment, which has business-wide engagement, is an integral process for identifying climate-related risks that could impact the Group

(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 Sustainability Committee provides a channel for climate related issues to be raised by business areas and escalated up and across the Group's governance structure as appropriate
- The Sustainability Committee has three working groups with remits which cover climate change and other aspects of sustainability. These groups include personnel from across the business allowing for risk and opportunities to be identified and escalated
- The climate change principal risk policy articulates the Group's approach to climate risk management, ensuring ambitions are achieved and necessary controls are effective. More detail on the Group's ERMF and its 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 groups
- 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	<ul style="list-style-type: none"> For the Group's mortgage portfolios, energy efficiency (measured by EPC grades) and flood risk are key metrics used to assess climate risk For SME lending Standard Industrial Classification ('SIC') codes are used to identify customers operating in industries with increased exposure to climate risk Throughout the year the amount of lending on our green mortgage range continued to increase The 2023 ICAAP assessed the alignment of the mortgage portfolio's projected emissions with a well-below 2°C scenario The Group has offset its operational footprint via the purchase of carbon credits, formulating a carbon price helping to drive future investment into internal emission reductions The determination of the levels at which PSP awards for executive directors vest include a climate metric. The metric which is subject to annual review, focuses on the development and delivery of the process to manage the Group's operational emissions and the financed emissions attributable to asset portfolios 	<p>(c) Risk management</p> <ul style="list-style-type: none"> Quantifying our climate exposure <p>(d) Metrics and targets</p> <p>(b) Strategy</p> <ul style="list-style-type: none"> Use of scenario analysis
b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks	<ul style="list-style-type: none"> Scope 3 financed emissions which make up a significant majority of the emissions across the Group's value chain, have been disclosed for the mortgage portfolio and areas of the Commercial Lending division The Group reports the emissions associated with its operational footprint (Scope 1,2 and 3 emissions) 	<p>(e) Financed emissions</p> <ul style="list-style-type: none"> Scope 3 financed emissions balance sheet <p>(f) Operational impact</p> <ul style="list-style-type: none"> 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	<ul style="list-style-type: none"> The Group has become a member of B4NZ and has committed to net zero by 2050 In March 2021 the Company issued a £150 million Green Tier-2 Bond which throughout the year was fully allocated with EPC A / B buy-to-let loans The Group has committed to achieve net zero across its operational footprint by 2030 The Group continues to work towards establishing a full financed emissions balance sheet and interim ambitions for financed emissions reduction 	<p>(b) Strategy</p> <ul style="list-style-type: none"> Climate-related opportunities <p>(f) Operational impact</p> <ul style="list-style-type: none"> Performance indicators <p>(g) Future developments</p>

(a) Governance

Board oversight

Climate change risk is a principal risk within the ERMF, therefore, information and metrics on climate change risk 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 arising from climate change and to oversee these risks within the Group’s overall business strategy and risk appetite. Performance against this objective is assessed annually and impacts the bonus or incentive they receive (see Section B7).

Regular engagement by the Board and enhanced governance act as key channels for the consideration of climate change within the setting of performance objectives and their monitoring. The Board is updated on a regular basis through the CEO’s monthly report, which provides oversight of sustainability and climate-related matters and how they impact strategy. The focus continues to be on improving the directors’ 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:

- The Board was updated on the Group’s climate change commitments across the operational footprint and financed emissions. The briefing covered short-term deliverables and ambitions, along with relevant updates on other climate-related risks and opportunities. The session highlighted the implications of net zero on business strategy, stressing the importance of the dependency the commitments have on wider industry and government action.
- As part of the 2023 ICAAP, a climate change scenario analysis module was presented to the Board for approval. Focused training was delivered on the outcomes of the business-wide climate risk review, the impact of the originally proposed MEES in the private rented sector, and the key challenges of net zero alignment across the mortgage portfolio.

Sustainability Committee and climate change working groups

The Sustainability Committee, chaired by the External Relations Director, 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. 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 data on concentrations of monthly advances, pre and post offer pipeline cases 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.

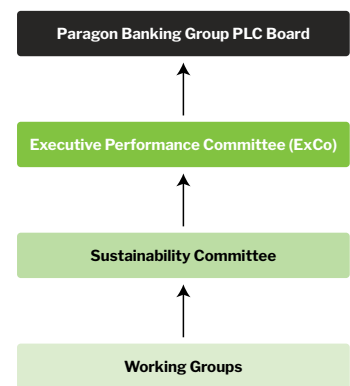
During the year, with the support of the climate change working groups and the Sustainability Committee, the Group has:

- Developed an initial view of the Group’s financed emissions balance sheet
- Reviewed the Group’s climate change maturity against supervisory expectations
- Delivered a climate change scenario analysis exercise included in the 2023 ICAAP
- Reported on the operational footprint on a quarterly basis to track reductions versus the 2019 baseline
- Provided insight into UK Finance, B4NZ, the Climate Financial Risk Forum (‘CFRF’) Scenario Analysis industry Working Group (‘SAWG’) and various Partnership for Carbon Accounting Financials (‘PCAF’) working groups to leverage experience and develop the Group’s understanding whilst also providing a voice on future policy and processes

Climate and sustainability governance structure

Throughout the year, climate change continued to be further embedded within the Group’s governance structure and culture. The governance structure outlines how climate and sustainability related matters are escalated throughout the Group and upwards to the Board.

The approach to managing climate change risk is incorporated within the ERMF to ensure a consistent and comprehensive approach is taken across the business. 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.



Improved governance and increased climate-related reporting into the Sustainability Committee and executive risk sub-committees provide the Group with a robust process for identifying and managing climate-related risks and opportunities.

During the year, a sustainability training module was undertaken by all employees to enhance their awareness of climate change and sustainability issues across the Group.

(b) Strategy

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 it recognises the scale of the challenge ahead and understands that without support from industry and policy makers any business is unlikely to achieve net zero by its own efforts alone.

The Group's decarbonisation approach focuses on reducing the emissions associated with its operational footprint, and reducing financed emissions through customer engagement and education, and by lending on sustainable products. The Group also actively engages in public policy advocacy through industry initiatives and collaborations including B4NZ and the Mission Zero Network to promote the development of the policy and regulatory framework necessary to support a just and fair transition to net zero.

Overall, the Group's strategic objectives are not expected to change significantly due to the impacts of climate change. Its products, customers and the types of assets funded will need to evolve over time as the UK economy transitions to net zero – this is core and aligned with the Group's purpose of supporting the ambitions of the people and the businesses of the UK by delivering specialist financial services. There continue to be some areas where technological advancements are required, for instance to facilitate the replacement of fossil fuels through electrification or the use of alternative low-carbon fuels. It is expected that these technologies and their supporting infrastructure will become available in the future, aligned with the UK economy's planned transition to net zero by 2050.

Climate-related opportunities

Climate change related business opportunities continue to be addressed 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 2023, and shows the full targeted allocation had been reached.

Sustainable finance is a vital mechanism to drive the transition to a low-carbon economy, and the Group continues to develop products which its customers need to support them on their individual sustainability journeys. To incentivise the purchase of more energy-efficient properties, the Group currently offers a discounted rate for landlords securing their mortgage on properties with an EPC rating of C or better. Since the launch of these products, new inflows of mortgages with EPC ratings of C and better have exceeded concentrations in the extant portfolio.

In its development finance business the Group offers reduced exit fees for customers who construct highly energy-efficient properties with the majority of units in a development needing to achieve an EPC rating of A to receive the discount.

The Group also aims to enable the transition and identify further opportunities, through education and engagement with customers, brokers, stakeholders and other industry initiatives.

In particular, the Group has posted educational articles and blogs covering the development of new EPC requirements for the PRS as they emerge, outlining who they are likely to affect and how they are expected to be enforced.

The challenge of decarbonising UK residential real estate and the related risks are shared by all property-based lenders and their customers and will continue out to 2050. The Group will continue to support the transition, leveraging its strong balance sheet and robust credit standards.

Use of scenario analysis

During the year a climate change scenario analysis exercise was undertaken as part of the 2023 ICAAP. The analysis built on previous risk driver assessments, which had identified the areas most significant to the Group. The Group prioritised the mortgage portfolio for its quantitative climate change risk assessment due to the relative size of the portfolio, the potential impact of climate change risk and the availability of climate related data. The approach leveraged the Bank of England's Climate Biennial Exploratory Scenario ('CBES') and Network for Greening the Financial System ('NGFS') to provide a comparable and consistent outcome. Details of the forecasting approaches are outlined below.

Scenario	Outcome
Transition risk	
<p>The NGFS divergent 1.5° net zero scenario was used to forecast key macroeconomic variables under the influence of climate change.</p> <p>In addition, the impact of achieving compliance with the originally proposed MEES in the PRS was considered across the mortgage portfolio.</p> <p>These two stress drivers were combined to assess the outcome on credit and capital across the mortgage portfolio.</p>	<p>The outcomes of this analysis suggest that, due to the extended time horizons over which climate risks may materialise, the ongoing uncertainty in Government policy and the minor overall increase to expected credit losses in the scenario, there is currently no significant and quantifiable link to asset values or impairments attributable to the climate-related factors considered.</p>
Physical risk	
<p>The flood risk across the mortgage portfolio was projected to 2050 and 2080 in line with the CBES scenarios. The flood risk projections considered Representative Concentration Pathways ('RCP') of varying severity with RCP 8.5 considered in the 'no additional action scenario' and RCP 2.6 and 4.5 considered in the 'early action' and 'late action' scenarios respectively.</p> <p>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.</p>	<p>Across the scenarios considered, the analysis indicated a small overall impact over the short and medium term and, considering both the lack of historic losses and the controls currently in place, the impact of flood risk on mortgage values is not considered to be significant.</p>
Net zero scenario analysis	
<p>Analysis was performed considering the emissions across the entirety of the Group's value chain.</p> <p>Although the assessment considered all the Group's emissions, the scenario analysis focused on the decarbonisation of the mortgage portfolio, its most significant asset class, aligned with a well below 2°C scenario.</p> <p>The analysis considered the implication of a 2030 interim decarbonisation target, and the key contributors to achieving the required emissions reductions.</p>	<p>The analysis identified retrofitting, electrification of heat, and low-emission electricity as key influences.</p> <p>The analysis indicated a key dependency of portfolio decarbonisation on appropriate government policy and strategy to drive consumer demand for decarbonisation and retrofit investment.</p>

In addition, a qualitative review of the Group's climate change risk and opportunities by business area was performed to enable a broader view of how such risks are mitigated and how opportunities are captured where material. The review was facilitated by the Sustainability Committee's Financed Emissions and Opportunities Working Group and received groupwide input. The risk review did not identify any significant impacts on cash flows, finance or the cost of capital.

Climate change scenario analysis has improved the Group's understanding of its key climate change risk drivers, the potential impact they could have, and the mitigating options available. The approach to climate change scenario analysis will continue to mature as the Group integrates its learnings from the SAWG.

The results of both the qualitative and the quantitative assessments identified no significant gaps or vulnerabilities related to climate change across the Group, and confirmed that current processes are fit for purpose. The outcomes were presented to, and approved by, the Board.

(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 most significant to the Group's business and strategy, and the timeframes over which they might impact. The Group prioritises risk by expected impact and likelihood of the risk materialising.

Source	Risk driver examples	Most relevant lending area	Most relevant principal risks	Timeframe	Expected impact
Transition risk					
Current and emerging regulation	Continued tightening of energy efficiency regulations in the private rented sector and buildings regulations in the UK	Mortgages	Credit and operational	Short, medium and long term	Medium Although controls are in place to reduce the risk of impacts from current and future regulation, the potential fast pace of change of policy and regulation in this area could increase the impact
Technology	Transition to low carbon technologies which could impact asset values and infrastructure requirements This also includes the risk that such new low-carbon technologies may prove ineffective	SME lending and motor finance	Credit	Short and medium term	Low The Group takes a prudent approach to new and developing technology and has robust controls and reporting to limit its exposure to obsolescent technologies
Reputation	Increased stakeholder, shareholder and regulatory scrutiny if there is perceived to be a lack of action to mitigate climate change	Mortgages	Reputational	Short and medium term	Low The Group has a very low exposure to climate sensitive sectors

Source	Risk driver examples	Most relevant lending area	Most relevant principal risks	Timeframe	Expected impact
Physical risk					
Acute	Damage to property, business disruption and higher insurance costs from climate-driven events such as flooding	Mortgages and development finance	Credit and operational	Short, medium and long term	Low The Group and its lending portfolio have low exposure to physical risk and there are numerous controls and procedures in place to reduce the impact of this risk
Chronic	Alterations in weather patterns affecting subsidence and ground stability which may damage mortgaged property assets	Mortgages and development finance	Credit	Long term	Very low The Group has numerous controls in place, and the longer impact duration offers sufficient time to adapt to changes in risk profiles

Assessment at underwriting

One of the key processes for managing climate-related risk is through assessments made at a loan's underwriting stage. This acts as a key mitigant to the environmental and climate risk factors most likely to have an impact on the Group's business or customers.

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. 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.

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.

In the Group's development finance business the initial due diligence considers flood risk, ground instability, local ecology and current and future regulations. In addition each project has an independent monitoring surveyor assigned throughout the life of the build, part of whose task is to monitor these risks as they emerge, and assess how they are being considered and mitigated by the customer, where material.

Quantifying climate exposure

EPC ratings assess the energy efficiency of a property and are a key measure of transition risk across the mortgage portfolio. The Credit Committee and the Credit Risk function have an ongoing programme to analyse the potential for any linkage between EPC and loan performance. To date, neither this programme, nor the scenario analysis performed in 2023 have identified any requirement to adjust current processes or lending criteria. The Group's EPC data capture process continues to be enhanced to improve its understanding of current exposure, but also for use in longer-term climate scenario analysis.

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.

Current UK Government policy requires properties in the PRS to have EPC ratings of E or better. Although the timings and impacts of future public policy initiatives and changes in market preferences on energy efficiency remain highly uncertain, the tightening of standards and increased demand for more energy-efficient properties are both expected in the short to medium term. This is expected to evolve continuously throughout the UK's pathway to net zero by 2050.

The Group conducted research with over 1,200 landlords which found that the vast majority (91%) of landlords were aware of the potential impact of the EPC regulations on their businesses, and most (70%) have plans to address them. The results also indicated that one in four landlords surveyed had already made, or were in the process of making, such improvements.

The research found that the original government-proposed MEES may have resulted in a level of divestment, albeit a low degree. Less than one in ten landlords in the sample reported that they had sold properties that would be too expensive to upgrade to meet the proposed new standards.

(d) Metrics and targets

Mortgage Lending

The Group's Mortgage Lending division is focused on first charge buy-to-let mortgages, and also includes legacy owner-occupied first and second charge mortgage books, where no new lending takes place. Climate analysis to date has been targeted on the buy-to-let portfolio.

The tables below summarise the principal metrics for the Group's exposure on first charge buy-to-let mortgages in England and Wales. The data covers 94.6% of accounts with properties in England or Wales (2022: 92.8%), which represent 97.4% of the total portfolio (2022: 97.6%). Work is ongoing to source comparable data for the Group's Scottish and Northern Irish exposures.

Indicator	Measure	2023	2022
EPC	Grading A or B	8.3%	8.2%
	Grading C	33.2%	31.1%
	Grading A to C	41.5%	39.3%
	Grading D or E	57.7%	59.6%
	Grading F or G	0.8%	1.1%

The Group's flood risk assessment is based on location-specific data which covers the whole of the UK. This assessment includes flood risk from rivers, surface water and coastal flooding. Data has been obtained for 94.0% of properties on the mortgage book (2022: 93.4%), summarised below as at the year end.

Indicator	Measure	2023	2022
Flood risk	Very high risk	0.1%	0.1%
	High risk	2.9%	2.9%
	High or very high risk	3.0%	3.0%

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 with 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 8.7% in the year to £904.6 million (2022: £832.2 million). The distribution of EPC grades amongst the 99.9% of new buy-to-let mortgages in England and Wales advanced during the year where an EPC was available (2022: 99.6%) is set out below.

Indicator	Measure	2023	2022
EPC	Grading A to B	10.1%	9.2%
	Grading C	39.5%	36.0%
	Grading A to C	49.6%	45.2%
	Grading D or E	50.3%	54.6%
	Grading A to E	99.9%	99.8%
	Grading F or G	0.1%	0.2%

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 continue to be accelerated by the green mortgage range. However, banks focussing their lending on EPC A-C rated properties will not, of itself, deliver the desired changes in the UK housing stock, which currently has an average EPC rating of D.

Commercial Lending

The Group's Commercial Lending division comprises SME lending, development finance, motor finance and structured lending operations. Within the division the initial focus of climate analysis has been on the SME lending business.

Recognising that the term carbon-related assets is broad, the Group has assessed the exposure to carbon-related assets across its SME lending business, which has the most heterogeneous exposure type. Limited company customers have been broadly analysed by SIC codes to identify those operating in sectors potentially exposed to increased climate risk. These sectors were identified as part of the climate risk assessment and discussed with industry experts across the Group. Although the sectors are identified as having heightened climate-related risks, the Group's regular review of industry performance and its credit control and other processes leave a low overall residual risk.

The results, which cover the entire SME lending portfolio, are set out below:

Indicator	Sector	Relative climate risk exposure	Residual risk after controls	2023	2022
Sector	Construction		Low	16.7%	15.9%
	Transportation and storage	Moderately High	Low	13.9%	14.9%
	Mining and quarrying		Low	1.5%	1.8%
	Administrative and support service activities		Low	21.2%	20.5%
	Agriculture, forestry and fishing		Low	2.3%	2.3%
	Water supply, sewerage, waste management and remediation activities	Medium	Low	3.7%	4.1%
	Manufacturing		Low	8.7%	8.0%
	Real estate activities		Low	0.8%	0.7%
	Electricity, gas, steam and air conditioning supply		Low	0.1%	0.1%
	Total increased climate risk exposure				68.9%

The administrative and support service sector is not typically considered to be one with an increased level of climate risk, however the sector includes activities such as plant hire, and the customers and assets funded by the Group in this sector are closely aligned with the other sectors above that are identified as having increased climate change risk.

Measures addressing other climate risk elements within the SME lending business, such as the environmental impacts of business assets financed, and those elsewhere in the Commercial Lending division, including those in its other business streams, such as the classification of the environmental impacts of motor vehicles financed and classification of development finance projects by environmental rating, are under development and continue to evolve.

(e) Financed emissions

The Group's financed emissions, which are considered as Scope 3 emissions, are those generated by its customers which are facilitated by the financing it provides. 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, which make up the significant majority of emissions across its value chain.

The Group's strategy will continue to evolve, delivering initiatives and products to drive emission reductions across each of its business areas. There continues to be an external dependency on emissions reductions driven by policy, customer behaviour, and infrastructure and technology developments across the sectors in which the Group operates.

Absolute financed emissions have been calculated in accordance with the PCAF standard. Under this approach a lender is considered to be responsible for a proportion of emissions relating to assets which they finance based on an 'attribution factor'. The financed emissions reported are based on the customers' scope 1 and 2 emissions and do not cover any connected scope 3 (value chain) emissions.

Emissions intensities are calculated in accordance with the PCAF standard to provide comparable data. However, this comparability will be compromised by differences in method, data quality and assumptions used by each firm in its financed emissions calculations.

Physical emission intensity is a measure normalised by physical output, based on customer output or asset use. Therefore the normalisation factor will change depending on the asset or finance provided. Economic emission intensities refer to absolute emissions per pound of lending or investment.

Scope 3 Financed emissions balance sheet

The financed emissions balance sheet covers 89% of assets covered by the PCAF standard by exposure (2022: 85%). The Group's ambition is to increase this coverage level over time. The prioritisation for increasing data coverage is based on the size of the Group's exposure to a particular lending stream, expected level of emissions, the availability and accuracy of emissions data and the ability to report meaningful year-on-year data.

PCAF Scope 3 financed emissions balance sheet

Business area	Asset type	Balance	Balance with emissions data	Data coverage	Absolute financed emissions	Economic emission intensity	Physical emissions intensity	Physical activity factor	Indicative PCAF data quality score
		£m			kilotonnes CO ₂ e	tonnes CO ₂ e per £ million balance	kgCO ₂ e per physical activity factor		
30 September 2023									
Mortgages ¹		12,902.3	12,902.3	100%	257.9	19.9	46.4	/m ²	3.1
Motor finance ²	Passenger vehicles and LCVs	206.1	193.2	94%	13.2	69.1	0.3	/mile	2.6
	Leisure vehicles	91.6	Excluded						
SME lending ⁴	Motor vehicles ³	106.4	106.4	100%	37.8	356.3	0.3	/mile	2.8
	Other assets	651.1	Under development ⁵						
Development finance		747.8	Under development ⁶						
Structured lending		169.0	Under development ⁷						
Other assets		3,545.9	Not in scope of financed emissions balance sheet ⁸						
Total		18,420.2							
30 September 2022 (restated¹⁰)									
Buy-to-let mortgages ¹⁰		12,086.0	12,086.0	100%	247.8	20.6	47.5	/m ²	3.1
Other mortgage lending		242.7	Under development						
Motor finance		261.3	Under development						
SME lending		721.7	Under development						
Development finance		719.9	Under development						
Structured lending		178.7	Under development						
Other assets ⁸		2,443.3	Not in scope of financed emissions balance sheet						
Total		16,653.6							

Notes on calculation methods

1. Emissions related to mortgage assets are calculated using EPC data. The annual emissions relating to the financed property are attributed to the mortgage provider on a loan-to-value basis. The attribution factor uses outstanding loan value and original valuation to calculate the (unindexed) loan-to-value factor – this is aligned with the PCAF guidelines.

The data contained in the EPC has not been altered or updated. The calculation of physical emissions intensity used the sum of attributed floor area using loan-to-value ratios. Where EPC data is not available, emission intensity is estimated based on property type and age. Where no information is available a UK average is applied from the EPC database.

Mortgage lending includes first charge buy-to-let and owner-occupied mortgages and second charge mortgage loans.

2. Motor finance data currently excludes leisure vehicles (motor homes and caravans). Electric vehicles are assumed to have an emissions rate based on the DEFRA conversion factors. Attribution is based on outstanding loan value divided by vehicle value at point of origination.
3. For asset-backed lending in the SME lending and motor finance divisions vehicles with matched number plates have been identified. The number plates provide accurate emissions data when combined with estimated annual mileage. Attribution is based on the outstanding loan value divided by vehicle value at point of origination.
4. SME lending includes asset finance, aircraft mortgages, invoice finance, professions finance, RLS, CBILS and BBLS.
5. Metrics for other loan and asset types in the SME lending portfolio remain under development due to the complexity in calculating emissions across the wide range of assets financed and the industries in which customers operate. High level estimates are available for exposures relating to heavy good vehicles and plant, but these rely heavily on assumptions and are subject to change.
6. Financed emissions for the development finance business may be estimated using sector or industry proxies, but these rely on a significant number of assumptions reducing the accuracy and usefulness of the outputs. Metrics for development finance remain under development until improved industry data for more accurate and comparable reporting becomes available.
7. Structured lending remains an area for development.
8. Out of scope assets include cash, derivative financial assets, intangible assets, pension surplus and other receivables. Items disclosed as property, plant and equipment are also out of scope for this purpose. These include operational assets, where the emissions are considered under scopes 1, 2 or 3 in the operational footprint outlined in '(f) operational impacts'; and assets leased under operating leases, where the approach for the attributable downstream scope 3 emissions is still under development.
9. Physical activity factor data is based on customer and loan data where available. Where unavailable an industry average is applied.
10. The 2022 financed emissions disclosure covered buy-to-let mortgage emissions only. The 2022 figures have been restated to use the extrapolation method adopted for the 2023 disclosure for a more meaningful comparison. This covers 100% of buy-to-let mortgage loans.

(f) Operational impact

The Group is mainly engaged in mortgage 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 office and resource use, procurement in offices and business travel.

The Group's operations are not considered to be significantly exposed to the financial risks of climate change materialising from either transitional or physical risks.

Policy

The Group complies with all applicable laws and regulations relating to the environment and includes these within its legal compliance framework.

Groupwide recycling and awareness campaigns are run with employees to reduce various forms of waste such as food, consumables and energy.

Risk management

The Group Property function, which reports ultimately to the Chief Operating Officer, manages the environmental risks inherent in the Group's operations. The Group's second line Operational Risk team and the Operational Risk Committee monitor compliance within the Group's wider risk management framework.

Group Property are responsible for the oversight of all premises occupied by the Group and compile information on energy use and waste production. All locations, whether directly owned or tenanted, have their energy data and emissions actively tracked. This is reported at the Sustainability Committee and Performance ExCo and escalated upwards to the Board.

SFS operates from a number of workshops around the UK and has exposure to several different waste streams (oils, vehicle parts etc) generated in the normal course of its vehicle maintenance 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'), which is a UK Government initiative that requires companies to identify and report on their energy consumption. The Group last submitted its ESOS compliance notification to the Environment Agency in December 2019. The next submission is due in June 2024.

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 are therefore 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 indirect.

During the year a sustainability survey was carried out to better understand the sustainability maturity of suppliers to the Group Property function. The results are being processed internally with the same survey due to be sent out to a wider supplier base. During the year, the Group upgraded its procurement systems to improve the onboarding and oversight process for suppliers. This enhanced infrastructure also enabled a greater understanding of the maturity of ESG and climate change approaches across the Group's supplier base, through ESG scoring.

All pre-printed stationery items used by the Group are from renewable sources certified by FSC.

92.1% (2022: 86.4%) of the Group's purchased electricity in the year was obtained from sources certified as renewable by the Office of Gas and Electricity Markets ('OFGEM').

Environmental initiatives

The Group's environmental initiatives in the period include:

- Carrying out a decarbonisation assessment of the head office to identify additional initiatives for achieving greenhouse gas emission reductions
- Updating the Building Management System ('BMS') at the head office building to provide improved temperature control, which included installing occupancy sensors to power down any heating / cooling systems when areas are unoccupied
- Completing a project to install 1,550 units of energy-efficient intelligently-controlled lighting throughout the head office site in March 2023, with all waste generated by the project being segregated and disposed of responsibly through an approved third-party contractor
- Reassessing the EPC rating of the head office, resulting in an upgrade to EPC grade C from D
- Installing additional electric vehicle charging points at the Group's locations in Solihull, bringing the total to 16 across the two sites
- Implementing a Sustainability Management System to the best practices of the ISO14001:2015 and ISO50001:2018 standards

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 of £466.0 million (2022: £388.4 million excluding gains on sale).

Data for 2019 is presented as, during 2022, this year was designated as the operational footprint baseline against which the Group will measure its progress on carbon reduction.

During the current year data collection procedures related to emissions reporting have been enhanced. This included a review of the methodology and approach used to report the historical emissions. As a result of the updated procedures and the increased data quality, the 2019 baseline has been restated to be better aligned with future reporting and coverage of the operational footprint.

Operational footprint greenhouse gas ('GHG') emissions

	2023	2022	2019
	Tonnes CO ₂ e	Tonnes CO ₂ e	Baseline (restated) Tonnes CO ₂ e
Scope 1 (Direct emissions)			
Combustion of fuel:			
Operation of gas heating boilers	504	507	520
Petrol and diesel used by company cars	450	401	465
Operation of facilities:			
Air conditioning systems	22	33	24
	976	941	1,009
Scope 2 (Energy indirect emissions)			
Directly purchased electricity (Location-based)	524	540	995
Directly purchased electricity (Market-based)	62	81	990
Total scopes 1 and 2 (Location-based)	1,500	1,481	2,004
Total scopes 1 and 2 (Market-based)	1,038	1,022	1,999
Normalised tonnes - Scope 1 and 2 CO ₂ e per £m income (Location-based)	3.2	3.8	6.6
Normalised tonnes - Scope 1 and 2 CO ₂ e per £m income (Market-based)	2.2	2.6	6.7
Scope 3 (Other indirect emissions)			
Fuel and energy related activities not included in scope 1 or 2	433	441	520
Water consumption	4	4	14
Waste generated in operations	50	136	88
Total scope 3	487	581	622
Total scopes 1, 2 and 3 (Location-based)	1,987	2,062	2,626
Total scopes 1, 2 and 3 (Market-based)	1,525	1,603	2,621
Normalised tonnes Scope 1,2 and 3 CO ₂ e per £m income (Location-based)	4.3	5.3	8.8
Normalised tonnes Scope 1,2 and 3 CO ₂ e per £m income (Market-based)	3.3	4.1	8.8

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. All these emissions relate to activities in the UK and its offshore area.

CO₂ equivalent ('CO₂e') values above, other than for market-based Scope 2 elements, are calculated using the conversion factors published by the Department for Energy Security and Net Zero and DEFRA on 28 June 2023. 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.

The majority of emissions included above relate to the provision of heat, light and power to the Group's premises. The reduction across Scope 2 market-based emissions is driven by the increase in the amount of electricity purchased from renewable sources which meets the GHG protocol Scope 2 quality criteria. 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 reduction in emissions from the 2019 baseline continues to be principally driven by the shift to hybrid working. There has been a slight decrease in location-based emissions compared to 2022 due to decreased emissions attributable to electricity consumption and waste generated on sites. Emissions attributable to employees working from home are not, at present, included within the scope of the regulations.

GHG emissions reduction target

The Group's target is to achieve net zero across its operational footprint by 2030.

- Operational footprint is defined as 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 market-based 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 with any residual emissions being neutralised by removal offsets.

The Group aims to deliver its net zero operational footprint commitment through the decarbonisation of heating across its office sites, the electrification of business travel, switching to low-carbon green electricity where possible and the reduction and recycling of waste across the sites it operates.

Carbon offsetting

The Group has offset the emissions attributable to its operational footprint in the year ended 30 September 2023, set out in the table above. Emissions for the preceding year ended 30 September 2022 were offset following the end of that year. Offsetting has been achieved through the purchase of carbon credits certified under the Gold and VCS Standard programmes, two of the most widely accepted international certification systems.

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.

Assurance

The emissions data set out in the table above has been independently verified. The limited verification procedures provide a higher level of assurance that the emissions produced have been 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.

The EcoAct 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.

Compliance with environmental laws and regulations

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 2023 is shown below.

	2023	2022	2019 Baseline (restated)
	MWh	MWh	MWh
Renewable electricity	2,330.0	2,409.3	3,123.5
Other electricity	200.7	380.7	768.1
Electricity	2,530.7	2,790.0	3,891.6
Natural gas	2,754.9	2,780.2	2,817.1
Motor fuel	2,118.9	1,877.7	2,303.7
	7,404.5	7,447.9	9,012.4
Normalised MWh per £m income	15.9	19.2	30.3

Consumption levels have seen a small decrease from 2022 linked to reduced electricity consumption following the delivery of energy saving measures at the Group's principal site. Travel has increased across the Group, with higher mileage across the company car fleet. Consumption 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 2023 was 10,002m³ (2022: 10,202m³), based on consumption recorded on purchase invoices, a normalised amount of 21.5m³ per £m income (2022: 26.3m³ per £m income). Water usage has remained at the level which resulted from previously delivered water efficiency measures, with office occupancy levels under the hybrid working approach largely similar year-on-year.

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.

In June 2023 the Group partnered with Reconomy, a waste solution provider, to further segregate waste streams and maximise recycling opportunities. The collection of better-quality data on waste generation also means that internal recycling campaigns can be better targeted. 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 2023 together with the methods of disposal are shown below.

	2023	2022	2019
	Tonnes	Tonnes	Baseline Tonnes
Recycled	44	123	122
Waste-to-Energy Initiatives	37	21	-
Landfill	95	287	187
	176	431	309
Normalised tonnes per £m income	0.38	1.11	0.75

Waste generation data is based upon volumes reported on disposal invoices.

The decrease in waste during the period was driven by enhanced data collection across the SFS division and a reduction in the number of office moves compared to the last period. This significantly reduced the waste going to landfill and being recycled. The increase in waste going through Waste-to-Energy Initiatives was due to our new waste contractor across our principal sites which now provides better data covering a wider range of waste streams.

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

The Group's Company Car Policy supports the Group's efforts to decarbonise. It targets the elimination of diesel and petrol only vehicles from the fleet by 31 December 2025 and to meet this objective the following steps have been agreed:

- No diesel or petrol vehicles have been ordered since January 2022
- CO₂ 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 its first phase of electric vehicle charging points at its Solihull Head Office. During the year further charging points were installed at both Solihull sites. In addition, the Group's Southampton site was equipped with charging points before the Group occupied the premises. The aim is to reduce emissions from commuting and business travel by employees.

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 runs a cycle-to-work scheme year-round, supporting the purchase of new cycles by employees.

(g) Future developments

The Group's climate change programme going forward also includes:

- Continued development of climate change scenario analysis, leveraging off industry good practice to determine the resilience of the Group's strategy under different climate-related scenarios
- Expanding the range of sustainable products available to customers
- Educating and engaging with customers on key climate-related issues and opportunities relevant to each of the Group's business lines
- Continuing to work towards reducing the Group's operational footprint to net zero by 2030
- Further engaging and promoting positive sustainable public policy across industry and government, through membership of B4NZ and Mission Zero Coalition

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 and where the data is sufficiently mature to reliably inform decision making. Although industry-wide emissions data continues to improve, the timelines for delivering decision-useful emissions data remain uncertain.

The table below outlines the key emissions from all scopes across the Group's value chain and their current reporting status. The current focus remains on the Group's operational footprint, where it is able to have a more direct influence on outcomes, and financed emissions, which are the most significant emissions across the Group's value chain. It is intended that as the Group's understanding broadens, more action will be taken to reduce emissions across all areas of the value chain.

Scope	Emissions source	Significance of emissions	Approach	Commitments
Scope 1	Operating gas heating boilers	Very Low	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	Very Low	Included within '(f) Operational impact'	Offset from 2022 Commitment to net zero by 2030
Scope 3	Fuel and energy related activities not in Scope 1 or 2	Very Low	Included within '(f) Operational impact'	Offset from 2022 Commitment to net zero by 2030
	Waste generated in operations			
	Water consumption			
Scope 3	Working from home emissions	Very Low	Under development	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	Very Low	Not yet started	
Scope 3	Supply chain emissions	Low	Under development	
Scope 3	Financed emissions – Mortgages	High	Reported in '(e) Financed emissions'	
Scope 3	Financed emissions – Commercial Lending	Very High	Under development but partially reported in '(e) Financed emissions'	
Scope 3	Operating leases (as lessor)	Low	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. It also supports the provision of housing in the UK through buy-to-let lending to the PRS.

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.

It also actively engages with external bodies, particularly those focussed on climate change and diversity to ensure best practice within the organisation. Details of some of these initiatives are given in the people and environmental impact sections of this report (Sections A6.3 and A6.4).

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 HM Treasury's Home Finance Forum and the Managing Director – Mortgages is a member of the Bank of England Residential Property Forum, both of which provide input to policy at the highest levels. The Group's senior management have also given evidence to UK parliamentary committees several times during the year.

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, and it was particularly pleasing that John Phillipou, the Managing Director of the Group's SME lending operation, was appointed as Chair of the FLA in October 2023.

The Mortgage Lending business continues to work with a number of industry and government initiatives on climate change in the property sector. This has included work 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 is a member of the Bankers for Net Zero initiative, which continues 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 has also been active in industry diversity initiatives. Richard Rowntree, Managing Director – Mortgages was recognised by the City of London for his work in promoting socio-economic diversity in the financial services industry and the Group is represented in Women in Property, sponsoring the Inspiring Women in Property awards.

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. A designated member of ExCo, Deborah Bateman, the External Relations Director and Chair of the Sustainability Committee, oversees 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 across these initiatives totalled £56,000 (2022: £50,100).

Charities which benefitted from the Group's donations included local schools, sports clubs, hospitals and hospices, Thrombosis UK, Papyrus (Prevention of Young Suicide), Alzheimer's Society, Wellchild, Food Life-Line, Solihull Conservation Volunteers and many others. During Pride month the Group encouraged fundraising for LGBTQ+ affiliated charities with one of the beneficiaries being Birmingham LGBT.

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. For each financial 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 ended 30 September 2023 £45,000 was raised for Newlife, a charity which supports children who have cancer, birth defects, diseases and infections, and their parents. The employees' chosen charity for the year ending 30 September 2024 is Molly Ollys, which supports children with life-threatening illnesses and their families, helping with their emotional wellbeing. The new year of fundraising has already begun and more events are being planned across the Group's locations.

Community volunteering

Employees are offered one paid volunteering day each year to support volunteering projects as part of our sustainability strategy. As a specialist lender, the Group is conscious of the potential impact it may have on society and the environment. Therefore, community volunteering opportunities have focussed on poverty, education and sustainability. These have included initiatives building on long-standing relationships with charities and schools.

Engagement in the Group's volunteering programme across all of the Group's locations has increased throughout the year, with the number of volunteer days completed in the financial year totalling 469 (2022: 286), bringing the total number of volunteering hours since October 2022, to over 3,517.

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 18 employees volunteered their services to help prepare food at the drop-in centre and lend a friendly ear to their clients.

St Basils are a charity who work with young people aged 16 to 25 who are homeless or at risk of homelessness, helping almost 4,000 young people per year across the West Midlands region. The Group has maintained a strong relationship with the charity, leading to 18 individuals working on gardening projects to help improve the environment of its premises.

Bedworth Community Grocery Store support local people to help them keep their families fed. People can sign up to be members where they can purchase food at a fraction of the cost from a supermarket. 13 of the Group's people volunteered by stocking the shelves, working on the tills, and sharing experiences with customers.

For Christmas 2022, employees again donated food and luxury items to Christians Against Poverty, in what has become a festive tradition. 114 bags of items were collected for inclusion in hampers for families in need across the West Midlands.

Other local projects supported include the Walsall Black Sisters Collective, St. Joseph's Care Home in Harborne, and Blue Cross.

Education

Working with schools. In total 54 employees supported careers fairs and work experience events, including interview skills preparation, at schools in the Birmingham and Solihull area. The Group worked with schools and colleges local to its Solihull head office, including Arden School, Tudor Grange, Alderbrook School and Solihull College, whilst supporting schools across Birmingham, including Aston Manor Academy, Colmers School and Park Hall Academy.

Support has also been provided to help improve the outdoor wildlife areas for Heronswood Primary school and Hollywood Primary School.

Enhancing employability. The Group has continued its 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 three 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.

Sustainability

The Canal and River Trust care for a 2,000 mile long, 200-year-old network of canals, rivers and reservoirs. Their vision is to have living waterways that transform places, enrich lives and bring wellbeing opportunities to millions. Three project teams completed clear-up projects on sections of the waterways.

Thames21 works with communities in the London area to improve rivers and canals for people and wildlife. They mobilise volunteers every year to clean the capital's 400-mile network of waterways. 20 of the Group's London-based people completed a clear-up project at Pool Linear Park, Lewisham, during the year.

Newlife undertake de-labelling activities to recycle clothing, allowing them to sell items in their stores. Clothing recycling prevents items from going to landfill where it contributes to pollution. On three occasions, Newlife visited the Group's Solihull and Southampton offices to set-up a temporary de-labelling operation. In addition, 38 employees volunteered in the Newlife warehouse in Cannock.

Employees also supported a number of litter-picking projects around the country, including a team from Southampton who took part in a beach clean organised by Surfers Against Sewage in Portsmouth.

There were also multiple gardening and general cleaning projects, supporting Solihull MIND, Solihull Synagogue and Spencer's Retreat.

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 'reports, results 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 directly 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.

	2023	2023	2022	2022
	£m	£m	£m	£m
Taxes borne directly				
<i>UK Taxation</i>				
Corporation tax	75.1		56.5	
Employers' payroll taxes	11.6		11.6	
Irrecoverable VAT and other indirect taxes	7.4		8.2	
Stamp duty	0.6		0.3	
Total UK national taxation		94.7		76.6
<i>Local taxation</i>				
Business rates		1.4		1.4
		96.1		78.0
Taxes collected				
Employees' payroll taxes	28.7		23.8	
VAT	0.3		0.7	
		29.0		24.5
		125.1		102.5

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. These principles are embedded in its culture and reflected in its Code of Conduct.

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 (2022: 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.

A commitment to the fair treatment of all suppliers is central to the Group's approach. 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, which was revised during the year. The code is available on its website (www.paragonbankinggroup.co.uk), and sets out the Group's 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 at the beginning of the financial year, supervised by the Sustainability Committee. The results of the survey were generally positive and were reported upwards to ExCo level. The Group is continuing to invest in tools to assist in enhanced and efficient due diligence of suppliers as appropriate, and the findings of the survey were fed into the development of the Group's supplier management process.

The supplier survey will be repeated going forward in order to monitor the effectiveness of these arrangements. Towards the end of the year a further survey was issued, focussing on sustainability issues and the Group's most significant suppliers.

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.

The only significant outsourcing arrangements used by the Group relate to:

- the administration of its savings operations by the outsourcing arm of a major UK building society
- third-party ('cloud-based') hosting of IT systems by a leading supplier
- provision of the hosted administration platform for the Group's invoice finance business by a industry specialist

All of these activities take place within the UK and all data remains onshore.

When outsourcing activities, the Group retains responsibility for those services and the associated risks. The Group remains focused on meeting enhanced regulatory requirements under the PRA Supervisory Statement on Outsourcing and Third Party Risk Management (SS2/21) 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. To support suppliers in avoiding such issues, it has published invoicing guidance on its website.

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 six month reporting periods ended 30 September in the three most recent years, calculated on the basis set out in the regulations, is shown below.

	Six months ended 30 September		
	2023	2022	2021
Average time to pay invoices (days)	21	22	22
Invoices paid within 60 days	94%	94%	95%

Sensitive business sectors

As a matter of credit policy, the Group does not lend in the following controversial business sectors which pose a potential reputational and financial risk to the business:

- Public houses and bars
- Licensed clubs
- Gambling and betting activities
- Activities of political organisations
- Manufacturers of weapons and ammunition

This list is kept under review as part of the Group's sustainability strategy.

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 significant outsourced operations also take place within the country. The UK is not considered a jurisdiction with a high incidence of corrupt practices, ranking eighteenth safest out of 180 countries and territories in the Corruption Perceptions Index for 2022, the most recent to be published. 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 2023.

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 (2022: 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. The Group continues to monitor the increasing complexity of financial crime risk, regulatory enforcement action and any potential or actual changes to the legislative framework to manage the emerging threats. During the financial year additional 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 and meet the changing legal and regulatory landscape.

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 B4.6.

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 2023

B.

Corporate Governance

How the Group is run and how risk is managed

- P90** **B1. Chair's statement on governance**
An overview of governance in the year
- P92** **B2. Corporate governance statement**
How the Company complied with the Code in the year
- P94** **B3. Board of Directors and senior management**
The directors and the operation of the Board during the year
- P102** **B4. Governance framework**
The system of governance, committee structure and how the Board fulfils its duties
- P120** **B5. Nomination Committee**
Policies and procedures on governance, board appointments and diversity
- P126** **B6. Audit Committee**
How the Group controls its external and internal audit processes and its financial reporting systems
- P136** **B7. Remuneration Committee**
Policies and procedures determining how directors are remunerated
- P168** **B8. Risk management**
How the Group identifies and manages risk in its businesses
- P183** **B9. Directors' report**
Other information about the structure of the Company required by legislation
- P186** **B10. Responsibility statement**
Statement of the responsibilities of the directors in relation to the preparation of the financial statements





Our values

PROFESSIONALISM

To maintain the highest standards and deliver our products and services with care and accuracy



The Board appreciates the value which the Group's corporate governance framework brings to its activities and the part which the Code plays in that. We seek to comply with the Code wherever possible, and I hope that as the Code develops, its requirements will remain attainable, relevant and proportionate.

Robert East, Chair of the Board

B1. Chair's statement on corporate governance

Dear Shareholder

This section of the Annual Report and Accounts describes the Group's corporate governance processes and explains how the Board and its committees have addressed the significant strategic issues facing it in the year. This year's challenges have included the impact of the rapidly changing economic landscape in the UK over the last twelve months on the Group's strategy, businesses and risk profile and monitoring the Group's ongoing digitalisation activities, which are fundamental to its strategy going forward.

This was my first full year as Chair, having taken office on 1 September 2022, and a significant part of my tenure to date has involved familiarising myself with the Group, its operations and its people, and particularly how the Group's corporate governance framework operates.

During the year an independent external evaluation of the Board's effectiveness was carried out, which I found very useful in evaluating how the Board needs to develop in the future, adopting emerging best practice and responding to the Group's progress towards its strategic goals.

I have also followed with interest the emerging results of the UK Government's review of Corporate Governance and Auditing, including the potential for the creation of a new regulator for external audit, corporate reporting and governance in place of the FRC, together with the proposals for an updated UK Corporate Governance Code (the 'Code'), where the regulator has recently announced a significantly changed approach.

The Board appreciates the value which the Group's corporate governance framework brings to its activities and the part which the Code plays in that. We seek to comply with the Code wherever possible, and I hope that as the Code develops, its requirements will remain attainable, relevant and proportionate. In this context we welcome the recent statements by the UK Government and the FRC, suggesting a more focussed approach to reform than that originally consulted upon.

Engagement

As a board, we value feedback from shareholders and other stakeholder groups, both outside and inside the organisation. I was pleased to note the level of shareholder support for the Group's new remuneration policy at the 2023 AGM, a policy which was developed through extensive consultation with shareholders, proxy agencies and other investor groups during the year. I have also been pleased to have had the opportunity of meeting a number of shareholders during the year. These conversations provide the Board with valuable insights into other investor issues and priorities. I would like to thank those stakeholders who made time to meet with us, and would encourage all stakeholders to take advantage of opportunities for dialogue when they arise in the future.

During the last twelve months I have attended several meetings of the Group's People Forum, and I found the perspective the Forum members offered on the Group and its businesses a significant help in developing my understanding of the organisation. I have also spent time with people across the Group as part of my induction process, and I thank them for their insights.

Inclusion

Inclusion and diversity continue to be a priority for me and my fellow directors, both within the boardroom and more widely across the Group. Our strategy requires continuous development of products, people and processes and that cannot be achieved without diversity of thought and outlook at all levels. I was pleased to note the continuing development of the Group's internal diversity networks in the year, and am proud of the work the Group's people have done to support industry initiatives in this field.

At board level I am pleased to be able to report that we are compliant with the new FCA Listing Rule on diversity, and able to state that we have met the FCA's diversity targets for boards. We continue to support the Women in Finance initiative, and are moving to a position where we will be able to announce our Parker Review targets for ethnic diversity amongst management in line with the timescales specified by the review committee.

Effectiveness

During the year an externally facilitated review of the Board's effectiveness was completed. This was delayed from 2022, due to the board changes in that year, including my appointment as Chair in September 2022. The results of the review were very positive, and I found the process most helpful in forming my views on the future development of the Board and its operations, as an incoming chair. As a result of the review some areas for development were identified and I look forward to the benefits these will bring to the Board and its deliberations.

Board changes

In June I was pleased to welcome Zoe Howorth to the Board as an additional non-executive director. Her background in consumer-facing marketing roles brings a different perspective to the Board's discussions, and I look forward to her contributions over the years to come.

In November 2023, Hugo Tudor reached the ninth anniversary of his appointment to the Board and during the year he handed over his responsibilities as Senior Independent Director to Alison Morris. Preparations are also in progress for Hugo to hand over his duties as Remuneration Committee Chair once the Committee's work on the 2022/23 remuneration cycle is complete.

Conclusion

I am confident that not only has the Board complied with the requirements of the Code and its other legal and regulatory obligations, but that it has successfully discharged its responsibilities to ensure the good governance of the Group and its businesses. I cordially invite shareholders to join us on 6 March 2024 in London for our Annual General Meeting, where there will be an opportunity to put questions to the Board. I hope to see as many shareholders as possible in attendance.

Robert East

Chair of the Board
6 December 2023

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 2023, the Company complied with the principles and provisions of the Code.

The appointment of the new Chair of the Board in September 2022 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. During 2022 the decision was taken to defer the evaluation to the year ended 30 September 2023 to allow the new Chair sufficient time in post to make the evaluation more relevant and meaningful. The externally facilitated board evaluation for 2023 was completed and 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	B5
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



Robert D East

Chair of the Board
Nomination Committee Chair
(Age 63)



Appointed to the Board as Chair of the Board in 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 track record of leading and chairing financial services businesses
- Extensive experience in, and understanding of, banking and the financial services sector
- Significant experience of leading transformational change

Current external appointments

Director of RCWJ Limited



Key

Committee memberships at 30 September 2023 are indicated as follows.

- ★ Nomination Committee
- ▲ Audit Committee
- ◆ Remuneration Committee
- ⬡ Risk and Compliance Committee
- Disclosure Committee

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.

Nigel S Terrington

Chief Executive
(Age 63)



Appointed to the Board as Treasury Director in 1990, and became Finance Director in 1992 and CEO in 1995.

Experience

Nigel's early career began in investment banking, which included working for UBS, where he 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.

Nigel takes an active role in engaging with regulators and government on banking matters, particularly those which impact the UK mid-tier banking community.

He is a member of HM Treasury's Home Finance Forum and, until September 2023, was on the Board of UK Finance. Nigel was previously Chair of UK Finance's Specialist Bank Advisory Committee, Chair of the Council of Mortgage Lenders ('CML'), Chair of the Intermediary Mortgage Lenders Association ('IMLA'), Chair of the 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*

- Strategic and detailed understanding of banking and of the Group, its markets, its operations and its people
- Leadership of the Group's diversification from a monoline buy-to-let lender to a broadly-based specialist banking group
- Long term, through-the-cycle expertise, including successful management of the Group through the 1992 and 2007 financial crises

Current external appointments

Member of HM Treasury's Home Finance Forum



Richard J Woodman

Chief Financial Officer
(Age 58)



Appointed to the Board as Director of Corporate Development in 2012 and became CFO in June 2014.

Experience

Richard 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*

- 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 and reporting, liquidity, stress testing and capital management
- Executive director responsible for climate change matters and, alongside the Group's Chief Risk Officer, Richard takes a lead on progressing Paragon's IRB accreditation

Current external appointments

Director of Woodman Portfolio Holdings Limited

Director of Rose Wine Limited



Alison C M Morris

Non-executive director
Audit Committee Chair
(Age 64)



Appointed in 2020 - three years served. Senior Independent Director since August 2023.

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

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



* 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

Peter A Hill

Non-executive director
Risk and Compliance
Committee Chair
(Age 62)



Appointed in 2020 – three years served.

Experience

Peter's career in financial services has spanned over forty years, including eight years as CEO of Leeds Building Society between 2011 and 2019, where he previously held the role of Operations Director.

He is Chair of Mortgage Brain Holdings Limited and was a non-executive director and Chair of the Risk Committee at Pure Retirement from 2019 until 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

Current external appointments

Chair of Mortgage Brain Holdings Limited

Director, Trustee and Chair of the Finance & Governance Committee of Leeds Rugby Foundation

Deputy chair and Treasurer, Leeds Rugby Foundation Services Limited



Hugo R Tudor

Non-executive director
Remuneration Committee Chair
(until 7 December 2023) (Age 60)



Appointed in 2014 – nine years served.
Senior Independent Director between July 2020 and August 2023.

Experience

Hugo 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

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



Barbara A Ridpath

Non-executive director
(Age 67)



Appointed in 2017 – six years served.

Experience

Barbara 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 operational risk professionals (including cyber risk), and a director of ORX UK Limited. Until recently she was a non-executive director of Open Banking Limited.

Specific areas of expertise*

- Strong knowledge of the operation and implementation of operational risk management systems
- Detailed knowledge of the securitisation market

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 Change Banking Limited

Member of the International Advisory Council of the Institute of Business Ethics



Graeme H Yorston

Non-executive director
(Age 66)



Appointed in 2017 – six years served.

Experience

Graeme Yorston was Group Chief Executive of Principality Building Society, the sixth largest mutual in the UK. He has over 49 years' experience in financial services having carried out a number of senior roles at Abbey National (now Santander) including IT Director for the Retail Bank and Regional Director, and ran 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 the Prince of Wales's 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
- Board Champion for Consumer Duty

Current external appointments

None



Tanvi P Davda

Non-executive director
(Age 51)



Appointed in 2022 – one year served.
Becomes Chair of the Remuneration Committee from 7 December 2023.

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 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

Current external appointments

Director of Ashrah Advisory Limited
Director of CLC Services Limited
Trustee for Cheltenham Ladies College



Zoe L Howorth

Non-executive director
(Age 52)



Appointed on 1 June 2023 – less than a year served.

Experience

Zoe brings an extensive range of skills and experience to the Board. Zoe's executive career included over sixteen years' experience at the Coca-Cola Company across a variety of roles that culminated in her role as UK Marketing Director.

Zoe is a Board member of AG Barr PLC, a FTSE 250 consumer goods business, where she is chair of the ESG Committee and member of the Remuneration Committee.

She is also a Fellow of Chapter Zero, which works in partnership with the Global Climate Initiative to build a community of non-executive directors equipped to lead crucial UK boardroom discussions on the impact of climate change as organisations transition from ambition to action.

Specific areas of expertise*

- Extensive fast-moving consumer goods, consumer brand and digital marketing expertise
- ESG strategy and governance

Current external appointments

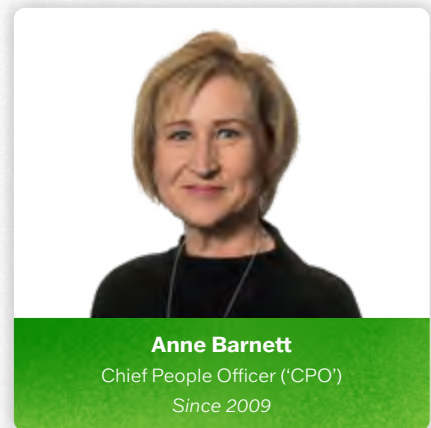
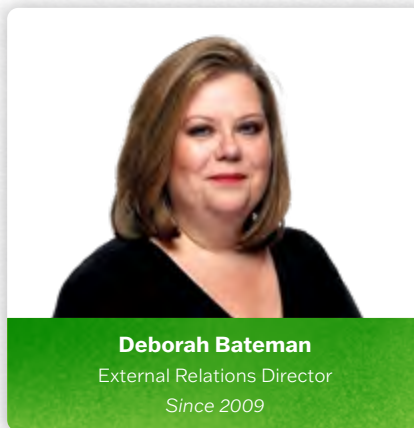
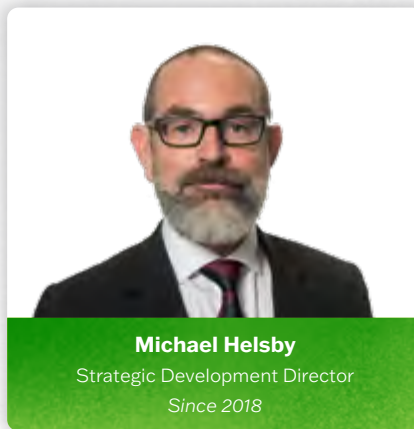
Non-executive director: AG Barr PLC
Non-executive director: International Schools Partnership Limited
Non-executive director: Water Babies Group Limited and TCA Children First Limited



* 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

B3.2 Executive Committee

The members of the Group's executive committees are set out below, together with their tenure in their current role.



All members sit on both the Executive Performance Committee ('Performance ExCo') and the Executive Risk Committee ('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:

- Continued consideration of the impact of interest rate volatility, inflation and other macro-economic uncertainties in the UK on the Group
- Monitoring progress of the Group's digitalisation programme
- Oversight of the Group's implementation of the FCA Consumer Duty which went live in the year

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, regulatory changes, treasury and funding, the work of its committees and investor relations and shareholder feedback.

A non-exhaustive list of other significant matters overseen by the Board during the year is set out below by theme:

Topic	Meeting
Business strategy	
Update on the Group's change programme	Oct 2022, Jan, Apr, Jul 2023
Approval of the corporate plan for the financial years ending 2022 to 2027. More detail on the Group's strategy can be found in sections A3 and A4	Nov 2022
Market update following the mini-budget announcement provided by an economic research consultancy	Nov 2022
Update on a programme of work that looks at implementing changes to the Group's target operating model, ways of working, governance and building requirements	Dec 2022
Detailed update on progress of significant elements of the Group's digitalisation strategy	Jan 2023
Deep dive review of the Group's development finance business provided by senior management from the area	Mar 2023
Deep dive review of the Group's savings business provided by the Savings Director	Mar 2023
Market update on the financial services sector provided by an investment bank	Apr 2023
Deep dive review of the Group's SME lending business provided by senior management from the area	Apr 2023
Deep dive review of the Group's Mortgage Lending business provided by the Managing Director - Mortgages which included an update on the Private Rented Sector	May 2023
Update on corporate development opportunities	Sep 2023
Risk and regulation	
Approval of the Group's Consumer Duty Implementation Plan and appointment of Graeme Yorston as Paragon's Consumer Duty Board Champion	Oct 2022
Update on the Consumer Duty Programme and final approval of the detailed Consumer Duty Implementation Plan	Dec 2022
Review of the proposed approach to reporting management information relating to the FCA Consumer Duty	Mar 2023
Progress update on implementation of Consumer Duty management information reporting	Apr 2023
Progress update on the Consumer Duty Programme	Jul 2023
Update on the Group's IRB application	Mar 2023
Consideration of the PRA's Consultation Paper 16/22 on the implementation of Basel 3.1 standards and its strategic implications for the Group's capital	Mar 2023

Topic	Meeting
Risk and regulation	
Approval of the 2023 ICAAP	Jul 2023
Review of elements of the 2023 Recovery Plan	Apr 2023
Approval of the 2023 Recovery Plan	Jul 2023
Training on the 2023 ILAAP	Jul 2023
Annual review and approval of the Group's principal risk categories	Jul 2023
Consideration of the implications of the FCA's 14-point action plan on savings for the Group's deposit business	Sep 2023
Cyber security / operational resilience	
An update from the COO on technology and change in the Group	Mar 2023
Approval of the Group's operational resilience self-assessment	Mar 2023
Corporate governance	
Recommendation of the declaration of a final dividend of 19.2 pence per share in respect of the financial year ended 30 September 2022 and of a share buy-back programme for 2023 (with £50 million announced with the preliminary results)	Dec 2022
Consideration of succession planning for the Board and senior management in conjunction with the Nomination Committee	Feb & Jul 2023
Annual review of the Corporate Governance Policy Framework	Mar 2023
Approval of the cancellation of the Company's capital redemption reserve by way of a court-approved reduction of capital, to increase its distributable reserves	Mar 2023
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, and approval of the Whistleblowing Policy	Mar 2023
Approval of the Modern Slavery Statement and Policy following an annual review	Mar 2023
Annual review of tax strategy and compliance, and approval of policy statement	Mar 2023
Approval of the declaration of an interim dividend of 11.0 pence per share and an agreement to increase the total amount of the share buy-back programme from £50.0 million to £100.0 million as part of the half year consideration of the Group's capital position	May 2023
Annual review of the Group's purpose, to confirm that it remained relevant and appropriate 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	Jul 2023
Consideration of the Board evaluation findings. Further detail on this can be found in Section B4.4	Sept 2023

Topic

Meeting

Sustainability

Consideration of shareholder feedback following the full year results announcement	Dec 2022
Customer insights update which included intermediary and customer feedback	Jan and Apr 2023
Update on employee feedback through the Nomination Committee. This was obtained through surveys, the EDI Network and the employee-led People Forum, amongst other channels	Feb and July 2023
Sustainability / climate change update	May 2023
Annual review and approval of the Group's Equality, Diversity and Inclusion Policy	Jul 2023
Assessment of shareholder feedback following the half year results announcement	Jul 2023
Consideration of insights from the Group's employee engagement survey	Sep 2023

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.

In addition the CEO's reporting to the Board provided regular updates on:

- The Group's change programme
- Operational resilience
- Sustainability
- People
- Corporate development opportunities

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	10 (10)	-	5 (5)	5 (5)	3 (3)
Nigel S Terrington	10 (10)	-	-	-	-
Richard J Woodman	10 (10)	-	-	-	-
Tanvi P Davda	10 (10)	-	5 (5)	5 (5)	-
Peter A Hill	10 (10)	5 (5)	5 (5)	-	-
Zoe L Howorth	2 (2)	-	1 (1)	2 (2)	-
Alison C M Morris	10 (10)	5 (5)	5 (5)	5 (5)	1 (1)
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
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
B4.4	B4.5	B4.6
Board evaluation – how the Board ensures the framework is, and will remain, fit for purpose	Board training – how the Board ensures that its members develop and maintain the necessary level of skills and knowledge for the framework to operate as required	Whistleblowing – how concerns may be raised and the action that is taken

B4.1 Board and committee structures

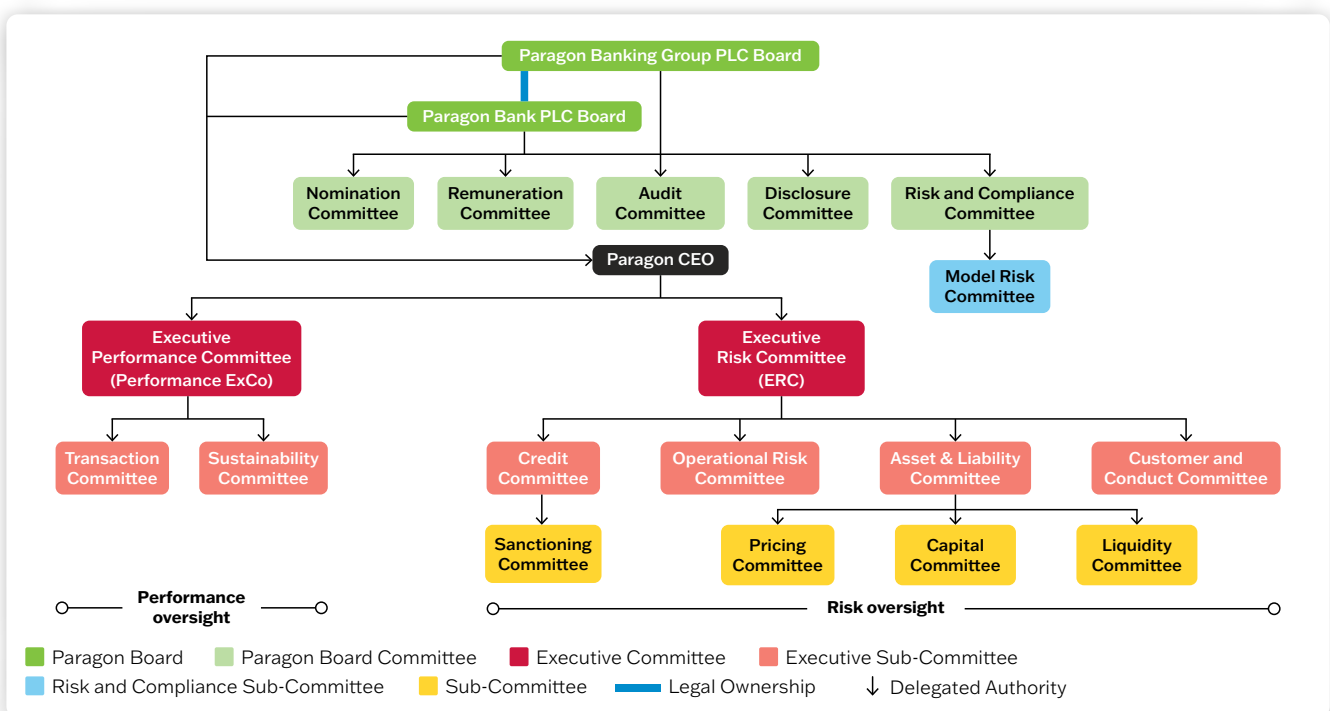
Board leadership, group purpose and the Group Corporate Governance Policy Framework

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, assisted by its committees, governs 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 and are thereafter provided with annual training updates.

Board and committee structure and membership

The Board and the CEO operate 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

Members	Independent non-executive	Audit	Remuneration	Risk and Compliance	Nomination
R D East	Chair*	No	Yes	Yes	Yes
T P Davda †	Yes	No	Yes	Yes	No
P A Hill	Yes	Yes	No	Yes	No
Z L Howorth	Yes	No	From 1 June 2023	From 1 June 2023	No
A C M Morris	Yes	Yes	Yes	Yes	Yes
H R Tudor	Yes	Yes	Yes	Yes	Yes
B A Ridpath	Yes	Yes	No	Yes	Yes
G H Yorston	Yes	No	Yes	Yes	Yes

* Considered independent on appointment as Chair of the Board of Directors on 1 September 2022.

† To become Chair of the Remuneration Committee and a member of the Nomination Committee from 7 December 2023.

In addition to the above, Hugo Tudor attends Model Risk Committee meetings, representing the non-executive directors.

Hugo Tudor reached nine years on the Board on 23 November 2023. The Board considered the extension of his appointment beyond this point and agreed that it should be extended for an additional one-year period given the value and knowledge he contributes to the Board and to ensure an effective transition of duties to the new Senior Independent Director and the new Chair of the Remuneration Committee. The Board agreed that Hugo would be deemed to be a non-independent non-executive director from the conclusion of the 2024 AGM. He will hand over his duties as Remuneration Committee Chair to Tanvi Davda on 7 December 2023, having taken part in the finalisation of remuneration matters pertaining to the financial year ended 30 September 2023. Further details on Hugo's re-appointment and independence are set out in sections A4.5.2 and B5.3.

In addition to the board committees outlined in the above tables, the Board has established a Disclosure Committee which assists in the design, implementation and periodic evaluation of disclosure controls and procedures. It also monitors compliance with the Company's disclosure controls, considers the requirements for announcements and determines the disclosure treatment of material information. The Disclosure Committee's members are the CEO, CFO and the External Relations Director, of which any two can form a quorum.

An informal 'NED Technology Change Group' was also established in 2021 comprising some of the non-executive directors, the COO and senior managers from the IT and Change functions. The group met in November 2022, and in March, June and September 2023 as part of an ongoing programme of meetings to provide updates on the change programme (the methods and processes of making changes to the Group's IT systems and business procedures), the IT strategy and wider technology trends. The meetings also facilitated challenge by the non-executive directors and increased 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 / or 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 reviews the appropriateness and effectiveness of the Group's risk management framework as appropriate from time to time, 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, 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 sustainability matters, including key areas such as environmental impacts (including climate change), social considerations, commercial implications, disclosure 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 must 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, and to provide oversight of the acquisition, due diligence and migration process.

ERC sub-committees

Four principal executive risk sub-committees, with membership consisting of appropriate senior employees, report to the ERC. All 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, were reviewed during the year to determine whether further enhancements could 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. The Board considered the Group's culture as part of the annual review of the Group's purpose in July 2023.

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 May 2023, which included specific questions on the Group's culture. Results from this survey, together with feedback received via the People Forum, were reviewed in depth by the Nomination Committee on behalf of the Board, with the Board subsequently considering the results itself. The strong employee engagement and employee attestations, including that the employees lived the Company's values and purpose, 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. Whilst a number of matters are reserved for the Board, the Board delegates certain responsibilities and authorities to the CEO, CFO 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.

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. While the Board has determined that Hugo Tudor will cease to be considered independent following the 2024 AGM, non-executive directors will still form a majority of the Board at that point.

In addition to the general legal and regulatory responsibilities of all directors, non-executive directors' more specific responsibilities include providing independent oversight. Non-executive directors who are members of the Remuneration Committee determine appropriate levels of remuneration for executive directors. Non-executive directors 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 principles. As outlined in section B4.1, certain non-executive directors also meet with the change and IT functions throughout the year.

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 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 or 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

Alison Morris succeeded Hugo Tudor as Senior Independent Director on 14 August 2023, during the financial year. 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 Tudor met with shareholders to discuss governance and remuneration matters and to address any queries or concerns raised. Going forward, Alison Morris will seek engagement with, and be available to, shareholders, and the new Remuneration Chair Tanvi Davda, will also do the same with respect to remuneration matters. More detail on the engagement with shareholders regarding remuneration matters can be found in section B7.

The Senior Independent Director is responsible for leading the appraisal of the Chair of the Board's performance with the non-executive directors. As part of the external board evaluation carried out in the year, which is described in section B4.4, an appraisal of the Chair was carried out by the external evaluator, the output of which was shared with the Senior Independent Director.

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, which is reviewed by the Board twice a year.

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 2022 meeting.

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 current financial year which began on 1 October 2022. These requirements are a particular area of focus for the Board and the Nomination Committee. The Group was fully compliant with these requirements for its year ended 30 September 2023 and the Board expects that it will remain so. The Board is also mindful of the targets set by the FTSE Women Leaders Review and Parker Review as detailed further in section B5.

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. An externally facilitated Board evaluation took place during the year. This was deferred from 2022 to ensure that the Chair had been in position for a reasonable period of time to make the evaluation more relevant and meaningful. 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 B4.5.

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 B4.6.

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

Consideration of 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 and sustainability, 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 long-term, sustainable 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 2023, 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 46 meetings were held with shareholders and analysts. In addition, the CEO and CFO hold regular analyst briefing meetings
- A comprehensive update on Investor Relations is included in the CEO's report presented at each Board meeting
- After commencing a wide-ranging consultation process in 2022, covering remuneration policy and other governance issues, the SID/Chair of the Remuneration Committee continued to engage with major shareholders and shareholder advisory groups before and after the 2023 AGM
- The Board receives an in-depth update on Investor Relations, which includes investor feedback, following the publication of the Company's financial results



Capital management



Growth



Diversification



Digitalisation

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 which was approved at the 2023 AGM, with 96.99% of the votes cast
- 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 2023, all resolutions were approved by shareholders
- A total dividend for the year of 37.4 pence per share is proposed, and a further share buy-back programme of up to £100.0 million was authorised in the year

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, including quarterly surveys of SME and buy-to-let customers
- The Board took part in an insights day with the Mortgage Lending business, which included visiting the team and taking part in a question and answer session with a panel of brokers
- The Board receives Customer Insight updates bi-annually
- The Board received periodic updates on the Group's progress towards implementing the new FCA Consumer Duty throughout the year
- Graeme Yorston, an independent non-executive director has been designated as the Board's Consumer Duty Champion since October 2022
- Customer metrics are a key element of the Performance Share Plan ('PSP')



Digitalisation



Sustainability



Diversification



Growth

Outcome

- Rollout of the 'Think Customer!' initiative to all employees
- 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.

How we engage and / or monitor

- Regular group-wide anonymous employee engagement surveys are conducted, most recently in the current year
- 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 employee-led 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



Sustainability

Outcome

- 88% of employees took part in the engagement survey, with the Group achieving an overall engagement score of 90%, its best result in eight years
- The Group is accredited as an Investor in People with Platinum IIP status
- 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 launch of the Paragon Moments Rewards app which allows employees to recognise the performance of colleagues who demonstrate one or more of the Group's values

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 regulatory requirements 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 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
- 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 formal and structured basis

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

- 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



Sustainability

Outcome

- In the twelve months ended 30 September 2023 employees raised more than £45,000 for Newlife, a disabled children's charity
- The Group's Charity Committee is sponsored by a member of ExCo
- Employees were supported to take part in a range of volunteering activities
- 469 employee volunteering days were used to support specific initiatives in 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.

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 as 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 is a member of Bankers for Net Zero and the Mission Zero Coalition
- Strategic priorities have been mapped against the United Nations Sustainable Development Goals
- 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



Sustainability

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
- 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 under the Gold Standard or VCS programmes
- Environmental / climate change targets are considered as part of the Remuneration Policy
- The Group publishes an annual sustainability report (the Responsible Business Report) and has a dedicated sustainability section on its website
- All employees undertook training focussed on sustainability issues during the financial year

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.

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
- The Board met with a selection of mortgage intermediaries as part of its Mortgage Lending insight day
- Regular feedback surveys are conducted amongst intermediaries with the results fed back to ExCo and Board
- The Group has a Supplier Code of Conduct which sets out its overall approach to supplier engagement and its expectations of its suppliers
- A comprehensive questionnaire covering broad sustainability topics was issued to critical suppliers



Digitalisation



Sustainability

Outcome

- Intermediary feedback key to updating and streamlining 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
- Results of the Group's 2022 supplier survey were used to inform the ongoing development of its supplier management and procurement processes
- The Group is a signatory to the UK's Prompt Payment Code, and ensuring that suppliers are paid promptly is a priority

The Group's management of business partner relationships is discussed further in Section A6.7



Shareholder relations

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 2024 AGM will take place at 9am on 6 March 2024 at the offices of Computershare, Moor House, 3rd Floor, 120 London Wall, London EC2Y 5ET.

The CEO and CFO have a full programme of meetings with institutional investors and during the year ended 30 September 2023, 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 Chair of the Remuneration Committee (who, until August 2023 was also the Senior Independent Director), held meetings with shareholder advisory groups covering governance and remuneration matters as set out in the Remuneration Report in B7. Following the publication of the 2022 Annual Report and Accounts and the AGM notice, the Company invited its largest stakeholders, who collectively represent over 89% of the Company's total voting rights, to share their views, and many of these shareholders, representing over 56% of the Company's total voting rights, responded.

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 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. Alison Morris became Senior Independent Director during the year, succeeding Hugo Tudor from August 2023. 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

Board evaluation

The effectiveness of the Board, individual directors and the Board's main committees is reviewed annually. Given the change of Board Chair in September 2022, a decision was made to defer the externally facilitated evaluation until the current financial year, given that it would be more meaningful for this to take place once the new Chair had been in the role for a reasonable period of time.

This review was completed in the year and is described below.

2023 external board evaluation

In line with recognised best practice, the Group undertakes board reviews on an annual basis to increase board effectiveness and to identify areas for improvement.

A number of providers were considered to undertake this year's review. Following consideration of prospective providers' proposals by the Chair, Company Secretary and a number of board members, Lintstock Ltd ('Lintstock') was engaged to conduct an external review of the performance of the Board and its committees. Lintstock is an advisory firm that specialises in board reviews and has no other connection with the Company or individual directors.

The review was conducted in line with the Code of Good Practice for Board Reviewers published by the Chartered Governance Institute UK & Ireland ('CGI'), and Lintstock was provided with the opportunity to comment on the description of the process followed and the findings contained in this annual report, and agreed any opinions attributed to them.

In drafting this disclosure on the Board evaluation, the CGI guidance notes 'Principles of Good Practice for listed companies using external board reviewers' and 'Reporting on board performance reviews: Guidance for listed companies', published in July 2023, were consulted. The Board evaluation process was initiated before the guidance was published. However, in the main, the principles were followed.

Evaluation methodology

The steps involved in the evaluation process and their timings are set out below.

Phase and timing	Activities
Scoping	
February 2023	The scope and objectives of the review were agreed following a briefing meeting between the Chair of the Board, the Company Secretary and Lintstock.
Tailoring	
March to April 2023	<p>Lintstock collaborated with the Chair and the Company Secretary to design bespoke surveys tailored to the business needs of the Group and to ensure that key action points from the internal 2021 board review had been addressed.</p> <p>As well as covering core aspects of governance such as information, board and committee composition, and dynamics, the review considered people, strategy and risk areas relevant to the Group's performance. The review had a particular focus on the following areas:</p> <ul style="list-style-type: none">• the Chair transition during 2022• the Board's understanding of digital and data opportunities• the quality of executive succession planning
Observation	
May 2023	Lintstock representatives observed the May meetings of the Board and the Audit Committee and reviewed the accompanying meeting packs. In addition Lintstock also observed: the Board's site visit to, and interaction with, the Mortgage Lending division; an insight presentation attended by the Board; and a board question and answer session with a panel of the Group's mortgage intermediaries.
Completion of surveys	
July 2023	Board members and other key stakeholders completed surveys assessing the performance of the Board and each of its committees, as well as the performance of the Chair of the Board. Each director also completed a self-assessment questionnaire addressing their own performance.
Interviews	
July 2023	In-depth interviews with board members and key stakeholders were conducted by two Lintstock partners. The findings from the survey stage enabled Lintstock to focus discussions on the key priorities for each director.
Analysis and delivery of reports	
August 2023	Lintstock analysed the findings from the surveys and interviews and delivered focused reports documenting the findings, including a number of recommendations to increase effectiveness.
Board discussion and presentation	
September 2023	Lintstock's findings were shared with the Chair of the Board and then discussed by the Board at its September meeting. Actions were agreed for implementation and monitoring.

Key findings

Lintstock found the Board to be highly engaged. Effective communication has been established between the new Chair and the CEO, and strong interaction is apparent between the non-executive directors and management. Board meetings were seen to be well-run, and the review confirmed that non-executive directors benefit from a strong network of support and training.

The review identified a number of focus areas, including:

- Providing opportunities for informal strategic discussion throughout the year, to supplement existing board strategy sessions
- Continuing to strengthen the Board's familiarity with relevant technological developments
- Further enhancing the Group's focus on customers, including the user experience and various target customer groups across the business
- Continuing to monitor executive succession plans closely

As part of the review, Lintstock delivered a board discussion document informed by the Lintstock Governance Index, which comprises around 60 core board performance metrics from over 200 board reviews that Lintstock has recently facilitated, specifically in financial services. The Index provides a robust baseline for the evaluation, helping the directors to understand how the Company's Board compares with those of other similar organisations, putting the findings into context.

An update on progress on addressing these key findings will be given in the governance section of next year's annual report and accounts.

Other evaluation activities

In addition to the externally facilitated evaluation, the Nomination Committee also evaluated:

- Whether each non-executive director had sufficient time to devote to their board duties
- The independence of non-executive directors
- Whether each director should be put forward for election / re-election at the 2024 AGM
- The structure, size and composition (skills, experience, knowledge and diversity) of the Board and its Committees

Where appropriate, recommendations were then put to the Board for deliberation. More details of these considerations are given in the Report of the Nomination Committee (section B5).

A review of the performance of the executive directors, including the observations from the external board evaluation, took place at the Remuneration Committee meeting in September 2023 that considered remuneration packages for 2023/24 and variable remuneration outcomes for 2022/23. Further information on this process is given in the Directors Remuneration Report (section B7).

At the 2024 AGM, the Chair will confirm to shareholders, when proposing the election or 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.

B4.5 Board training and development

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.

Zoe Howorth, who was appointed to the Board on 1 June 2023, commenced her induction programme and met with stakeholders across the business. Further, Tanvi Davda, who was appointed on 1 September 2022, continued her induction. During the coming financial year Tanvi will receive further induction training as she takes up her new role as Remuneration Committee Chair, building on her experience as a Remuneration Committee member.

Development

Following Board approval in October 2022, a skills matrix was completed 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, customer insight, risk, management, governance and professional development. In addition, 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. Specific detailed training sessions were provided in the year on the following subjects.

Topic	Board meeting
Hedge accounting , provided by members of the finance function	Jan 2023
Interest Rate Risk in the Banking Book , provided by members of the treasury team	Mar 2023
ICAAP elements , provided by members of the Balance Sheet Risk, Capital and Credit Risk teams	Mar 2023
Legal and regulatory , which covered topics such as UK MAR and directors' duties	Jul 2023
Cyber , delivered by a combination of in-house experts and an external cyber security solutions provider	Jul 2023
Sustainability / Climate Change , provided by the Chair of the Sustainability Committee and in-house experts	Jul 2023
2023 ILAAP , delivered by members of the treasury team	Jul 2023

These topics were drawn from the fields of risk, financial crime, accounting, cyber security and sustainability.

B4.6 Whistleblowing

The Group has an established policy 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 advisory 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, CRO, 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 2023, there was one instance of whistleblowing which resulted in a requirement for full consideration and investigation by the Whistleblowing Group (2022: two). This case was 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.



The Board supports the drive from The Parker Review to encourage increased ethnic diversity for the Group's senior leadership and an appropriate target for the Group has been considered by the Committee during the year.

Robert East, Chair of the Board and the Nomination Committee

B5. Nomination Committee

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. As Chair of the Board I serve concurrently as Chair of the Nomination Committee.

During the year the Committee has overseen the appointment of an additional non-executive director. Our primary aim in this process was to ensure that the person appointed had the requisite skills and knowledge for their role, benchmarked against the board skills matrix, and brought an increased diversity of experience to complement the existing skillset of the Board.

Zoe Howorth was appointed as a non-executive director from June 2023. She has outstanding experience as a customer-driven, brand-led and commercial executive in a PLC environment with strong strategy and ESG capabilities. Zoe has undertaken several non-executive director appointments since retiring from her executive career in 2014.

In addition, the Committee has overseen the appointment of a new Senior Independent Director, Alison Morris, in place of Hugo Tudor, who reached his nine-year tenure on the Board in November 2023, and also initiated a process which will result in Hugo's replacement as Chair of the Remuneration Committee by Tanvi Davda on 7 December 2023, which will coincide with the completion of the Committee's work on the 2023 remuneration cycle.

The remit of the Committee also covers people-related sustainability issues and during the year the Committee has considered the application of the new FCA Listing Rule requirements in relation to gender and ethnic diversity at board and executive management level, which apply to the Group from its current financial year. This has been a key priority and area of focus to ensure these requirements were met by 30 September 2023, and I am pleased to confirm that this process has been successfully completed.

The Board supports the drive from The Parker Review to encourage increased ethnic diversity for the Group's senior leadership and an appropriate target for the Group has been considered by the Committee during the year. As required by The Parker Review, the Group's voluntary target to increase the number of ethnic minority appointments across senior leadership by 31 December 2027 will be published in the Annual Report and Accounts for the year ending 30 September 2024.

The Committee also noted the PRA's publication of a consultation paper on Diversity and Inclusion in September 2023, and will be monitoring the progress of this project with interest in the coming year.

The importance of employee voice has underpinned the transition to hybrid working over recent years, 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 particularly value the perspective provided by my interactions with the Group's employee-led People Forum and other employees in the year.

Overall, I believe the Committee has enjoyed a year of positive achievement, helping to set the course of the Group's future governance, and fully satisfied its mandate from the Board.

Robert East

Chair of the Board and the Nomination Committee
6 December 2023

B5.2 Operation of the Committee

The Nomination Committee is chaired by the Chair of the Board and includes four 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, including that of Company Secretary, and for 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 the Parker Review, and reporting including that on the gender pay gap
- 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 an additional non-executive director, Zoe Howorth, who joined the Board at the beginning of June 2023. Zoe's executive experience included over 16 years with the Coca-Cola Company across a variety of roles, culminating in her role as UK Marketing Director. Zoe is a non-executive director, chair of the ESG Committee and member of the Remuneration Committee at AG Barr PLC, a FTSE-250 consumer goods business. In 2021, Zoe joined the Board of International Schools Partnership Limited, a global education business, where she has board responsibility for ESG and brand, and she is also a non-executive board member of the Water Babies Group Limited.

Zoe's breadth of knowledge, which includes branding, digital and understanding of many aspects of the sustainability agenda, together with her strong focus on the customer experience, will enhance the diversity of perspective on the Board. This appointment complements the Board's existing skillset, and broadly maintains the balance of gender diversity. Zoe was also appointed to the Risk and Compliance and Remuneration Committees on her appointment.

The search process for the additional non-executive director, was led by the Chair, Robert East. The process was supported by Anne Barnett, Chief People Officer, and undertaken in conjunction with Jamie Risso-Gill from Per Ardua Associates Limited. Per Ardua Associates Limited do not have any connection with the Group or any of its directors.

In initiating this appointment, the Committee also considered the consequent increase in the size of the Board from nine to ten members. It was determined that this expansion of the Board was appropriate, in view of the increasing size of the Group and of the growing regulatory expectations which accompany this, as well as a desire to broaden the range of experience on the Board.

In November 2023, Hugo Tudor reached his nine-year tenure on the Board. During the year the Committee oversaw the process to appoint his successors as Senior Independent Director and Chair of the Remuneration Committee. Alison Morris was appointed as Senior Independent Director from 14 August 2023, recognising her experience as a Board member to date and as Chair of the Audit Committee. In addition, the Committee has overseen the process which resulted in the announcement that Tanvi Davda will succeed Hugo as Chair of the Remuneration Committee with effect from 7 December 2023, following the completion of the committee's work on the 2022/23 remuneration cycle.

In accordance with its annual process, the Committee considered the appropriateness of the re-appointment of the serving directors and recommended to the Board that resolutions for their re-appointment should be proposed at the forthcoming AGM. The Board agreed that Hugo Tudor's appointment as a director should be extended for an additional one-year period given the value and knowledge he contributes to the Board and to ensure an effective transition of duties. The Board agreed that Hugo would be deemed to be a non-independent non-executive director following the conclusion of the 2024 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 in each business area 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.

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 capable 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 the board skills matrix at its September 2023 meeting following the outputs from the Group's strategy event in July 2023 and feedback from the external board evaluation described in Section B4.4. This was reviewed and subsequently approved by the Board in October 2023.

The matrix reflects the Group's strategic aim of becoming a technology-enabled specialist bank, and the skills considered include matters such as:

Economic environment	Lending markets	Funding
Sound knowledge of the UK banking environment and macro-economic drivers that influence and impact the Group's purpose and strategic objectives	The Group's key lending markets	Understanding capital requirements and liquidity models
Digital technology	Customers	Sustainability
Considering the application and emergence of digital technology trends and developments in a financial services environment	Customer insight, marketing and communications in the specialist lending sector	Sustainability matters including government and regulatory policy and guidance, climate change and sustainability goals, social responsibility and governance standards.

This 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 B4.5.

Diversity

The Group recognises the importance of diversity, including gender and ethnic diversity, at all levels of the organisation. The Board is pleased to have maintained a consistent female representation of 38.6% at board and senior management level (2022: 38.1%), exceeding the original Hampton-Alexander Review targets and the Group is aligned to the ongoing objectives of the FTSE Women Leaders Review. The Group is committed to increasing the number of women in senior positions, and the Committee is monitoring its progress towards the new Women in Finance target of 40% female representation at board and senior management level by 30 September 2025.

In September 2023 the PRA published a consultation paper (CP 18/23) on 'Diversity and inclusion in PRA-regulated Firms', proposing new rules and codified expectations aimed at improving diversity in the financial services sector. This consultation builds on a 2021 discussion paper issued by the PRA, FCA and the Bank of England, and the Committee has been monitoring regulatory progress on this agenda for some time. In the coming year the Committee will supervise, with interest, the Group's analysis of and response to, the consultation.

The Committee has noted with interest the part being played by the Group's people in addressing socio-economic diversity at senior levels within the financial services industry, with the Group being a Founder Partner of the Progress Together initiative. It was gratifying to see this recognised in the year when Richard Rowntree – Managing Director Mortgages, and a member of the Progress Together board, was awarded the freedom of the City of London for his work in this field.

Board and executive management diversity

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 Equality, Diversity and Inclusion ('EDI') policy, which applies to the Board, its committees, the executive committees and senior management as well as the wider workforce, is set out below, under 'wider diversity in the Group'. It addresses such matters as age, gender, ethnicity, sexual orientation, disability and educational, professional or socio-economic background.

The Group's adherence to the FCA Listing Rule requirement and its voluntary targets to meet the expectation of the Parker Review and Women in Finance Charter demonstrate its commitment to achieving a diverse workforce at all levels.

The data on diversity amongst the Board and senior management at 30 September 2023 required by Listing Rule LR 9.8.6R(10) is set out below.

Gender

	Number of board members	Percentage of the board	Number of senior positions on the board	Number in executive management	Percentage of executive management
Men	6	60%	3	9	69%
Women	4	40%	1	4	31%
Not specified / prefer not to say	-	-	-	-	-
Total	10	100%	4	13	100%

Ethnic background

	Number of board members	Percentage of the board	Number of senior positions on the board	Number in executive management	Percentage of executive management
White British or other White	9	90%	4	12	92%
Mixed / multiple ethnic groups	-	-	-	-	-
Asian / Asian British	1	10%	-	1	8%
Black / African / Caribbean / Black British	-	-	-	-	-
Other ethnic group including Arab	-	-	-	-	-
Not specified / prefer not to say	-	-	-	-	-
Total	10	100%	4	13	100%

For the purposes of the tables above the senior positions on the board are the Chair of the Board, the CEO, the CFO and the Senior Independent Director. Executive management is defined by the Listing Rules as including the executive committee members and the Company Secretary. This definition thus differs from those used for other purposes. The Group has interpreted this definition as including the Internal Audit Director, who attends the executive committees as an observer and reports directly to the Chair of the Audit Committee, a member of the Board.

Gender is based on legal gender recorded in the Company's payroll records. Ethnicity is based on each individual's response to a diversity questionnaire where respondents were asked to identify the most appropriate classification from a list based on the categories used by the UK Office for National Statistics.

At 30 September 2023 the Company therefore met the following targets specified by the Listing Rules of the FCA.

- At least 40% of the directors were women
- At least one of the senior positions on the Board of Directors was held by a woman
- At least one individual on the Board of Directors was from an ethnic minority background

No changes in Board composition have occurred between the year end and the date of approval of this Annual Report and Accounts which would affect the Company's ability to meet these targets. The Committee expects that the Company will be able to continue to achieve these levels of representation in the longer term.

Wider diversity within the Group

The Group believes the achievement of a diverse workforce at all levels delivers the best culture, behaviours, customer outcomes, profitability and productivity and therefore supports its success as a business.

The Group is committed to eliminating discrimination and promoting equality, diversity and inclusion amongst all its employees through its policies, procedures, and practices and through its professional dealings with each other, customers and third parties.

The objective of the EDI policy is to outline the Group's approach and its expectations of employees and, in particular, line managers to ensure that its approach is understood and appropriately managed.

The EDI policy is implemented through the development and communication of its supporting people processes and procedures, making this policy available to all colleagues and engaging with and supporting people to display the policy's intent through the provision of regular training.

The Committee is pleased that 73.1% of employees provided diversity data for analysis at the beginning of the year and this increased to 76.8% by 30 September 2023. 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. This will continue to be a focus for the Committee.

The Group's diversity policies 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 communication channels. 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.



Accounting standards require approaches to both impairment provisioning and income recognition on loan assets which rely on assumptions about future behaviours. The Committee has given considerable focus to both areas, engaging with both financial and operational management, and with KPMG, the external auditor, to ensure that all judgements are rigorously challenged.

Alison Morris, Chair of the Audit Committee

B6. Audit Committee

B6.1 Statement by the Chair of the Audit Committee

Dear Shareholder

The changing economic landscape of the UK during this year has continued to present accounting challenges, with the Audit Committee fully engaged in ensuring that the Group's response provides the best possible information for shareholders and other users of these accounts. The lack of recent similar experience has meant that, once again, my colleagues and I have had a demanding, but interesting year.

Accounting standards require approaches to both impairment provisioning and income recognition on loan assets which rely on assumptions about future behaviours. The Committee has given considerable focus to both areas, engaging with both financial and operational management, and with KPMG, the external auditor, to ensure that all judgements are rigorously challenged.

The rate of change of interest rates, and the levels they had reached by year end, have had a clear impact on the behaviour of customers with maturing accounts, and on the reversionary interest rates charged after the point of maturity. As the EIR method, which aims to spread income over the life of a loan, requires these factors to be projected for current loans, the level of judgement required is substantial, and the lack of substantial recent relevant experience makes this even more complex. The Committee has had to carefully consider and weigh a great deal of evidence, with members applying their experience in order to conclude on the appropriateness of the final position reflected in these accounts.

For impairment provisions, while some deterioration in loan performance has been seen over the period, this has been less severe, so far, than many predictions. The Committee has had to give much thought in the year to the extent to which this performance merely represents a delayed impact, and to the likely effects of an economic outlook which appears to be more negative for a longer period than some of the potential scenarios contemplated at the beginning of the year. Modelled approaches provide a useful framework for these considerations, and we were pleased to see upgrades in the Group's impairment models in the year, allowing us to reduce the level of judgemental adjustments required. However, the overriding requirement for the final position to be truly representative of the Group's exposures and credit risks was at the forefront of the Committee's mind in evaluating and challenging the judgements made.

The Committee continues to appreciate the value which the effective operation of the Internal Audit function brings to the Group, and the confidence it provides over the systems of internal control. I consider that the importance of Internal Audit to the effective governance of an organisation's control framework cannot be overstated, and I was gratified to receive the results of this year's externally conducted review of the Group's Internal Audit arrangements, which found that they were operating in an appropriate manner, with very limited suggestions for improvement. I would like to congratulate Sarah Mayne and her team on this excellent result.

The year has also been one where the UK corporate governance framework has been in a process of change, with the Committee monitoring proposals from the FRC and the UK Government which would affect its operations and the Group's reporting. The Committee reviewed the new FRC Minimum Standard for Audit Committees, issued in the year, finding that it largely reflected the Committee's existing practice, and has ensured any changes to its terms of reference needed to clarify conformity with the Minimum Standard were made in the year.

As the year closes, the likely direction of the reforms remains unclear, and, after five years of the process, I would be pleased if the coming year brought a degree of certainty, and final proposals which are proportionate and sensible, and have both clear objectives and potentially significant benefits for the UK's attractiveness as a place to do business.

These accounts are the eighth to be reported on by KPMG as external auditor, and, as I indicated last year, the Committee intends to conduct a tender process in the coming financial year with respect to its external audit arrangements for the year ending 30 September 2026 and thereafter. We intend to conduct the process in line with the best practice recommendations of the FRC, but I would be grateful to receive input from interested shareholders on the process.

Planning activities for the tender have already commenced, including preliminary contacts with a range of potential candidates and we expect to be able to report on the results of this process in next year's Audit Committee report.

For the coming year ending 30 September 2024, the main priorities for the Committee will include:

- Continuing to monitor the ongoing credit risk environment and its impact on impairments, both in terms of forward-looking indicators and in terms of the support actual results give to the Group's modelling approaches
- Further monitoring of EIR related assumptions as more evidence emerges of actual customer behaviour in the current higher interest rate environment
- Ensuring that the Group's control processes and internal audit capabilities continue to evolve alongside developments in the business and emerging best practice
- Progressing the external audit tender process, with the intention of being able to report a decision in the Committee's next annual report
- Analysing the impacts of new accounting, reporting and governance initiatives on the Group, particularly the proposed new Code and the UK Government's corporate governance and auditing agenda, and ensuring the Group is properly positioned to respond to them

Overall, the year has been a challenging and busy one for the Audit Committee and I would like to thank my colleagues for the enthusiasm and diligence with which they have applied themselves to the complex issues involved. I would also like to thank Hugo Tudor for his nine years' service on the Committee, as he steps down from the Committee next year. His fund management experience has helped bring a different perspective to the Committee's deliberations, which has been particularly useful. My thanks also go to the people across the business whose work has informed the Committee's discussions in the year, and contributed to the compilation of this Annual Report and Accounts.

The Committee and I are pleased with the way in which the Annual Report reflects the Group's year, and we commend it to shareholders for approval at the AGM in March 2024, along with the resolutions concerning the reappointment of KPMG as auditors and their remuneration.

Alison Morris

Chair of the Audit Committee

6 December 2023

B6.2 Operations of the Committee

The Audit Committee currently comprises four independent non-executive directors of the Company. 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 2023 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 operations of the Committee are conducted in accordance with the FRC 'Audit Committees and the External Audit: Minimum Standard' (the 'Minimum Standard').

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, having been a senior partner in a major accountancy firm, specialising in audit and assurance for financial services entities, while other committee members have substantial experience in various aspects of the financial services industry obtained over the course of their careers. Details of Committee members' relevant experience are set out in section B3.1.

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.

Four times a year the Committee meets separately with representatives of the external auditor and with the Internal Audit Director without management present.

During the year ended 30 September 2023, the Committee met five times. Its principal activities were:

- 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
- 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
- Consideration of the results of the work carried out by the external auditor on the Group's annual and half-yearly financial reporting including their views on significant judgements, disclosures and the control environment
- 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 recommendation of revised terms to the Board for approval
- Consideration of the potential impact of the UK Government's corporate governance reform process on the Group and the Committee itself
- Ensuring that the provisions of the FRC Minimum Standard are reflected in the Committee's operational practice and terms of reference
- Planning for the audit tender process due to take place during the financial year ending 30 September 2024
- Consideration of the Group's readiness to address other forthcoming accounting and reporting changes which will affect it
- Consideration of the results of the External Quality Assessment of the Internal Audit function carried out in the year
- Approval of the Group's Internal Audit Plan 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 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 2023 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	<p data-bbox="411 264 1385 315">IFRS 9 requires that companies provide for future ECLs on any financial asset held on the balance sheet on the amortised cost basis.</p> <p data-bbox="411 338 1337 412">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.</p> <p data-bbox="411 439 1385 589">The current economic environment, with high levels of UK inflation, rising 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. These factors increase the potential requirement for management judgement in arriving at final ECL estimates and hence the level of scrutiny required by the Committee.</p> <p data-bbox="411 613 1358 665">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:</p> <ul data-bbox="411 687 1374 954" style="list-style-type: none">• The methods used to estimate probabilities of loss and potential losses, both mechanical and judgemental, including the new model for SME lending introduced in the year• 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 <p data-bbox="411 978 1362 1077">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.</p> <p data-bbox="411 1102 1406 1176">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.</p> <p data-bbox="411 1200 1369 1252">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.</p> <p data-bbox="411 1276 1385 1328">Further information on these estimates can be found in note 69a to the accounts. The impairment charge for the year and the movements in provision for impairment are shown in notes 20 to 25.</p> <p data-bbox="411 1352 1010 1375"><i>The Group's exposure to credit risk is discussed in note 63.</i></p>

Matter	Particular areas of focus
Interest income recognition	<p>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 procurement, 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.</p> <p>The Committee assessed the appropriateness of the assumptions made, considering performance of the portfolios against expectations and the impact of changes in product specifications.</p> <p>Redemption profiles used in the modelling of mortgage books were an area of focus, particularly with substantial tranches of five-year fixed rate products reaching maturity in the year.</p> <p>Given the higher interest rate environment, the Committee also reviewed the assumptions surrounding the interest rates which mortgage loans would revert to following initial fixed rate product periods and the impact of this rate environment on customer behaviour.</p> <p><i>Further information on these estimates can be found in note 69b to the accounts, and the interest income and expense recognised on this basis is shown in notes 4 and 5.</i></p>
Goodwill impairment	<p>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.</p> <p>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 discount rate used was also an area of focus.</p> <p><i>The potential impairment of goodwill is discussed in notes 69c and 31.</i></p>
Defined benefit pension obligations	<p>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.</p> <p>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.</p> <p><i>Further information on the Plan surplus, the basis of valuation and the assumptions underlying it can be found in note 60 to the accounts, along with an analysis of sensitivities to the more significant assumptions.</i></p>
Viability statement	<p>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.</p> <p>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.</p> <p><i>A fuller discussion of the directors' consideration of the viability statement is set out in Section A5.</i></p>
Going concern	<p>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.</p> <p>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.</p> <p>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.</p> <p><i>A fuller discussion of the directors' consideration of the going concern statement is set out in Section A5 and in note 70 to the accounts.</i></p>

Matter	Particular areas of focus
Internal control and risk management	<p>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.</p> <p>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.</p> <p><i>The Board statements on internal control and risk management are set out in sections B8 and B9.</i></p>
Fair, balanced and understandable	<p>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.</p> <p>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.</p> <p>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.</p>

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 could 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 2023 to the Board for approval.

The Committee's consideration of the financial statements for the year ended 30 September 2022, which took place in the year under review, is discussed in the Audit Committee report for that year.

The PRA Rulebook 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 III reports, considering whether they included all material matters required by the PRA Rulebook and whether they formed a fair representation of these matters.

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.

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 was appointed as auditor, 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 2023 is the eighth reported on by KPMG. Michael McGarry took over as engagement partner for the current year in place of Simon Ryder, who has retired from KPMG. The year ended 30 September 2023 is therefore the first for which Michael has been engagement partner. 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 seventh 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 to report its conclusions to shareholders.

Having considered the performance of the external auditor 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 during the forthcoming financial year, to avoid any issues of independence for potential bidders.

During the year the Committee considered the planning for the process and approved a structure and outline timetable, with the tender expected to take place over the second half of the 2024 financial year. This has taken account of the FRC guidance on audit tenders and the expectations set out in the Minimum Standard, and included consideration of how second-tier firms can be included in the process. Full details of the tender process and its conclusion will be provided in the Audit Committee report in next year's Annual Report and Accounts.

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 2023 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 external auditor was also asked to provide feedback on the degree to which their audit plan had been efficiently and effectively carried out
- 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 auditor

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 2022 audit, undertaken at the time of approval of the Group's 2022 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, and the FRC's most recent AQR audit inspection review on KPMG, published in July 2023.

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 2024 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.

Audit fees of Group entities for the year, including fees for the review of the half-year report, have increased by 13.5% to £2,385,000 (2022: £2,102,000). 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 2023 should be no more than 70% of the average of the audit fees for 2020, 2021 and 2022. As this average was £1,689,000, 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 £192,000 (2022: £213,000), 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:

	2023	2022
	£000	£000
Auditors – KPMG	-	38
Other big four firms	1,148	2,677
Other firms	-	-
	1,148	2,715

The Group maintains relationships with all the major accounting firms and considers a variety of providers for these types of assignment. There were engagements in place with non-big four firms at the year end.

B6.5 Internal Audit

The Committee is responsible for considering and approving the remit of the Internal Audit function, approving the Internal Audit Plan ('IAP'), and ensuring the function 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 the 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, Audit Committee and Risk and Compliance Committee that the governance, risk management and internal 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 2023. 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 the 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 2023, the Committee considered and approved the annual IAP for the year ending 30 September 2024, 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 financial year ended 30 September 2023 was approved before the beginning of the year, with the plus six half-year review of the IAP completed by the Committee in March 2023, 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 IAP for the year ending 30 September 2024, the Chair of the Committee met with the Internal Audit Director to discuss audit planning priorities, key business risks and to assess current resourcing.

All internal audit reports are circulated to the Board. During the year the Board has received reports covering themes including: prudential, model and credit risk management; the operation of lending and customer servicing areas; data and IT; and 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 (as described in section B8.2).

On an annual basis, Internal Audit reports to the Committee on its assessment of the effectiveness of the operation of risk management and control arrangements, including details of themes raised within internal audit reports. Review of this assessment is one of the means by which the Committee assesses and challenges related management judgements and conclusions as disclosed in this Annual Report and Accounts, as noted above.

The last such report, in November 2023, 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 appropriately skilled resources to complete the plan and to ensure the ongoing capabilities of Internal Audit remain strong to support future assurance. Alongside review and approval of the IAP, the Committee 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 ('CIIA') on an annual basis. In May 2023, the Committee considered the output of an external quality assessment ('EQA'), undertaken by an independent specialist firm, which was commissioned by the Committee to benchmark internal audit activities against best practice and peers, and to ensure the Group's Internal Audit function was in conformance with the CIIA standards.

The review concluded that Internal Audit was operating effectively, meeting the assurance needs of the Committee and conforming with CIIA Standards in all material respects.

As a matter of policy, the Committee intends to commission an EQA at least every five years and, as such, an EQA review will next take place during the year ending 30 September 2028. In the intervening years the Committee will consider the outputs of internal effectiveness reviews undertaken on a self-assessment basis.



The alignment with shareholder interests for the executive directors remains a key consideration for the Committee. The Group's performance has been very strong for the year and this is reflected in the outturns for the executive directors.

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 2023 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 (section B7.1) and the Annual Report on Remuneration (section B7.2). The policy summary tables extracted from the Remuneration Policy approved at the Annual General Meeting held on 1 March 2023 are reproduced for reference as section B7.3

The full Remuneration Policy is set out in the Annual Report and Accounts for the year ended 30 September 2022, a copy of which can be found at www.paragonbankinggroup.co.uk.

B7.1 Statement by the Chair of the Remuneration Committee

The information provided in this section is not subject to audit

Dear Shareholder

This financial year will mark the end of my tenure as Remuneration Committee Chair. I have been Chair since June 2018 during which time there have been two policy updates. Both policy updates sought to further align Paragon's remuneration structure with that of the wider banking industry and the most recent review included further simplification of the policy. I am very pleased to say that the latest policy vote in March 2023 achieved over 96% of votes cast in its favour.

I am stepping down as Chair in December 2023 having reached my nine years on the Board in November 2023. My thanks go to the Committee and Board for their support throughout my tenure. My successor, Tanvi Davda, has been a member of the Committee since September 2022 and brings strong finance and regulatory experience to the role. I wish her and the Committee well for the future.

Business performance

The Group's performance has been very strong for the year ended 30 September 2023 and this is reflected in the outturns for the executive directors as described below. These themes are expanded on further in this report as a whole and in the remainder of this letter.

Variable pay earned in the year

Both executive directors are being awarded an annual bonus of 97% of maximum opportunity. The balanced scorecard assessment shown later in this report records and expands on the excellent performance in all areas. When determining the annual bonus, the Committee noted the outstanding financial performance for the year which delivered record underlying operating profits, capital returns and earnings per share.

The PSP awards that are due to vest in December 2023 will vest at 96.41% of maximum. This also reflects strong performance over the period including TSR performance of over 75%, being above the upper quartile of the peer group. Underlying EPS was materially above the threshold for maximum vesting, being up 158.1% across the three years, with the growth translating to a 159.7% increase in the Group's dividend to 37.4 pence per share. These returns to shareholders have been supplemented by share buy-backs of £100.0 million announced in the year.

This level of vesting is reflective of the wider shareholder experience as each of the Group's profit, RoTE, earnings per share and dividend returns have, since 2020, increased. In respect of both absolute and relative TSR, only two of the peer group and the Company produced over 75% TSR over the three year period with four of the comparators being negative over the same period. The risk portion of the PSP, which considers both key elements of the Group's risk appetite as well as strategic risk across the medium term, provided a strong outturn for each element. The Group's credit, capital and liquidity risk were all well within risk appetite during the performance period and reflect the Group's strategic priorities of capital management and diversification. The customer and people metrics also performed in the top quartile and these support the Group's priority of having a customer and people focused culture. Additional detail on the customer and people outcomes is provided later in the report.

When considering this strong vesting performance, the Committee also noted the price at grant of these awards was £4.554 compared to the closing price at 30 September 2023 of £4.92. It was determined that this 8.0% increase, when put into the context of both the wider macro-economic environment and shareholder experience, did not constitute a windfall gain.

As detailed in the single figure remuneration summary, the total remuneration for the executive directors fell 3.7% from 2022 to 2023 despite these record results and distributions.

Group's remuneration philosophy

Our remuneration philosophy remains unchanged in seeking to recognise fairly the contribution of all employees and consistency of the application of this approach can be seen in the CEO pay ratio tables later in this report. During the year, the Committee undertook its annual review related to the fair pay agenda which confirmed its view that the Group is a fair pay employer. The fair pay section, included in the report to provide context for shareholders, can be found in section B7.2.4.

Further, the alignment with shareholder interests for the executive directors remains a key consideration for the Committee, with 20% of salary, 50% of annual bonuses and 100% of the longer term PSP being paid in shares. Both executive directors hold personal shareholdings materially above the Group's shareholding policy requirements.

Annual General Meeting remuneration report vote 2023

At the AGM in March 2023 both the binding and advisory votes on the directors' remuneration policy and report were approved by shareholders. The Committee was disappointed that the report received a vote in favour of only 69%. Engagement with a significant number of the Company's shareholders was undertaken, both before and after the AGM, and the Committee noted that there were no consistent themes for voting against the remuneration report by the minority of shareholders who did so.

Having reflected on the feedback received and the support of the majority of shareholders, the Committee continues to be satisfied that it acted in the best interests of the Company and all its stakeholders. While there were no consistent feedback themes, one area where the Committee acknowledges that disclosure could be improved relates to the determination of the number of share awards granted under the Performance Share Plan ('PSP'). As such, this report includes additional detail on how the PSP awards were calculated for those awards made in December 2022 (see 'Awards granted during the year ended 30 September 2023').

The calculation methodology last year is in line with standard practice in the banking industry due to the regulatory prohibition on paying dividend equivalents and the same methodology will be followed for the 2023 grant (with additional detail being included in both the Stock Exchange announcement detailing the awards made to executive directors and the 2024 Annual Report and Accounts).

Work of the Committee during the year

Over the year, discussions have been held with shareholders and proxy advisors regarding remuneration matters. I have also met with our People Forum to discuss both executive director and all-employee remuneration. Both of these interactions contributed to ensuring that the views and reflections of stakeholders are incorporated into the Committee's decision making.

Remuneration for the year ending 30 September 2024

Reflecting on the application of the policy over 2023, the Committee is satisfied that the policy approved at the 2023 AGM is working well and as such, there are no changes to the structure of remuneration for the year ending 30 September 2024. Salaries for the executive directors have been increased by 3%, which is lower than the workforce average of 5%.

Additionally, the Committee has reviewed the PSP metrics and has made changes to how the conditions operate, in respect of each of the climate and people metrics, reflecting the Group's strategic priorities. The changes to the climate metric have been made to reflect this new and constantly developing area. The people metric is updated to reflect market-wide developments and will, from the 2023 PSP grant, encompass diversity issues broader than simply gender.

PSP awards to be granted in December 2023 – consideration of windfall gains

Prior to granting the PSP in December 2023, the Committee will give due consideration to the need to apply any adjustment to reflect the potential for a windfall gain. At this stage, and considering the current share price relative to the share price used to grant the PSP awards in December 2022, the Committee does not consider that any adjustment is needed; however, this will be kept under review.

Conclusion

I trust that shareholders will support how the Group's remuneration philosophy has been implemented during the year. I recommend this report to shareholders and ask you to continue to support the work of the Committee by supporting the resolution to approve the Company's Directors' Remuneration Report set out in section B7.2, being put to the AGM in March 2024.

Hugo Tudor

Chair of the Remuneration Committee

6 December 2023

B7.2 Annual Report on Remuneration

Contents of the annual remuneration report

- The Remuneration Committee, key responsibilities and advisers (section B7.2.1)
- Directors' remuneration for the year ended 30 September 2023 (section B7.2.2)
- Application of remuneration policy for the year ending 30 September 2024 (section B7.2.3)
- Other information including Fair Pay (section B7.2.4)

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	Financial performance	EPS and relative TSR
Diversification	Liquidity – increasing sources of funding Growing profitability outside of BTL	Risk measures and financial performance	EPS, relative TSR and risk assessment
Digitalisation	Increasing direct business flows and reducing customer lead times	Financial performance	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 Chair of the Board being considered independent on appointment): Hugo Tudor (Chair of the Committee), Robert East (Chair of the Board), Tanvi Davda, Alison Morris and Graeme Yorston. In addition, Zoe Howorth was appointed to the Committee from 1 June 2023 (the date of her appointment as a director). Hugo Tudor will cease to be Chair from 7 December 2023 and Tanvi Davda will then become Chair.

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 the 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 advisers 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 was 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 objectivity

Fees – the total fees paid to PwC for advice to the Committee during the year amounted to £122,364 (including VAT) on a part fixed fee and a part time and materials basis

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 voting outcome for the resolution to approve the Annual Report on Remuneration and the resolution to approve the Remuneration Policy at the Company's AGM held on 1 March 2023 are set out below.

Resolution	Votes for	% for	Votes against	% against	Total votes cast	Votes withheld
Annual Report on Remuneration (2023)	126,778,994	69.19%	56,445,866	30.81%	183,224,860	5,780,942
Remuneration Policy (2023)	177,558,900	96.99%	5,517,947	3.01%	183,076,847	5,928,955

B7.2.2 Directors' remuneration for the year ended 30 September 2023

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 £000	R J Woodman £000	Total £000
Year ended 30 September 2023				
Fixed remuneration				
Salaries	(a)	921	582	1,503
Allowances and benefits	(b)	20	15	35
Role based allowance ('RBA')	(c)	-	-	-
Pension allowance	(d)	74	47	121
Total fixed remuneration		1,015	644	1,659
Variable remuneration				
Bonus	(e)	876	553	1,429
Share awards	(f)	1,364	859	2,223
Total variable remuneration		2,240	1,412	3,652
Total		3,255	2,056	5,311

	Note	N S Terrington £000	R J Woodman £000	Total £000
Year ended 30 September 2022				
Fixed remuneration				
Salaries	(a)	629	396	1,025
Allowances and benefits	(b)	17	14	31
Role based allowance	(c)	140	90	230
Pension allowance	(d)	126	79	205
Total fixed remuneration		912	579	1,491
Variable remuneration				
Bonus	(e)	905	570	1,475
Share awards	(f)	1,560	982	2,542
Total variable remuneration		2,465	1,552	4,017
Total		3,377	2,131	5,508

a) Salaries

Effective from 1 October 2022, a portion of the executive directors' salaries has been paid quarterly in shares. The share element is not subject to performance conditions, is not pensionable, and is released over five years in equal tranches.

b) 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 is a reimbursement from the Company in respect of: (i) costs associated with the purchase of shares for the RBA / salary as shares and (ii) certain travel costs incurred in connection with the performance of executive director duties which constitute taxable benefits in kind. These amounts represent amounts that HMRC treats as taxable together with an allowance to cover the tax. 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.

c) Role based allowance ('RBA')

This allowance was introduced following the AGM in 2020 and was withdrawn, effective from 1 October 2022, under the Remuneration Policy approved at the 2023 AGM.

The RBA was paid quarterly in shares and released over five years in equal tranches. The RBA was not subject to performance conditions. Release of shares in connection with the RBA will continue until 2027.

d) Pension allowance

Both Nigel Terrington and Richard Woodman received a cash allowance in lieu of pension of 10% of cash salary for the year ended 30 September 2023.

e) Bonus

Bonus opportunity during the year was, in line with the Policy, 98% (2022: 150%) of salary. Based on the performance measures set out below, a bonus of 97% of maximum opportunity was awarded. 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 outcome.

The awards made and the way in which they will be delivered to satisfy the regulatory requirement for 60% of variable remuneration (including PSP awards) to be deferred are set out below.

Executive director	Salary	Maximum opportunity	Percentage award	Total bonus	Cash	Delivered in Shares ¹	DSBP awards ²
	£000	% of salary	% of max	£000	£000	£000	£000
N S Terrington	921	98%	97%	876	393	393	90
R J Woodman	582	98%	97%	553	248	248	57

1. Delivered as shares, with all shareholder rights except the right to transfer shares until a year from the award date has lapsed, when the shares can be transferred or sold.
2. Bonus deferred under the DSBP as nil cost options which vest, in accordance with regulatory requirements, in equal tranches from year three to year seven. Each tranche will be subject to a one year holding period post-vest.

Balanced scorecard assessment

Measure	Weighting	Threshold	Target	Maximum	Actual	Outcome
Financial performance	60%					59%
Operating profit	30%	£222.2m	£242.9m	£253.3m	£277.6m	30%
RoTE (underlying)	12%	15.0%	17.25%	18.4%	20.2%	12%
NIM	6%	2.79%	2.95%	3.04%	3.09%	6%
Cost: income ratio (underlying)	6%	40.0%	38.6%	37.9%	36.6%	6%
CET1 ratio	6%	13.0%	14.5%	16.0%	15.5%	5%

Measure	Weighting	How measured	Outcome
Risk	20%	Qualitative assessment by the Remuneration Committee of:	20%
		<ul style="list-style-type: none"> • Credit performance has been exemplary across all of the Group's portfolios • Capital, liquidity and customer related risk appetite measures all significantly within appetite • Adoption of incoming Consumer Duty regulations completed successfully and by the required deadline • ERMF enhanced, leading to a stronger overall risk framework with a positive culture of first line ownership of risk 	

Measure	Weighting	How measured	Outcome
Personal performance	20%	Qualitative assessment by the Remuneration Committee of individual targets as detailed below for each director.	18%
Overall outcome			97%

Individual targets	Actual performance
Nigel Terrington	<ul style="list-style-type: none"> Record underlying profit before tax of £277.6 million increased by 25.4% from 2022 Savings expansion to £13.3 billion with margin enhancement of 40 basis points Regular surveys of intermediaries and customers show that levels of satisfaction were strong across all areas Financial metrics strength has been delivered alongside improved liquidity
Continue with technology development to digitalise the business for our customers, with improved service delivery, faster decision making and improved cost efficiencies	<ul style="list-style-type: none"> Technology roadmap delivered the development finance origination platform, first two phases of post-completion portal for mortgages and decision accelerator for SME lending origination platform Additional investment in infrastructure, cybersecurity and data controls Continued progress made with over 82% of all applications processed through the SME lending digital origination portal
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	<ul style="list-style-type: none"> Growth in deposits has facilitated all lending objectives and enabled liquidity flexibility Significant enhancement to platform utilisation Artificial intelligence ('AI') assessment commenced
Progress the Group's sustainability strategy by supporting customers to meet their climate change requirements and obligations	<p>Operations:</p> <ul style="list-style-type: none"> Second 'Responsible Business Report' delivered with positive feedback from employees, investors and other stakeholders Decarbonisation report completed for Homer Road, Solihull (head office) and next steps to be agreed Using a 2019 baseline, achieved a 42% reduction for 2023 emissions Head office EPC rating improved to C during the year <p>Lending:</p> <ul style="list-style-type: none"> Quality of lending stock improved as new lending to EPC rated A to C properties in the Mortgages portfolio exceeded redemptions month-on-month 30% increase in lending on electric vehicles
Continue to build a succession plan pipeline for Executive Committee roles	<ul style="list-style-type: none"> Senior leadership programme is successfully continuing to support career development for top talent and build internal strengths Internal successor for Managing Director of Premier Asset Finance appointed and strengthening senior sales and leadership capability in SME lending

Individual targets**Actual performance****Richard Woodman**

Strong leadership to deliver the Group's business plan and financial performance, within agreed risk appetites, upholding our values and always delivering good customer outcomes

- Strong financial metrics delivered in 2023
- Impairment coverage ratio increased to 49 basis points
- EIR assumptions refined to ensure no debtor escalation in higher interest rate environment
- Contingent liquidity enhanced
- Investment grade corporate rating re-confirmed

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

- Strong capital buffers maintained. Increased liquidity facilitated repurchase of legacy funding line and the acceleration of first TFSME payments in the first quarter of 2024, well ahead of original schedule
- Share buy-back extended to £100.0 million reflecting increased capital capacity

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

- Delivery of enhanced climate disclosures for this reporting cycle
- Increased focus on the Group's operational footprint and those financed emissions under its control

Prioritise and embed IRB to boost the Group's risk capability and longer-term capital efficiency

- IRB phase 2 engagement with regulator throughout 2023

Continue to improve financial control and reporting systems to enhance internal, external and regulatory reporting

- Reporting processes running smoothly including preparations for IRB requirements, embedding stress testing frameworks
- Forward-looking management of EIR approach in rising interest rate environment confirms the strong reporting and control focus

f) Share awards: Paragon Performance Share Plan

The value shown in the single figure table in respect of share awards represents the value of those awards for the performance period ended 30 September 2023, as set out below.

Grant date	Vesting in year to 30 September 2023		Vesting in year to 30 September 2022	
	N S Terrington	R J Woodman	N S Terrington	R J Woodman
	Dec 2020	Dec 2020	Jul 2020	Jul 2020
Shares granted	236,661	149,046	312,429	196,763
Vesting percentage	96.41%	96.41%	93.13%	93.13%
Shares vesting	228,164	143,695	290,965	183,245
	£	£	£	£
Share price at vesting	5.1762 ¹	5.1762 ¹	4.8620 ²	4.8620 ²
Dividend equivalent per share	0.8010	0.8010	0.4990	0.4990
Value per share at vesting	5.9772	5.9772	5.3610	5.3610
Value of award at vesting	1,363,775	858,889	1,559,863	982,376

1. The PSP value for the year ended 30 September 2023 has been determined using the average closing share price for the three months ended 30 September 2023 as an estimate. The actual value of the awards will not be finalised until the share price on the vesting date in December 2023, following the Preliminary Results announcement, is known.
2. The value for the year ended 30 September 2022 has been restated based on the market value of the shares at the vesting date, 6 December 2022.

For the executive directors, the PSPs cannot be exercised for another two years following the completion of the three-year performance period, in line with the holding period in the Policy. During this period the executive directors will continue to be entitled to dividend equivalents.

The determination of the vesting outcomes for the December 2020 grant is described below. That for the July 2020 grant was set out in the Directors' Remuneration Report for the year ended 30 September 2022.

The vesting value in 2023 reflected a 14% increase in the share price between grant and vesting.

Awards vesting in respect of the year ended 30 September 2023

Awards granted in December 2020 under the Group's PSP are subject to performance conditions measured over the three financial years ended 30 September 2023. The metrics are split between financial and non-financial performance conditions.

The awards were granted at 180% of salary. Overall vesting as a percentage of maximum award was 96.41%.

The detail of the outturns of each of the conditions was as follows:

PSP grant in December 2020: financial performance conditions

	Weighting	Threshold vesting for 25% of maximum award	Maximum vesting	Actual performance	Vesting outcome
Relative TSR	25%	Median performance (being 55.3%)	Upper quartile performance (being 74.7%)	Above upper quartile performance (being 75.2%)	100.0%
Underlying basic EPS	25%	58 pence	66 pence or more	94.2 pence	100.0%

PSP grant in December 2020: non-financial performance conditions

	Weighting	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: <ul style="list-style-type: none"> There were no material regulatory breaches Credit losses have been well within risk appetite across all the Group's portfolios Complaints management performance was strong throughout Conduct risk framework and quality assurance strengthened Operational risk appetites include metrics relating to operational losses, issue management, IT and cyber security and people and outcomes as a whole have been positive Surplus capital has been maintained and excess capital has significantly increased with a share buyback programme in place for part of the last three financial years 	88%	
		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: <ul style="list-style-type: none"> The loan portfolio has performed exceptionally well, with EWIs ('early warning indicators') being broadly benign. Interest rate risk management has protected NIM and customer positions Appropriate processes with regards to recruitment and retention of staff have given a near full employment position Earnings have diversified with the Commercial Lending division contribution increasing from £45.9 million in 2020 to £113.2 million in the year ended 2023 Paragon pension plan moved from £20.4 million deficit in 2020 to a £13.0 million surplus 	100%	
Customer	12.5%	Customer insight feedback on key product lines	<ul style="list-style-type: none"> NPS in line with industry average of +48 Industry average for customer satisfaction was 78% with the Group's at 79% 	90.0%
		Customer complaints relative to risk appetite levels	<ul style="list-style-type: none"> Complaints consistently below risk appetite tolerance Complaints resolved within eight weeks was on average 97.6% 	

PSP grant in December 2020: non-financial performance conditions

	Weighting	Actual performance	Vesting outcome
People	12.5%	<p>Employee engagement</p> <ul style="list-style-type: none"> • Outcome for the full engagement survey in June 2023 was +11 above the industry norm • Wellbeing surveys during the pandemic (October 2020 to October 2021) delivered consistently positive scores for physical, social and overall wellbeing • Independent all employee survey for Investors in People ('IiP') achieved scores at or above the IiP average <p>Voluntary attrition compared to the industry norm</p> <ul style="list-style-type: none"> • Voluntary attrition (at 9.6%) remained consistently below the industry average of 16.4% as reported by XpertHR in their most recent December 2022 data <p>Gender diversity of senior management</p> <ul style="list-style-type: none"> • Gender diversity above the target level throughout the performance period 	93.3%

There is no vesting for below threshold performance. There is straight-line vesting between the threshold and maximum for the TSR and EPS conditions. For the customer and people metrics there is 25% vesting at threshold performance and 50% vesting at target performance. For the risk metric the Committee determines the level of vesting between 0% and 100%.

Vesting was also subject to the Committee's determination that individual performance and the underlying financial performance of the Group were satisfactory. In respect of both these points the Committee concluded that the vesting level was appropriate for all participants.

Awards granted during the year ended 30 September 2023

On 16 December 2022 the following awards were granted as part of the executive directors' variable remuneration in respect of the year ended 30 September 2022. These awards are designed to fulfil the majority of the regulatory requirement that 60% of executive directors' variable remuneration should be deferred, with awards under the DSBP fulfilling the remainder of the requirement.

The awards were granted as nil-cost options, under the PSP with a face value of 180% of salary in line with the then extant Policy.

Executive director	Salary £000	Percentage grant	Face value of grant £000	Number of shares
N S Terrington	629	180%	1,132	290,331
R J Woodman	396	180%	713	182,847

The value of these awards will be disclosed in the single figure table for the year ending 30 September 2025, at the end of the performance period.

These awards have a three-year performance period, from 1 October 2022 to 30 September 2025, but become exercisable in equal annual tranches from the third to the seventh anniversaries of the grant.

The prices used to translate the monetary amounts of each tranche to a number of shares were based on market price data. The price was derived from 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 2022, discounted to allow for the fact that no dividend equivalents are payable in connection with this grant. This dividend adjustment was based on market estimates of the expected dividend yield.

Following these calculations, the adjusted price used for the tranche that becomes exercisable on the third anniversary of the grant was £4.358, with the prices of the tranches which become exercisable in the four succeeding years being £4.127, £3.909, £3.703 and £3.507 respectively reflecting the dividend yield adjustment.

These awards are subject to the following performance conditions.

Financial measures			
Performance measure	Weighting	Threshold vesting for 25% of maximum award	Maximum vesting
Relative TSR	25.0%	Median performance	Upper quartile performance
Underlying Basic EPS	25.0%	74.4 pence	88.1 pence or more
Non-financial measures			
Performance measure	Weighting		
Risk	20.0%	50% weighting is determined by the Committee based on an assessment by 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	10.0%	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	10.0%	Consideration will be given to (i) customer insight feedback on key product lines and (ii) customer complaints relative to risk appetite levels In addition, the Committee must be satisfied with the implementation of the FCA's Consumer Duty requirements before any part of the Customer tranche can vest	
People	10.0%	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 other metrics the assessment is based on 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 performance of the employee and the underlying financial performance of the Group are satisfactory.

Relative TSR measure

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
Secure Trust Bank PLC	S&U PLC	Vanquis Banking Group PLC
Virgin Money UK PLC		

Single figure of total remuneration for the Chair of the Board and non-executive directors

	Year ended 30 September 2023			Year ended 30 September 2022		
	Fees	Benefits ¹	Total	Fees	Benefits ¹	Total
	£000	£000	£000	£000	£000	£000
Chair of the Board						
R D East ²	255	2	257	21	-	21
F J Clutterbuck ³	-	-	-	235	13	248
Non-executive directors						
T P Davda ⁴	80	-	80	6	-	6
P A Hill	100	-	100	90	-	90
Z L Howorth ⁵	27	-	27	-	-	-
A C M Morris	103	-	103	90	-	90
B A Ridpath	80	-	80	70	-	70
H R Tudor	117	-	117	100	-	100
G H Yorston	80	-	80	70	-	70
Total	842	2	844	682	13	695

¹The Chair of the Board receives private health cover on an individual or family basis in the same way as the executive directors. The Chair is also eligible for life cover. In addition, the previous Chair received a car allowance.

²R D East was appointed to the Board on 1 September 2022

³F J Clutterbuck resigned from the Board on 1 September 2022

⁴T P Davda was appointed to the Board on 1 September 2022

⁵Z L Howorth was appointed to the Board on 1 June 2023

Payments for loss of office

No payments for loss of office were made during the year ended 30 September 2023.

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 2023 (including those held by their connected persons) were:

	N S Terrington Number	R J Woodman Number
Unvested awards subject to performance conditions		
PSP	498,942	314,172
Unvested awards not subject to performance conditions		
DSBP	228,499	142,199
Sharesave	4,245	4,245
Total unvested awards	731,686	460,616
Vested but unexercised awards		
PSP ¹	519,129	326,940
DSBP	112,930	-
Total vested but unexercised awards	632,059	326,940
Shares beneficially held		
Acquired as salary in shares or RBA and subject to restrictions related to disposal	89,802	56,947
Not subject to restrictions on disposal	1,224,929	527,844
Total shares beneficially held	1,314,731	584,791
Total interest in shares	2,678,476	1,372,347
Awards exercised in the year		
DSBP	97,670	25,759
Total awards exercised in the year	97,670	25,759

¹For the purposes of the table above, the awards granted in December 2020 are assumed to be vested but unexercised in respect of the percentage which will vest, 96.41%, and to have lapsed in respect of the balance.

Awards under the PSP and DSBP schemes noted above were granted in the form of nil cost options.

The interests of the Chair of the Board and the non-executive directors at 30 September 2023, which consist entirely of ordinary shares, beneficially held, were as follows:

	2023
R D East	10,000
T P Davda	5,701
P A Hill	2,659
Z L Howorth	-
A C M Morris	4,168
B A Ridpath	4,358
H R Tudor	63,000
G H Yorston	8,167

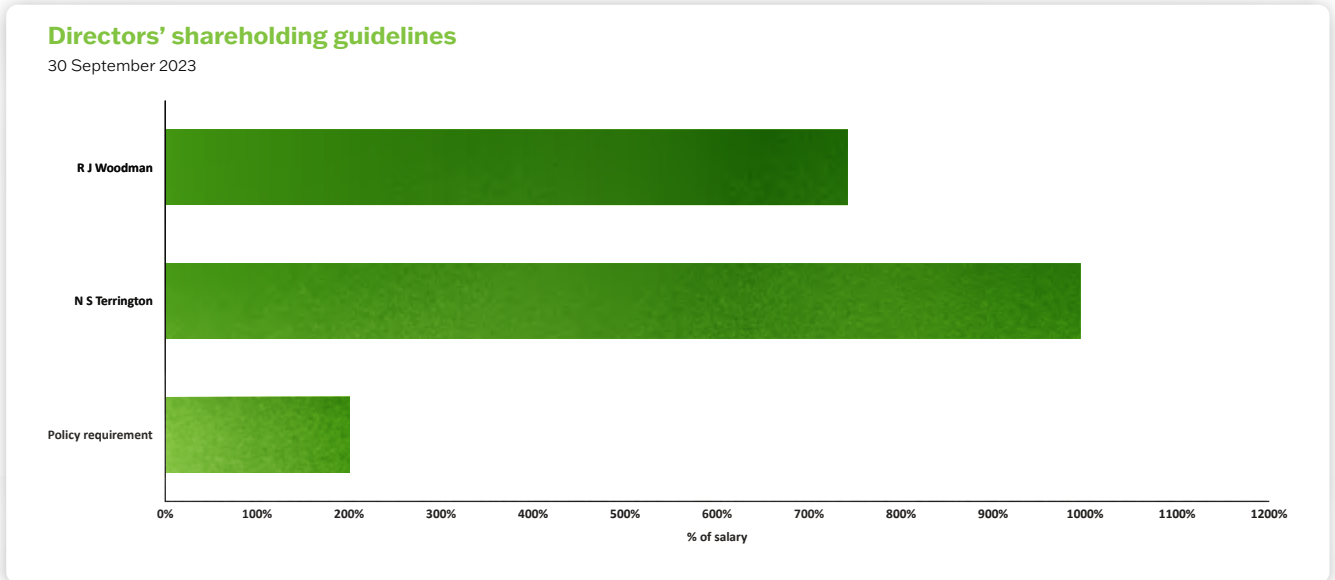
As at 1 December 2023, the last practicable date prior to approving this Report, the Company had not been advised of any changes to the interests of the directors and their connected persons as set out in the tables above.

Share ownership guidelines

Executive directors are required to hold a minimum number of shares in the Company with a value of 200% of their total salary (both the cash and shares element), calculated as at 31 December each year (as it was approved at the AGM in 2023). The valuation is calculated on a net of income tax and national insurance basis where relevant.

For the purposes of these guidelines, directors' shareholdings include all beneficial holdings and unexercised share awards, other than those which are subject to performance conditions, as set out in the table above.

The chart below compares the executive directors' holdings at 30 September 2023 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 2023.



At 30 September 2023, 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 guidelines, or (if lower) the number of shares actually held at the date of departure.

Relevant shares include all unexercised share awards not subject to a performance condition and those beneficial holdings acquired as part of a director's remuneration arrangements.

No former directors are subject to these guidelines.

B7.2.3 Application of remuneration policy for the year ending 30 September 2024

The information provided in this section of the Directors' Remuneration Report is not subject to audit.

Overview

It is intended that the Remuneration Policy approved at the AGM in March 2023 will be applied for the year ending 30 September 2024 in the same way as it was applied in the preceding year.

Executive directors

Fixed pay

The salaries of the executive directors were increased by 3% from 1 October 2023, as set out below.

		Salary 1 October 2023	Salary with effect from 1 October 2022
		£000	£000
N S Terrington	Salary – paid in cash	759	737
	Salary – paid in shares	190	184
Total salary		949	921
R J Woodman	Salary – paid in cash	480	466
	Salary – paid in shares	120	116
Total salary		600	582

Delivery of fixed remuneration, pension allowance and benefit entitlements remain as described above for the year ended 30 September 2023.

Annual bonus

In line with the new Policy, the bonus opportunity for the financial year ending 30 September 2024 will be 98% of salary. In combination with the PSP, the bonus will be delivered in line with regulatory requirements.

Aligned with last year, 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 80% of the financial performance award, but the Committee annually determines the appropriate secondary measures by reference to the strategic focus for the year. For 2024 the secondary measures will cover margin and costs.

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 awards in respect of variable remuneration for the year ended 30 September 2023 are expected to be made in December 2023. Awards made to the executive directors will represent a value of 118% of salary, with the number of shares to be awarded calculated on the basis of market data at the grant date.

The intended performance conditions and weightings are set out below. Changes have been made to the climate and people metric, as detailed below.

In addition, there is an individual performance condition and a Group underlying performance underpin which must be met prior to vesting occurring.

Financial measures			
Performance measure	Weighting	Threshold vesting for 25% of maximum award	Maximum vesting
Relative TSR	25%	Median performance	Upper quartile performance
Underlying basic EPS	25%	80.0 pence	100.0 pence or more
Non-financial measures			
Performance measure	Weighting		
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) operational footprint emissions reduction ii) financed emissions decarbonisation assessments; iii) sustainable products and iv) education and engagement	
Customer	10%	Consideration will be given to (i) customer insight feedback on key product lines and (ii) customer complaints relative to risk appetite levels In addition, the Committee must be satisfied with the implementation of the FCA's Consumer Duty requirements before any part of the Customer tranche can vest	
People	10%	Consideration will be given to (i) employee engagement, (ii) voluntary attrition compared to industry averages and (iii) 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 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%.

TSR, Risk and Customer Metrics

No changes are proposed to the TSR, Risk and Customer metrics from those which applied to the December 2022 grant, noted above.

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.

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 and regulation 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.

Success in respect of financed emissions will be measured by progress towards the development and delivery of decarbonisation assessments across core elements of the financed emissions portfolio, together with the continued development of the financed emissions balance sheet. The focus will, in part, be 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. Success in respect of sustainable products will be measured by the development of products to stimulate and meet customer demand. For the Group's operational footprint emissions (financed emissions and sustainable lending framework) there will be reporting of outcomes both internally and externally as appropriate.

People metric

The matters considered in respect of the people metric have remained unchanged since it was first introduced for the grant made in July 2020. The diversity element of the metric will, from the 2023 grant, be updated to encompass wider diversity matters, including comparison to Women in Finance Charter and the Parker Review targets, as well as considering the Group's compliance with relevant regulatory requirements on such matters.

Chair of the Board and non-executive director fees

During the year the fees payable to the Chair of the Board and non-executive directors were reviewed, by the Remuneration Committee and Board respectively, and the following increases set out below approved to take effect from 1 October 2023.

The Chair's fees had not increased since October 2017 and consequently a 10% increase was agreed to realign the fees to the market. Additionally non-executive directors' base fee increased by 5% aligned with the wider workforce (the other fees having increased or been introduced in 2022). The intention is that future increases for both the Chair and the non-executive directors will be annual and align with those given to the wider workforce so that spikes are less likely to occur.

Fees payable to the Chair of the Board and the non-executive directors are set out below on a per annum basis.

	Fee with effect from	
	1 October 2023	1 October 2022
	£000	£000
Chair of the Board	280.5	255.0
Non-executive directors		
Senior independent director (when also a committee chair)	123.5	120.0
Other committee chairs	103.5	100.0
Other non-executive directors	83.5	80.0

Each non-executive director receives a base annual fee of £73,500 with those non-executive directors who are chairs of committees receiving an additional £30,000 fee, while other non-executive directors receive £10,000 per annum in respect of their committee duties. The Senior Independent Director receives an additional £20,000 per annum for undertaking that role.

B7.2.4 Other information

The information provided in this section of the Directors' Remuneration Report is not subject to audit

This section provides information related to remuneration across the Group. This includes a description of the overall approach to all-employee remuneration in the Group and information showing how executive directors' remuneration compares with that for other employees and how it aligns with stakeholders' interests more widely.

Fair pay

Fair pay: group-wide remuneration philosophy

The Group is committed to rewarding all its employees fairly for their contribution, whilst ensuring they are motivated to always deliver the best outcomes for customers. This approach to remuneration reflects the Group's culture, vision and values and supports its purpose whilst being aligned to its long-term strategy 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 confirmed its view that the Group is a fair pay employer. 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 during the year was £21,255 per annum outside London and was increased to £23,400 per annum in October 2023. This was applied by the Group from 1 November 2023
- Payment of Profit Related Pay ('PRP') to around 87% 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 2023

Principle	Application	Example
Clarity	The executive director and group remuneration policies are clearly communicated to directors and all employees	The Remuneration Report in this document is available to all employees as is the group-wide Internal Remuneration Policy
	The Remuneration Committee Chair and Chair of the Board regularly consult with our major shareholders as part of our commitment to a transparent and open relationship	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
Simplicity	Straightforward remuneration structures apply to all levels of the Group's employees	Discussion on executive remuneration and how it aligns to the workforce forms part of the regular People Forum discussions with the Committee Chair
	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 links between awards and delivery of strategy and performance are shown in the table above which provides examples of remuneration alignment
	The Committee also has the discretion to override formulaic outturns to ensure outcomes do not reward poor performance	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 in the Annual Report and Accounts 2022 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 its values. This applies when determining incentive outcomes for all employees as well as through its commitments to EDI policies and the Living Wage Foundation	Demonstration of the Group's values underpins our variable incentive frameworks. 30% of PSP awards for directors and other senior managers are assessed against ESG related (Customer, Climate and People) metrics to ensure alignment to our sustainability strategy
	The current Remuneration Policy is fully aligned with our pay principles	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	The risk conditions in the annual and long-term incentives are tested annually by the Committee. The Committee has discretion to override formulaic outcomes
	Risk conditions are included within variable remuneration arrangements to align with regulatory expectations and shareholder interests	Both annual bonus for MRTs and PSP outcomes for all participants are subject to malus and clawback provisions
	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	

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 on a regular basis. 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 2023 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 the People Forum and 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 into employees' views.

How all-employee remuneration is aligned with stakeholders' interests

Within the Remuneration Policy Summary (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 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:

- **Salary as shares** – in the year ended 30 September 2023, salary in the form of shares was only paid to the executive directors and certain members of the executive committee.
- **Sharesave** – opportunities to participate in the Sharesave scheme 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 approximately 63% 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
Salary		
Same as executive directors (see Policy Summary 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 – 2022 Annual Report and Accounts 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.	Where private healthcare is provided as part of an employee's remuneration, it is on the same basis as for the executive directors. 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		
<p>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.</p> <p>A number of legacy arrangements exist including the Paragon Pension Plan.</p> <p><i>In respect of annual bonus and PSP 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:</i></p>	<p>Maximum contribution for the Paragon Worksave Pension Plan is 10% of salary.</p> <p>Maximum contribution to the Paragon Pension Plan, from April 2023, is 12.5% of salary.</p> <p>Maximum cash supplement contribution (where a former member of the Paragon Pension Plan below executive director level has left the Plan) is 45% of salary.</p>	<p>None.</p>
Annual bonus		
<p>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.</p> <p><i>* Deferral:</i></p> <p><i>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.</i></p>	<p>Maximum bonus potential varies across the Group depending on role and experience and for a small number of roles the maximum can be in excess of that 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.</p>	<p>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.</p>
Paragon Performance Share Plan ('PSP')		
<p>Same as executive directors (see Policy Summary section B7.3) excepting the applicability, or otherwise, to an individual of PRA remuneration rules in respect of post-performance period deliverability of the award outcomes.</p>	<p>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.</p>	<p>Same as executive directors (see Policy Report – 2022 Annual Report and Accounts section B7.3).</p>

Other variable pay opportunities

The Group provides other variable pay opportunities to certain groups of employees:

- **PRP** – 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 are then reviewed at least annually. Payments under such arrangements, 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 four 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 in the prior year data, information on directors who were no longer directors at the beginning of the current financial year. Neither does it contain information for any director in their year of appointment as they did not receive any remuneration in the comparator period.

			Salaries and fees	Allowances and benefits	Bonus
			%	%	%
2023					
N S Terrington	(a)		46.4%	17.6%	(3.2)%
R J Woodman	(a)		47.0%	7.1%	(3.0)%
R D East	From 01/09/22	(b)	1,114.2%	-	-
T P Davda	From 01/09/22	(b)	1,233.3%	-	-
P A Hill			11.1%	-	-
A C M Morris	(c)		14.4%	-	-
B A Ridpath			14.2%	-	-
H R Tudor	(c)		17.0%	-	-
G H Yorston			14.2%	-	-
Average Employee			4.9%	(4.5)%	(13.2)%
2022					
N S Terrington			5.0%	21.4%	4.9%
R J Woodman			5.0%	16.7%	4.8%
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					
NS Terrington			6.4%	(46.2)%	45.3%
RJ Woodman			6.5%	-	45.5%
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)%
B A Ridpath			-	-	-
H R Tudor	(c)		2.3%	-	-
G H Yorston			-	-	-
Average Employee			8.5%	19.2%	(25.7)%

(a) Impact of remuneration policy changes

(b) Appointed during the comparator year

(c) Change of responsibilities in the year

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:

For differences between prior years please see the relevant prior years' Annual Report and Accounts.

(a) Impact of remuneration policy changes

Following the approval by shareholders of a new directors' remuneration policy at the AGM in March 2023 the remuneration packages of the executive directors were rebalanced. The changes represent a minor rebalancing between variable and fixed pay such that total maximum pay was reduced while maintaining target pay. This rebalancing significantly impacted individual line items, meaning that the line-by-line comparison set out above should be set in the following context.

'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.

Following the AGM in 2023 and effective from 1 October 2022 a new definition of salary was introduced which included salary in shares with the RBA being removed. As such, the portion of salary used in the comparison calculation between 2023 and 2022 excludes the RBA for 2022 but includes the proportion of salary delivered in shares for 2023.

(b) Appointed during the comparator year and (c) Change of responsibilities during the year

'Salaries and fees' – for non-executive directors (excluding R D East and T P Davda where the comparison is between a month's fees in 2022 and a full year's fees in 2023) the increases are due to changes in the fees for chairing a committee, being senior independent director ('SID') or being a member of a committee in 2023. The base fee remained unchanged between 2022 and 2023. Further, Alison Morris became SID in August 2023 when Hugo Tudor ceased to be SID.

Other 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 certain brokerage costs together with travel costs incurred in connection with the performance of executive director duties which constitute taxable benefits in kind. The amounts included represent the amounts HMRC treats as taxable together with an allowance to cover the tax. The Group provides the amount required to cover the tax liability.

The changes in the average employee section of the table for this item in cash terms are due to a decrease of around £90 between 2023 and 2022.

- **'Bonuses'** – the decline in the bonuses between 2023 and 2022 for the average employee is primarily due to the decrease in the level of PRP, following a record PRP payment in 2022.

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.

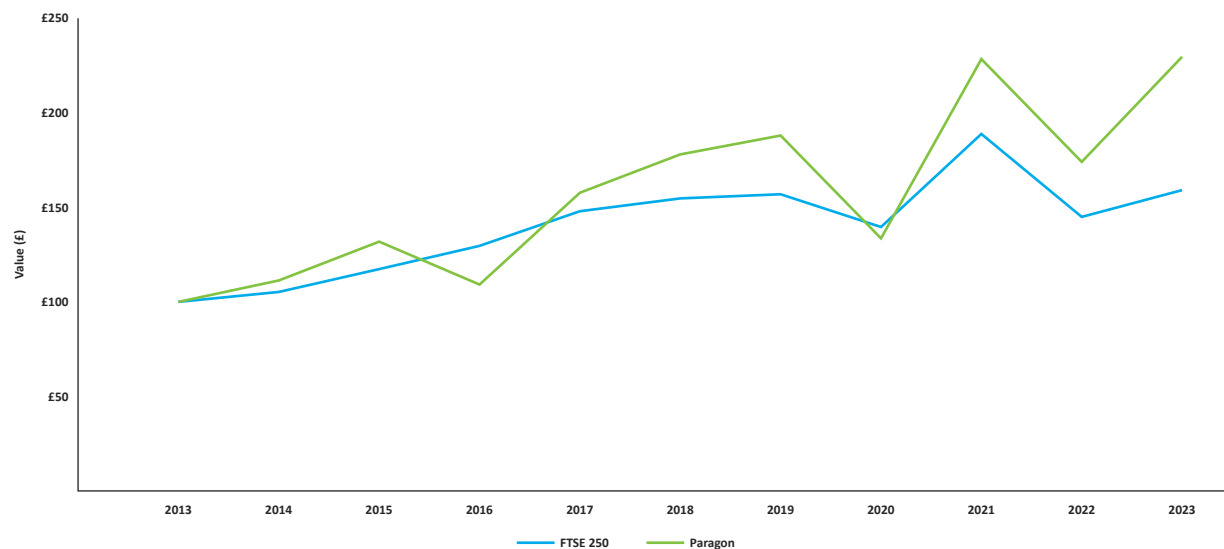
	Single figure of total remuneration	Annual bonus earned against maximum opportunity	Long-term incentive vesting outcome against maximum opportunity
	£000	%	%
2023	3,255	97.0	96.41
2022	3,377	96.0	93.13
2021	2,991	96.1	97.00
2020	2,174	66.1	72.00
2019	3,001	89.4	95.44
2018	2,426	90.0	72.47
2017	2,305	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

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 2023, of £100 invested in Paragon Banking Group PLC on 30 September 2013, compared with £100 invested in the FTSE 250 index.

Ten-year return index for the FTSE 250

Ten years ended 30 September 2023



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 2023.

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
2023	Option A	113:1	83:1	53:1
2022	Option A	112:1	84:1	52:1
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.

	2023			2022		
	25th percentile pay	Median pay	75th percentile pay	25th percentile pay	Median pay	75th percentile pay
	£	£	£	£	£	£
Base salary	26,000	35,000	56,000	22,000	29,000	55,000
Total remuneration	30,000	40,000	64,000	30,000	40,000	65,000

Change in CEO pay ratios

The limited changes in the CEO pay ratios shown above across all percentiles (with the exception of the early part of the Covid pandemic included in 2020) show a consistency of approach to remuneration for all employees over the noted periods. Whilst it was expected that the CEO pay ratio might be volatile from year to year, reflective of the bonus and PSP outcomes in any year this, to date, has not been the case.

The median pay ratio for each financial year is consistent with Paragon's remuneration and career progression policies because it shows that Paragon has continued to recognise all employees consistently and equitably.

Gender pay

Details of the Group's gender pay gap analysis are shown in Section A6.3. 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	2023 £m	2022 £m	Change £m
Wages and salaries	57	84.6	81.9	2.7
Dividend paid	48	67.9	68.9	(1.0)
Share buy-backs	47	111.5	66.9	44.6
Loan advances		3,008.6	3,214.7	(206.1)
Corporation tax paid	49	75.1	56.5	18.6

Loan advances are 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.

Other information

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, 10 March 2010 and 21 March 2023)
R J Woodman	8 February 1996 (as amended 10 March 2010 and 21 March 2023)

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 2026
Z L Howorth	1 June 2023	31 May 2026
A C M Morris	26 March 2020	25 March 2026
B A Ridpath	20 September 2017	19 September 2026
H R Tudor	24 November 2014	23 November 2024
G H Yorston	20 September 2017	19 September 2026

B7.3 Policy summary

The information provided in this part of the Directors' Remuneration Report is not subject to audit.

This part of the Directors' Remuneration Report summarises the Directors' Remuneration Policy that was adopted at the AGM on 1 March 2023. This is outline information only in respect of the executive directors, included here for ease of reading the Annual Report on Remuneration, and these pages do not constitute a Policy Statement in accordance with the Regulations.

For the full Policy Report, please refer to the Annual Report and Accounts for the year ended 30 September 2022 available at www.paragonbankinggroup.co.uk.

The table below illustrates how the remuneration of the executive directors is structured and delivered:

Structure	Delivered as	
Salary	Shares	20%
	Cash	80%
Pension 10% of cash salary		All in cash
Annual bonus 98% of salary	Shares	50%
	Cash	50%
Paragon Performance Share Plan (LTIP) 118% of salary		All in shares

Elements of the remuneration policy for executive directors

Purpose and link to strategy	Operation
Salary	
To provide a competitive, fixed component that reflects the scope of individual responsibilities and recognises sustained individual performance in the role.	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 salary is paid 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.
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. Other benefits may be offered from time to time taking into account individual circumstances.
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).

Purpose and link to strategy**Operation****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 below.

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 at least 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.

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. Malus and clawback apply to the PSP awards as described below.

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 all-employee Sharesave Plan.

A savings contract over three or five years with the funds used on maturity either to purchase shares by exercising options or returned to the participant.

The option is granted at a discount to the share price at the time of grant of up to 20%.

Malus and clawback

Annual bonus and PSP awards are subject to malus and clawback provisions in exceptional circumstances as detailed in the Directors' Remuneration Policy included in the Annual Report and Accounts 2022. Any incentive awards may be reduced or cancelled before vesting or clawed back for a period of up to seven years from date of grant. 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.

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.

B7.4 Approval of Director's Remuneration Report

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 Summary, 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 2023



As we look ahead to 2024, it is anticipated that many of the issues impacting the Group and the UK economy more broadly during the last twelve months will continue to dominate the Committee's agenda. We fully expect the macroeconomic environment to continue to be challenging, and remain a key area of focus.

Peter Hill, Chair of the Risk and Compliance Committee

B8. Risk management

B8.1 Statement by the Chair of the Risk and Compliance Committee

Dear Shareholder

As Chair of the Risk and Compliance Committee I am writing to you to explain the work we, as a committee, have undertaken during the last year and how we have successfully discharged our responsibilities in this respect. The Group has faced an evolving and diverse risk agenda over the last twelve months and the Committee has provided oversight and challenge throughout the period, ensuring that current and emerging risks are appropriately assessed and managed.

Looking back over the last financial year, the start of the period was dominated by the consequences of the mini-budget and the ensuing market volatility. Further uncertainty was witnessed during early 2023 with the collapse of several banks in the US and internationally, and the potential for wider contagion to UK banks. This has been coupled with the ongoing effects of the conflict in Ukraine, which has continued to impact the global economy, particularly affecting the supply of various commodities. The combination of these factors has continued to generate significant economic challenges and spiralling cost of living fuelled by inflationary pressures and consecutive interest rate rises.

The Committee has responded positively to these challenges, and I remain impressed with how these have been handled, with appropriate strategies implemented to ensure the Group continues to operate effectively and within its stated risk appetite.

I expect these issues to remain high on the risk agenda over the coming months and the Group will continue to focus on managing these impacts as a matter of course. However, it is important that the Committee remains a forward-looking body and, as the Chair of the Committee, my priority is to ensure that we also consider those emerging risks that may impact the Group's strategy or operating capability in the future.

The Enterprise Risk Management Framework ('ERMF') is key in ensuring the Group continues to identify, assess and manage those risks which may be detrimental, and I am pleased to see that this framework continues to mature and embed in an appropriate way. The refinement of the ERMF is an ongoing process, ensuring it remains proportionate, and the Committee remains committed to continual investment to maintain an ERMF with robust systems and controls that maintain compliance with statutory and regulatory obligations.

The enhancements made to the ERMF over the last few years have been enabled by a strong and pervasive risk culture embedded in day-to-day decision making and understood throughout the organisation. This continues to be a key enabler of effective risk management across the Group. These improvements have been evidenced in the regular dedicated risk culture reporting provided to the Committee and also in the Group's employee engagement survey, which reflected a good understanding of individual risk management responsibilities at all levels.

The importance of a positive and well-understood risk culture has also been a helpful foundation in the Group successfully meeting the first regulatory deadlines for the FCA's Consumer Duty, relating to on-sale products. The Consumer Duty requires a strong, customer-focussed culture to deliver good outcomes for retail customers and, during the year, the Committee has discussed and overseen the programme of work implementing the changes required by the Consumer Duty across the business, as a priority. Progress updates have been provided at each meeting and reporting has been enhanced to ensure that the Committee receives meaningful information to challenge effectively and gain assurance that the Consumer Duty is fully embedded.

As the 2024 final deadline for legacy products approaches, management information will continue to evolve and report potential areas of poor customer outcomes across the Group's in-scope portfolios, with the Committee overseeing the identification and resolution of issues.

The ongoing embedding of the obligations under the Consumer Duty will continue to remain a priority for the Committee over the coming years as we approach the next deadline, and continue to implement a culture of continuous challenge and improvement in the delivery of good customer outcomes.

Focus during 2023

Last year I set out the Committee's priorities for the 2023 financial year and I am pleased to say that these commitments have been met comprehensively, despite the challenges posed by new and emerging issues, which have required the Committee to react promptly and reprioritise accordingly. I can therefore confirm the Committee has diligently provided oversight and consideration of the following key areas:

- Ongoing monitoring of the macro-economic challenges with particular attention paid to the assessment of customer affordability and its impact on lending decisions. Credit appetites and policies have been subject to constant review and the Committee has considered the impact on stakeholders, ensuring, in particular, that appropriate support is provided to customers
- Reviewing any impacts on the Group of possible supply issues particularly in respect of energy, which was subject to detailed scenario testing during the winter of 2022/23
- Reviewing the implementation of the programme of work undertaken ensuring that the Group successfully met the July 2023 deadline for the first phase of the new FCA Consumer Duty. The Committee has provided continuous oversight of progress ensuring alignment with regulatory expectation and the Group's commitment to ensuring that customers receive good outcomes
- Oversight of the ongoing IRB application, including refinements made following PRA feedback
- Ongoing review of the Group's refinement of its financial crime risk and controls framework to ensure that it remains fit for purpose and continues to evolve to meet increasing regulatory expectations
- Continuing review of the potential impacts of the post-Brexit financial services regulatory regime with particular focus on potential impacts on the Group and its obligations following adoption of the Financial Services and Markets Bill in June 2023
- Further embedding of the Group's risk culture, which is key to supporting the maturing ERMF, with ongoing enhancement to risk reporting capabilities, ensuring appropriate focus on high materiality matters and improving the robustness of horizon scanning

In addition to these stated priorities, the Committee continues to maintain a balance between overseeing items in line with its core responsibilities as laid out in its terms of reference and ensuring that new and emerging issues are appropriately included in the agenda. During the year the Committee has provided close oversight of specific risk issues including:

- Monitoring the ongoing impacts of elevated levels of inflation and rising interest rates across the suite of principal risks

In particular, the Committee has considered a range of economic scenarios and reviewed the potential impacts on liquidity and market risk exposures. In light of these assessments the Committee has overseen and approved revisions to risk appetite ensuring that the approach to management of such risks remains prudent and well within buffers

- Continuing focus on the impact of the economic downturn on the lending lines and the impacts on credit policy. Despite the resilience of the buy-to-let portfolio, the Committee has focussed heavily on monitoring trends in arrears together with broader implications of the increased cost of living more generally for both customers and employees
- Maintaining a focus on good outcomes for customers in light of challenging economic conditions and further guidance from the FCA to ensure that appropriate support is in place for those customers facing financial difficulties

Other items addressed by the Committee, including ongoing oversight of the treatment of customers in vulnerable circumstances, the Group's response to climate change, and operational resilience are set out in section B8.2.

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. This included an overview of the scenario library which supports all stress testing processes to ensure they remain relevant and forward-looking. The Committee has also reviewed and approved the risk policies for each principal risk which included review and challenge of the relevant risk appetite measures.

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.

2024 and beyond

As we look ahead to 2024, it is anticipated that many of the issues impacting the Group and the UK economy more broadly during the last twelve months will continue to dominate the Committee's agenda. We fully expect the macroeconomic environment to continue to be challenging, and remain a key area of focus. However, I am confident that the Committee's close oversight of any credit stresses, coupled with the Group's prudent lending approach, effective capital management and robust liquidity levels will position it strongly in the face of further market volatility.

Whilst these conditions will undoubtedly continue to pose challenges across the industry, the Committee will continue to oversee all the principal risks facing the Group, ensuring that it remains vigilant in ensuring that any new and emerging issues are identified, undertaking robust assessment of these to ensure effective management in accordance with the Group's risk appetite.

Other priorities for the Committee will include:

- Ongoing monitoring of the embedding of the FCA Consumer Duty with enhanced reporting and oversight of plans and delivery to meet the final 2024 regulatory deadline
- Focus on identifying any signs of customer vulnerability in light of the continuing economic challenges and ensuring that the Group delivers good outcomes for all customers
- Review of the impacts of strategic transformation on the risk profile given the level of change in train and planned across all business lines. Change execution risk remains a key area of focus as the Group looks at new and innovative ways to ensure it remains financially and operationally resilient
- Ongoing review of the final policy implications of Basel 3.1 as the Group prepares to meet the 2025 implementation deadline
- Oversight and review of the Group's progress in obtaining IRB accreditation
- Close monitoring of wider industry trends in rising levels of claims management company activity
- Ongoing oversight of liquidity management given the failure of Silicon Valley Bank earlier this year

Whilst the challenges this year have been significant, the Group has clearly demonstrated its ability to react in a timely and agile way. The Group has been able to respond quickly as new threats have emerged, and I am confident that the skills and experience I have seen employed during the year, in managing both actual and emerging risks, position the Group well as circumstances continue to evolve.

The robustness of the firmly embedded three lines of defence model, together with the Group's established risk governance and reporting processes continues to ensure the Committee is able to provide effective oversight of risk issues therefore ensuring that the Group is well-placed to assess and manage any challenges it may face over the coming year.

Peter Hill

Chair of the Risk and Compliance Committee

6 December 2023

B8.2 Risk governance

The Group's approach to governance and the committee structures are described in Section B4.1. 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 2022 and again in November 2023, after the end of the year, align with the 2018 Code and good practice.

The Committee's responsibilities include reviewing, on behalf of the Board:

- Recommendations and matters escalated from the ERC
- The Group's current and future risk appetite, including the extent and categories of risk which the Board regards as acceptable
- 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 good outcomes for 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 Group's processes for compliance with laws, regulations and ethical codes of practice and the prevention of fraud

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 the review and approval of material aspects of the rating and estimation processes in relation to credit and finance models to the MRC.

The Committee meets at least four times a year. The executive directors, CRO, Chief Operating Officer, General Counsel and Internal Audit Director are invited to attend meetings of the Committee. 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 meets annually with the CRO, without the presence of executive management, to discuss his remit and any issues arising from it.

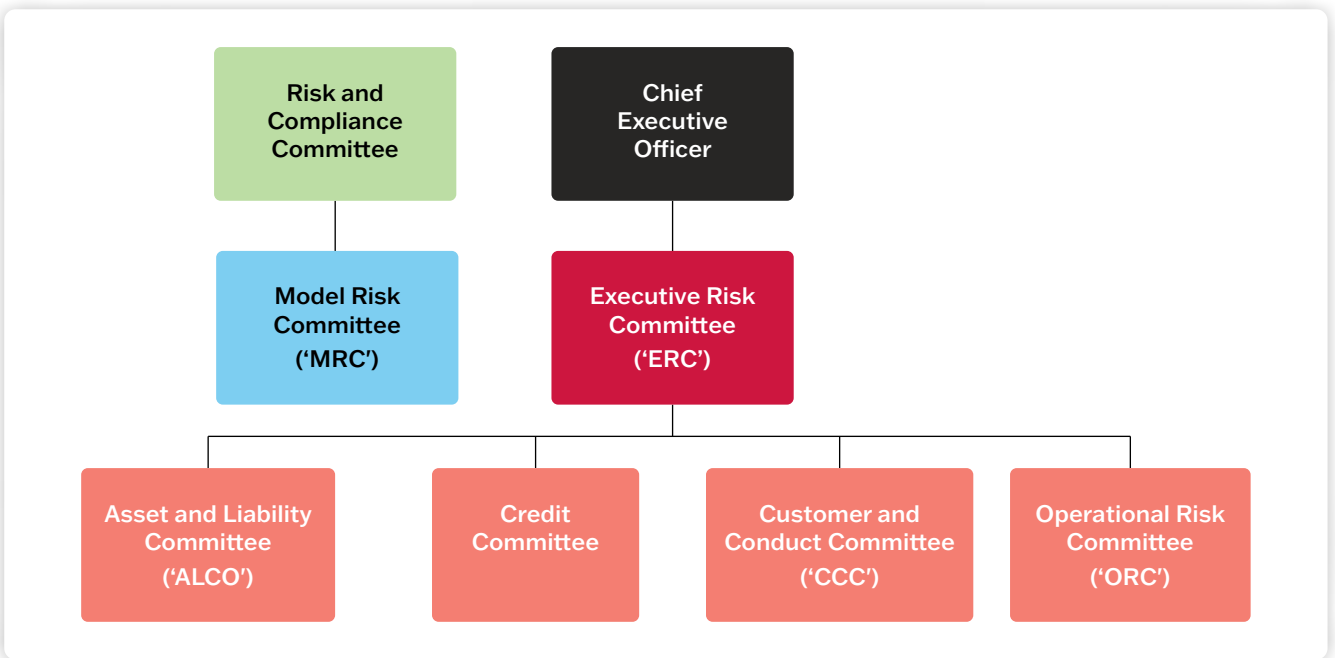
The Committee also has the power to requisition a meeting with the Internal Audit Director and/or the external auditor without the presence of executive management to discuss any matters that any of these parties believe should be discussed privately.

Standing items covered in each meeting of the Committee include:

- Reviews of the principal risks facing the Group
- Consideration of new or emerging risks and regulatory developments and their impact on the Group with particular focus in the year on Consumer Duty, Operational Resilience and the impacts of Basel 3.1
- Consideration and challenge of management's rating of the various risk categories to which the Group is exposed
- Consideration of the root causes and impacts 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 for each of the Group's principal risks to ensure they remained consistent with the delivery of the Group's strategic objectives, proposing any required changes to the Board, as required
- Reviewed the ongoing enhancements to the Group's ERMF including approaches to risk acceptance and the wider risk assurance framework



- Continued to monitor progress in respect of the Group's application for regulatory approval of its IRB approach to credit risk management
- Maintained ongoing focus on fair treatment of customers in light of challenging economic conditions and further guidance from the FCA to ensure that appropriate support is in place for those customers facing financial difficulties
- Provided ongoing oversight as the Group worked to implement the requirements of the FCA Consumer Duty on its products and services to ensure it successfully met the July 2023 deadline
- Reviewed the Group's ongoing embedding of its approach to Operational Resilience with a regular focus on the impacts of the Group's technology transformation programme on the risk and resilience profile. The Committee also continued to receive updates on the broader cyber landscape and the potential risks this may pose to the Group's resilience
- Maintained oversight of the Group's long-term digitalisation programme, considering the execution risk inherent in any such transformation, evaluating the impact across the principal risks of the adoption of new systems and ways of working and ensuring that the development of risk management and control systems proceeds in parallel with that of operational applications
- Provided oversight on the Group's progress on responding to the increasing challenges posed by climate change and the further embedding of climate change risk through enhancements to measures and standards to support the Group's broader climate change commitments
- Undertook ongoing oversight of third-party outsourcing and material supplier arrangements to ensure that the management of these remains commensurate with the Group's risk appetite
- Provided oversight of the Group's engagement in the PRA consultation process on the implementation of Basel 3.1 and reviewed its potential impacts on capital requirements
- Conducted deep-dive reviews into targeted risk areas, particularly where broader industry issues or regulatory publications have required an internal impact analysis

During the year themes for these reviews included: the impact of the collapses of Silicon Valley Bank and Credit Suisse; specific scenarios on the impact of rising interest rates following the Bank of England's increases in the base rate; and potential further interest rate increases, rising inflation and the broader consequences of the cost of living crisis

- Undertook regular focussed reviews of the principal risks including credit risk, capital risk, liquidity and market risk, climate change risk, conduct risk, strategic risk, reputational risk, model risk and across the different categories of operational risk
- 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 its subsequent updates
- Reviewed, challenged and approved the Money Laundering Reporting Officer's annual report in addition to providing continued oversight of the ongoing work to strengthen AML controls
- Considered and challenged reports in relation to the ICAAP and Recovery Plan, recommending approval to the Board

- Undertook preliminary work in respect of the 2023 ILAAP, scheduled to be presented for approval after the year end
- Challenged and approved various key risk policies
- Reviewed the potential impacts of regulatory publications including FCA and PRA priorities

To ensure the Committee is able to provide effective oversight, members undertake regular training on risk matters through a comprehensive board education programme (section B4.5). 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: Deep-dives across all business areas; ICAAP and Stress and Scenario Testing; Interest Rate Risk in the Banking Book; Cyber Risk; ESG and Climate Change; and Macro-Economic Trends.

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.

Executive risk committees

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, 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:

- Reviewing, as appropriate from time to time, the appropriateness and effectiveness of the ERMF and supporting frameworks 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 Performance ExCo)
- Reviewing the process and outcome of the Group's ICAAP, ILAAP and Recovery Plan and making 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 the 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 management of the Group's conduct risk and regulatory compliance risk (including financial crime risk), so that they are managed within appetite and customers receive good outcomes.

The CCC considers conduct risk information such as: details of conduct or regulatory compliance breaches; systems and procedures for delivering good 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. It is responsible for overseeing adherence to FCA Consumer Duty principles and outcomes through robust project oversight and the review and challenge of the annual Consumer Duty report prior to escalation to the Board.

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 and Compliance, 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 Credit Committee oversees the management of the credit portfolios, the post-origination risk management processes and the management of past due or impaired credit accounts. It also monitors performance against appetite on an on-going basis and makes recommendations for revisions to the credit risk appetites to the Board or the Risk and Compliance Committee. The Credit Committee also operates the Group's most senior lending mandate.

Operational Risk Committee ('ORC')

The ORC comprises the heads of relevant functions and lines of business 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. Although the CCC is the prime oversight body relating to Financial Crime, the ORC retain oversight through the annual review of the Money Laundering Reporting Officer report, and of fraud-related risk events, given that financial crime is an Operational Risk category.

The remit of the ORC also includes risks arising from personnel, technology and environmental matters within the business, including those arising from the use of third parties. The ORC 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.

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. An effective risk culture is seen as a key enabler to the successful delivery and execution of the Group's ERMF.

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 and fundamental to its Code of Conduct, which applies to all employees.

Enhancing and embedding the formal approach to measuring and monitoring the Group's risk culture has been a priority activity throughout the financial year, and the success in achieving this was evident through the results of the employee engagement survey in June. It was pleasing that 100% of respondents indicated that they clearly understood their risk management responsibilities and considered risk in their day-to-day roles, while 95% stated that management actions consistently aligned to their communications on risk management.

Various initiatives have also 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 included:

- Regular reporting to risk committees on the Group's risk culture based on four agreed components: Leadership and Direction; Individual Commitment; Joint Ownership; and Governance, together with clear measures to evidence these
- Undertaking of an annual risk maturity assessment across each area of the business that includes an evaluation of each area's perception of risk and how its risk management activities are viewed and put into practice
- Strengthening the community of risk champions, who represent each of the business areas, to promote and embed a risk-aware culture across the Group

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 good outcomes, particularly for those customers considered to be vulnerable, is central to the Group's risk management approach and is aligned with the embedding of the FCA Consumer Duty
- 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 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 provide 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 continuous improvement in its enterprise-wide risk management system to ensure it remains proportionate and fit for purpose. 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 the planned programme of work to enhance the risk management approach and further strengthen the ERMF to support the Group's strategic aspirations has been completed. Key achievements during the year have included a refresh of all principal risk policies, ensuring they remain relevant and reflect the minimum controls expected. Particular focus has been on enhancing the Conduct risk policy to ensure it fully aligns to the expectations under the new FCA Consumer Duty.

Further development and refinement of risk appetite measures and metrics remains a key priority across all risk types and reporting has been enhanced to reflect this. Given the work already undertaken over the last two years on developing the framework, the present focus is on ensuring that the ERMF operates in line with expectations, through a more structured programme of assurance across all risk types and components of the framework. Delivery of these enhancements has been facilitated by further embedding the Group's risk culture, effective stakeholder management, targeted education, and a collaborative approach between business areas and the Risk and Compliance function which continues to work well.

Priorities for the next twelve months include focussing on the alignment of business areas' risk management and control activities to the core control requirements set out in the Group's risk policies including broadening the coverage of first line control testing around these core controls. A key objective will be completing a comprehensive assessment of the appropriateness of the Group's risk management software, to ensure it can continue to fully support its risk management capability.

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 to support 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 its 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, the 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:
 - o Risk identification, assessment, treatment, monitoring and reporting
 - o Control implementation, and ongoing monitoring and assessment of operations
 - o 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 chairs the ERC. The function is overseen by the Risk and Compliance Committee, ERC and its supporting executive committees. Line 2 provides support and independent challenge on all risk-related issues, specifically:
 - o Developing, maintaining and monitoring effectiveness of the ERMF across the Group
 - o Developing and maintaining supporting risk processes within that framework, ensuring these are consistent with the Board's risk appetite
 - o Ensuring that risks identified by Line 1 are measured, monitored, controlled and reported consistently and on a timely basis
 - o 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 Line 1 and Line 2. This function is overseen by the Audit Committee and led by the Internal Audit Director who reports directly to the Chair of the Audit Committee. Internal Audit provides independent assurance on:
 - o Line 1 and Line 2 risk management activities
 - o Effectiveness of the ERMF
 - o Appropriateness and effectiveness of internal controls
 - o 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 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 the 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 and escalated to the Risk and Compliance Committee when appropriate.

Risk appetite is central to the effective implementation and operation of the ERMF. The risk appetite framework ensures 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. Further information on these risks is provided 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.

Capital risk	Liquidity and funding risk	Market risk	Credit risk	Model risk
Reputational risk	Strategic risk	Climate risk	Conduct risk	Operational risk

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
<p>The Group faces the risk that it maintains insufficient capital to operate effectively, including meeting minimum regulatory requirements, operating within board-approved risk appetite, and supporting its strategic goals.</p> <p>The Bank of England have yet to publish their final policy for the implementation of the Basel 3.1 standards in the UK, which is currently intended to be effective from 1 July 2025.</p>	<p>A robust process exists over reporting capital metrics, both internally and to the PRA, with a comprehensive annual ICAAP assessment including all material capital risks.</p> <p>An internal capital buffer is maintained in excess of minimum regulatory requirements to protect against unexpected losses.</p> <p>The Group continues to engage with the PRA in respect of its application for the accreditation of its IRB approach to buy-to-let credit risk for capital adequacy purposes, responding to feedback as the regulator proceeds with its internal assessment process.</p> <p>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, which would have a favourable impact on the Group if retained in the ultimate rules.</p>	<p></p> <p>While there has been little impact on the overall capital risk framework in the financial year, the global and UK economic outlook has continued to be subject to the pressures which arose following Russia's intervention in Ukraine, although these have not worsened significantly over the period.</p> <p>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.</p>


Further information about the Group's management of capital, including quantitative capital measures, is set out in note 61 to the accounts.

Liquidity and Funding Risk

Description	Mitigation	Year-on-year change
<p>The Group is exposed to the risk that it has insufficient funds to meet its obligations as they fall due.</p> <p>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.</p>	<p>The Group maintains a diversified range of both retail and wholesale funding sources to cover current and future business requirements.</p> <p>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.</p> <p>The Group has a dedicated Treasury function which is responsible for the day-to-day management of its overall liquidity and wholesale funding. The Board, through the delegated authority provided to the ALCO, sets limits for the level, composition and maturity of funding and liquidity resources.</p> <p>The Group's holdings of its own mortgage backed securities, together with assets pre-positioned with the Bank of England, mean that it has ready access to wholesale funding or liquidity if required.</p>	<p></p> <p>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, resulting in increased levels of liquid assets being held, and higher LCR and OLAR levels year-on-year.</p> <p>Despite a number of market disruptions during the year, including a number of bank failures in March and April 2023, liquidity risk is considered to have reduced from its level at the start of the year, when it was elevated by the fallout from the September 2022 'mini-budget'.</p>


More detailed information on the Group's liquidity risk profile, including quantitative data, is set out in note 64 to the accounts.

Market Risk

Description	Mitigation	Year-on-year change
<p>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.</p>	<p>This risk is managed within board-approved risk appetite limits with comprehensive treasury policies in place to ensure that the risks posed by changes and mismatches in interest rates are effectively managed.</p> <p>Day-to-day management of interest rate risk within board-approved limits is the responsibility of the treasury function, with control and oversight provided by ALCO.</p> <p>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 mismatches.</p>	<p></p> <p>While 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, markets were generally more stable at 30 September 2023 than a year earlier.</p> <p>The Group's overall market risk profile, relative to its balance sheet, has remained broadly similar to that at the previous year end, and therefore associated risk levels remain generally stable compared to the previous period end.</p>

More detailed information on the Group's management of market risk is set out in note 65 to the accounts.

Credit Risk

Description	Mitigation	Year-on-year change
<p>Credit risk elements which could expose the Group to the risk of unexpected material losses include:</p> <ul style="list-style-type: none"> • Customer risks through failure to screen potential borrowers, or to manage repayments • Concentration risk in credit portfolios through an uneven distribution of exposures of borrowers, asset classes, sectors or geographies • Reduction in the value of collateral owned by the Group, or secured against debt owed to it • Wholesale counterparty risk • Outsourcer default risk 	<p>The Group has a robust credit risk 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.</p> <p>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.</p> <p>The Group also continues to develop 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.</p> <p>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.</p> <p>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.</p> <p>Ongoing monitoring of the credit rating and financial performance of all outsourced relationships and critical suppliers is undertaken.</p>	<p></p> <p>Higher interest rates, rising costs, and resource shortages have been a key feature of the lending environment during the last twelve months. However, the Group's prudent credit policies combined with consistently high lending standards, have ensured that the impact on customer loan repayments has been modest so far. Arrears remain favourable compared with historical levels, with impacts being generally confined to early arrears states as borrowers adjust their cashflows to accommodate the higher costs. Tracking of customer risk profiles across lending areas shows little indication of stress, and asset equity coverage continues to provide significant credit risk mitigation.</p> <p>Whilst current loan performance remains robust, the Group continues to monitor the potential future impacts of the increased interest rate environment, house price movements and higher costs of living and doing business, 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 is considered to have increased compared to 30 September 2022.</p>

More information on the Group's retail and wholesale credit risk profiles, including quantitative credit measures, is set out in note 63 to the accounts.

Model Risk

Description	Mitigation	Year-on-year change
<p>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.</p>	<p>A robust framework of management and governance is in place to manage the risks associated with the use of internally developed models. This includes the MRC which oversees the development, implementation and ongoing monitoring of models across the Group.</p> <p>The Model Risk Management Framework provides a structured and disciplined approach to the management of model risk. It includes clear development, implementation and ongoing oversight principles, together with requirements for independent validation based on model materiality criteria.</p> <p>PRA Supervisory Statement SS 1/23, which addresses model risk management principles for banks and applies to firms with permission to use internal models to calculate regulatory capital, was published in the year. Firms have twelve months from the grant of such permissions to comply with the expectations of the SS. The Group has begun a programme of work to ensure compliance with the principles in advance of the Group receiving IRB accreditation, and is well-placed to meet the requirements within the timeframes required.</p>	<p>◆</p> <p>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 and the Group's continuing investment in this area, model risk remains within appetite and the outlook remains stable.</p>

Information on the Group's use of models in its impairment provision calculations is given in note 21 to the accounts.

Reputational Risk

Description	Mitigation	Year-on-year change
<p>Maintenance of a strong reputation across all business lines, operational activities, and the conduct of employees and associated third parties is core to the Group's philosophy.</p> <p>Detrimental reputational impacts may result from internal actions and external events, as a consequence of the crystallisation of other principal risks, or through failure to safeguard the integrity of the Group's brand or meet external expectations in its business practices.</p>	<p>The reputational risk policy supports reputational risk management across the Group. Reputational issues are considered at Board and ExCo level and, where relevant, will be identified, reviewed and escalated through risk committee governance.</p> <p>The reputational impacts of changes to strategy, pricing, people, processes or third-party relationships are explicitly considered in the decision-making process and are reviewed by the Director of External Relations. The Group will not undertake any activity it considers might be damaging to its reputation.</p> <p>Employees adhere to defined standards of conduct, encompassing policies, procedures and ways of working. These are defined in the Group's Code of Conduct.</p> <p>The Group has an experienced External Relations function which manages all Group communications and ensures that the reputational profile of the Group is protected. Reputational risk is monitored through tracking traditional and social media coverage, net promoter scores, review platforms and regular customer surveys.</p> <p>Any material risk events are reviewed for reputational impact, and mitigating actions are initiated as appropriate.</p>	<p>◆</p> <p>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.</p>

Strategic Risk

Description	Mitigation	Year-on-year change
<p>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.</p>	<p>The Group closely monitors economic developments in the UK and overseas, with support from leading independent macro-economic and other advisors.</p> <p>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.</p> <p>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.</p>	<p>◆</p> <p>Whilst the political and economic landscape has stabilised somewhat over the year, there remains some uncertainty around the performance of the UK economy in both the near and longer term. Material increases in the cost of living, interest rates and businesses' input costs, continue to put pressure on household and corporate disposable income. The full impacts of this uncertainty, coupled with implications of the UK's new trading relationships post-Brexit, are still to be fully determined, as are those of any potential change of political direction, with a UK general election due before January 2025.</p> <p>Despite the wider economic challenges, the Group has remained resilient throughout the year, and has made strong progress in meeting the strategic targets in its corporate plan. In particular it has continued to make significant progress with its digitalisation programme which remains a key priority.</p> <p>Notwithstanding the apparently more stable economic situation and its continuing strong activity levels, the Group recognises that the full impact of interest rate rises is unlikely to be immediate, with the potential for further economic and property market disruption into the new financial year presenting a further risk to the execution of the Group's strategy.</p>

Climate Risk


Description	Mitigation	Year-on-year change
<p>The Group considers the impact of climate change either directly on the Group or indirectly through its third-party relationships or its lending activities.</p> <p>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.</p>	<p>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.</p> <p>The Group continues to actively engage with public forums such as Bankers for Net Zero ('B4NZ'), the Mission Zero Coalition and UK Finance to support the development of future policy and regulation.</p> <p>Ongoing and enhanced climate change analysis, supported by scenario testing, continues to be further embedded throughout the business to inform longer term strategic planning.</p> <p>The Sustainability Committee provides comprehensive oversight of climate initiatives across each business line, whilst the Credit Committee monitors the performance of mortgaged property collateral against EPC data.</p>	<p>◆</p> <p>The Group has continued to make progress on its climate change agenda, with activity focused on enhancing its financed emissions balance sheet, continued public policy advocacy through B4NZ, and enhancing its approach to climate change scenario analysis.</p> <p>The levels of regulatory scrutiny and public interest in this area continue to be high. However, the Group's approach has matured in the year, and a proportionate approach to managing the risks and opportunities associated with climate change has been maintained.</p> <p>Although there is significant uncertainty in respect of the direction of government policy and regulation in this area, the Group's scenario analysis assessment indicates that its exposure to climate change impacts is being managed appropriately and does not pose it a significant or increasing risk.</p>

Information on the Group's management of climate-related risks is set out in Section A6.4 in accordance with the recommendations of the TCFD.

Conduct Risk

Description	Mitigation	Year-on-year change
<p>The commitment to delivering good customer outcomes is at the heart of the Group's culture and strategy.</p> <p>Conduct risk arises where the culture and behaviours fail to promote the customer's best interests and avoid foreseeable consumer harm, resulting in poor outcomes for the customer.</p>	<p>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, including those in financial difficulties.</p> <p>During the year work was undertaken to review and enhance the Group's management of conduct risk in preparation for the introduction of the FCA Consumer Duty in the year. All employees are required to undertake conduct risk related training.</p> <p>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 Remuneration Committee and the CCC annually and individual schemes require approval from the Chief People Officer, CFO and Conduct and Compliance Director before implementation.</p>	<p>▲</p> <p>Whilst the Group is well-placed to provide appropriate support, the current economic environment, including the cost of living crisis, increasing input costs for businesses, and rising interest rates and mortgage payments, is likely to place strain on some of the Group's customers. This will potentially increase the risk of customer vulnerabilities, particularly in relation to financial resilience.</p> <p>The introduction of the FCA's Consumer Duty also raises the expectations of firms to proactively seek to prevent causes of foreseeable harm, and to identify harm when it occurs.</p>

Operational Risk

Description	Mitigation	Year-on-year change
<p>Operational risk arises across the Group through the possible inadequacy or failure of internal processes, people and systems or from external events.</p> <p>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 will be exacerbated through periods of transformation and / or stress.</p>	<p>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.</p> <p>Operational risk is managed 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 Information Technology, Data Protection, Change Management, Procurement, Financial Crime and People.</p> <p>The Group is committed to ensuring it remains resilient, particularly in respect of IT capability. Significant investment has been undertaken to ensure that the Group is well-protected in the face of the evolution of cyber threats particularly as it increasingly moves to cloud-based infrastructure and looks to harness digital capability as part of its IT roadmap.</p> <p>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. Operational resilience remains a key driver with consideration at all stages of the project lifecycle.</p> <p>The Group relies on third party providers for a number of key services including in support 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.</p> <p>The Group continues to focus on building an engaged and highly skilled workforce through the delivery of effective reward, succession planning, recruitment, development and retention strategies. In addition, the Group remains committed to the wellbeing of its employees, and its employee networks play a crucial role in ensuring leadership understand and can act on employee feedback.</p>	<p> The Group does not consider that it has a higher than average likelihood of being subject to a cyber threat, however the general threat level has significantly increased following the impacts of the conflict in Ukraine. Given the pace at which the external cyber threat level continues to evolve, the Group remains committed to investment in this area on a long-term basis, focussing on key areas such as data loss prevention and vulnerability management. Ongoing assessment of, and response to, the Group's cyber profile remains integral to successful execution of its overall strategy.</p> <p>Recruitment and retention in some specialisms remain challenging given wider skill shortages across the industry. Changing working patterns and economic uncertainty continue to influence the recruitment market. More generally, impacts of the war in Ukraine and the wider cost of living challenges have further increased potential risk exposures across key operational risk categories such as financial crime.</p> <p>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.</p> <p>The Group continues to make strong progress on its strategic transformation programme, which it anticipates will benefit operational risk management in the longer term. However, it is recognised that significant change can exacerbate operational strains in the short term. Potential for such issues is being carefully managed through robust governance and oversight.</p> <p>Whilst the Group continues to maintain a robust control environment and operational risk related losses remain at historically low levels, the present operating environment poses considerable challenges which increase inherent operational risks.</p>

B9. Directors' report

The directors of Paragon Banking Group PLC (registered number 2336032) submit their Report prepared in accordance with Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ('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 Zoe Howorth who was appointed as a director on 1 June 2023.

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 2023.

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 corporate 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 2024.

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 45 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 59 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 £11.5 million and to make market purchases of up to 23.0 million £1 ordinary shares. These authorities expire at the conclusion of the forthcoming AGM on 6 March 2024 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 1 March 2023 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 14 June 2022 the Group announced an extension of its share buy-back programme originally announced on 7 December 2021 to up to £75.0 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 2022. On 6 December 2022 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 2022. This programme was extended to £100.0 million on 6 June 2023 for reasons set out in section 4.3 of the Half Year Financial Report for the six months ended 31 March 2023, published on that day. During the year 20,721,957 £1 ordinary shares (2022: 13,011,285) having an aggregate nominal value of £20,721,957 (2022: £13,011,285), were purchased under these programmes and initially held as treasury shares. Total consideration paid in the year was £111.5 million, including costs (2022: £66.9 million). This programme was completed on 22 September 2023.

On 1 June 2023, 12,870,044 ordinary shares previously held in treasury were cancelled, leaving a balance held in treasury of 2,000,000 shares. The cancelled shares had a nominal value of £12,870,044 and represented 5.68% of the issued share capital excluding treasury shares at that time.

During the year 1,418,430 shares held in treasury were transferred to the holders of maturing options granted under the Group's Sharesave share option plan (2022: nil). Consideration received in respect of these shares was £4.0 million (2022: nil).

The number of treasury shares held at 30 September 2023 was 10,074,002 (2022: 3,640,519), representing 4.61% of the issued share capital excluding treasury shares (2022: 1.53%). The maximum holding of treasury shares during the year was 14,870,044 (2022: 12,100,834) representing 6.56% of the issued share capital excluding treasury shares at that time (2022: 4.83%).

Dividends

An interim dividend of 11.0 pence per share was paid during the year (2022: 9.4 pence per share).

The directors recommend a final dividend of 26.4 pence per share (2022: 19.2 pence per share) which would give a total dividend for the year of 37.4 pence per share (2022: 28.6 pence per share) subject to approval at the forthcoming AGM.

Capital reorganisation

On 28 March 2023 the High Court confirmed the cancellation of Company's capital redemption reserve, following approval at the AGM on 1 March 2023. This reserve had arisen on the cancellation of ordinary shares which had been purchased in the market and held in treasury. The £71.8 million balance outstanding on the capital redemption reserve was transferred to the profit and loss account and included within distributable reserves.

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 2023.

Shareholder	% Held	Notification date
Liontrust Investment Partners LLP	5.07	21/09/2020
Royal London Asset Management	5.04	26/04/2023
Dimensional Fund Advisors LP	5.00	21/07/2021
Franklin Templeton Fund Management Limited	4.96	10/01/2022

On 1 November 2022, Pental Group Limited notified the Company that their interest had dropped below 5%.

On 15 November 2022, Janus Henderson Group PLC notified the Company that their holding had reduced below 5%.

The percentages quoted above were calculated by reference to the total voting rights ('TVR') at the relevant date.

As at 5 December 2023, 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 2023 no political donations were made by any Group company (2022: £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 6 March 2024 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 47).

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 1.5 million ordinary shares (2022: 2.5 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 47 and details of the share-based remuneration arrangements are given in note 59.

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 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 62 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 2023, 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 2023

B10. Responsibility statement

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 2023, 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 Disclosure Guidance and Transparency Rule ("DTR") 4.1.16R, the financial statements will form part of the annual financial report prepared in accordance with DTR 4.1.17R and 4.1.18R. The auditor's report on these financial statements provides no assurance over whether the annual financial report has been prepared in accordance with those requirements.

Confirmation by the Board of Directors

The Board of Directors currently comprises:

R D East (Chair of the Board)	G H Yorston (Non-executive director)
N S Terrington (CEO)	A C M Morris (Non-executive director)
R J Woodman (CFO)	P A Hill (Non-executive director)
H R Tudor Non-executive director	T P Davda (Non-executive director)
B A Ridpath (Non-executive director)	Z L Howorth (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 2023

C.

Independent Auditor's Report

On the financial statements

P190 C1. Independent Auditor's Report to the members of Paragon Banking Group PLC

Report by the independent auditor of the Company, KPMG LLP, on the financial statements.





Our values

INTEGRITY

To be honest and open
in everything we do

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') for the year ended 30 September 2023 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 67 other than the disclosures labelled as unaudited in note 61.

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 2023 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 eight financial years ended 30 September 2023. 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 2022), 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

Impairment allowances on loans to customers

Risk vs 2022 ← →

(£73.6 million; 2022: £63.5 million)

Refer to the Audit Committee Report, accounting policy note and notes 21 to 25 (financial disclosures).

Subjective estimate

The measurement of expected credit losses ('ECL') involves significant judgements and estimates. The risk of material misstatement of ECL remains 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.

Judgemental 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. The Buy-to-Let mortgages and Asset Finance loans portfolios are the most significant in this regard.

Model estimations – Inherently, judgemental 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 and assumptions used are the key drivers of the Group's ECL results and are therefore the most significant judgemental 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 allowances on 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 25).

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.

Our response

We performed the tests below 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.

Our procedures included:

- **Our economics expertise:** We involved our own economic specialists, who assisted us in:
 - assessing the reasonableness of the Group's methodology for determining the economic scenarios used and the probability weightings applied to them; and
 - assessing the overall reasonableness of the economic forecasts by comparing the Group's forecasts to our own modelled forecasts.
- **Our credit risk modelling expertise:** We involved our own credit risk modelling specialists, who assisted us in:
 - evaluating the Group's impairment methodologies for compliance with IFRS 9;
 - for models which were changed or updated during the year, evaluating whether the changes or updates were appropriate by assessing the updated model methodology against the applicable accounting standard;
 - for a selection of models, assessing the reasonableness of the model predictions by reperforming the model monitoring to compare the predictions against actual results and evaluating the resulting differences;
 - evaluating the model output for a selection of models by independently rebuilding the model code in line with the corresponding model functionality and comparing our output with management's output; and
 - independently applying management's staging methodology and inspecting model code for the calculation of the ECL model to assess its consistency with the Group's approved staging criteria and the output of the model.
- **Test of details:** Key aspects of our testing in addition to those set out above involved:
 - assessing the reasonableness of each judgemental adjustment by comparing these against our independent assessment calculated by applying alternative calculations and assumptions; and performing sensitivity analysis;
 - testing the key LGD assumptions impacting the Group's overall ECL model calculation to assess their reasonableness. This included performing sensitivity analysis to understand the significance of certain assumptions; and assessing the key assumptions against the Group's historical experience;
 - for a selection of portfolios, reperforming the calculation of the loan staging applied and comparing to management's staging outputs; and
 - for a selection of portfolios, reperforming the calculation of the LGD and the ECL measured on the loan portfolio.

Our response

- **Benchmarking assumptions:** Key aspects of our testing involved:
 - assessing the completeness of judgemental adjustments to the model-driven ECL by performing benchmarking to comparable peer group organisations and using our knowledge of the Group and its industry to challenge the completeness of risks addressed in the adjustments; and
 - testing the key LGD assumptions impacting the Group's overall ECL model calculation by comparing the Group's assumptions to those of comparable peer group organisations.
- **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.
- **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the Group's overall ECL. We assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the key judgements and assumptions made was sufficiently clear.

Our results

As a result of our work, we found the impairment provision recognised and the related disclosures to be acceptable (2022: acceptable).

Key audit matter

Interest receivable on originated loan accounts

Risk vs 2022 ↑

(£642.9 million; 2022: £486.7 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 and the expectations regarding future reversionary interest rates.

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 and reversionary interest rate assumptions based on its forecasting process which incorporates historical experience. Ongoing developments in the UK economy result in a greater degree of subjectivity in this assessment for the current year.

Our response

We performed the tests below 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.

Our procedures included:

- **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. We also applied alternative repayment profiles based on our recalculations. The historical comparison 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 and reversionary interest rates against our own knowledge of industry experience and trends, including market rates. We also challenged the appropriateness of the level of segmentation applied to the loan portfolios by management.

Key audit matter

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 69).

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.

Our response

- **Sensitivity analysis:** We performed sensitivity analysis over the repayment profiles by applying alternative profiles incorporating the results from 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. 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

As a result of our work, we found the interest receivable on originated loan accounts and the related disclosures to be acceptable (2022: acceptable).

Key audit matter

Recoverability of goodwill

Risk vs 2022 ← →

(£162.8 million; 2022: £164.4 million)

Refer to the Audit Committee Report, accounting policy note and note 31 (financial disclosures).

Forecast-based assessment

The carrying amount of goodwill is significant to the financial statements and there may be risks to its recoverability due to changes in market factors since acquisition. The estimated recoverable amount is subjective due to the inherent judgement 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. Continued 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 recoverability of goodwill 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 31) 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.

Our response

We performed the tests below 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. Our procedures included:

- **Historical comparisons:** We compared the Group's previous cash flow forecasts 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 industry 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 considering the discount rates and sensitising the forecast future cash flows.
- **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the estimated recoverable amount. We assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the key judgements and assumptions made, was sufficiently clear.

Our results

As a result of our work, we found the resulting carrying amount of goodwill and the related disclosures to be acceptable (2022: acceptable).

Key audit matter

Valuation of the retirement benefit pension obligation

Risk vs 2022 ← →

(£89.3 million, 2022: £97.6 million)

Refer to the Audit Committee Report, accounting policy note and note 60 (financial disclosures).

Subjective valuation

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 the discount rate, inflation rate and mortality rates/life expectancy. Continued 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 60).

Our response

We performed the tests below 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. Our procedures included:

- **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 evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the valuation of the retirement benefit pension obligation. As a part of this, we assessed the sensitivity analysis that is disclosed.

Our results

As a result of our work, we found the valuation of the retirement benefit pension obligation and the related disclosures to be acceptable (2022: acceptable).

Key audit matter

Recoverability of parent company's investment in subsidiaries

Risk vs 2022 ← →

(£637.4 million; 2022: £638.7 million)

Refer to the accounting policy note and note 32 (financial disclosures).

Low risk, high value

The carrying amount of the parent company's investments in subsidiaries represents 60.2% (2022: 65.8%) 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 tests below rather than seeking to rely on the parent company's controls because the nature of the balance is such that we would expect to obtain audit evidence primarily through the detailed procedures described. Our procedures included:

- **Tests of detail:** We considered the fair value of the Group with reference to its share price, and also 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

As a result of our work, we found the resulting carrying amount of the investments in subsidiaries to be acceptable (2022: 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 £10.0 million determined with reference to a benchmark of Group profit before tax, normalised to exclude fair value movements and TBMC closure costs in 2023 as disclosed in note 13 and note 11 respectively, of £280.1 million (2022: £8.8 million determined with reference to a benchmark of Group profit before tax normalised to exclude fair value movements). This materiality level represents 3.6% (2022: 3.9%) of the stated benchmark.

Materiality for the parent company financial statements as a whole was set at £7.0 million (2022: £3.9 million), determined with reference to a benchmark of current year net assets, of which it represents 1.0% (2022: 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% (2022: 75%) of materiality for the financial statements as a whole, which equates to £7.5 million (2022: £6.6 million) for the Group and £5.2 million (2022: £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 £0.50 million (2022: £0.44 million), in addition to other identified misstatements that warranted reporting on qualitative grounds for the Group and £0.35 million (2022: £0.19 million) for the parent company.

Of the Group's two (2022: two) reporting components, we subjected one (2022: two) to full scope audits for group purposes and one (2022: nil) to review of financial information (including enquiry). The component for which we performed a review of financial information was not individually significant enough to require an audit for group reporting purposes, but a review was performed for complete coverage. The components within the scope of our work accounted for 100.0% (2022: 100.0%) of total Group revenue, 100.0% (2022: 100.0%) of Group profit before tax, and 100.0% (2022: 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 2023 Annual Report, Section A6.4, on pages 64 to 82.

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. The Annual Report includes narrative 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, 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 and Company, 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 and Company's financial forecasts.

We considered whether the going concern disclosure in note 70 to the financial statements gives a full and accurate description of the directors' assessment of going concern. We assessed the completeness of the going concern disclosure.

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 70 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 70 to be acceptable; and
- the related statement under the Listing Rules set out in Section A5 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.
- Involving our forensics specialists in assessing the completeness and appropriateness of the identified fraud risk factors and associated fraud risks.

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.

We did not identify any additional fraud risks.

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. This included searching for those posted and approved by the same user, journals posted to seldom used accounts, unbalanced journal postings and those including specific descriptors, and testing any journal entries identified where applicable;
- Assessing whether the judgements made in making accounting estimates are indicative of a potential bias.

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 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 (including consumer duty), 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 (Section A5) 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.

The Company is required to include these financial statements in an annual financial report prepared under Disclosure Guidance and Transparency Rule ("DTR") 4.1.17R and 4.1.18R. This auditor's report provides no assurance over whether the annual financial report has been prepared in accordance with those requirements.

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.

Michael McGarry (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

15 Canada Square

London

E14 5GL

6 December 2023

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

P202 D1. Primary Financial Statements

- P202** D1.1 Consolidated statement of profit or loss
- P203** D1.2 Consolidated statement of comprehensive income
- P204** D1.3 Consolidated balance sheet
- P205** D1.4 Company balance sheet
- P206** D1.5 Consolidated cash flow statement
- P206** D1.6 Company cash flow statement
- P207** D1.7 Consolidated statement of movements in equity
- P208** D1.8 Company statement of movements in equity

P209 D2. Notes to the Accounts

- P209** D2.1 Analysis
- P275** D2.2 Employment costs
- P290** D2.3 Capital and financial risk
- P316** D2.4 Basis of preparation





Our values

COMMITMENT

To drive the business forward with determination and to do so with effort and enthusiasm

D1. Primary Financial Statements

D1.1 Consolidated statement of profit or loss

For the year ended 30 September 2023

	<i>Note</i>	2023	2023	2022	2022
		£m	£m	£m	£m
Interest receivable	4		1,010.6		545.7
Interest payable and similar charges	5		(561.7)		(174.5)
Net interest income			448.9		371.2
Other leasing income	6	27.4		24.6	
Related costs	6	(21.8)		(20.0)	
Net operating lease income		5.6		4.6	
Gain on disposal of financial assets	7	-		4.6	
Other income	8	11.5		12.6	
Other operating income			17.1		21.8
Total operating income			466.0		393.0
Operating expenses	9		(170.4)		(153.0)
Provisions for losses	12		(18.0)		(14.0)
Operating profit before fair value items			277.6		226.0
Fair value net (losses) / gains	13		(77.7)		191.9
Operating profit being profit on ordinary activities before taxation			199.9		417.9
Tax charge on profit on ordinary activities	14		(46.0)		(104.3)
Profit on ordinary activities after taxation for the financial year			153.9		313.6
	<i>Note</i>		2023		2022
Earnings per share					
- basic	16		68.7p		129.2p
- diluted	16		66.3p		125.9p

The results for the current and preceding years relate entirely to continuing operations.

D1.2 Consolidated statement of comprehensive income

For the year ended 30 September 2023

	Note	2023	2023	2022	2022
		£m	£m	£m	£m
Profit for the year			153.9		313.6
Other comprehensive income					
<i>Items that will not be reclassified subsequently to profit or loss</i>					
Actuarial gain on pension scheme	60	2.4		15.3	
Tax thereon		(0.8)		(3.7)	
Other comprehensive income for the year net of tax			1.6		11.6
Total comprehensive income for the year			155.5		325.2

D1.3 Consolidated balance sheet

For the year ended 30 September 2023

	Note	2023 £m	2022 £m	2021 £m
Assets				
Cash – central banks	17	2,783.3	1,612.5	1,142.0
Cash – retail banks	17	211.0	318.4	218.1
Loans to customers	18	14,495.0	13,650.4	13,408.2
Derivative financial assets	26	615.4	779.0	44.2
Sundry assets	27	51.0	39.2	69.2
Current tax assets	28	8.9	5.4	-
Deferred tax assets	44	-	-	14.4
Retirement benefit obligations	60	12.7	7.1	-
Property, plant and equipment	29	74.7	71.4	70.4
Intangible assets	30	168.2	170.2	170.5
Total assets		18,420.2	16,653.6	15,137.0
Liabilities				
Short-term bank borrowings		0.2	0.4	0.3
Retail deposits	33	13,234.4	10,569.5	9,297.4
Derivative financial liabilities	26	39.9	102.1	43.9
Asset backed loan notes	34	28.0	409.3	516.0
Secured bank borrowings	35	-	586.0	730.0
Retail bond issuance	36	112.4	112.3	237.1
Corporate bond issuance	37	145.8	149.2	149.0
Central bank facilities	38	2,750.0	2,750.0	2,819.0
Sale and repurchase agreements	39	50.0	-	-
Sundry liabilities	40	631.2	513.1	90.7
Current tax liabilities	28	-	-	1.4
Deferred tax liabilities	44	17.7	44.4	-
Retirement benefit obligations	60	-	-	10.3
Total liabilities		17,009.6	15,236.3	13,895.1
Called up share capital	45	228.7	241.4	262.5
Reserves	46	1,257.5	1,223.9	1,056.1
Own shares	47	(75.6)	(48.0)	(76.7)
Total equity		1,410.6	1,417.3	1,241.9
Total liabilities and equity		18,420.2	16,653.6	15,137.0

Approved by the Board of Directors on 6 December 2023.

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 2023

	Note	2023 £m	2022 £m	2021 £m
Assets				
Cash – retail banks	17	27.6	19.7	19.6
Sundry assets	27	228.8	39.2	73.1
Deferred tax assets	44	1.6	-	-
Property, plant and equipment	29	13.2	14.6	16.0
Investment in subsidiary undertakings	32	787.9	897.1	978.5
Total assets		1,059.1	970.6	1,087.2
Liabilities				
Retail bond issuance	36	112.4	112.3	237.1
Corporate bond issuance	37	149.4	149.2	149.0
Sundry liabilities	40	38.4	51.1	41.9
Current tax liabilities	28	1.8	-	-
Deferred tax liabilities	44	-	0.1	1.8
Total liabilities		302.0	312.7	429.8
Called up share capital	45	228.7	241.4	262.5
Reserves	46	582.4	445.5	455.6
Own shares	47	(54.0)	(29.0)	(60.7)
Total equity		757.1	657.9	657.4
		1,059.1	970.6	1,087.2

Approved by the Board of Directors on 6 December 2023.

Signed of behalf of the Board of Directors.

N S Terrington
Chief Executive

R J Woodman
Chief Financial Officer

D1.5 Consolidated cash flow statement

For the year ended 30 September 2023

	<i>Note</i>	2023	2022
		£m	£m
Net cash generated by operating activities	49	2,171.7	1,168.7
Net cash (utilised) by investing activities	50	(3.1)	(2.4)
Net cash (utilised) by financing activities	51	(1,105.0)	(595.6)
Net increase in cash and cash equivalents		1,063.6	570.7
Opening cash and cash equivalents		1,930.5	1,359.8
Closing cash and cash equivalents		2,994.1	1,930.5
Represented by balances within:			
Cash	17	2,994.3	1,930.9
Short-term bank borrowings		(0.2)	(0.4)
		2,994.1	1,930.5

D1.6 Company cash flow statement

For the year ended 30 September 2023

	<i>Note</i>	2023	2022
		£m	£m
Net cash generated by operating activities	49	86.0	191.3
Net cash generated by investing activities	50	99.0	69.5
Net cash (utilised) by financing activities	51	(177.1)	(260.7)
Net increase in cash and cash equivalents		7.9	0.1
Opening cash and cash equivalents		19.7	19.6
Closing cash and cash equivalents		27.6	19.7
Represented by balances within:			
Cash	17	27.6	19.7
Short-term bank borrowings		-	-
		27.6	19.7

D1.7 Consolidated statement of movements in equity

For the year ended 30 September 2023

	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	-	-	-	-	153.9	-	153.9
Other comprehensive income	-	-	-	-	1.6	-	1.6
Total comprehensive income	-	-	-	-	155.5	-	155.5
Transactions with owners							
Dividends paid (note 48)	-	-	-	-	(67.9)	-	(67.9)
Own shares purchased	-	-	-	-	-	(120.5)	(120.5)
Irrevocable instruction accrual	-	-	-	-	-	10.8	10.8
Exercise of share awards	0.2	0.3	-	-	(11.4)	14.8	3.9
Shares cancelled	(12.9)	-	12.9	-	(67.3)	67.3	-
Capital reorganisation	-	-	(71.8)	-	71.8	-	-
Charge for share based remuneration (note 57)	-	-	-	-	9.6	-	9.6
Tax on share based remuneration	-	-	-	-	1.9	-	1.9
Net movement in equity in the year	(12.7)	0.3	(58.9)	-	92.2	(27.6)	(6.7)
Opening equity	241.4	71.1	71.8	(70.2)	1,151.2	(48.0)	1,417.3
Closing equity	228.7	71.4	12.9	(70.2)	1,243.4	(75.6)	1,410.6

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	-	-	-	-	313.6	-	313.6
Other comprehensive income	-	-	-	-	11.6	-	11.6
Total comprehensive income	-	-	-	-	325.2	-	325.2
Transactions with owners							
Dividends paid (note 48)	-	-	-	-	(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	-
Capital reorganisation	-	-	-	-	-	-	-
Charge for share based remuneration (note 57)	-	-	-	-	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

D1.8 Company statement of movements in equity

For the year ended 30 September 2023

	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	-	-	-	-	254.6	-	254.6
Other comprehensive income	-	-	-	-	-	-	-
Total comprehensive income	-	-	-	-	254.6	-	254.6
Transactions with owners							
Dividends paid (note 48)	-	-	-	-	(67.9)	-	(67.9)
Own shares purchased	-	-	-	-	-	(111.5)	(111.5)
Irrevocable instruction accrual	-	-	-	-	-	10.8	10.8
Exercise of share awards	0.2	0.3	-	-	(5.3)	8.4	3.6
Shares cancelled	(12.9)	-	12.9	-	(67.3)	67.3	-
Capital reorganisation	-	-	(71.8)	-	71.8	-	-
Charge for share based remuneration (note 57)	-	-	-	-	9.6	-	9.6
Net movement in equity in the year	(12.7)	0.3	(58.9)	-	195.5	(25.0)	99.2
Opening equity	241.4	71.1	71.8	(23.7)	326.3	(29.0)	657.9
Closing equity	228.7	71.4	12.9	(23.7)	521.8	(54.0)	757.1

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 48)	-	-	-	-	(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	-
Capital reorganisation	-	-	-	-	-	-	-
Charge for share based remuneration (note 57)	-	-	-	-	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

D2. Notes to the Accounts

For the year ended 30 September 2023

1. General information

Paragon Banking Group PLC (the 'Company') is a company domiciled in the United Kingdom and incorporated in England and Wales under the Companies Act 2006 with company number 2336032. The Company controls a number of subsidiary entities and presents financial statements on a consolidated basis for the Company and all its subsidiaries (together the 'Group'). The address of the Company's 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 2023

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 at 30 September 2023 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

These segments are the same as those used at 30 September 2022.

Dedicated financing and administration costs of each of these businesses are allocated to the segment. With effect from the 2023 financial year, interest impacts of fair value hedging activities have been allocated to segments for management accounting purposes. Comparative figures have been adjusted for consistency. Shared central costs are not allocated between segments, nor is income from central cash balances or the carrying costs of unallocated savings balances.

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 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.

Year ended 30 September 2023

	Mortgage Lending	Commercial Lending	Unallocated items	Total
	£m	£m	£m	£m
Interest receivable	713.6	207.4	89.6	1,010.6
Interest payable	(436.0)	(71.7)	(54.0)	(561.7)
Net interest income	277.6	135.7	35.6	448.9
Other operating income	5.6	11.5	-	17.1
Total operating income	283.2	147.2	35.6	466.0
Operating expenses	(26.2)	(26.4)	(117.8)	(170.4)
Provisions for losses	(10.4)	(7.6)	-	(18.0)
	246.6	113.2	(82.2)	277.6

Year ended 30 September 2022 (restated)

	Mortgage Lending	Commercial Lending	Unallocated items	Total
	£m	£m	£m	£m
Interest receivable	399.7	134.8	11.2	545.7
Interest payable	(148.5)	(23.6)	(2.4)	(174.5)
Net interest income	251.2	111.2	8.8	371.2
Other operating income	7.4	9.8	4.6	21.8
Total operating income	258.6	121.0	13.4	393.0
Operating expenses	(24.4)	(24.9)	(103.7)	(153.0)
Provisions for losses	(4.6)	(9.4)	-	(14.0)
	229.6	86.7	(90.3)	226.0

The segmental profits disclosed above reconcile to the Group results as shown below.

	2023	2022
	£m	£m
Results shown above	277.6	226.0
Fair value items	(77.7)	191.9
Operating profit	199.9	417.9

The assets and liabilities attributable to each of the segments at 30 September 2023, 30 September 2022 and 30 September 2021 on the basis described above were:

	<i>Note</i>	Mortgage Lending	Commercial Lending	Total Segments
		£m	£m	£m
30 September 2023				
Segment assets				
Loans to customers	18	12,902.3	1,972.0	14,874.3
Operating lease assets	29	-	44.3	44.3
Securitisation cash	17	86.1	-	86.1
		12,988.4	2,016.3	15,004.7
Segment liabilities				
Allocated deposits		13,160.4	2,199.4	15,359.8
Securitisation funding		28.0	-	28.0
		13,188.4	2,199.4	15,387.8
30 September 2022				
Segment assets				
Loans to customers	18	12,328.7	1,881.6	14,210.3
Operating lease assets	29	-	41.6	41.6
Securitisation cash	17	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
30 September 2021				
Segment assets				
Loans to customers	18	11,829.6	1,573.1	13,402.7
Operating lease assets	29	-	39.3	39.3
Securitisation cash	17	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

An analysis of the Group's financial assets by type and segment is shown in note 18. 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 £15.3m (2022: £14.5m) 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.

	2023	2022
	£m	£m
Total segment assets	15,004.7	14,492.4
Unallocated assets		
Central cash and investments	2,908.2	1,690.4
Derivative financial instruments	615.4	779.0
Fair value hedging adjustments	(379.3)	(559.9)
Operational property, plant and equipment	30.4	29.8
Retirement benefit obligations	12.7	7.1
Intangible assets	168.2	170.2
Other	59.9	44.6
Total assets	18,420.2	16,653.6
	2023	2022
	£m	£m
Total segment liabilities	15,387.8	15,053.7
Unallocated liabilities		
Unallocated retail deposits	(2,094.5)	(3,389.2)
Derivative financial instruments	39.9	102.1
Central borrowings	3,058.4	3,011.9
Tax liabilities	17.7	44.4
Other	600.3	413.4
Total liabilities	17,009.6	15,236.3

3. Revenue

	<i>Note</i>	2023	2022
		£m	£m
Interest receivable	4	1,010.6	545.7
Operating lease income	6	27.4	24.6
Other income	8	11.5	12.6
Total revenue		1,049.5	582.9
Arising from:			
Mortgage Lending		719.2	407.1
Commercial Lending		240.6	164.6
Total revenue from segments		959.8	571.7
Unallocated revenue		89.7	11.2
Total revenue		1,049.5	582.9

4. Interest receivable

Interest receivable is analysed as follows.

	<i>Note</i>	2023	2022
		£m	£m
Interest receivable in respect of			
Loans and receivables		642.9	486.7
Finance leases		59.6	45.0
Invoice finance income		4.3	3.4
Interest on loans to customers		706.8	535.1
Effect of fair value hedging of loan assets		210.0	(1.5)
Interest on loans to customers after hedging		916.8	533.6
Pension scheme surplus	<i>60</i>	0.4	-
Other interest receivable		93.4	12.1
Total interest on financial assets		1,010.6	545.7

The above amounts relate to:

	2023	2022
	£m	£m
Financial assets held at amortised cost	740.6	502.2
Finance leases	59.6	45.0
Pension scheme surplus	0.4	-
Derivative financial instruments held at fair value	210.0	(1.5)
	1,010.6	545.7

Other interest receivable relates principally to cash deposits at central and retail banks.

5. Interest payable and similar charges

	<i>Note</i>	2023	2022
		£m	£m
On financial liabilities			
Retail deposits		334.1	108.8
Effect of fair value hedging of deposits		54.4	4.2
Interest on retail deposits after hedging		388.5	113.0
Asset backed loan notes		10.9	9.1
Bank loans and overdrafts		34.8	13.3
Corporate bonds		6.6	6.6
Effect of fair value hedging of bonds		0.6	-
Retail bonds		6.5	9.1
Central bank facilities		111.9	22.2
Sale and repurchase agreements		0.7	-
Total interest on financial liabilities		560.5	173.3
Pension scheme deficit	<i>60</i>	-	0.2
Discounting on contingent consideration	<i>41</i>	-	0.1
Discounting on lease liabilities		0.3	0.2
Other finance costs		0.9	0.7
		561.7	174.5

The above amounts relate to:

	2023	2022
	£m	£m
Financial liabilities held at amortised cost	505.5	169.1
Derivative financial instruments held at fair value	55.0	4.2
Other items	1.2	1.2
	561.7	174.5

6. Net operating lease income

	<i>Note</i>	2023	2022
		£m	£m
Income			
Operating lease rentals		19.5	17.7
Maintenance income		7.9	6.9
Total operating lease income		27.4	24.6
Costs			
Depreciation of lease assets	<i>29</i>	(10.7)	(10.1)
Maintenance salaries	<i>57</i>	(3.2)	(2.7)
Other maintenance costs		(7.9)	(7.2)
Total operating lease costs		(21.8)	(20.0)
Net operating lease income		5.6	4.6

7. Gain on derecognition of financial assets

On 8 June 2022 the Group disposed of almost all of its unsecured consumer loan balances, and 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.

8. Other income

	2023	2022
	£m	£m
Loan account fee income	4.8	6.1
Broker commissions	2.1	2.3
Third party servicing	4.3	3.5
Other income	0.3	0.7
	11.5	12.6

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

9. Operating expenses

	Note	2023	2022
		£m	£m
Employment costs	57	108.3	103.6
Auditor remuneration	10	2.9	2.5
Amortisation of intangible assets	30	1.8	2.0
Depreciation of operational assets	29	3.9	3.5
TBMC closure	11	2.0	-
Restructuring costs		2.6	-
Other administrative costs		48.9	41.4
		170.4	153.0

Restructuring costs arise from a strategic review of the Group's operational structures and resources carried out in the year and include consultancy costs and redundancy-related expenses.

The Group incurred no costs in respect of short-term operating leases in the year (2022: 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.

	2023	2022
	£m	£m
Audit fee of the company	0.7	0.7
Other services		
Audit of subsidiary undertakings pursuant to legislation	1.5	1.2
Total audit fees	2.2	1.9
Audit related assurance services		
Interim review	0.2	0.2
Other	-	-
Total fees	2.4	2.1
Irrecoverable VAT	0.5	0.4
Total cost to the Group (note 9)	2.9	2.5

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. TBMC closure

During the year, after a review of strategic priorities, the Group announced the closure of its TBMC mortgage brokerage business, which it considered to be non-core. As a result of this decision the remaining goodwill balance of the TBMC CGU and the other intangible assets relating to the business have been derecognised.

The total amount expensed to the profit and loss account on the closure is set out below.

	<i>Note</i>	2023
		£m
Goodwill derecognised	<i>30</i>	1.6
Intangible assets derecognised	<i>29</i>	0.2
Other closure costs		0.2
Total closure costs	<i>9</i>	2.0

The contribution to profit of the closed business in the year, which was included in the Mortgage Lending segment, was a loss of £0.5m excluding the costs shown above (2022: loss of £0.8m).

12. 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 2023			
Provided in period (note 23)	10.8	8.3	19.1
Recovery of written off amounts	(0.4)	(0.7)	(1.1)
	10.4	7.6	18.0
Of which			
Loan accounts	10.4	10.5	20.9
Finance leases	-	(2.9)	(2.9)
	10.4	7.6	18.0
30 September 2022			
Provided in period (note 23)	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

13. Fair value net (losses) / gains

	2023	2022
	£m	£m
Ineffectiveness of fair value hedges (note 26)		
Portfolio hedges of interest rate risk		
Deposit hedge	7.8	11.6
Loan hedge	(23.7)	15.1
	(15.9)	26.7
Individual hedges of interest rate risk	-	-
	(15.9)	26.7
Other hedging movements	(53.5)	4.7
Net gains / (losses) on other derivatives	(8.3)	160.5
	(77.7)	191.9

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 26 which also provides a full description of the Group's use of derivative financial instruments for hedging purposes.

14. Tax charge on profit on ordinary activities

(a) Analysis of charge in the year

	2023	2022
	£m	£m
Current tax		
UK Corporation Tax on profits of the period	73.6	50.6
Adjustment in respect of prior periods	(1.1)	0.3
Total current tax	72.5	50.9
Deferred tax (note 44)	(26.5)	53.4
Tax charge on profit on ordinary activities	46.0	104.3

The standard rate of corporation tax in the UK applicable to the Group in the year was 22.0% (2022 : 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. Consequently, the current year falls partly in the period during which the 19.0% rate applies and partly in that where the rate is 25.0%. These measures will increase the standard rate of corporation tax applicable to the Group 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 rate of tax to the extent these profits exceed a threshold. The effect of the surcharge shown in note (b) below.

In the financial year ended 30 September 2022 the UK Government enacted legislation reducing the rate of the Banking Surcharge from 8.0% to 3.0%, from April 2023, while increasing the profit threshold at which the surcharge applies to £100.0m from £25.0m. This has resulted in the surcharge applying to Paragon Bank in the current year reducing to 5.5%, with a threshold of £62.5m, while in future years a surcharge of 3.0% on earnings over £100.0m will apply. The impact of this change on deferred tax balances was accounted for in the year ended 30 September 2022. The combination of the standard rate of tax and the surcharge results in taxable profits in excess of the annual threshold arising in Paragon Bank being taxed at 27.5% in the current year (2022: 27.0%). This will rise to 28.0% in subsequent financial years.

(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 22.0% (2022: 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.

	2023	2022
	£m	£m
Profit on ordinary activities before taxation	199.9	417.9
Profit on ordinary activities multiplied by the UK standard rate of corporation tax	44.0	79.4
Effects of:		
Permanent differences		
Recurring disallowable expenditure and similar items	0.5	(0.1)
Mismatch in timing differences	(1.3)	0.8
Change in rate of taxation on current and deferred tax (excluding Bank Surcharge)	(2.1)	10.9
Impact of Bank Surcharge on current and deferred tax	5.1	13.1
Prior year charge	(0.2)	0.2
Tax charge for the year	46.0	104.3

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 movements in the year, which form the largest part of this balance.

(c) Factors affecting future tax charges

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.

Various asset leasing businesses are included within the Group's 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').

15. Profit attributable to members of Paragon Banking Group PLC

The Company's profit after tax for the financial year amounted to £254.6m (2022: £136.5m). 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 2023 or 30 September 2022.

16. Earnings per share

Earnings per ordinary share is calculated as follows:

	2023	2022
Profit for the year (£m)	153.9	313.6
Basic weighted average number of ordinary shares ranking for dividend during the year (m)	224.1	242.7
Dilutive effect of the weighted average number of share options and incentive plans in issue during the year (m)	8.0	6.4
Diluted weighted average number of ordinary shares ranking for dividend during the year (m)	232.1	249.1
Earnings per ordinary share		
- basic	68.7p	129.2p
- diluted	66.3p	125.9p

17. 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.

	2023	2022	2021
	£m	£m	£m
Deposits with the Bank of England	2,783.3	1,612.5	1,142.0
Balances with central banks	2,783.3	1,612.5	1,142.0
Deposits with other banks	211.0	318.4	218.1
Balances with other banks	211.0	318.4	218.1
Cash and cash equivalents	2,994.3	1,930.9	1,360.1

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:

	2023	2022	2021
	£m	£m	£m
Available cash	2,907.7	1,689.1	1,236.5
Securitisation cash	86.1	240.5	123.3
ESOP cash	0.5	1.3	0.3
	2,994.3	1,930.9	1,360.1

The 'Cash and Cash Equivalents' amount of £27.6m (2022: £19.7m, 2021: £19.6m) shown in the Company balance sheet is not subject to restrictions.

Cash and cash equivalents are classified as Stage 1 exposures (see note 22) for the purposes of impairment provisioning. The probabilities of default have been assessed to be so low as to require no significant impairment provision.

18. Loans to customers

The Group's loans to customers at 30 September 2023, analysed between the segments described in note 2 are as follows:

	Note	2023	2022	2021
		£m	£m	£m
First mortgages		12,747.8	12,122.4	11,460.6
Second charge mortgages		154.5	206.3	281.7
Unsecured consumer loans		-	-	87.3
Total Mortgage Lending		12,902.3	12,328.7	11,829.6
Finance lease receivables	19	907.3	825.2	720.3
Development finance		747.8	719.9	608.2
Other secured commercial lending		227.6	238.1	168.0
Other commercial loans		89.3	98.4	76.6
Total Commercial Lending		1,972.0	1,881.6	1,573.1
Loans to customers		14,874.3	14,210.3	13,402.7
Fair value adjustments from portfolio hedging	26	(379.3)	(559.9)	5.5
		14,495.0	13,650.4	13,408.2

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.

	2023	2022
	£m	£m
First mortgage loans	9.6	10.9
Consumer loans	49.0	64.4
Motor finance loans	0.2	0.5
	58.8	75.8

Information on the Estimated Remaining Collections ('ERCs'), the undiscounted forecast collectible amounts, for first mortgages and consumer loans is given in note 63. 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 64. The table also shows assets prepositioned with the Bank of England for use in future drawings.

	2023	2022	2021
	£m	£m	£m
Pledged as collateral in respect of			
Asset backed loan notes	1,529.5	2,099.8	2,414.5
Warehouse facilities	-	850.8	1,041.1
Central bank facilities	4,109.0	3,790.9	2,901.0
Total pledged as collateral	5,638.5	6,741.5	6,356.6
Prepositioned with Bank of England	2,568.7	2,675.5	3,190.1
Other first mortgage assets	4,540.6	2,705.4	1,913.9
Total first mortgage assets	12,747.8	12,122.4	11,460.6

No assets of other classes were pledged as collateral at 30 September 2023, 30 September 2022 or 30 September 2021.

19. Finance lease receivables

The Group's finance leases can be analysed as shown below.

	2023	2022	2021
	£m	£m	£m
Motor finance	297.7	261.3	229.2
Asset finance	559.1	498.8	440.5
RLS and CBILS	50.5	65.1	50.6
Carrying value	907.3	825.2	720.3

The minimum lease payments due under these loan agreements are:

	2023	2022	2021
	£m	£m	£m
Amounts receivable			
Within one year	318.5	284.7	255.5
Within one to two years	269.9	244.4	220.3
Within two to three years	218.7	189.5	164.8
Within three to four years	143.5	136.5	105.0
Within four to five years	67.1	60.5	50.5
After five years	60.2	46.2	41.6
	1,077.9	961.8	837.7
Less: future finance income	(158.1)	(119.8)	(96.3)
Present value	919.8	842.0	741.4

The present values of those payments, net of provisions for impairment, carried in the accounts are:

	2023	2022	2021
	£m	£m	£m
Amounts receivable			
Within one year	272.9	248.7	225.0
Within two to five years	597.0	554.0	480.2
After five years	49.9	39.3	36.2
Present value	919.8	842.0	741.4
Allowance for uncollectible amounts	(12.5)	(16.8)	(21.1)
Carrying value	907.3	825.2	720.3

20. 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 18, 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:

- 21 Loan impairments – Basis of provision
- 22 Loan impairments by stage and division
- 23 Loan impairments – Provision movements in the year
- 24 Loan impairments – Economic inputs to calculations
- 25 Loan impairments – Sensitivity analysis

The impact on the Group's profit and loss account for the year is set out in note 12.

21. 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. 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 case monitoring practices and professional credit judgement.

The largest portfolio where a fully modelled approach is not taken is the Group's development finance book, which has a relatively low number of cases (less than 250) and a low incidence of historical losses on which to base a model. For this portfolio the impairment provision is based on the output of internal case-by-case monitoring.

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 conditions at the balance sheet date. 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.

During the current financial year interest rates have risen to their highest levels in some time, and with unusual speed. Rates of inflation in the UK have been subject to significant fluctuations in the year, reaching 9.6% in October 2022, which the ONS suggested was a forty-year high point. This type of economic environment is not significantly represented in the historic data sets used by the Group to construct its IFRS 9 impairment models. It was also noted that the rate of change in the economic situation over the year might lead to a lagging impact on the credit bureau data which forms an input to models of customer behaviour, which may delay the recognition of an account potentially at risk.

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.

The methodologies used to derive the Group's ECL provisions at 30 September 2023 are analysed below.

	Gross £m	Impairment £m	Net £m
30 September 2023			
Modelled portfolios	13,825.4	(48.3)	13,777.1
Judgemental adjustments thereon	-	(6.5)	(6.5)
	13,825.4	(54.8)	13,770.6
Non-modelled portfolios	1,122.5	(18.8)	1,103.7
Total	14,947.9	(73.6)	14,874.3
30 September 2022			
Modelled portfolios	13,167.2	(39.9)	13,127.3
Judgemental adjustments thereon	-	(15.0)	(15.0)
	13,167.2	(54.9)	13,112.3
Non-modelled portfolios	1,106.6	(8.6)	1,098.0
Total	14,273.8	(63.5)	14,210.3

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, either from operational experience or its regular credit risk monitoring activities. No such evidence was noted at 30 September 2023 or 30 September 2022, and hence no additional accounts were identified as having an SICR.

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 used for internal monitoring 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 in note 22, 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 2023 a major update to the SME Lending PD model took place, meaning that two of the Group's four principal PD models, covering over 96% of modelled balances, have been updated since IFRS9 was implemented.

The adoption of the new SME lending model has enabled the reporting process in the year to be more streamlined, and supported increased use of scenario analysis, and increased the ability of the model to respond to economic inputs and wider customer credit data. This included more extensive use of external credit bureau data, enabling at risk cases to be identified for provisioning on a more timely basis.

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 the next generation of 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 SME lending PD model in the year ended 30 September 2023 on a like-for-like basis were to increase provision by £0.9m and transfer £10.8m of gross balances from Stage 1 to Stage 2.

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.

In the year ended 30 September 2023 the most significant factors in these considerations were the extent to which uncertainties in the UK economy arising from rapidly rising interest rates, increases in the cost of living and doing business in the UK and the impacts of the continuing conflict in Ukraine were reflected in current customer performance at the period end and were being fully addressed by the Group's provision modelling, particularly in view of the lack of recent observations relating to similar conditions.

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.

The Group's approach to impairment modelling is based on the analysis of historical credit data. 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 and broker feedback, insight surveys, industry intelligence, evidence on the wider economy and quantitative and qualitative data and statements from industry, government and regulatory bodies. These were combined with the expert knowledge within the business to form a broad estimate of the level of provision required across the Group.

As part of this exercise, the potential for climate related issues to impact on customer business models or security values over the timescales for ECL calculation required by IFRS 9 was considered. No specific requirement for additional impairment provisions over the amounts already determined was identified.

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.

	2023	2022
	£m	£m
Mortgage Lending	3.0	5.0
Commercial Lending	3.5	10.0
	6.5	15.0

The movements in the year represent principally the extent to which the anticipated economic and customer behaviours which gave rise to judgemental adjustments at 30 September 2022 are now observable and thus are reflected by the Group's models. The movements also reflect the enhanced ability of the new SME lending PD model introduced in the year to identify potential impairment, reducing the need for additional overlays. There has also been a reduction in the levels of economic and political uncertainty in the UK, compared to the position at 30 September 2022, which also impacts on the level of adjustments required. The movements in the 2022 financial year represented a transition from Covid related overlays to ones which related more to the responsiveness of the Group's provision models to economic conditions at the end of that year.

The adjustment at 30 September 2022 in the Mortgage Lending book was 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. While some of the anticipated impacts have begun to manifest themselves in arrears performance, neither the Group nor the mortgage industry more generally has seen a significant reaction to higher levels of interest rates and inflation in credit performance as yet. Combined with potential model limitations in responding to significant rapid changes in interest and inflation rates, management determined it was appropriate to reduce, but not remove the judgmental adjustment.

In the Commercial Lending segment the adjustment at 30 September 2022 related to general economic exposures for SMEs, with the outlook for the sector considered to be less positive than credit metrics indicated at that time. While business confidence is somewhat improved over the period, views on the outlook are generally mixed, with contradictory indicators on the likely future direction. Overall, however, the available information is indicative of a more negative position than indicated by the credit metrics in the portfolio alone.

During the period a new SME lending model was introduced, addressing some of the weakness in the Group's modelling approach, reducing the need for judgemental adjustments. However, issues relating to the availability of data representing similar economic conditions to those currently being observed remain, and it is likely that in the short term a judgemental adjustment will remain necessary to ensure appropriate provisioning levels. These factors together reduced the SME lending overlay to £2.5m (2022: £10.0m).

In addition a £1.0m overlay was made to the modelled motor finance provision (2022: £nil) to allow for difficulties noted in that model in responding to a period of falling inflation rapidly following a period of sharp price rises. This economic scenario depressed the calculated provision below a level management considered reasonable, given other portfolio data.

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, SME lending and motor finance portfolios, as appropriate, to individual Stage 1 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 are more fully 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.

22. 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.

The recommendations of the taskforce on Disclosures about Expected Credit Loss ('DECL') suggest standard categories for analysis of firm's loan books. In the context of the DECL categorisation the Group's Mortgage Lending balances are classified as 'UK retail mortgage' business while its Commercial Lending balances, being advanced primarily to SME entities correspond with the 'UK other retail' business classification.

The Group defines coverage as the value of the ECL provision divided by the gross carrying value of the related loans.

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

	Stage 1 £m	Stage 2* £m	Stage 3* £m	POCI £m	Total £m
30 September 2023					
Gross loan book					
Mortgage Lending	12,159.7	625.0	142.2	17.7	12,944.6
Commercial Lending	1,812.6	119.8	63.8	7.1	2,003.3
Total	13,972.3	744.8	206.0	24.8	14,947.9
Impairment provision					
Mortgage Lending	(4.8)	(6.1)	(31.4)	-	(42.3)
Commercial Lending	(14.8)	(3.3)	(8.4)	(4.8)	(31.3)
Total	(19.6)	(9.4)	(39.8)	(4.8)	(73.6)
Net loan book					
Mortgage Lending	12,154.9	618.9	110.8	17.7	12,902.3
Commercial Lending	1,797.8	116.5	55.4	2.3	1,972.0
Total	13,952.7	735.4	166.2	20.0	14,874.3
Coverage ratio					
Mortgage Lending	0.04%	0.98%	22.08%	-	0.33%
Commercial Lending	0.82%	2.75%	13.17%	67.61%	1.56%
Total	0.14%	1.26%	19.32%	19.35%	0.49%

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

	Stage 1 £m	Stage 2* £m	Stage 3* £m	POCI £m	Total £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.

Finance leases included above, analysed by staging, were:

	Stage 1	Stage 2	Stage 3	POCI	Total
	£m	£m	£m	£m	£m
30 September 2023					
Gross loan book	873.0	40.6	6.0	0.2	919.8
Impairment provision	(8.0)	(1.9)	(2.6)	-	(12.5)
Net loan book	865.0	38.7	3.4	0.2	907.3
Coverage Ratio	0.92%	4.68%	43.33%	-	1.36%
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%

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 its closed second charge mortgage portfolios. Acquired loans which were performing on acquisition are included in the staging analysis above.

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

Analysis of Stage 2 loans

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

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

The value of accounts in Stage 2 has reduced significantly in the Mortgage Lending segment over the year. This is driven principally by a lower number of accounts identified through model based criteria which are driven by the economic scenarios input into the models. The economic forecasts at 30 September 2022 included significant short term shifts in interest rates and house prices. These have been reflected in actual economic performance, to some extent, and the initial parts of the September 2023 scenarios have lower rate movements.

The number of arrears cases being recorded has increased, as a result of increasing economic pressure on customers, to some extent representing a proportion of the SICR cases identified at the previous year end. However the scale of this increase is less than indicated by the Group's modelling at 30 September 2022, with accounts not, so far, as severely impacted by rate rises and cost-of-living issues as predicted. Together these factors have led to a reduction in the overall Stage 2 pool.

In the Commercial Lending segment the number of Stage 2 accounts has increased across all categories as the impact of economic pressures begins to be demonstrated, but arrears levels remain low. The number of Stage 2 cases has also been increased through the adoption of a new SME lending model, which is better able to identify cases where external data indicates a customer having credit problems before any impact is seen on the Group's loan book.

Overall Stage 2 provisions have increased with the Stage 2 balance, with coverage levels, on average, also increasing. Provision coverage levels in the Mortgage Lending segment have generally increased, partly as a result of downward pressure on property prices impacting on security values. Coverage levels in the Commercial Lending segment increased, although this was more related to the mix of Stage 2 assets, and the relatively small number of cases involved.

	< 1 month arrears £m	Recent arrears £m	> 1 <= 3 months arrears £m	Total £m
30 September 2023				
Gross loan book				
Mortgage Lending	518.1	15.8	91.1	625.0
Commercial Lending	116.3	0.4	3.1	119.8
Total	634.4	16.2	94.2	744.8
Impairment provision				
Mortgage Lending	(2.3)	(0.1)	(3.7)	(6.1)
Commercial Lending	(2.9)	-	(0.4)	(3.3)
Total	(5.2)	(0.1)	(4.1)	(9.4)
Net loan book				
Mortgage Lending	515.8	15.7	87.4	618.9
Commercial Lending	113.4	0.4	2.7	116.5
Total	629.2	16.1	90.1	735.4
Coverage ratio				
Mortgage Lending	0.44%	0.63%	4.06%	0.98%
Commercial Lending	2.49%	-	12.90%	2.75%
Total	0.82%	0.62%	4.35%	1.26%
	< 1 month arrears £m	Recent arrears £m	> 1 <= 3 months arrears £m	Total £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%

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 number and value of Stage 3 accounts has increased in the year across all books. This has mostly been driven by increases in the number of accounts in serious arrears and by an increased number of poorly performing development finance cases in the Commercial Lending book. This sort of increase is not unexpected in a climate of economic tightening.

Realisations cases, particularly in Mortgage Lending have increased, as the increase in arrears cases reported at the half year works its way through the system. RoR cases in the Mortgage Lending division have remained broadly stable, however there has been a level of churn in the book with old cases settled and new appointments made.

Coverage levels in the Mortgage Lending segment on Stage 3 cases have remained broadly similar, despite the falls in house prices and thus security cover in the year.

The relatively low amount of Commercial Lending cases and the variety of credit profiles covered by the division's lending means that the coverage ratio at any particular time tends to be more a function of the particular accounts in the Stage 3 population at that point, rather than indicative of a general trend. The increased number of development finance cases, where security cover is relatively high, within the arrears population has reduced the overall percentage provision requirement in that division.

	Probation £m	> 3 month arrears £m	RoR managed £m	Realisations £m	Total £m
30 September 2023					
Gross loan book					
Mortgage Lending	8.8	40.4	50.3	42.7	142.2
Commercial Lending	1.1	57.8	-	4.9	63.8
Total	9.9	98.2	50.3	47.6	206.0
Impairment provision					
Mortgage Lending	-	(1.2)	(16.6)	(13.6)	(31.4)
Commercial Lending	(0.3)	(5.5)	-	(2.6)	(8.4)
Total	(0.3)	(6.7)	(16.6)	(16.2)	(39.8)
Net loan book					
Mortgage Lending	8.8	39.2	33.7	29.1	110.8
Commercial Lending	0.8	52.3	-	2.3	55.4
Total	9.6	91.5	33.7	31.4	166.2
Coverage ratio					
Mortgage Lending	-	2.97%	33.00%	31.85%	22.08%
Commercial Lending	27.27%	9.52%	-	53.06%	13.17%
Total	3.03%	6.82%	33.00%	34.03%	19.32%

	Probation £m	> 3 month arrears £m	RoR managed £m	Realisations £m	Total £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%

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.

	2023	2022
	£m	£m
First mortgages	89.5	66.2
Second mortgages	10.2	14.6
Asset finance	1.6	1.6
Motor finance	1.2	0.7
	102.5	83.1

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

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 2023		30 September 2022	
	No.	£m	No.	£m
Managed accounts				
<i>Appointment date</i>				
2010 and earlier	135	20.1	199	31.2
2011 to 2015	31	4.5	49	7.1
2016 to 2020	15	2.0	24	3.2
2021 and later	154	23.7	62	8.1
Total managed accounts	335	50.3	334	49.6
Accounts in the process of realisation	225	41.0	141	23.5
	560	91.3	475	73.1

Receiver of rent accounts in the process of realisation at the period end are included under that heading in the Stage 3 tables above. In addition to the cases analysed above there were four other receiver of rent cases in acquired mortgage books classified as POCI (2022: nil), meaning that the Group's total of receiver of rent cases at 30 September 2023 was 564 (2022: 475).

23. 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	Commercial Lending	Total
	£m	£m	£m
At 30 September 2022	38.0	25.5	63.5
Provided in period (note 12)	10.8	8.3	19.1
Amounts written off	(6.5)	(2.5)	(9.0)
Assets derecognised	-	-	-
At 30 September 2023 (note 22)	42.3	31.3	73.6
At 30 September 2021	37.7	27.7	65.4
Provided in period (note 12)	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 22)	38.0	25.5	63.5

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 2023, enforceable contractual balances of £7.6m (2022: £4.9m) 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 2023 and 30 September 2022 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.

The changes in models introduced during the year did not create significant movements in balances.

	Stage 1	Stage 2	Stage 3	POCI	Total
	£m	£m	£m	£m	
Loss allowance at 30 September 2022	25.5	8.0	28.5	1.5	63.5
New assets originated or purchased	9.5	-	-	-	9.5
Changes in loss allowance					
Transfer to Stage 1	2.8	(2.7)	(0.1)	-	-
Transfer to Stage 2	(1.7)	2.0	(0.3)	-	-
Transfer to Stage 3	(0.2)	(1.9)	2.1	-	-
Changes on stage transfer	(2.5)	2.3	14.6	-	14.4
Changes due to credit risk	(13.8)	1.7	4.0	3.3	(4.8)
Loans sold	-	-	-	-	-
Write offs	-	-	(9.0)	-	(9.0)
Loss allowance at 30 September 2023	19.6	9.4	39.8	4.8	73.6
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

During the year ended 30 September 2023 the impairment allowance increased, driven mostly by the increase in Stage 3 and POCI cases, a result of the level of actual defaults in the period, particularly in the development finance business, and by reduced levels of available security through declining house prices in the mortgage segment.

The net reduction in Stage 1 provisions includes the effect of changes in judgemental adjustments in the period, with items formerly addressed by these provisions beginning to move through Stage 2 and Stage 3. These movements were driven by both account performance, and by the impact of more severe actual and forecast economic conditions.

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 in that year came mostly from new lending, coupled with the need to make judgemental increases in the provision balance. Stage 2 provisions reduced slightly as the impacts of additional Covid-related SICRs in 2021 fell away. Stage 3 provision declined as bought forward cases were resolved, in both the Commercial Lending and Mortgage Lending divisions.

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

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Balance at 30 September 2022	12,157.0	1,963.6	124.4	28.8	14,273.8
New assets originated or purchased	3,128.4	-	-	-	3,128.4
Changes in staging					
Transfer to Stage 1	1,258.9	(1,255.7)	(3.2)	-	-
Transfer to Stage 2	(365.6)	372.9	(7.3)	-	-
Transfer to Stage 3	(28.9)	(104.7)	133.6	-	-
Redemptions and repayments	(2,773.3)	(250.6)	(44.8)	(10.5)	(3,079.2)
Loans sold	-	-	-	-	-
Write offs	-	-	(9.0)	-	(9.0)
Other changes	595.8	19.3	12.3	6.5	633.9
Balance at 30 September 2023	13,972.3	744.8	206.0	24.8	14,947.9
Loss allowance	(19.6)	(9.4)	(39.8)	(4.8)	(73.6)
Carrying value	13,952.7	735.4	166.2	20.0	14,874.3
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

Other changes includes interest and similar charges.

24. 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 outcomes.

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 2023 forecasting cycle (the 'October forecast'), the Group has adopted a central economic scenario derived using a broadly equivalent approach to that used in September 2022, with the starting point of the scenario updated to reflect the actual movements of economic variables in the year.

The general trend of the Group's central forecasts follows that published by the Bank of England in August 2023, however the Group has taken a more pessimistic position than the Bank. Monetary policy is forecast to remain tight, with pressure on real incomes, leading to minimal growth, rising unemployment and a slow decline in inflation. As a result, interest rates are forecast to remain high, with a short-term decline in property values.

Compared to the central scenario adopted at 30 September 2022, the new central forecast is generally more pessimistic across most variables, with a much more severe decline in house prices than in the earlier scenario and a more prolonged period of elevated interest rates. The scenario also begins from the actual September 2023 economic position, so the interest rate rises, increased inflation and house price falls observed in the period are included in the starting position.

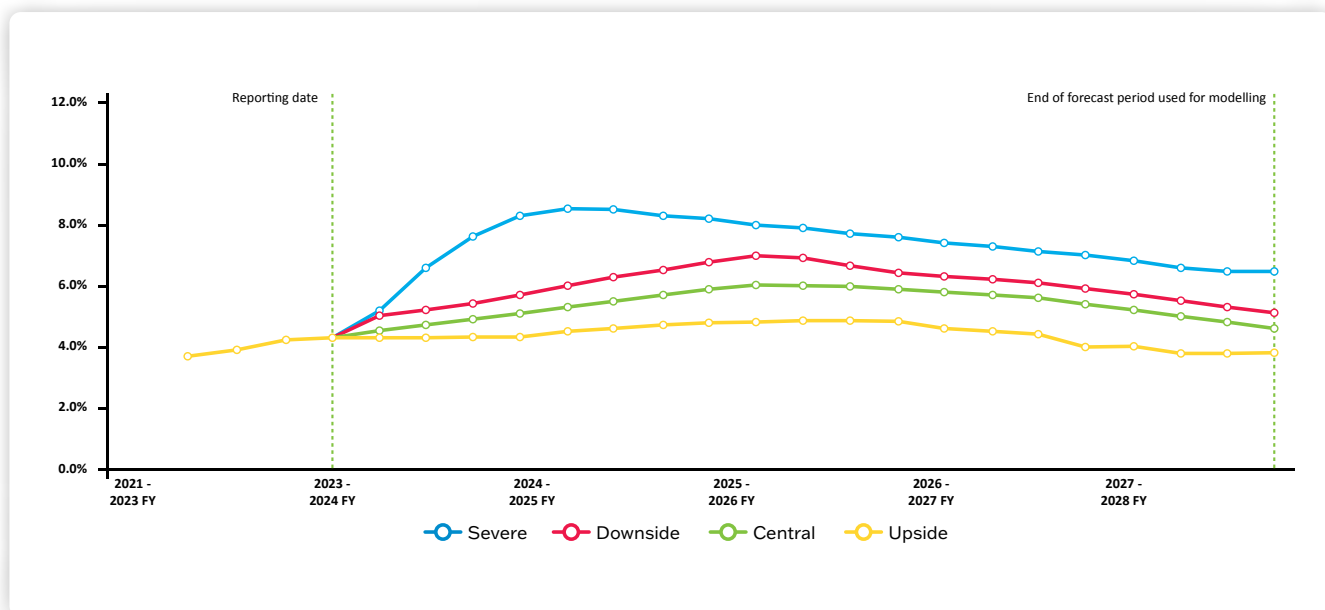
The upside and downside scenarios continue to be derived from the central scenario, as they have been in previous periods. The shapes of these three scenarios are broadly similar across the forecast period, with the upside scenario having a more rapid reduction in inflation, leading to a faster reduction in base rates and a stronger recovery. The downside includes traditional recessionary factors with additional pressure on house prices and rising unemployment, with interest rates being reduced more rapidly in response.

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 ('ACS') being used at 30 September 2023. This scenario is based on a pronounced recession with interest rates remaining high, rising unemployment and a slump in house prices.

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.

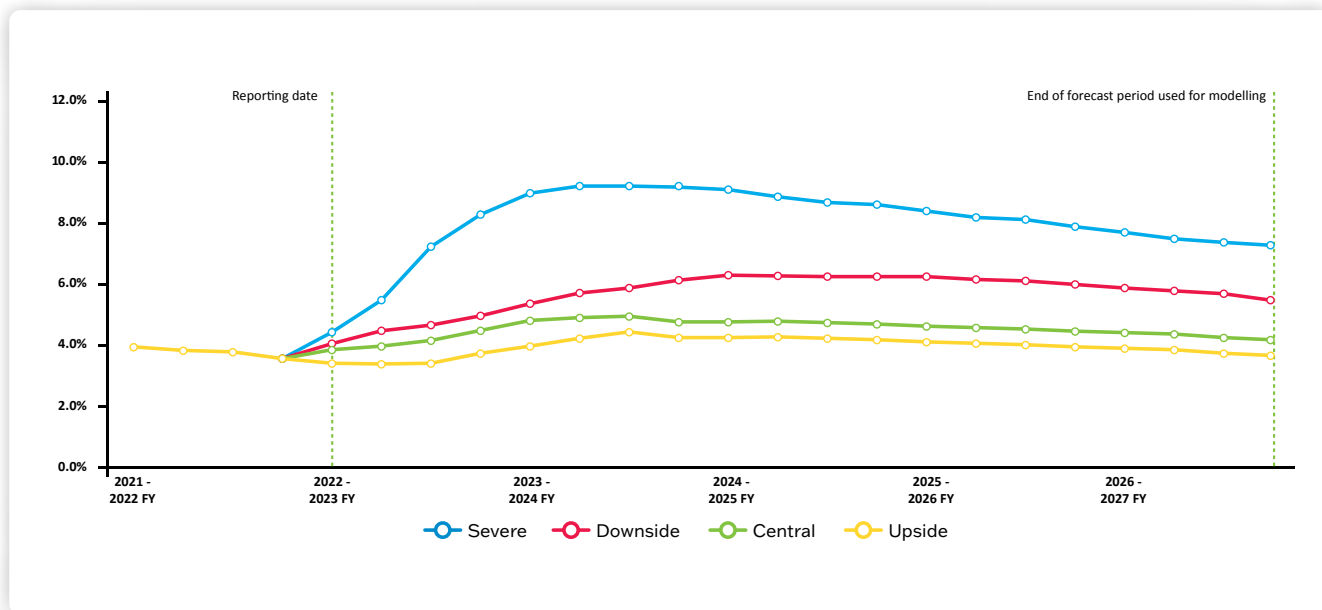
Historical and forecast Unemployment rates (End point measure)

As at September 2023



Historical and forecast Unemployment rates (End point measure)

As at September 2022



Following a review of the weightings of the different scenarios, set against the overall potential for variability in the future economic outlook, the Group decided to maintain the scenario weightings used at 30 September 2022. While the economic outlook is more settled than it was twelve months earlier there remains a significant divergence in opinions on the likely outlook for the UK economy, with a potential for serious downside outcomes. This supports the maintenance of the September 2022 weightings.

Sensitivities comparing the effect of these weightings with those which might be seen in a more normal economic environment are set out in Note 25.

	2023	2022
Central Scenario	40%	40%
Upside Scenario	10%	10%
Downside Scenario	30%	30%
Severe Scenario	20%	20%
	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 for 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 2023

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

	2024	2025	2026	2027	2028
Central Scenario	0.4%	0.9%	1.0%	1.2%	1.2%
Upside Scenario	1.6%	1.4%	1.0%	1.2%	1.2%
Downside Scenario	(0.4)%	0.7%	1.0%	1.2%	1.2%
Severe Scenario	(3.6)%	(0.2)%	1.2%	1.2%	1.2%

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

	2024	2025	2026	2027	2028
Central Scenario	(6.4)%	(1.7)%	4.7%	4.4%	3.2%
Upside Scenario	(1.1)%	5.8%	6.8%	5.0%	4.5%
Downside Scenario	(10.7)%	(2.2)%	4.0%	4.0%	2.6%
Severe Scenario	(13.1)%	(15.1)%	-	7.0%	5.6%

Bank Base Rate ('BBR') (rate)

	2024	2025	2026	2027	2028
Central Scenario	5.5%	5.4%	4.8%	4.4%	4.1%
Upside Scenario	5.2%	4.4%	3.7%	3.5%	3.5%
Downside Scenario	5.6%	3.8%	2.6%	2.0%	2.0%
Severe Scenario	6.0%	5.8%	5.1%	4.3%	3.4%

Consumer Price Inflation ('CPI') (rate)

	2024	2025	2026	2027	2028
Central Scenario	4.4%	2.6%	1.6%	1.8%	2.0%
Upside Scenario	3.7%	2.1%	2.1%	2.0%	2.1%
Downside Scenario	4.5%	1.0%	0.7%	1.8%	2.0%
Severe Scenario	15.7%	12.8%	3.7%	2.4%	2.1%

Unemployment (rate)

	2024	2025	2026	2027	2028
Central Scenario	4.8%	5.6%	6.0%	5.6%	4.9%
Upside Scenario	4.3%	4.6%	4.8%	4.4%	3.9%
Downside Scenario	5.3%	6.4%	6.7%	6.1%	5.4%
Severe Scenario	6.9%	8.4%	7.8%	7.2%	6.6%

Secured lending (annual change)

	2024	2025	2026	2027	2028
Central Scenario	0.8%	0.3%	1.8%	3.0%	3.0%
Upside Scenario	1.5%	1.0%	2.5%	3.2%	3.0%
Downside Scenario	-	(0.5)%	1.0%	2.8%	3.0%
Severe Scenario	(1.3)%	(1.8)%	(0.3)%	2.5%	3.0%

Consumer credit (annual change)

	2024	2025	2026	2027	2028
Central Scenario	3.5%	2.3%	3.9%	4.9%	5.0%
Upside Scenario	4.3%	3.0%	4.7%	5.1%	5.0%
Downside Scenario	2.8%	1.5%	3.2%	4.8%	5.0%
Severe Scenario	1.5%	0.3%	1.9%	4.4%	5.0%

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%

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 2023

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max	Min	Max	Min	Max	Min	Max	Min
	%	%	%	%	%	%	%	%
Economic driver								
GDP	1.2	0.3	2.3	0.9	1.2	(0.8)	1.2	(5.0)
HPI	4.4	(8.2)	7.4	(3.1)	4.1	(13.4)	7.2	(16.4)
BBR	5.5	4.0	5.3	3.5	5.8	2.0	6.0	3.3
CPI	5.0	1.5	4.3	1.8	6.0	0.4	17.0	2.0
Unemployment	6.0	4.5	4.8	3.8	7.0	5.0	8.5	5.2
Secured lending	3.0	-	3.8	0.8	3.0	(0.8)	3.0	(2.0)
Consumer credit	5.0	2.0	5.8	2.8	5.0	1.3	5.0	-

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)

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.

	2023	2022
	£m	£m
Provision using central scenario 100% weighted		
Mortgage Lending	38.4	29.1
Commercial Lending	29.0	24.2
	67.4	53.3
Calculated impairment provision	73.6	63.5
Effect of multiple economic scenarios	6.2	10.2

25. 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.

Scenario	2023		2022	
	Provision	Difference	Provision	Difference
	£m	£m	£m	£m
Central	67.4	(6.2)	53.3	(10.2)
Upside	59.0	(14.6)	46.8	(16.7)
Downside	73.4	(0.2)	62.5	(1.0)
Severe	95.7	22.1	100.3	36.8

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. The sensitivity 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 three most recent year ends.

The weightings used, and the results of applying these sensitivities to the 30 September 2023 scenarios are set out below.

	Weighting				Impairment £m	Difference £m
	Central	Upside	Downside	Severe		
As reported	40%	10%	30%	20%	73.6	-
Sensitivity	40%	30%	25%	5%	67.6	(6.0)

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 £68.4m would transfer from Stage 1 to Stage 2 (2022: £136.8m), and the total provision would increase by £0.8m 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 (2022: £0.9m).

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 £0.7m (2022: £2.7m).

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 £0.1m (2022: £0.4m).

26. 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 62 to 65) 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
- Fair value hedges of interest rate risk relating to individual financial liabilities.

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 pre-hedging 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.

	2023	2023	2022	2022
	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m
Derivatives in hedge accounting relationships				
<i>Fair value portfolio hedges</i>				
Interest rate swaps				
Fixed to floating	519.0	(5.1)	652.7	-
Floating to fixed	76.2	(27.0)	0.3	(98.5)
Total derivatives in portfolio fair value hedging relationships	595.2	(32.1)	653.0	(98.5)
<i>Individual fair value hedges</i>				
Interest rate swaps				
Floating to fixed	-	(3.7)	-	-
Total derivatives in hedge accounting relationships	595.2	(35.8)	653.0	(98.5)
Other derivatives				
Interest rate swaps	20.2	(4.1)	125.5	(3.6)
Currency futures	-	-	0.5	-
Total recognised derivative assets / (liabilities)	615.4	(39.9)	779.0	(102.1)

The credit risk inherent in the derivative financial assets shown above is discussed in note 63.

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.

	<i>Note</i>	2023	2022
		£m	£m
Derivative financial instruments			
Assets		615.4	779.0
Liabilities		(39.9)	(102.1)
		575.5	676.9
Fair value hedging adjustments			
On loans to customers	18	(379.3)	(559.9)
On retail deposits	33	30.9	99.7
On borrowings		3.7	
		(344.7)	(460.2)
Net balance sheet position		230.8	216.7
Collateral balances			
Posted (in sundry assets)	27	-	-
Received (in sundry liabilities)	40	(383.4)	(388.6)
		(383.4)	(388.6)

(a) Fair value macro 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 pre-hedging of assets in the pipeline. Interest rate swaps used to pre-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 ended 30 September 2022 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 and the two sections of each hedge were combined in the second half of the financial year.

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 macro hedges is updated, on a month-by-month basis, using software which compares the overall tenor, value and rate positions in order that the expected fair value movement of the designated swaps matches the expected interest rate risk related movement in the fair value of the relevant assets or liabilities as closely as possible over the designation period. 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 pre-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 63)
- 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 pre-hedging of the lending pipeline.

Hedging Instruments

The hedging portfolios at 30 September 2023 and 30 September 2022 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 the SONIA reference rate

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.

	2023		2022	
	Deposit Hedge	Loan Hedge	Deposit Hedge	Loan Hedge
Average fixed notional interest rate	4.22%	1.77%	1.45%	0.99%
Average notional margin over SONIA	-	-	-	-
	£m	£m	£m	£m
Notional principal value				
SONIA BGS	-	31.6	-	47.0
Other SONIA swaps	6,257.0	7,781.8	4,286.0	6,853.1
	6,257.0	7,813.4	4,286.0	6,900.1
Maturing				
Within one year	5,253.5	1,616.3	3,097.0	1,369.9
Between one and two years	857.5	1,238.0	987.5	1,641.7
Between two and five years	146.0	4,959.1	201.5	3,886.0
More than five years	-	-	-	2.5
	6,257.0	7,813.4	4,286.0	6,900.1
Fair value	49.2	513.9	(98.2)	652.7

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.

	2023		2022	
	Deposit hedge	Loan hedge	Deposit hedge	Loan hedge
	£m	£m	£m	£m
Hedging instruments				
<i>Interest rate swaps</i>				
Included in derivative financial assets	76.2	519.0	0.3	652.7
Included in derivative financial liabilities	(27.0)	(5.1)	(98.5)	-
	49.2	513.9	(98.2)	652.7
Notional principal value	6,257.0	7,813.4	4,286.0	6,900.1
Change in fair value used in calculating hedge ineffectiveness	77.7	(262.2)	(94.8)	598.1

	2023		2022	
	Deposit hedge	Loan hedge	Deposit hedge	Loan hedge
	£m	£m	£m	£m
Hedged items				
<i>Fixed rate deposits</i>				
Monetary amount of risk relating to Retail Deposits	5,758.1	-	3,986.4	-
<i>Fixed rate loans</i>				
Monetary amount of risk relating to Loans to Customers	-	8,043.5	-	7,168.6
Accumulated amount of fair value hedge adjustments included on balance sheet (notes 33 and 18)*	30.9	(379.3)	99.7	(559.9)
Of which: amounts related to discontinued hedging relationships being amortised	(4.3)	108.2	(7.9)	73.4
Change in fair value used in recognising hedge ineffectiveness	(69.9)	238.5	106.4	(583.0)
Hedge ineffectiveness recognised				
Included in fair value gains / (losses) in the profit and loss account (note 13)	7.8	(23.7)	11.6	15.1

*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.

(b) Fair value micro hedges

Background and hedging objectives

The Group's individual fair value hedges of interest rate risk ('micro hedges') relate to its long-term fixed interest rate liabilities. The structure of these borrowings exposes the Group to interest rate risk, in the event of an adverse movement in market interest rates and during the year the decision was taken to hedge against any future interest rate movements.

The hedge takes the form of a single interest rate swap which is intended to be in place for the expected fixed rate period of the related borrowing. The terms of the fixed rate leg of the derivative match the terms of the borrowing as far as possible and the hedging relationship was designated at the point at which the swap contract was entered into.

The hedging relationship is tested for effectiveness on a monthly basis by comparing the movements in the calculated fair value of the hedged item to the fair value movement in the derivative hedge.

Potential sources of ineffectiveness

In its interest rate hedging for individual items the Group seeks to minimise hedge ineffectiveness by aligning the terms of the hedging instrument as closely as possible with those of the hedged item. The notional amount of the derivative matches that of the hedged item and settlements are due on the same days and at the same intervals.

Nonetheless, the Group has identified the following possible sources of hedge ineffectiveness in its hedges of interest rate risk:

- 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 63)
- The small difference between the fixed rate of interest charged on the hedged item and the fixed rate leg of the derivative, where the impact of discounting will mean that movements in present values of the two flows are not exactly parallel
- The use of different discounting curves in measuring fair value changes in the hedged items and hedging instruments

Hedging instrument

The financial derivative used in the Group's individual fair value hedge is a single sterling denominated interest rate swap with a notional value of £150.0m.

Settlement on the swap is twice-yearly, on the same days as those when interest payments on the hedged item fall due. On settlement:

- The payment received by the Group is calculated based on a fixed rate of interest of 3.989% and the notional value of the swap
- The opposite payment made by the Group is calculated based on the same notional value but using a floating interest rate set at the compound SONIA reference rate

The swap matures on 25 September 2026 (between two and five years after the balance sheet date).

Accounting impacts

Movements affecting the micro fair value hedges during the year are set out below.

	2023	2022
	£m	£m
Hedging instruments		
<i>Interest rate swaps</i>		
Included in derivative financial assets	-	-
Included in derivative financial liabilities	(3.7)	-
	(3.7)	-
Notional principal value	150.0	-
Change in fair value used in calculating hedge ineffectiveness	(3.7)	-
	2023	2022
	£m	£m
Hedged items		
<i>Fixed rate borrowings</i>		
Corporate bond	(150.0)	-
Accumulated amount of fair value hedge adjustments included in carrying value	3.7	-
Of which: amounts related to discontinued hedging relationships being amortised	-	-
Change in fair value used in recognising hedge ineffectiveness	3.7	-
Hedge ineffectiveness recognised		
Included in fair value gains / (losses) in the profit and loss account (note 13)	-	-

(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 pre-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

	2023		2022	
	Pay fixed	Pay floating	Pay fixed	Pay floating
Average fixed notional interest rate	3.88%	5.52%	2.11%	4.31%
Average notional margin over SONIA	-	-	-	-
	£m	£m	£m	£m
Notional principal value				
SONIA swaps	708.0	722.6	1,578.1	377.1
	708.0	722.6	1,578.1	377.1
Maturing				
Within one year	7.5	583.5	351.6	288.0
Between one and two years	23.5	126.0	23.5	86.0
Between two and five years	457.0	13.1	542.5	3.1
More than five years	220.0	-	660.5	-
	708.0	722.6	1,578.1	377.1
Fair value	15.2	0.9	124.8	(2.9)

Currency futures

	2023	2022
<i>US dollar futures</i>		
Average future exchange rate	1.22	1.07
	£m	£m
Notional principal value	7.6	13.4
Maturing		
Within one year	7.6	13.4
Between one and two years	-	-
Between two and five years	-	-
	7.6	13.4
Fair value	-	0.5

27. Sundry assets

(a) The Group

	<i>Note</i>	2023	2022	2021
		£m	£m	£m
Current assets				
Accrued interest income		4.6	1.0	-
Trade receivables		1.5	1.9	1.3
CSA assets		-	-	36.6
CRDs		38.0	30.2	23.7
Sovereign receivables		0.1	0.3	0.9
Other receivables		1.8	2.0	3.2
Sundry financial assets	<i>71</i>	46.0	35.4	65.7
Prepayments		5.0	3.8	3.5
		51.0	39.2	69.2

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 BBLIS 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

	2023	2022	2021
	£m	£m	£m
Current assets			
Intra-group term deposit	193.6	-	-
Amounts owed by Group companies	35.1	39.1	73.0
Accrued interest income	0.1	0.1	0.1
	228.8	39.2	73.1

The intra-group cash deposits comprise a 100 day notice balance and a demand balance, both placed with the Company's subsidiary, Paragon Bank PLC, for onward placement with the Bank of England.

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.

28. Current tax assets / liabilities

Current tax in the Group and the Company represents UK corporation tax owed or recoverable.

29. Property, plant and equipment

(a) The Group

	Leased assets	Land and buildings	Plant and machinery	Total
	£m	£m	£m	£m
Cost				
At 1 October 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
Additions	15.9	1.4	2.6	19.9
Disposals	(6.6)	(0.1)	(1.9)	(8.6)
At 30 September 2023	81.5	37.0	14.7	133.2
Accumulated depreciation				
At 1 October 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
Charge for the year	10.7	2.2	1.7	14.6
On disposals	(4.6)	(0.1)	(1.9)	(6.6)
At 30 September 2023	36.7	10.9	10.9	58.5
Net book value				
At 30 September 2023	44.8	26.1	3.8	74.7
At 30 September 2022	41.6	26.9	2.9	71.4
At 30 September 2021	39.3	28.0	3.1	70.4

Land and buildings and plant and machinery shown above are used within the Group's business. Leased assets includes £31.3m in respect of assets leased to customers under operating leases (2022: £31.4m), £0.5m of vehicles leased to employees under the Group's green car salary sacrifice scheme (2022: £nil) and £13.0m of assets available for hire (2022: £10.2m).

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.

	Leased assets	Land and buildings	Plant and machinery	Total
	£m	£m	£m	£m
Cost				
At 1 October 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
Additions	0.6	1.0	1.4	3.0
Disposals	-	(0.1)	(0.4)	(0.5)
At 30 September 2023	0.6	12.5	2.8	15.9
Accumulated depreciation				
At 1 October 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
Charge for the year	0.1	1.7	0.7	2.5
On disposals	-	(0.1)	(0.4)	(0.5)
At 30 September 2023	0.1	5.3	1.4	6.8
Net book value				
At 30 September 2023	0.5	7.2	1.4	9.1
At 30 September 2022	-	7.9	0.7	8.6
At 30 September 2021	-	8.5	0.8	9.3

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 £16.8m (2022: £17.1m).

(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 1 October 2021, 30 September 2022 and 30 September 2023	18.8
Accumulated depreciation	
At 1 October 2021	2.8
Charge for the year	1.4
On disposals	-
At 30 September 2022	4.2
Charge for the year	1.4
On disposals	-
At 30 September 2023	5.6
Net book value	
At 30 September 2023	13.2
At 30 September 2022	14.6
At 30 September 2021	16.0

30. Intangible assets

	Goodwill (note 31)	Computer software	Other intangible assets	Total
	£m	£m	£m	£m
Cost				
At 1 October 2021	170.4	14.8	10.6	195.8
Additions	-	1.7	-	1.7
Derecognition	-	-	-	-
At 30 September 2022	170.4	16.5	10.6	197.5
Additions	-	1.6	-	1.6
Derecognition	(7.6)	-	(8.1)	(15.7)
At 30 September 2023	162.8	18.1	2.5	183.4
Accumulated amortisation and impairment				
At 1 October 2021	6.0	11.4	7.9	25.3
Amortisation charge for the year	-	1.2	0.8	2.0
Derecognition	-	-	-	-
At 30 September 2022	6.0	12.6	8.7	27.3
Amortisation charge for the year	-	1.1	0.7	1.8
Derecognition	(6.0)	-	(7.9)	(13.9)
At 30 September 2023	-	13.7	1.5	15.2
Net book value				
At 30 September 2023	162.8	4.4	1.0	168.2
At 30 September 2022	164.4	3.9	1.9	170.2
At 30 September 2021	164.4	3.4	2.7	170.5

Other intangible assets comprise brands and the benefit of business networks recognised on the acquisition of businesses. Derecognitions above relate to the cessation of the TBMC business (note 11).

31. 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:

	2023	2022
	£m	£m
CGU		
SME lending	113.0	113.0
Development finance	49.8	49.8
TBMC	-	1.6
	162.8	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 2023 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 2023 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 14.12%, compared with 10.56% used in the calculation at 30 September 2022. 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 1.20% (2022: 1.54%) 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 16.2% (2022: 14.8%)

As an illustration of the sensitivity of this impairment test to movements in key assumptions, the Group has calculated that a 0.0% growth rate combined with an 11.5% reduction in profit levels would eliminate the projected headroom of £59.1m. While such movements are not expected by management, they are considered 'reasonably possible' for the purposes of IAS 36. A 0.0% growth rate combined with an 14.4% reduction in profit levels would generate a write down of £10.0m.

In the testing carried out at 30 September 2022, a 0.0% growth rate combined with a 7.5% reduction in profit levels, would have eliminated the projected headroom at that date of £45.3m. A 0.0% growth rate combined with an 11.2% reduction in profit levels 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 2023 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 2023 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 11.12%, compared with 8.77% used in the calculation at 30 September 2022. Cash flows beyond the five-year budget are extrapolated using a constant growth rate of 1.2% (2022: 1.54%) 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 15.9% (2022: 14.4%)

As an illustration of the sensitivity of this impairment test to movements in key assumptions, the Group has calculated that a 1.07% growth rate combined with a 3.1% reduction in profit levels would eliminate the projected headroom of £13.9m. While such movements are not expected by management, they are considered 'reasonably possible' for the purposes of IAS 36. A 0.17% growth rate combined with a 2.9% reduction in profit levels would generate a write down of £10.0m.

On the basis of the testing carried out at 30 September 2022, management concluded that no reasonably possible change in the key assumptions above would cause the recoverable amount of the development finance CGU to fall below the balance sheet carrying value.

(c) TBMC

During the year the Group announced the closure of its TBMC mortgage brokerage business (note 11), which corresponded to the TBMC CGU. The goodwill relating to this CGU, which was recognised on an acquisition in December 2008 and impaired by £6.0m in 2009, was therefore derecognised in the year, with the remaining net goodwill of £1.6m expensed.

An impairment review carried out in the previous year, on the basis that the business would continue to operate, indicated no requirement for additional impairment provision at 30 September 2022.

32. Investment in subsidiary undertakings

	Shares in group companies	Loans to group companies	Loans to ESOP Trusts	Total
	£m	£m	£m	£m
At 1 October 2021	638.7	339.5	0.3	978.5
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
Loans advanced	-	-	8.0	8.0
Loans repaid	-	(107.0)	-	(107.0)
Provision movements	(1.3)	-	(8.9)	(10.2)
At 30 September 2023	637.4	150.0	0.5	787.9

Loans to group companies includes principally investments in the tier 2 equity instruments issued by the Company's banking subsidiary, Paragon Bank PLC.

During the year ended 30 September 2023 the Company received £262.5m in dividend income from its subsidiaries (2022: £152.7m) and £18.6m of interest on loans to group companies (2022: £12.0m).

The Company's subsidiaries, and the nature of its interest in them, are shown in note 72.

33. 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:

	2023	2022	2021
	£m	£m	£m
Fixed rate	8,690.2	6,201.3	5,466.0
Variable rates	4,575.1	4,467.9	3,834.4
	13,265.3	10,669.2	9,300.4

The weighted average interest rate on retail deposits at 30 September 2023, analysed by charging method, was:

	2023	2022	2021
	%	%	%
Fixed rate	4.07	1.74	1.25
Variable rates	3.74	1.55	0.42
All deposits	3.95	1.66	0.91

The contractual maturity of these deposits is analysed below.

	2023	2022	2021
	£m	£m	£m
Amounts repayable			
In less than three months	1,589.4	929.0	789.0
In more than three months, but not more than one year	5,193.7	3,732.1	3,105.4
In more than one year, but not more than two years	1,643.0	1,627.3	1,580.1
In more than two years, but not more than five years	631.8	421.4	507.4
Total term deposits	9,057.9	6,709.8	5,981.9
Repayable on demand	4,207.4	3,959.4	3,318.5
	13,265.3	10,669.2	9,300.4
Fair value adjustments for portfolio hedging (note 26)	(30.9)	(99.7)	(3.0)
	13,234.4	10,569.5	9,297.4

34. Asset backed loan notes

The Group's asset backed loan 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 2023 interest was payable on the notes at a fixed margin above the compounded Sterling Overnight Interbank Average Rate ('SONIA').

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 64.

Notes in issue at 30 September 2023 and 30 September 2022, net of any held by the Group, were:

Issuer	Maturity date	Call date	Principal outstanding		Average interest margin	
			2023	2022	2023	2022
			£m	£m	%	%
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	28.4	107.9	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 64).

The details of the assets backing these securities are given in note 18.

During the year, on 15 May 2023, the Group redeemed all of the outstanding notes of the Paragon Mortgages (No. 25) PLC securitisation at par. The underlying assets were subsequently funded by other group companies.

On 1 November 2023, after the year end, a group company, Paragon Mortgages (No. 29) PLC, issued £855.0m of sterling mortgage backed floating rate notes, analysed below, at par.

Class	Fitch Rating	Moody's rating	Interest margin above compounded SONIA	Principal value £m
A	AAA	Aaa	1.20%	747.0
B	AA	Aa1	1.90%	33.7
C	A-	Aa2	2.75%	29.3
D	B+	A2	3.80%	45.0
				855.0

All the above notes were retained by the Group.

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 53.

35. 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 64 and details of assets held within the warehouse facilities are given in note 18. Details of the Group's bank borrowings are set out below.

	2023			2022		
	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
ii) Paragon Seventh Funding	-	-	-	170.0	450.0	170.0
	-	-	-	586.0	866.0	586.0

- 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. The loan was repaid in full on 29 September 2023. This loan was a sterling facility provided to Paragon Second Funding Limited by a consortium of banks and was secured on all the assets of Paragon Second Funding Limited, Paragon Car Finance (1) Limited and Paragon Personal Finance (1) Limited. Interest on this loan was payable monthly at 0.704% above SONIA.
- 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 was 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 0.60% over three month LIBOR thereafter up to 8 November 2021.

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 expired on 24 July 2023.

36. Retail bonds

The Group has one outstanding issue of retail bonds, issued under its Euro Medium Term Note Programme. These bonds are listed on the London Stock Exchange and mature on 28 August 2024, but are callable by the Company in certain circumstances. The principal amount of notes in issue at 30 September 2023 is £112.5m (2022: £112.5m) and they bear interest at a fixed rate of 6.0% per annum.

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 £112.4m (2022: £112.3m), all of which falls due within one year (2022: £nil).

37. 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 at 30 September 2023 was £145.8m (2022: £149.2m), while the carrying value of the bonds in the accounts of the Company at 30 September 2023 was £149.4m (2022: £149.2m), with the difference arising as a result of the hedging treatment described in note 26.

38. Central bank facilities

During the year, the Group has utilised facilities provided by the Bank of England 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 64, 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 25 months (2022: 37 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 Indexed Long-Term Repo Scheme ('ILTR') have a maturity of six months and a rate of interest set in an auction process. The Group has not accessed the ILTR during the year, but retains access to this programme for liquidity purposes.

The amounts drawn under these facilities are set out below.

	2023	2022
	£m	£m
TFSME	2,750.0	2,750.0
ILTR	-	-
Total central bank facilities	2,750.0	2,750.0

All TFSME borrowings fall due after more than one year.

During the year ended 30 September 2022 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 64). The mortgage assets pledged in support of these drawings are set out in note 17.

The balances arising from the TFSME carried in the Group accounts are shown below.

	2023	2022
	£m	£m
TFSME at IAS 20 carrying value	2,716.3	2,700.2
Deferred government assistance	33.7	49.8
	2,750.0	2,750.0

39. Sale and repurchase agreements

From time to time the Group enters into short-term sale and repurchase agreements with highly-rated UK banks as part of its liquidity management operations.

At 30 September 2023 £50.0m was outstanding under such arrangements (2022: £nil). The average term of the agreements was 3 months and the average remaining term 2.8 months. The average interest rate payable was 0.80% above compounded SONIA.

The securities subject to the sale and repurchase agreement were certain of the Group's retained asset backed loan notes, described in note 64.

40. Sundry liabilities

(a) The Group

	2023	2022	2021
	£m	£m	£m
Current liabilities			
Accrued interest	156.7	42.2	22.2
Trade creditors	1.6	0.7	1.4
CSA liabilities	383.4	388.6	0.2
Purchase of own shares (note 47)	-	10.8	-
Other accruals	35.6	35.9	32.9
Sundry financial liabilities at amortised cost	577.3	478.2	56.7
Contingent consideration (note 41)	-	2.2	4.6
Sundry financial liabilities	577.3	480.4	61.3
Lease payables (note 42)	2.6	2.2	1.5
Deferred income	5.9	3.7	3.3
Conduct (note 43)	-	-	-
Other taxation and social security	4.1	3.7	2.5
	589.9	490.0	68.6
Non-current liabilities			
Accrued interest	31.5	13.0	9.5
Sundry financial liabilities at amortised cost	31.5	13.0	9.5
Contingent consideration (note 41)	-	-	2.9
Sundry financial liabilities	31.5	13.0	12.4
Lease payables (note 42)	6.3	6.8	8.0
Deferred income	3.5	3.3	1.7
	41.3	23.1	22.1
Total sundry financial liabilities at amortised cost	608.8	491.2	66.2
Total sundry financial liabilities at fair value	-	2.2	7.5
Total other sundry liabilities	22.4	19.7	17.0
Total sundry liabilities	631.2	513.1	90.7

CSA liabilities represent collateral received in respect of interest rate swap agreements and are described further in notes 26 and 63.

(b) The Company

	2023	2022	2021
	£m	£m	£m
Current liabilities			
Amounts owed to Group companies	24.0	23.2	22.6
Accrued interest	0.7	0.7	2.0
Purchase of own shares (note 47)	-	10.8	-
Other financial liabilities	-	1.4	1.0
Sundry financial liabilities at amortised cost	24.7	36.1	25.6
Lease payables (note 42)	1.3	1.3	1.3
	26.0	37.4	26.9
Non-current liabilities			
Lease payables (note 42)	12.4	13.7	15.0
Total sundry liabilities	38.4	51.1	41.9

41. 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.

	2023	2022
	£m	£m
At 1 October 2022	2.2	7.5
Payments	(1.5)	(4.6)
Revaluation	(0.7)	(0.8)
Unwind of discounting (note 5)	-	0.1
At 30 September 2023 (note 40)	-	2.2

The write downs above were the result of the finalisation of the contingent consideration liability based on actual business volumes.

42. Lease payables

The Group's lease liabilities arise under the leasing arrangements described in note 54. Related right of use assets are shown in note 29.

	The Group		The Company	
	2023	2022	2023	2022
	£m	£m	£m	£m
Leasing liabilities falling due:				
In more than five years	0.5	1.1	6.7	8.2
In more than two but less than five years	3.4	3.8	4.3	4.2
In more than one year but less than two years	2.4	1.9	1.4	1.3
In more than one year (note 40)	6.3	6.8	12.4	13.7
In less than one year (note 40)	2.6	2.2	1.3	1.3
	8.9	9.0	13.7	15.0

43. 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 material 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.

44. 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
	£m	Current £m	Prior £m	£m	£m
Year ended 30 September 2023					
Accelerated tax depreciation	(6.9)	(5.0)	3.6	-	(8.3)
Retirement benefit obligations	0.5	1.8	-	0.8	3.1
Interest rate hedging	53.2	(20.4)	-	-	32.8
Loans and other derivatives	2.2	(0.8)	-	-	1.4
Share based payments	(3.7)	(2.8)	-	(1.0)	(7.5)
Tax losses	(0.1)	0.1	(3.0)	-	(3.0)
Other timing differences	(0.8)	(0.2)	0.2	-	(0.8)
Total	44.4	(27.3)	0.8	(0.2)	17.7
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)
	(14.4)	53.5	(0.1)	5.4	44.4

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 (e.g. 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 £3.7m (2022: £3.0m) in entities whose current taxable profits are insufficient to support the recognition of a deferred tax asset.

(b) The Company

The net deferred tax (asset) / 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
	£m	Current £m	Prior £m	£m	£m
Year ended 30 September 2023					
Accelerated tax depreciation	0.1	-	-	-	0.1
Tax losses carried forward	-	-	(1.7)	-	(1.7)
Other timing differences	-	-	-	-	-
Total	0.1	-	(1.7)	-	(1.6)
Year ended 30 September 2022					
Accelerated tax depreciation	-	0.1	-	-	0.1
Tax losses carried forward	-	-	-	-	-
Other timing differences	1.8	-	(1.8)	-	-
	1.8	0.1	(1.8)	-	0.1

45. 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:

	2023	2022
	Number	Number
Ordinary shares		
At 1 October 2022	241,409,624	262,495,185
Shares issued	160,833	386,039
Shares cancelled	(12,870,044)	(21,471,600)
At 30 September 2023	228,700,413	241,409,624

During the year, the Company issued 160,833 shares (2022: 386,039) to satisfy options granted under Sharesave schemes for a consideration of £534,954 (2022: £1,309,525).

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 ended 30 September 2022 were also cancelled.

On 1 June 2023, 12,870,044 of the shares held in treasury at that date were cancelled (note 47).

46. Reserves

(a) The Group

	2023	2022	2021
	£m	£m	£m
Share premium account	71.4	71.1	70.1
Capital redemption reserve	12.9	71.8	50.3
Merger reserve	(70.2)	(70.2)	(70.2)
Profit and loss account	1,243.4	1,151.2	1,005.9
	1,257.5	1,223.9	1,056.1

(b) The Company

	2023	2022	2021
	£m	£m	£m
Share premium account	71.4	71.1	70.1
Capital redemption reserve	12.9	71.8	50.3
Merger reserve	(23.7)	(23.7)	(23.7)
Profit and loss account	521.8	326.3	358.9
	582.4	445.5	455.6

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.

On 28 March 2023 the High Court confirmed the cancellation of the Company's capital redemption reserve, following shareholder approval at the AGM on 1 March 2023. This reserve had arisen on the cancellation of ordinary shares which had been purchased in the market and held in treasury. The balance outstanding on the capital redemption reserve at that time was transferred to the profit and loss account.

47. Own shares

	The Group		The Company	
	2023	2022	2023	2022
	£m	£m	£m	£m
Treasury shares				
Opening balance	18.2	60.7	18.2	60.7
Shares purchased	111.5	66.9	111.5	66.9
Options exercised	(8.4)	-	(8.4)	-
Shares cancelled	(67.3)	(109.4)	(67.3)	(109.4)
Closing balance	54.0	18.2	54.0	18.2
ESOP shares				
Opening balance	19.0	16.0	-	-
Shares purchased	9.0	12.6	-	-
Options exercised	(6.4)	(9.6)	-	-
Closing balance	21.6	19.0	-	-
Irrevocable authority to purchase				
Opening balance	10.8	-	10.8	-
Given in year	-	10.8	-	10.8
Expiring / utilised in year	(10.8)	-	(10.8)	-
Closing balance	-	10.8	-	10.8
Total closing balance	75.6	48.0	54.0	29.0
Total opening balance	48.0	76.7	29.0	60.7

At 30 September 2023 the number of the Company's own shares held in treasury was 10,074,002 (2022: 3,640,519). These shares had a nominal value of £10,074,002 (2022: £3,640,519). These shares do not qualify for dividends.

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 2023, the trust held 4,009,490 ordinary shares (2022: 3,879,160) with a nominal value of £4,009,490 (2022: £3,879,160) and a market value of £19,727,084 (2022: £15,314,924). Options, or other share-based awards, were outstanding against all of these shares at 30 September 2023 (2022: all). The dividends on all of these shares have been waived (2022: all).

48. Equity dividend

Amounts recognised as distributions to equity shareholders in the Group and the Company in the period:

	2023	2022	2023	2022
	Per share	Per share	£m	£m
<i>Equity dividends on ordinary shares</i>				
Final dividend for the previous year	19.2p	18.9p	43.7	46.6
Interim dividend for the current year	11.0p	9.4p	24.2	22.3
	30.2p	28.3p	67.9	68.9

Amounts paid and proposed in respect of the year:

	2023	2022	2023	2022
	Per share	Per share	£m	£m
Interim dividend for the current year	11.0p	9.4p	24.2	22.3
Proposed final dividend for the current year	26.4p	19.2p	56.7	44.9
	37.4p	28.6p	80.9	67.2

The proposed final dividend for the year ended 30 September 2023 will be paid on 8 March 2024, subject to approval at the AGM, with a record date of 2 February 2024. The dividend will be recognised in the accounts when it is paid.

49. Net cash flow from operating activities

(a) The Group

	2023	2022
	£m	£m
Profit before tax	199.9	417.9
Non-cash items included in profit and other adjustments:		
Depreciation of operating property, plant and equipment	4.0	3.5
(Profit) on disposal of operating property, plant and equipment	(0.1)	(0.1)
Amortisation and derecognition of intangible assets	3.6	2.0
Non-cash movements on borrowings	(2.5)	1.9
Impairment losses on loans to customers	18.0	14.0
Charge for share based remuneration	9.6	9.2
Net (increase) / decrease in operating assets:		
Assets held for leasing	(2.7)	(2.3)
Loans to customers	(682.0)	(821.6)
Derivative financial instruments	163.6	(734.8)
Fair value of portfolio hedges	(180.6)	565.4
Other receivables	(15.0)	22.9
Net increase / (decrease) in operating liabilities:		
Retail deposits	2,596.1	1,368.8
Derivative financial instruments	(62.2)	58.2
Fair value of portfolio hedges	68.8	(96.7)
Other liabilities	128.3	416.9
Cash generated by operations	2,246.8	1,225.2
Income taxes (paid)	(75.1)	(56.5)
	2,171.7	1,168.7

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

(b) The Company

	2023	2022
	£m	£m
Profit before tax	255.5	133.6
Non-cash items included in profit and other adjustments:		
Depreciation on property, plant and equipment	1.4	1.4
Non-cash movements on borrowings	0.3	0.4
Impairment provision on investments in subsidiaries	10.2	11.9
Charge for share based remuneration	9.6	9.2
Net (increase) / decrease in operating assets:		
Other receivables	(189.6)	33.9
Net (decrease) in operating liabilities:		
Other liabilities	(0.6)	(0.3)
Cash generated by operations	86.8	190.1
Income taxes (paid) / received	(0.8)	1.2
	86.0	191.3

50. Net cash flow from investing activities

	The Group		The Company	
	2023	2022	2023	2022
	£m	£m	£m	£m
Proceeds from sales of operating property, plant and equipment	0.1	0.6	-	-
Purchases of operating property, plant and equipment	(1.6)	(1.3)	-	-
Purchases of intangible assets	(1.6)	(1.7)	-	-
Advances of loans to subsidiary undertakings	-	-	-	(177.0)
Repayment of loans by subsidiary entities	-	-	99.0	246.5
Net cash (utilised) / generated by investing activities	(3.1)	(2.4)	99.0	69.5

51. Net cash flow from financing activities

	The Group		The Company	
	2023	2022	2023	2022
	£m	£m	£m	£m
Shares issued (note 45)	0.5	1.4	0.5	1.4
Dividends paid (note 48)	(67.9)	(68.9)	(67.9)	(68.9)
Repayment of asset backed floating rate notes	(382.1)	(107.6)	-	-
Repayment of retail bond	-	(125.0)	-	(125.0)
Movement on central bank facilities	-	(69.0)	-	-
Movement on other bank facilities	(586.0)	(144.6)	-	-
Movement on sale and repurchase agreements	50.0	-	-	-
Capital element of lease payments	(2.4)	(1.7)	(1.3)	(1.3)
Purchase of own shares (note 47)	(120.5)	(79.5)	(111.5)	(66.9)
Exercise of share awards	3.4	(0.7)	3.1	-
Net cash (utilised) by financing activities	(1,105.0)	(595.6)	(177.1)	(260.7)

52. Reconciliation of net debt

(a) The Group

	Opening debt	Cash flows		Non-cash movements	Closing debt
		Debt issued	Other		
	£m	£m	£m	£m	£m
30 September 2023					
Asset backed loan notes	409.3	-	(382.1)	0.8	28.0
Bank borrowings	586.0	-	(586.0)	-	-
Corporate bonds	149.2	-	-	(3.4)	145.8
Retail bonds	112.3	-	-	0.1	112.4
Central bank borrowings	2,750.0	-	-	-	2,750.0
Sale and repurchase agreements	-	-	50.0	-	50.0
Lease liabilities	9.0	-	(2.4)	2.3	8.9
Bank overdrafts	0.4	-	(0.2)	-	0.2
Gross debt	4,016.2	-	(920.7)	(0.2)	3,095.3
Cash	(1,930.9)	-	(1,063.4)	-	(2,994.3)
Net debt	2,085.3	-	(1,984.1)	(0.2)	101.0
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
Sale and repurchase agreements	-	-	-	-	-
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

Other non-cash changes shown above represent:

- EIR adjustments relating to the spreading of initial costs of the facilities concerned
- Inception of new lease assets under IFRS 16
- Hedging fair value adjustments on the corporate bond (note 26)

(b) The Company

	Cash flows			Non-cash movements	Closing debt
	Opening debt	Debt issued	Other		
	£m	£m	£m	£m	£m
30 September 2023					
Corporate bonds	149.2	-	-	0.2	149.4
Retail bonds	112.3	-	-	0.1	112.4
Lease liabilities	15.0	-	(1.3)	-	13.7
Gross debt	276.5	-	(1.3)	0.3	275.5
Cash	(19.7)	-	(7.9)	-	(27.6)
Net debt	256.8	-	(9.2)	0.3	247.9
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

Non-cash changes shown above represent EIR adjustments relating to the spreading of initial costs of the bonds.

53. 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 £1.3m is included in third party servicing fees (note 8) (2022: £1.4m) and £0.5m is included in other debtors in respect of unpaid fees at the year end (2022: £0.2m). Outstanding collection monies due to the structured entity of £0.1m are included in other creditors at 30 September 2023 (2022: £0.1m).

54. 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.

It also leases green motor vehicles to its employees under a salary sacrifice scheme.

Disclosures in respect of these balances are set out in these financial statements as follows:

Disclosure	Note
Investment in finance leases	19
Finance income on net investment in finance leases	4
Assets leased under operating leases	29
Operating lease income	6

The undiscounted future minimum lease payments receivable by the Group under operating lease arrangements may be analysed as follows:

	2023	2022
	£m	£m
Amounts falling due:		
Within one year	14.5	14.0
Within one to two years	9.3	8.1
Within two to three years	5.8	5.8
Within three to four years	3.5	3.6
Within four to five years	1.6	1.7
After more than five years	0.3	0.8
	35.0	34.0

(b) As Lessee

The Group's use of leases as a lessee relates to the rental of office buildings and company cars, together with the procurement of vehicles for leasing to employees under its green car scheme. 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 (2022: 8 years) with rents subject to review every five years, while the average term of the vehicle leases is 3 years (2022: 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	29
Interest expense on lease liabilities	5
Expense relating to short-term leases	9
Additions to right of use assets	29
Carrying amount of right of use assets	29
Maturity analysis of lease liabilities	64

Salary sacrifice amounts of £0.1m in respect of the green car scheme are included within operating lease income (note 6). There was no other subleasing of right of use assets and the total cash flows relating to leasing as a lessee were £2.3m (2022: £1.9m).

55. 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 £720,000 were outstanding at the year end (2022: £779,000), and the maximum amounts outstanding during the year totalled £771,000 (2022: £793,000).

The Paragon Pension Plan (the 'Plan') is a related party of the Group. Transactions with the Plan are described in note 60.

The Group had no other transactions with related parties other than the key management compensation disclosed in note 58.

(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 59.

Details of the Company's investments in subsidiaries and the income derived from them are shown in notes 32 and 72.

Outstanding current account balances with subsidiaries are shown in notes 27 and 40.

During the year the Company incurred interest costs of £1.5m in respect of borrowings from its subsidiaries (2022: £1.0m).

The Company leased an office building from a subsidiary entity (note 54(b)). Finance charges recognised in respect of this lease were £0.4m (2022: £0.4m).

56. 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 72 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 2023 were:

	United Kingdom
	£m
<hr/>	
Year ended 30 September 2023	
Total operating income	466.0
Profit before tax	199.9
Corporation tax paid	75.1
Public subsidies received	-
Average number of full time equivalent employees	1,435
<hr/>	
	United Kingdom
	£m
<hr/>	
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

The Group's participation in Bank of England funding schemes is set out in note 38.

D2.2 Notes to the Accounts – Employment costs

For the year ended 30 September 2023

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.

57. Employees

The average number of persons (including directors) employed by the Group during the year was 1,527 (2022: 1,498). The number of employees at the end of the year was 1,522 (2022: 1,503).

Costs incurred during the year in respect of these employees were:

	2023	2023	2022	2022
	£m	£m	£m	£m
Share based remuneration	9.6		9.2	
Other wages and salaries	84.6		81.9	
Total wages and salaries		94.2		91.1
National Insurance on share based remuneration	1.9		0.5	
Other social security costs	10.2		9.7	
Total social security costs		12.1		10.2
Defined benefit pension cost	0.5		0.9	
Other pension costs	4.7		4.1	
Total pension costs		5.2		5.0
Total employment costs		111.5		106.3
Of which				
Included in operating expenses (note 9)		108.3		103.6
Included in maintenance costs (note 6)		3.2		2.7
		111.5		106.3

Details of the pension schemes operated by the Group are given in note 60.

The Company has no employees. Details of the directors' remuneration are given in note 58.

58. Key management remuneration

Key management

The key management personnel of the Group and the Company, as defined by IAS 24 – Related Party Transactions, are considered by the Group to be the members of its Executive Committees and the members of the Board of Directors of the Company. The details of key management remuneration required by IAS 24 are set out below. For persons joining or leaving the executive committees in the year, all remuneration for the twelve months is shown.

	2023	2023	2022	2022
	£m	£m	£m	£m
Salaries and fees	5.3		4.4	
Cash amount of bonus	3.3		3.1	
Social security costs	1.2		1.1	
Short-term employee benefits		9.8		8.6
Post-employment benefits		0.5		0.6
IFRS 2 cost in respect of key management	4.3		4.0	
National Insurance thereon	1.0		1.0	
Share based payment		5.3		5.0
		15.6		14.2

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.

	2023	2022
	£m	£m
Aggregate amount of remuneration	3.7	3.5
Pension allowances	0.1	0.2
Gains on exercise of share options	0.7	5.6

In the table above, remuneration includes the cash amount of bonuses and the value of benefits in kind. It excludes any amounts receivable under share-based payment arrangements. Where a monetary amount of salary is paid in shares based on the market price at the payment date, this is included.

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.

59. 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 57.

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 2023 and at 30 September 2022 is set out below.

	Number 2023	Number 2022
(a) Sharesave Plan	3,077,077	3,613,777
(b) Performance Share Plan	5,365,646	4,834,871
(c) Company Share Option Plan	56,591	87,716
(d) Deferred Bonus Plan	1,123,936	1,155,638
(e) Restricted Stock Units	412,676	616,709
	10,035,926	10,308,711

Following the year end, the Remuneration Committee agreed the amounts of variable remuneration in respect of the year to be satisfied in the form of share-based awards. These awards will be granted, following the approval of these accounts, based on the amounts approved and market pricing data at the date of grant.

(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 2023 and the year ended 30 September 2022 is shown below.

	2023 Number	2023 Weighted average exercise price p	2022 Number	2022 Weighted average exercise price p
Options outstanding				
At 1 October 2022	3,613,777	318.46	3,561,675	306.89
Granted in the year	1,235,757	400.40	737,978	391.20
Exercised or surrendered in the year	(1,579,263)	285.67	(386,039)	339.22
Lapsed during the year	(193,194)	357.44	(299,837)	333.10
At 30 September 2023	3,077,077	365.76	3,613,777	318.46
Options exercisable	439,546	279.43	109,654	359.92

The weighted average remaining contractual life of options outstanding at 30 September 2023 was 32.8 months (2022: 27.0 months). The weighted average market price at exercise for share options exercised in the year was 515.86p (2022: 507.07p).

Options are outstanding under the Sharesave plans to purchase ordinary shares as follows:

Grant date	Period exercisable	Exercise price	Number	
			2023	2022
28/07/2017	01/09/2022 to 01/03/2023	341.76p	-	1,403
31/07/2018	01/09/2023 to 01/03/2024	408.80p	2,933	20,391
30/07/2019	01/09/2022 to 01/03/2023	360.16p	-	108,251
30/07/2019	01/09/2024 to 01/03/2025	360.16p	4,577	4,577
29/07/2020	01/09/2023 to 01/03/2024	278.56p	436,613	1,925,599
29/07/2020	01/09/2025 to 01/03/2026	278.56p	449,263	478,876
28/07/2021	01/09/2024 to 01/03/2025	424.00p	257,591	278,279
28/07/2021	01/09/2026 to 01/03/2027	424.00p	54,118	63,315
27/07/2022	01/09/2025 to 01/03/2026	391.20p	528,429	622,064
27/07/2022	01/09/2027 to 01/03/2028	391.20p	108,722	111,022
15/09/2023	01/10/2026 to 01/04/2027	400.40p	1,022,746	-
15/09/2023	01/10/2028 to 01/04/2029	400.40p	212,085	-
			3,077,077	3,613,777

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 2023 and the year ended 30 September 2022, are shown below.

Grant date	15/09/23	15/09/23	27/07/22	27/07/22
Number of awards granted	1,203,672	212,085	623,122	114,856
Market price at date of grant	506.5p	506.5p	527.0p	527.0p
Contractual life (years)	3.5	5.5	3.5	5.5
Fair value per share at date of grant (£)	1.10	1.09	1.34	1.06
Inputs to valuation model				
Expected volatility	31.02%	35.67%	39.36%	33.75%
Expected life at grant date (years)	3.43	5.42	3.42	5.43
Risk-free interest rate	4.64%	4.39%	1.69%	1.74%
Expected annual dividend yield	5.96%	5.96%	5.37%	5.37%
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.

These awards are the principal means of delivering deferred variable remuneration to executive directors and Material Risk Takers ('MRT's) in accordance with regulatory remuneration requirements, although these are not the only employees to receive such awards.

Awards under this plan comprise a right to acquire ordinary shares in the Company for nil or nominal payment and are subject to performance criteria measured over a three year period beginning with the financial year including the date of grant (the 'test period').

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 and other employees identified as MRTs for regulatory purposes, 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 2021 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.

Vested awards made to the executive directors and other MRTs in December 2022 become exercisable in annual instalments between the end of the test period and the seventh anniversary of the grant date. The maximum deferral period is based on the regulatory classification of the individual MRT. The latest possible exercise date is the tenth anniversary of the grant date.

Where performance conditions are not met in full, awards lapse at the point at which the determination is made. Awards will also lapse on cessation of employment during the test period, 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 2023 and 30 September 2022 were:

Grant date	Period exercisable	Number	
		2023	2022
28/02/2013	28/02/2016 to 27/02/2023 [†]	-	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	5,005
22/12/2015	22/12/2018 to 21/12/2025 [†]	10,473	10,473
01/12/2016	01/12/2019 to 30/11/2026 [†]	33,493	34,894
08/12/2017	03/12/2020 to 07/12/2027 [†]	29,675	50,268
14/12/2018	14/12/2021 to 13/12/2028 [†]	61,952	155,092
06/07/2020	06/12/2022 to 05/07/2030 ^ψ	114,169	1,144,820
06/07/2020	07/12/2024* to 05/07/2030 ^ψ	509,192	509,192
11/12/2020	07/12/2023* to 10/12/2030 ^φ	1,074,596	1,122,904
11/12/2020	07/12/2025* to 10/12/2030 ^φ	385,707	385,707
15/12/2021	07/12/2024* to 14/12/2031 ^δ	1,034,343	1,069,870
15/12/2021	07/12/2026* to 14/12/2031 ^δ	339,936	339,936
16/12/2022	07/12/2025* to 15/12/2032 ^λ	932,315	-
16/12/2022	07/12/2026* to 15/12/2032 ^λ	259,233	-
16/12/2022	07/12/2027* to 15/12/2032 ^λ	268,683	-
16/12/2022	07/12/2028* to 15/12/2032 ^λ	148,229	-
16/12/2022	07/12/2029* to 15/12/2032 ^λ	156,513	-
		5,365,646	4,834,871

* 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.

^ψ These awards were subject to performance criteria, assessed over a period of three financial years, starting with the year of grant.

- 25% 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 67.0p, 25% vesting if EPS in this year is 60.0p and vesting between those points on a straight line basis
- 25% to a risk test. 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 Committee's 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. The Remuneration Committee will determine the extent to which the condition has been met between 0% and 100%. 50% of this tranche will vest for on-target performance, below a 25% threshold no vesting will occur
- 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. The Remuneration Committee will determine the extent to which the condition has been met between 0% and 100%. 50% of this tranche will vest for on-target performance below a 25% threshold no vesting will occur
- Due to the volatility of the share price at the time of grant, the Remuneration Committee could have adjusted the vesting levels at the vesting date if it believed that the use of this share price had created a potential windfall gain

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 test period also applies.

^φ These awards are subject to performance criteria, similar to those described at ^ψ above, except that:

- Under the EPS condition full vesting occurs if EPS for the third year of the test period is at least 66.0p, 25% vesting if EPS in this year is 58.0p 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

^δ These 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 72.0p, 25% vesting if EPS in this year is 63.0p and vesting between those points on a straight line basis
- Under the risk condition, the key measures component covers: regulatory breaches; conduct; operational incidents; capital and liquidity; and credit losses

^λ These 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 88.1p, 25% vesting if EPS in this year is 74.4p and vesting between those points on a straight line basis
- The risk condition relates to 20% of the grant, the customer service condition applies to 10% of the grant and the people condition relates to 10% of the grant
- The 25% and 50% vesting thresholds no longer apply to the customer service and people conditions
- 10% of the grant relates to a climate condition. The climate condition is based on the performance of the Group against its most significant climate-related targets, including the development of systems to quantify and manage its climate-related impacts.

On exercise, holders of awards granted between February 2013 and December 2021 receive a payment equivalent to the dividends accruing on the vested shares during the vesting period. No such payment is made in respect of awards granted at other dates.

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. Fair values are calculated separately for grant elements which became exercisable at different dates to allow for the impact of dividends. The principal inputs to this model for grants made in the year ended 30 September 2023 and the year ended 30 September 2022 are shown below.

Grant date	16/12/22	15/12/21
Market price at date of grant	541.5p	549.0p
Contractual life (years)	10.0	10.0
Expected volatility	40.54%	38.13%
Risk-free interest rate	3.27%	0.53%
Expected annual dividend yield	5.28%	N/A

For all the above grants no departures are expected and grantees are expected to exercise awards at the earliest opportunity. The expected volatility is based on the annualised standard deviation of daily changes in price over the three years preceding the grant date. For the purposes of the valuation, non-market conditions are assumed to be achieved 100% although this is unlikely to occur in practice.

The number of awards granted and their fair values for IFRS 2 purposes are set out below.

Grant date Time to exercise (Years)	16/12/22		15/12/21	
	Number of awards	IFRS 2 fair value	Number of awards	IFRS 2 fair value
3	926,721	423.32p	1,071,597	504.50p
4	259,233	404.23p	-	-
5	268,683	385.55p	339,936	504.50p
6	148,229	367.43p	-	-
7	156,513	349.93p	-	-
	1,759,379		1,411,533	

(c) Company Share Option Plan ('CSOP')

Before its amendment at the 2023 AGM, the PSP included a tax advantaged element under which CSOP options could 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 2023 or 30 September 2022, and the current PSP contains no provision to make CSOP grants.

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 2023 and the year ended 30 September 2022 is shown below.

	2023		2022	
	Number	Weighted average exercise price p	Number	Weighted average exercise price p
Options outstanding				
At 1 October 2022	87,716	406.31	241,574	403.66
Exercised or surrendered in the year	(28,715)	408.25	(148,680)	402.14
Lapsed during the year	(2,410)	477.76	(5,178)	402.37
At 30 September 2023	56,591	402.29	87,716	406.31
Options exercisable	56,591	402.29	87,716	406.31

The weighted average remaining contractual life of options outstanding at 30 September 2023 was 49.9 months (2022: 66.2 months). The weighted average market price at exercise for share options exercised in the year was 563.98p.

The entitlements outstanding under this scheme at 30 September 2023 and 30 September 2022 were:

Grant date	Period exercisable	Exercise price	Number	Number
			2023	2022
01/12/2016	01/12/2019 to 30/11/2026	361.88p	21,732	22,802
08/12/2017	08/12/2020 to 07/12/2027	477.76p	13,409	20,557
14/12/2018	14/12/2021 to 13/12/2028	396.04p	21,450	44,357
			56,591	87,716

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.

No separate fair value was 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

During the current financial year this plan has been used to defer annual bonus awards for executive directors and certain other MRTs to meet deferral levels required by regulatory remuneration rules. The plan has also been used to facilitate other long-term incentive arrangements.

Before the current financial year such plans were 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 2023 and 30 September 2022 were:

Grant date	Period exercisable	Number	Number
		2023	2022
10/12/2013	10/12/2016 to 09/12/2023	-	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
14/12/2018	14/12/2021 to 13/12/2028	-	26,437
12/12/2019	12/12/2022 to 11/12/2029	-	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	206,135	224,981
15/12/2021	15/12/2024 to 10/12/2031	244,953	244,953
16/12/2022	07/12/2023 * to 15/12/2032	5,011	-
16/12/2022	07/12/2024 * to 15/12/2032	104,089	-
16/12/2022	07/12/2025 * to 15/12/2032	14,742	-
16/12/2022	07/12/2026 * to 15/12/2032	15,565	-
16/12/2022	07/12/2027 * to 15/12/2032	16,018	-
16/12/2022	07/12/2028 * to 15/12/2032	10,775	-
16/12/2022	07/12/2029 * to 15/12/2032	11,384	-
		1,123,936	1,155,638

* Estimated date

† All-employee award

Awards made to executive directors and other MRTs in December 2022 become exercisable in annual instalments after the announcement of each year's results from the third anniversary of the grant to the seventh anniversary. The maximum deferral for each employee depends on the regulatory classification of the individual MRT.

Exercise arrangements for grants made to other employees in December 2022 are individually structured at the discretion of the Remuneration Committee at the point of grant.

All of these awards will lapse if the grantee ceases employment with the Group before the grant becomes exercisable, other than in 'good leaver' circumstances.

The Deferred Bonus shares granted in 2021 and earlier years under the executive awards can be exercised from the third anniversary of the award date (or other vesting date determined by the Remuneration Committee) 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 between December 2016 and December 2021 accrue dividends over the vesting period, unlike earlier grants which accrued dividends until the point of exercise. Awards granted in December 2022 do not include the right to payment in lieu of dividend. The fair value of Deferred Bonus awards issued in the year was determined using a Black-Scholes Merton model and allows for these dividend arrangements.

Details of the inputs to the valuation model for awards made in the year ended 30 September 2023 and the year ended 30 September 2022 are shown below.

Grant date	16/12/22	15/12/21
Market price at date of grant	541.5p	549.0p
Expected annual dividend yield	5.28%	N/A

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. Grantees are assumed to exercise their awards at the earliest possible opportunity.

The number of awards granted and their fair values for IFRS2 purposes are set out below.

Grant date	16/12/22		15/12/21	
	Number of awards	IFRS 2 fair value	Number of awards	IFRS 2 fair value
Time to exercise (Years)				
1	5,011	513.6p	-	-
2	104,089	487.2p	-	-
3	14,742	462.2p	244,953	549.0p
4	15,565	438.4p	-	-
5	16,018	415.9p	-	-
6	10,775	394.5p	-	-
7	11,384	374.2p	-	-
	177,584		244,953	

(e) Restricted Stock Units ('RSUs')

Between the 2016 and 2022 financial years, the Company permitted certain employees to elect to receive RSU awards instead of PSP awards. Following the approval of the new PSP at the 2023 AGM the Company no longer has the capacity to make new RSU 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 MRTs.

The conditional entitlements outstanding under this scheme at 30 September 2023 and 30 September 2022 were:

Grant date	Period exercisable	Number	Number
		2023	2022
06/07/2020	06/12/2022 to 05/07/2030	-	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	26,603
15/12/2021	07/12/2025* to 15/12/2031	355,880	368,953
		412,676	616,709

* Estimated date

The fair value of RSU awards issued in the year ended 30 September 2022 was determined using a Black-Scholes Merton model. Details of the awards made in that year are shown below. No awards were made in the year ended 30 September 2023.

Grant date	15/12/21	15/12/21
Number of awards granted	368,953	26,603
Market price at date of grant	549.0p	549.0p
Contractual life (years)	4.0	3.0
Fair value per share at date of grant	549.0p	549.0p

For all of these grants no departures are expected.

60. 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.

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.

Benefits accrued before 1 July 2021 may be accessed from the age of 60 without any reduction for early payment. Benefits accruing after 1 July 2021 may be accessed without penalty from the age of 65.

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 2022, by Aon Solutions UK Limited, the Plan's independent actuary and completed in the current year. 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 £195.5m, with a shortfall against the assets of £44.2m (2019: £85.0m). 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 £5.1m (2019: £18.2m). This valuation forms the basis of the IAS 19 valuation.

Following the agreement of the 2022 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 29). 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 29) but this arrangement provides the Plan with additional security in a stress event.

(b) Defined benefit plan – financial impact

For accounting purposes, the valuation at 31 March 2022 was updated to 30 September 2023 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 2023, 30 September 2022 and 30 September 2021 and their fair values were:

	2023	2022	2021
	£m	£m	£m
Cash and cash equivalents	0.6	0.7	17.1
Equity instruments	44.8	56.6	73.4
Debt instruments	56.6	47.4	54.8
Total fair value of Plan assets	102.0	104.7	145.3
Present value of Plan liabilities	(89.3)	(97.6)	(155.6)
Surplus / (deficit) in the Plan	12.7	7.1	(10.3)

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 61).

At 30 September 2023 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 meet a hedging target of 60% of the interest and inflation risks faced by the Plan. During the market turmoil encountered during September / October 2022 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'. This estimate is based on one permissible method, method C2. Following the year end, the Trustee, with the consent of the Company, chose to adopt an alternative approach, method B. However, the accounting impact of this is likely to be minimal. Once detailed calculations are performed it is possible that the final impact may vary due to idiosyncratic impacts on individual members, or due to the development of a wider legal and accounting consensus on the proper interpretation of the courts' requirements as further cases are determined.

The movement in the fair value of the Plan assets during the year was as follows:

	2023	2022
	£m	£m
At 1 October 2022	104.7	145.3
Interest on Plan assets	5.2	2.9
Cash flows		
Contributions by the Group	3.9	4.0
Contributions by Plan members	0.2	0.2
Benefits paid	(3.6)	(3.8)
Administration expenses paid	(0.6)	(0.8)
Remeasurement (loss) / gain		
Return on Plan assets (excluding amounts included in interest)	(7.8)	(43.1)
At 30 September 2023	102.0	104.7

The actual return on Plan assets in the year ended 30 September 2023 was a loss of £2.6m (2022: loss of £40.2m).

The movement in the present value of the Plan liabilities during the year was as follows:

	2023	2022
	£m	£m
At 1 October 2022	97.6	155.6
Current service cost	0.5	0.9
Past service cost	-	-
Funding cost	4.8	3.1
Cash flows		
Contributions by Plan members	0.2	0.2
Benefits paid	(3.6)	(3.8)
Remeasurement loss / (gain)		
Arising from demographic assumptions	(0.9)	2.2
Arising from financial assumptions	(11.1)	(61.9)
Arising from experience adjustments	1.8	1.3
At 30 September 2023	89.3	97.6

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.

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):

	2023	2022	2021
In determining net pension cost for the year			
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%
In determining benefit obligations			
Discount rate	5.55%	5.00%	2.00%
Rate of compensation increase:			
Pre 1 July 2021 accrual	3.25%	3.55%	3.40%
Post 1 July 2021 accrual	2.50%	2.50%	2.50%
Rate of price inflation	3.25%	3.55%	3.40%
Rate of increase of pensions	3.00%	3.25%	3.15%
Further life expectancy at age 60			
Male member aged 60	27	27	28
Female member aged 60	29	29	29
Male member aged 40	29	29	29
Female member aged 40	31	31	31

In the 2023 valuation the base mortality table used was the standard S3PMA/S3PFA_M (All) Year of Birth table, with future improvements projected by the CMI 2022 projection model with a 1.5% per annum long-term improvement rate.

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	2023 £m	2022 £m
Current service cost		0.5	0.9
Past service cost		-	-
Total service cost	57	0.5	0.9
Administration expenses		0.6	0.8
Included within operating expenses		1.1	1.7
Funding cost of Plan liabilities		4.8	3.1
Interest on Plan assets		(5.2)	(2.9)
Net interest (income) / expense	4 / 5	(0.4)	0.2
Components of defined benefit costs recognised in profit or loss		0.7	1.9

The amounts recognised in the consolidated statement of comprehensive income in respect of the Plan are:

	2023	2022
	£m	£m
Return on Plan assets (excluding amounts included in interest)	(7.8)	(43.1)
Actuarial gains / (losses)		
Arising from demographic assumptions	0.9	(2.2)
Arising from financial assumptions	11.1	61.9
Arising from experience adjustments	(1.8)	(1.3)
Total actuarial gain	2.4	15.3
Tax thereon	(0.8)	(3.7)
Net actuarial gain	1.6	11.6

Of the remeasurement movements reflected above:

- The return on plan assets to 30 September 2023 reflects a general reduction in asset values in the year, though not as marked as that seen in the year ended 30 September 2022 which saw sharp falls in global investment values over the year especially around the year end, including the effect on the Group's portfolio of its LDI hedging strategy.
- In the year ended 30 September 2023 the changes in demographic assumptions reflect the updating of the maturity tables used to the most recent versions, which show a general reduction in the expectancy compared to the previous editions.

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.

- The change in financial assumptions in the year ended 30 September 2023 reflects principally a continuation of the recent upward trend in bond yields, which has not been matched by long-term inflation expectations implied by gilt rates.

The movement in the year ended 30 September 2022 reflected 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 experience adjustments in the year ended 30 September 2023 represent the impact of actual UK inflation in the year on expected benefits, which is more significant than in previous years due to the inflation levels recorded in the period.

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 were 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 2023, 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	
		2023	2022
Discount rate	0.1% per annum	(1.6)%	(1.7)%
Rate of inflation*	0.1% per annum	1.6%	1.7%
Rate of salary growth	0.1% per annum	0.4%	0.4%
Rates of mortality	1 year of life expectancy	2.5%	2.9%

* 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 2024 are 50% growth assets (primarily equities), and 50% matching assets (primarily bonds) which includes LDI balances, with the hedge ratio rising to 75%.

Following the finalisation of the March 2022 valuation, the agreed rate of employer contribution reduced to 12.5% of capped pensionable salary from 15 March 2023, having been 25% since 1 July 2021, and 32.0% previously. An additional contribution for deficit reduction of £1.9m payable over the nine-month period ending on 30 November 2023, and an additional contribution of £2.5m per annum, payable monthly from 1 December 2023 were also agreed. These include amounts payable under the PRP and replace the £2.5m contribution for deficit reduction included in the previous funding plan. The Group continues to make an additional £0.4m per annum contribution in respect of the Plan's running costs, payable monthly.

The present best estimate of the contributions to be made to the Plan by the Group in the year ending 30 September 2024 is £3.9m.

The average durations of the discounted benefit obligations in the Plan at the year end are shown in the table below:

	2023	2022
	Years	Years
Category of member		
Active members	18	21
Deferred pensioners	18	21
Current pensioners	11	12
All members	16	18

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 completed the auto-enrolment process mandated by the UK Government in November 2013, using this scheme. Since the year ended 30 September 2020 the Group's contribution to the scheme for those employees making the maximum 6% contribution has been 10% of salary.

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 2023, which represent the total cost charged against income, were £4.7m (2022: £4.1m) (note 57).

D2.3 Notes to the Accounts – Capital and financial risk

For the year ended 30 September 2023

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 and market 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.

61. 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 relative to its Total Risk Exposure ('TRE') 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 3 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 by the Executive Risk Committee ('ERC') 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 2023 the Group's total regulatory capital of £1,338.9m (2022: £1,371.8m) exceeded the amounts required by the regulator, including £673.4m (2022: £660.6m) 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 2023 on the fully loaded basis of £1,325.4m (2022: £1,346.0m) was in excess of the TCR of £672.2m (2022: £658.4m) on the same basis (amounts not subject to audit).

At 30 September 2023, the Group's TCR represented 8.8% of TRE (2022: 8.8%).

The CRR also requires firms to hold additional capital buffers, including a Capital Conservation Buffer ('CCoB') of 2.5% of TRE (at 30 September 2023) (2022: 2.5%) and a Counter-cyclical Capital Buffer ('CCyB'), currently 2.0% of TRE (2022: 0.0%). The UK CCyB increased to 1.0% of TRE from December 2022 and to 2.0% of TRE from July 2023. This 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 2023 is set out below.

	Note	Regulatory basis		Fully loaded basis	
		2023	2022	2023	2022
		£m	£m	£m	£m
Total equity		1,410.6	1,417.3	1,410.6	1,417.3
<i>Deductions</i>					
Proposed final dividend	48	(56.7)	(44.9)	(56.7)	(44.9)
IFRS 9 transitional relief	*	13.5	25.8	-	-
Intangible assets	30	(168.2)	(170.2)	(168.2)	(170.2)
Pension surplus net of deferred tax	60	(9.6)	(5.3)	(9.6)	(5.3)
Prudent valuation adjustments	§	(0.6)	(0.9)	(0.6)	(0.9)
Insufficient coverage	ψ	(0.1)	(0.0)	(0.1)	(0.0)
Common Equity Tier 1 ('CET1') capital		1,188.9	1,221.8	1,175.4	1,196.0
Other Tier 1 capital		-	-	-	-
Total Tier 1 capital		1,188.9	1,221.8	1,175.4	1,196.0
Corporate bond	37	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')		1,338.9	1,371.8	1,325.4	1,346.0

* Firms are permitted to phase in the impact of IFRS 9 transition as described above.

§ 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.

ψ Regulatory deduction where there is insufficient coverage for non-performing exposures required under Article 47(c) of the CRR. This requirement remained in force in the UK, at the year end, under the Brexit arrangements but was removed by the PRA with effect from 14 November 2023. The amount required at 30 September 2022 was less than £0.1m.

φ The PRA Rulebook restricts the amount of tier 2 capital which is eligible for regulatory purposes to 25% of TCR.

The TRE amount calculated under the PRA Rulebook framework against which this capital is held, which includes Risk Weighted Asset ('RWA') amounts for credit risk, and the proportion of these assets which that capital represents, are calculated as shown below.

	Regulatory basis		Fully loaded basis	
	2023	2022	2023	2022
	£m	£m	£m	£m
<i>Credit risk</i>				
Balance sheet assets	6,784.2	6,652.1	6,784.3	6,652.1
Off balance sheet	87.2	85.4	87.2	85.4
IFRS 9 transitional relief	13.5	25.8	-	-
Total credit risk	6,884.9	6,763.3	6,871.5	6,737.5
Operational risk	740.2	633.1	740.2	633.1
Market risk	-	-	-	-
Other	43.6	118.6	43.6	118.6
Total risk exposure amount ('TRE')	7,668.7	7,515.0	7,655.3	7,489.2
Solvency ratios				
	%	%	%	%
CET1	15.5	16.3	15.4	16.0
TRC	17.5	18.3	17.3	18.0

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	2023 £m	2022 £m
Total balance sheet assets		18,420.2	16,653.6
Add: Credit fair value adjustments on loans to customers	18	379.3	559.9
Debit fair value adjustments on retail deposits	33	30.9	99.7
Adjusted balance sheet assets		18,830.4	17,313.2
Less: Derivative assets	26	(615.4)	(779.0)
Central bank deposits	17	(2,783.3)	(1,612.5)
CRDs	27	(38.0)	(30.2)
Accrued interest on sovereign exposures		(4.2)	(1.0)
On balance sheet items		15,389.5	14,890.5
Less: Intangible assets	30	(168.2)	(170.2)
Pension surplus	60	(12.7)	(7.1)
Total on balance sheet exposures		15,208.6	14,713.2
Regulatory exposure for derivatives		179.6	434.7
Total derivative exposures		179.9	434.7
Post offer pipeline at gross notional amount		993.3	1,307.9
Adjustment to convert to credit equivalent amounts		(815.7)	(1,094.1)
Off balance sheet items		177.6	213.8
Tier 1 capital		1,188.9	1,221.8
Total leverage exposure before IFRS 9 relief		15,565.8	15,361.7
IFRS 9 relief		13.5	25.8
Total leverage exposure		15,579.3	15,387.5
UK leverage ratio		7.6%	7.9%

This table is not subject to audit

The fully loaded leverage ratio is calculated as follows

	2023 £m	2022 £m
Fully loaded Tier 1 capital	1,175.4	1,196.0
Total leverage exposure before IFRS 9 relief	15,565.8	15,361.7
Fully loaded UK leverage exposure	7.6%	7.8%

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.

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 2023 is derived as follows:

	Note	2023 £m	2022 £m
Profit for the year after tax		153.9	313.6
Amortisation and derecognition of intangible assets	30	3.6	2.0
Adjusted profit		157.5	315.6
Divided by			
Opening equity		1,417.3	1,241.9
Opening intangible assets	30	(170.2)	(170.5)
Opening tangible equity		1,247.1	1,071.4
Closing equity		1,410.6	1,417.3
Closing intangible assets	30	(168.2)	(170.2)
Closing tangible equity		1,242.4	1,247.1
Average tangible equity		1,244.7	1,159.3
Return on Tangible Equity		12.7%	27.2%

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 46) 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. For the current year, based on its review of the Group's capital position and forecasts, and taking account of Covid-related impacts on the relative size of interim and final dividends in recent years and the desire to normalise the ongoing relationship between the half-year and final payments, the Board concluded that a one-off enhancement to the interim dividend could be made. It therefore declared an interim dividend for the year of 11.0p per share (2022: 9.4p per share). The Board also confirmed that the Group's normal approach of paying an interim dividend of 50% of the preceding year's final dividend would continue to apply in future years.

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, and the potential impacts of ongoing developments in the regulatory regime for capital including the introduction in the UK of Basel 3.1.

The Board particularly considered the appropriateness of including net losses relating to fair value adjustments from hedging in the calculation of any dividend or distribution, as these primarily result from the reversal of gains recorded in earlier years which were disregarded, at the time, for the purpose of determining dividends. 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 total 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 26.4p per share (2022: 19.2p per share) for approval at the 2024 AGM, making a total dividend for the year of 37.4p per share (2022: 28.6p per share).

During the year the share buy-back programme announced during the 2022 financial year was completed under an irrevocable authority put in place in September 2022. A share buy-back programme for the current financial year, for up to £50.0m of ordinary shares was authorised at the time of the Group's 2022 results announcement. This was extended to £100.0m in June 2022. The amount expended in these programmes in the year was £111.5m (note 47) and the share buy-back was completed before the year end.

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 2023 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 2023, 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.

62. 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 63 to 65 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 63 to 65 is materially similar to that existing throughout the year.

63. Credit risk

The assets of the Group and the Company which are subject to credit risk are set out below.

	Note	The Group		The Company	
		2023 £m	2022 £m	2023 £m	2022 £m
Financial assets at amortised cost					
Loans to customers	18	14,874.3	14,210.3	-	-
Trade receivables	27	1.5	1.9	-	-
Intra-group cash deposits	27	-	-	193.6	-
Amounts owed by Group companies	27	-	-	35.1	39.1
Cash	17	2,994.3	1,930.9	27.6	19.7
CRDs	27	38.0	30.2	-	-
Accrued interest income	27	4.6	1.0	0.1	0.1
		17,912.7	16,174.3	256.4	58.9
Financial assets at fair value					
Derivative financial assets	26	615.4	779.0	-	-
Maximum exposure to credit risk		18,528.1	16,953.3	256.4	58.9

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 64, 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 prudent credit management, both at the time of acquiring or underwriting a new loan, where robust 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, which reports to the ERC, 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 2023 are analysed as follows:

	2023		2022	
	£m	%	£m	%
Buy-to-let mortgages	12,720.1	85.6%	12,086.0	85.1%
Owner-occupied mortgages	27.7	0.1%	36.4	0.2%
Total first charge residential mortgages	12,747.8	85.7%	12,122.4	85.3%
Second charge mortgage loans	154.5	1.0%	206.3	1.4%
Loans secured on residential property	12,902.3	86.7%	12,328.7	86.7%
Development finance	747.8	5.0%	719.9	5.1%
Loans secured on property	13,650.1	91.7%	13,048.6	91.8%
Asset finance loans	559.1	3.8%	498.8	3.5%
Motor finance loans	297.7	2.0%	261.3	1.8%
Aircraft mortgages	26.9	0.2%	33.7	0.3%
Secured RLS and CBILS	50.5	0.4%	65.1	0.4%
Structured lending	169.0	1.1%	178.7	1.3%
Invoice finance	31.7	0.2%	25.7	0.2%
Total secured loans	14,785.0	99.4%	14,111.9	99.3%
Professions finance	52.2	0.4%	60.9	0.4%
Unsecured RLS, CBILS and BBLs	16.7	0.1%	22.9	0.2%
Other unsecured commercial loans	20.4	0.1%	14.6	0.1%
Total loans to customers	14,874.3	100.0%	14,210.3	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.

	2023	2022
	£m	£m
Buy-to-let mortgages	149.6	151.9
Development finance	390.6	306.9
Structured lending	160.3	179.4
Asset finance	24.6	-
	725.1	638.2

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 2023 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 2023					
Very low risk	11,393.7	23.0	1.9	6.6	11,425.2
Low risk	2,236.4	395.5	73.8	2.5	2,708.2
Moderate risk	157.1	147.3	9.7	1.8	315.9
High risk	34.0	113.3	13.6	3.2	164.1
Very high risk	37.7	63.3	104.1	9.3	214.4
Not graded	113.4	2.4	2.9	1.4	120.1
Total gross carrying amount	13,972.3	744.8	206.0	24.8	14,947.9
Impairment	(19.6)	(9.4)	(39.8)	(4.8)	(73.6)
Total loans to customers	13,952.7	735.4	166.2	20.0	14,874.3
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

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 22, 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 (2023: 0.8%, 2022: 0.9%) 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 2023 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	
	2023	2022	2023	2022
	%	%	%	%
Loan to value ratio				
Less than 70%	72.7	89.2	94.6	95.6
70% to 80%	23.8	9.4	3.2	2.4
80% to 90%	2.5	0.4	0.9	0.8
90% to 100%	0.2	0.3	0.3	0.2
Over 100%	0.8	0.7	1.0	1.0
	100.0	100.0	100.0	100.0
Average LTV ratio	62.7	57.8	52.3	50.6
<i>Of which:</i>				
Buy-to-let	62.8	57.9		
Owner-occupied	39.0	37.6		

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 decrease of 5.3% in the year ended 30 September 2023 (2022: increase of 9.5%).

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

	First charge		Second charge	
	2023	2022	2023	2022
	%	%	%	%
East Anglia	3.3	3.3	3.4	3.3
East Midlands	5.9	5.7	6.2	6.2
Greater London	18.2	18.2	7.4	7.8
North	3.5	3.3	4.2	4.1
North West	10.3	10.3	7.5	7.7
South East	30.6	31.2	37.8	38.2
South West	9.0	8.8	8.4	8.4
West Midlands	6.2	5.9	7.3	7.4
Yorkshire and Humberside	7.4	7.8	6.2	6.1
Total England	94.4	94.5	88.4	89.2
Northern Ireland	-	0.1	2.3	2.0
Scotland	2.5	2.3	5.5	5.4
Wales	3.1	3.1	3.8	3.4
	100.0	100.0	100.0	100.0

Development finance

Development finance loans have an average term of 26 months (2022: 24 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.

	2023		2022	
	By value	By number	By value	By number
	%	%	%	%
LTGDV				
50% or less	8.2	6.1	7.9	5.1
50% to 60%	17.3	21.7	17.0	21.7
60% to 65%	37.7	33.0	45.0	39.1
65% to 70%	25.5	27.4	22.2	27.2
70% to 75%	5.8	7.4	5.8	6.2
Over 75%	5.5	4.4	2.1	0.7
	100.0	100.0	100.0	100.0

The average LTGDV cover at the year end was 63.1% (2022: 62.1%).

LTGDV is calculated by comparing the current expected end of term exposure with the latest estimate of the value of the completed development based on surveyors' reports. 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 2023, the development finance portfolio comprised 230 accounts (2022: 276) with a total carrying value of £747.8m (2022: £719.9m). Of these accounts only 15 were included in Stage 2 at 30 September 2023 (2022: nine), with twelve accounts classified as Stage 3 (2022: nil). In addition, one acquired account had been classified as POCI (2022: 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.

	2023	2022
	%	%
East Anglia	4.4	2.8
East Midlands	11.8	11.7
Greater London	11.8	10.5
North	0.8	1.2
North West	0.4	0.1
South East	34.0	46.3
South West	21.3	13.0
West Midlands	6.2	7.1
Yorkshire and Humberside	6.6	6.0
Total England	97.3	98.7
Northern Ireland	-	-
Scotland	2.7	1.3
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 49 months (2022: 52 months) while that of the motor finance loans was 68 months (2022: 67 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.

	2023	2022
	%	%
Commercial vehicles	41.9	37.4
Construction plant	30.9	33.2
Manufacturing	6.3	6.1
Technology	4.8	4.9
Other vehicles	4.7	4.7
Refuse disposal vehicles	3.4	3.7
Agriculture	2.1	2.4
Print and paper	1.6	1.3
Other	4.3	6.3
	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.

	2023	2022
Number of active facilities	9	8
Total facilities (£m)	235.7	220.5
Carrying value (£m)	169.0	178.7

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 2023 one of these facilities was identified as Stage 2 with the remainder in Stage 1. At 30 September 2022, all of these facilities were identified as 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 2023 were:

	2023	2022
	£m	£m
RLS		
Term loans	1.0	0.6
Asset finance	36.0	41.5
Total RLS	37.0	42.1
CBILS		
Term loans	12.6	18.3
Asset finance	14.5	23.6
Total CBILS	27.1	41.9
BBLS	3.1	4.0
	67.2	88.0
Total term loans	16.7	22.9
Total asset finance (note 18)	50.5	65.1
	67.2	88.0

At 30 September 2023, £0.7m of this balance was considered to be non-performing (2022: £0.6m).

Unsecured consumer loans

The Group disposed of almost all its unsecured consumer loan portfolio during the year ended 30 September 2022 (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 2023 and 30 September 2022, compared to the industry averages at those dates published by UK Finance ('UKF') and the FLA, was:

	2023	2022
	%	%
First mortgages		
Accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	0.34	0.15
Buy-to-let accounts excluding receiver of rent cases	0.15	0.11
Owner-occupied accounts	2.93	2.79
UKF data for mortgage accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	0.69	0.41
Buy-to-let accounts excluding receiver of rent cases	0.64	0.39
Owner-occupied accounts	0.89	0.80
All mortgages	0.84	0.72
Second charge mortgage loans		
Accounts more than 2 months in arrears		
All accounts	23.48	21.33
Post-2010 originations	2.42	1.88
Legacy cases (pre-2010 originations)	26.58	24.45
Purchased assets	30.10	27.71
FLA data for second mortgage loans	6.30	7.50
Motor finance loans		
Accounts more than 2 months in arrears		
All accounts	1.08	2.07
Originated cases	1.07	1.58
Purchased assets	1.32	8.94
FLA data for consumer point of sale hire purchase	3.60	3.40
Asset finance loans		
Accounts more than 2 months in arrears	0.23	0.08
FLA data for business lease / hire purchase loans	0.60	0.80

No published industry data for asset classes comparable to the Group's other books has been identified. Where revised data at 30 September 2022 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 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's 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 2022 or the year ended 30 September 2023.

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 ERC values for the Group's purchased consumer loan assets, are set out below. These are derived using the same models and assumptions used in the EIR calculations. ERCs are set out both for all purchased consumer portfolios and for those classified as POCI under IFRS 9.

	2023	2022	2021
	£m	£m	£m
All purchased consumer assets			
Carrying value	58.6	75.3	185.2
84 month ERCs	68.9	88.6	221.2
120 month ERCs	73.4	94.2	245.2
POCI assets only			
Carrying value	17.7	21.4	113.2
84 month ERCs	24.5	29.9	143.9
120 month ERCs	27.8	33.0	163.4

Amounts shown above are disclosed as loans to customers (note 18). They include first mortgages, second charge mortgage loans and, in the amounts shown for 2021 unsecured consumer loans.

The reduction in the year ended 30 September 2022 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.

	2023	2022
	£m	£m
The Group		
Cash with central banks rated:		
AA-	2,783.3	1,612.5
	2,783.3	1,612.5
Cash with retail banks rated:		
AA-	78.9	46.9
A+	132.1	271.5
	211.0	318.4
Total exposure	2,994.3	1,930.9
The Company		
Cash with retail banks rated:		
A+	27.6	19.7

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 26).

In order to control credit risk relating to counterparties to the Group's derivative financial instruments, ALCO reviews and approves which counterparties the Group will deal with, establishes limits for each counterparty and monitors compliance with those limits. Any changes necessary are advised to ERC. 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 27, while collateral pledged to the Group is shown in note 40.

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.

	2023	2022
	£m	£m
Carrying value of derivative financial assets		
Counterparties rated		
AA	-	7.0
AA-	3.3	0.5
A+	588.9	757.0
A	5.5	14.5
A-	17.7	-
Gross exposure (note 26)	615.4	779.0
Collateral amounts posted		
CSA collateral amounts (note 40)	(383.4)	(388.3)
Total collateral	(383.4)	(388.3)
Net exposure	232.0	390.7

64. Liquidity risk

Liquidity risk is the risk that the Group might be unable meet its liabilities and financial commitments 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.

Other sources of liquidity risk in the normal course of business include that arising:

- 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				Total £m
	In one year or less, or on demand £m	In more than one year, but not more than two years £m	In more than two years but not more than five years £m	In more than five years £m	
30 September 2023					
Retail deposits	11,278.3	1,782.5	734.5	44.4	13,839.7
Borrowings	327.1	160.3	2,811.3	170.1	3,468.8
Contingent consideration	-	-	-	-	-
Total non-derivative liabilities	11,605.4	1,942.8	3,545.8	214.5	17,308.5
Derivative liabilities	52.8	(5.9)	8.7	0.3	55.9
	11,658.2	1,936.9	3,554.5	214.8	17,364.4
30 September 2022					
Retail deposits	8,703.4	1,697.8	452.0	32.0	10,885.2
Borrowings	116.8	251.3	2,928.2	178.1	3,474.4
Contingent consideration	2.2	-	-	-	2.2
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

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:

	2023	2022
	£m	£m
Payable on demand	4,181.5	3,934.6
Payable in less than three months	1,649.5	955.1
Payable in less than one year but more than three months	5,447.3	3,813.7
Payable in less than one year or on demand	11,278.3	8,703.4
Payable in one to two years	1,782.5	1,697.8
Payable in two to five years	734.5	452.0
Payable after more than five years	44.4	32.0
	13,839.7	10,885.2

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 2023 the liquidity buffer comprised the following on and off balance sheet assets. All these assets are held within the Bank and are readily realisable.

	2023	2022
	£m	£m
Balances with central banks	2,589.7	1,505.5
Total on balance sheet liquidity	2,589.7	1,505.5
Long / short repo transaction	150.0	150.0
	2,739.7	1,655.5

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 2023, 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 2023 and 30 September 2022 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:				Total £m
	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	
	£m	£m	£m	£m	
30 September 2023					
Secured bank borrowings	-	-	-	-	-
Asset backed loan notes	-	-	-	28.0	28.0
Total non-recourse funding	-	-	-	28.0	28.0
Bank overdrafts	0.2	-	-	-	0.2
Retail bonds	112.4	-	-	-	112.4
Corporate bond	-	-	-	145.8	145.8
Central bank facilities	-	-	2,750.0	-	2,750.0
Sale and repurchase agreements	50.0	-	-	-	50.0
Lease liabilities	2.6	2.4	3.4	0.5	8.9
	165.2	2.4	2,753.4	174.3	3,095.3
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
Sale and repurchase agreements	-	-	-	-	-
Lease liabilities	2.2	1.9	3.8	1.1	9.0
	2.6	284.2	2,753.8	975.6	4,016.2

The Company

	Financial liabilities falling due:				Total £m
	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	
	£m	£m	£m	£m	
30 September 2023					
Retail bonds	112.4	-	-	-	112.4
Corporate bond	-	-	-	149.4	149.4
Lease liabilities	1.3	1.4	4.3	6.7	13.7
	113.7	1.4	4.3	156.1	275.5
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

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 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 34 and the assets backing the notes are shown in note 18.

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 17 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 was no longer available for new drawings in the period and was repaid in September 2023.

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 and there were no active warehouses at 30 September 2023. There were no undrawn facilities available at the year end (2022: £280.0m).

Further details of the warehouse facilities are given in note 35 and details of the loan assets within the warehouses are given in note 18.

The final repayment date for the securitisation borrowings is more than five years from the balance sheet date, falling due in 2045.

The sterling principal amount outstanding at 30 September 2023 under the SPV and warehouse arrangements was £28.4m (2022: £996.5m). The total sterling amount payable under these arrangements, were these principal amounts to remain outstanding until the final repayment date, would be £43.3m (2022: £1,912.3m). 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 previous years, only the most recent bond remains outstanding. This is repayable within twelve months of the balance sheet date.

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 affirmed at BBB+ in February 2023.

Central bank facilities

The Group has accessed term credit facilities under the central bank schemes described in note 38. 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 2023 the amount of drawings available in respect of prepositioned assets was £1,715.4m (2022: £1,776.0m).

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.

Rating	2023			2022		
	Utilised £m	Available £m	Total £m	Utilised £m	Available £m	Total £m
AAA	222.1	986.9	1,209.0	1,212.7	213.0	1,425.7
AA+ / AA / AA-	5.3	100.9	106.2	5.3	100.9	106.2
A+ / A / A-	3.1	59.9	63.0	4.6	59.9	64.5
BBB+ / BBB / BBB-	3.1	57.9	61.0	4.3	81.4	85.7
	233.6	1,205.6	1,439.2	1,226.9	455.2	1,682.1

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 18.

Utilised notes includes those which the Group is obliged to hold under regulations governing securitisation issuance.

The available AAA notes would give access to £769.8m (2022: £171.6m) 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 (2022: £150.0m), utilising £26.5m 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 during the current year, and maintains the capability to access the repo market for liquidity purposes. Transactions in place at 30 September 2023 utilised £58.5m of the loan notes shown above (2022: £nil).

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.

	Corporate bonds	Retail bonds	Central bank facilities	Sale and repurchase transactions	Lease liabilities	Total
	£m	£m	£m	£m	£m	£m
a) The Group						
30 September 2023						
Payable in:						
Less than one year	6.6	119.3	147.8	50.8	2.6	327.1
One to two years	6.6	-	151.3	-	2.4	160.3
Two to five years	19.7	-	2,788.2	-	3.4	2,811.3
Over five years	169.6	-	-	-	0.5	170.1
	202.5	119.3	3,087.3	50.8	8.9	3,468.8
30 September 2022						
Payable in:						
Less than one year	6.6	6.8	101.4	-	2.0	116.8
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
	209.1	126.0	3,130.2	-	9.1	3,474.4
			Corporate bonds	Retail bonds	Lease liabilities	Total
			£m	£m	£m	£m
b) The Company						
30 September 2023						
Payable in:						
Less than one year			6.6	119.3	1.7	127.6
One to two years			6.6	-	1.7	8.3
Two to five years			19.7	-	5.0	24.7
Over five years			169.6	-	7.0	176.6
			202.5	119.3	15.4	337.2
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

Amounts payable in respect of the 'other accruals' and 'trade creditors' shown in note 40 fall due within one year. The cash flows described above will include those for interest on borrowings accrued at 30 September 2023 disclosed in note 40.

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:

	2023	2022
	Total cash outflow / (inflow)	Total cash outflow / (inflow)
	£m	£m
On derivative liabilities		
Payable in less than one year	52.8	88.8
Payable in one to two years	(5.9)	24.0
Payable in two to five years	8.7	3.6
Payable in over five years	0.3	0.1
	55.9	116.5
On derivative assets		
Payable in less than one year	(218.2)	(253.1)
Payable in one to two years	(175.4)	(246.2)
Payable in two to five years	(162.3)	(342.0)
Payable in over five years	-	(2.7)
	(555.9)	(844.0)
	(500.0)	(727.5)

65. 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 ended 30 September 2022. All new wholesale debt and interest rate swaps recognised since that point have referenced SONIA, while existing LIBOR linked instruments were transitioned before the start of the current financial year.

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.

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 repricing risk. The risk created when interest rates on assets, liabilities and off-balance sheet items reprice at different times causing them to move by different amounts
- Basis risk. The risk arising where assets and liabilities reprice with reference to different reference interest rates, for example rates set by the Group and market rates, such as Bank of England base rate and SONIA. 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 repricing 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 relating to its fixed rate lending, deposit taking and borrowing activities is discussed further in note 26.

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 2023, 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 £16.1m (2022: increase by £21.7m).

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 £16.0m (2022: increase by £34.6m). 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 (note 27) also includes £193.6m which is placed on deposit with the Bank of England (2022: £257.0m). 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 bear interest at rates based on SONIA. 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 2023 and 30 September 2022 are denominated in sterling.

The SME lending business has a limited amount of lending denominated in US dollars, principally £7.6m of aircraft mortgage balances. It may also 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 26.

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 2023

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.

66. 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 2023 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.

The particular accounting policies adopted have been set out in note 67 and the critical accounting judgements and estimates which have been required in preparing these financial statements are described in notes 68 and 69 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.

67. 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 2023. 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 72, 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 70.

(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 procurement 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. Impairment is determined based on the net asset values of subsidiary entities after provision for inter company balances and investments at the subsidiary level.

(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.

Any shortfall on disposal of such shares is offset against retained earnings. Any excess of disposal proceeds over cost is added to the share premium account. 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) Sale and repurchase agreements

Securities, including the Group's own retained asset-backed notes, can be sold subject to a commitment to repurchase them at a subsequent date at a price calculated on a pre-determined basis (a repo). Where this price comprises a fixed amount plus a lenders return, the funds received are treated as borrowings of the Group.

Where the securities concerned are retained notes no liability is recognised in asset-backed loan notes and where the securities are recognised on the Group's balance sheet prior to the transaction, these are not derecognised.

The difference between the sale and purchase price is accrued over the life of the agreement using the effective interest rate method.

(s) 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.

(t) 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.

(u) 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.

(v) 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.

(w) 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.

(x) 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.

(y) 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

(z) 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.

(aa) 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.

(bb) 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.

(cc) 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.

68. Critical accounting judgements

The most significant judgements which the directors have made in the application of the accounting policies set out in note 67 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 than 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 21.

(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 21.

(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.

69. 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 (which might include keeping current tenants in place, refurbish and relet, immediate sale etc).

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

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

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

In evaluating the potential impact of the economic situation at 30 September 2023 there is little recent history against which to benchmark likely customer behaviour. Interest rates have risen to higher levels, at a more rapid rate than at any time in recent history. UK base rates had reached 5.25% at the balance sheet date, a level they had not touched since April 2008, since when significant regulatory intervention in the UK's lending markets has taken place. There have also been significant changes in product structures in that period, including the growth of longer term fixed-rate mortgage lending in recent years. All of these make the historical record of behaviours in higher interest rate environments an uncertain guide to the likely impact of current rate levels.

There is also little agreement between economic forecasters as to the future direction of the UK economy, exacerbated by the potential impact of the general election which must be held within the next eighteen months. At the same time, the level to which economic pressures on customers have yet to manifest themselves in credit metrics is still unclear, with credit performance across the markets in which the Group is active being better than some expected over the past year, but considerable uncertainty as to whether this represents a more benign outcome, or merely a delay in credit issues emerging beyond what was anticipated. Together, these factors make forecasting credit behaviour in current conditions particularly challenging.

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 2023 have been derived in light of the current economic situation, at that date, modelling a variety of possible outcomes as described in note 24.

As noted above, there remains a significant range of different opinions amongst economists about the longer-term prospects for the UK, although these have converged, to some extent, over the twelve months since 30 September 2022, when the impact of the September 2022 mini-budget had significantly broadened the range of plausible outcomes.

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 represented by the economic scenarios, the Group recognises that economic situations can arise which lie outside the range of potential positions considered as a basis for its IFRS 9 approach to impairment when the current models were built. 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 outcomes. The nature and amounts of these judgemental adjustments are set out in note 21.

The position after considering all these matters is set out in notes 21 to 23, 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 24, while sensitivity analyses on impairment provisioning are set out in note 25.

(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 the cash flows relating thereto, including those relating to early redemption charges together with any initial fees receivable from the customer or procurement fees payable to a mortgage broker or other introducer.

Where an account may have differing interest charging arrangements in different phases of its contractual life, such as the Group's buy-to-let mortgage accounts which have a fixed interest rate for a set period and then revert to a variable rate set by the Group (the 'reversionary rate'), the behavioural life and the expected level of the reversionary rate will have a significant impact on the overall EIR. For each portfolio a model is in place to ensure that income is appropriately spread.

For loan accounts such as those in the Group's mortgage portfolios where borrowers typically repay their balances before the contractual repayment date, the estimated life of the account will be dependent on customer behaviour. The customer may choose to sell their property and redeem the mortgage at any point, but may also choose to refinance their account, if a more attractive alternative is available, based on the interest rate they are being charged at that point in time, or expect to be charged in the future. The behavioural life of the loan may therefore be influenced by levels of activity in the residential property market, or by the nature and pricing of alternative funding sources, at each point in the loan's life and these are likely to vary over time.

For loans which have a fixed-rate period, the length of that period will have a significant behavioural impact, with many customers choosing to consider their positions at the point at which the fixed rate expires, influenced by the market conditions then prevailing. The future forecast future choices of customers currently on fixed-rate products at this point therefore has a significant impact on the EIR modelling for these assets.

Where loans are more likely to run to contractual term, and interest rates are less likely to vary over that term, as is the case for the majority of the Group's motor finance and asset-backed SME lending, the determination of an EIR model is less judgemental, and reflects principally the spreading of known fees and commissions.

The Group models lives for each of its asset classes, based on its current expectation of future borrower behaviour, and uses these profiles, together with its expectations of future reversionary interest rates, to determine the correct EIR to be applied to each account. The underlying estimates are based on historical data, adjusted for expected changes, and reviewed regularly. The accuracy of the EIR applied would therefore be compromised by any differences between actual repayment profiles and charging rates and those predicted, which in turn would depend directly on customer behaviour and market conditions.

The Group therefore keeps its models under review and refines its modelling in the light of any emerging deviations from expected behaviour. These are particularly likely where the current or expected economic environment differs from historic scenarios for which relevant data observations are available. This is currently the case, with market mortgage rates at far higher levels than have been seen in many years. In such cases management consider carefully the impacts which any new conditions may have on customer behaviour and reversionary rates and reflect them in the model as appropriate, revisiting these assumptions regularly as observable data becomes available, with a detailed exercise to analyse any emerging themes taking place every six months as part of the half year and year end results processes.

For purchased loans the EIR calculation will involve estimating the likely future credit performance of the accounts at the time of acquisition as well as the customers' payment behaviour. In the initial modelling historical data obtained from the vendor will be examined, with assumptions revisited through the asset lives based on actual and expected customer behaviour.

The application of these estimates results in an overall increase in the carrying value of the Group's loans to customers, including POCL accounts, at 30 September 2023 of £20.5m.

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.

- Currently the average behavioural life used in the buy-to-let modelling for non-legacy assets, which have an average fixed period of 49 months, was 83 months.

A reduction of the assumed average lives of all loans secured on residential property by three months would reduce balance sheet assets by £9.3m (2022: £13.3m), while an increase of the assumed asset lives of such assets by three months would increase balance sheet assets by £9.2m (2022: £13.3m). £8.8m of both the increase and decrease related to non-legacy buy-to-let assets.

A reduction of the assumed average lives of all loans secured on residential property by six months would reduce balance sheet assets by £18.5m (2022: £25.8m), while an increase of the assumed asset lives of such assets by six months would increase balance sheet assets by £18.4m (2022: £25.8m). £17.5m of both the increase and decrease related to non-legacy buy-to-let assets.

- The EIR calculation is based on management estimates of the reversionary rates which would be charged to customers after the end of their fixed rate periods.

If it was assumed that the maximum reversionary rate which could be charged in future was 6.00%, then the value of the non-legacy buy-to-let loan book would be decreased by £3.0m (2022: £nil).

If it was assumed that the maximum reversionary rate which could be charged in future was 8.00%, then the value of the non-legacy buy-to-let loan book would be increased by £3.9m (2022: £nil).

- Where fixed rate buy-to-let assets redeem before the end of their fixed rate period, an early redemption charge is made, and an estimate for the impact of these charges must be included in the EIR calculation.

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 would increase balance sheet assets by £9.6m (2022: £8.8m).

- A reduction (or increase) in estimated cash flows from purchased loan assets (principally buy-to-let first mortgage loans and second charge consumer loan assets) of 5% would reduce (or increase) balance sheet assets by £1.6m (2022: £2.0m). Such assets now represent only £58.8m of the Group's loan portfolio (2022: £75.8m).

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 31, 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 31.

(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 60. 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 60.

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

The forecast is updated every six months, and the directors have based their going concern assessment on the forecast for the period beginning on 1 October 2023.

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:

- An increase in buy-to-let volumes. This examined the impact of higher volumes at a reduced yield on profitability and illustrated the extent to which capital resources and liquidity would be stretched due to the higher cash and capital requirements
- Higher funding costs. Higher cost on all new savings deposits, both front book and back book throughout the forecast horizon. This scenario illustrates the impact of a significant, prolonged margin squeeze on profitability, and whether this would cause significant impacts on any capital, liquidity or encumbrance ratios
- Higher buy-to-let redemption rates for buy-to-let mortgages reaching the end of their fixed-rate period. This illustrates the potential risk inherent in the five-year fixed rate business
- Increased economic stress on customers. As well as modelling the impact of each of the economic scenarios set out in note 24 across the forecast horizon, the severe economic scenario was also modelled over the five-year horizon. To ensure this represented a worst-case scenario all other assumptions were held steady, although in reality adjustments to new business appetite and other factors would be made
- Combined downside stress. The IFRS 9 downside economic scenario described in note 24 was modelled out for the plan horizon along with a plausible set of other adverse factors to the business model, creating a prolonged tail-risk

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 £13,265.3m (note 33), raised through Paragon Bank, are repayable within five years, with 82.9% of this balance (£10,990.5m) payable within twelve months of the balance sheet date. The liquidity exposure represented by these deposits is closely monitored; a process supervised by the ALCO. The Group is required to hold liquid assets in Paragon Bank to mitigate this liquidity risk. At 30 September 2023 Paragon Bank held £2,589.7m of balance sheet assets for liquidity purposes, in the form of central bank deposits (note 64). A further £150.0m of liquidity was provided by the off balance sheet long / short transaction described in note 64, bringing the total to £2,739.7m.

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 £1,715.4m. 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 2023 the Group had £1,205.6m of such notes available for use, of which £986.9m were rated AAA. The available AAA notes would give access to £769.8m if used to support drawings on Bank of England facilities.

The Group's securitisation funding structures, described in note 64, 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 during 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, confirmed by Fitch Ratings in February 2023, 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 61 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 2023 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.

71. 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 2023 or the year ended 30 September 2022 carried at fair value and valued using level 3 measurements, other than contingent consideration amounts (note 41).

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.

	<i>Note</i>	2023	2022
		£m	£m
Financial assets			
Derivative financial assets	26	615.4	779.0
		615.4	779.0
Financial liabilities			
Derivative financial liabilities	26	39.9	102.1
Contingent consideration	41	-	2.2
		39.9	104.3

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 sterling benchmark interest rates.

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 26.

Contingent consideration

The value of the contingent consideration balances shown in note 41 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	2023 Carrying amount £m	2023 Fair value £m	2022 Carrying amount £m	2022 Fair value £m
The Group					
Financial assets					
Cash	17	2,994.3	2,994.3	1,930.9	1,930.9
Loans to customers	18	14,874.3	14,524.0	14,210.3	13,898.4
Sundry financial assets	27	46.0	46.0	35.4	35.4
		17,914.6	17,564.3	16,176.6	15,864.7
Financial liabilities					
Short-term bank borrowings		0.2	0.2	0.4	0.4
Asset backed loan notes		28.0	28.0	409.3	409.3
Secured bank borrowings		-	-	586.0	586.0
Retail deposits	33	13,265.3	13,177.3	10,669.2	10,592.9
Corporate and retail bonds		258.2	234.8	261.5	254.4
Sale and repurchase agreements	39	50.0	50.0	-	-
Other financial liabilities	40	608.8	608.8	491.2	491.2
		14,210.5	14,099.1	12,417.6	12,334.2
The Company					
Financial assets					
Cash	17	27.6	27.6	19.7	19.7
Intra-group cash deposits	27	193.6	193.6	-	-
Amounts owed to group companies	27	35.1	35.1	39.1	39.1
Sundry financial assets	27	0.1	0.1	0.1	0.1
		256.4	256.4	58.9	58.9
Financial liabilities					
Corporate and retail bonds		261.8	234.8	261.5	254.4
Amounts owed by group companies	40	24.0	24.0	23.2	23.2
Other financial liabilities	40	0.7	0.7	12.9	12.9
		286.5	259.5	297.6	290.5

The fair values of retail deposits and corporate and retail bonds shown above will include amounts for the related accrued interest.

Cash, sale and repurchase agreements, bank loans and securitisation borrowings

The fair values of cash and cash equivalents, sale and repurchase agreements, 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 and the sale and repurchase agreements 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.

72. Details of subsidiary undertakings

Subsidiary undertakings of the Group at 30 September 2023, 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.

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
The Business Mortgage Company Limited	100%	Mortgage broker
Paragon Mortgages (No. 12) 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
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
Premier Asset Finance Limited	100%	Asset finance broker
Specialist Fleet Services Limited	100%	Asset finance and contract hire
Collett Transport Services Limited	100%	Non-trading
Homer Management Limited	100%	Non-trading
Lease Portfolio Management Limited	100%	Non-trading
Paragon Options PLC	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 2023 comprise:

Company	Principal activity
Paragon Seventh Funding Limited	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
Paragon Mortgages (No. 29) Holdings Limited	Holding company
Paragon Mortgages (No. 29) PLC	Residential mortgages
Arianty Holdings Limited	Non-trading
Arianty No. 1 PLC	Non-trading
Paragon Fifth Funding Limited	Non-trading
Paragon Sixth Funding Limited	Non-trading
Paragon Mortgages (No. 25) Holdings Limited	Non-trading
Paragon Mortgages (No. 25) PLC	Non-trading

All these companies are registered and operate in the UK.

Earlwood 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 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 2023. They do not form part of the consolidation as they are considered to be controlled by the liquidator.

Company	Holding	Principal activity
Direct subsidiaries of Paragon Banking Group PLC		
Moorgate Servicing Limited	100%	Non-trading
Paragon Mortgages (No. 11) PLC	100% *	Non-trading
Paragon Mortgages (No. 13) PLC	100% *	Non-trading
Paragon Mortgages (No. 14) PLC	100% *	Non-trading
Paragon Mortgages (No. 15) PLC	100% *	Non-trading
Plymouth Funding Limited	100%	Non-trading
Direct and indirect subsidiaries of Paragon Bank PLC		
City Business Finance Limited	100%	Non-trading
Fineline Holdings Limited	100%	Non-trading
Fineline Media Finance Limited	100%	Non-trading
PBAF (No.1) Limited	100%	Non-trading
State Securities Holdings Limited	100%	Non-trading
State Security Limited	100%	Non-trading

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.

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.

P336 E1. Appendices to the Annual Report





Our values

TEAM  ORK

**To work in harmony
and collectively towards
the delivery of our
overall objective**

E1. Appendices to the Annual Report

For the year ended 30 September 2023

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.

	<i>Note</i>	2023	2022
		£m	£m
Profit on ordinary activities before tax		199.9	417.9
Add back: Fair value adjustments	14	77.7	(191.9)
Profit on disposal of loans	7	-	(4.6)
Underlying profit		277.6	221.4

Underlying basic earnings per share, calculated on the basis of underlying profit adjusted for tax, is derived as follows.

	2023	2022
	£m	£m
Underlying profit	277.6	221.4
Tax on underlying result	(66.4)	(51.8)
Underlying earnings	211.2	169.6
Basic weighted average number of shares (note 16)	224.1	242.7
Underlying earnings per share	94.2p	69.9p

Tax has been charged on the underlying profit at 23.9%, being the effective rate which would result from the exclusion of the adjusting items from the corporation tax calculation (2022: 23.4%).

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.

	<i>Note</i>	2023	2022
		£m	£m
Underlying earnings		211.2	169.6
Amortisation and derecognition of intangible assets	9	3.6	2.0
Adjusted underlying earnings		214.8	171.6
Opening underlying tangible equity			
Equity		1,417.3	1,241.9
Intangible assets	30	(170.2)	(170.5)
Balance sheet impact of fair values	26	(216.7)	(8.8)
Deferred tax thereon	44	53.2	(2.2)
		1,083.6	1,060.4
Closing underlying tangible equity			
Equity		1,410.6	1,417.3
Intangible assets	30	(168.2)	(170.2)
Balance sheet impact of fair values	26	(230.8)	(216.7)
Deferred tax thereon	44	32.8	53.2
		1,044.4	1,083.6
Average underlying tangible equity			
		1,064.1	1,072.0
Underlying RoTE		20.2%	16.0%

B. Income statement ratios

NIM and cost of risk (impairment charge as a percentage of average loan balance) for the Group are calculated as shown below. Not all net interest is allocated to segments and therefore total segment net interest in these tables will not equal net interest for the Group.

Year ended 30 September 2023

	<i>Note</i>	Mortgage Lending £m	Commercial Lending £m	Group Total £m
Opening loans to customers	18	12,328.7	1,881.6	14,210.3
Closing loans to customers	18	12,902.3	1,972.0	14,874.3
Average loans to customers		12,615.5	1,926.8	14,542.3
Net interest	2	277.6	135.7	448.9
NIM		2.20%	7.04%	3.09%
Impairment provision charge	12	10.4	7.6	18.0
Cost of risk		0.08%	0.39%	0.12%

Year ended 30 September 2022

	<i>Note</i>	Mortgage Lending £m	Commercial Lending £m	Group Total £m
Opening loans to customers	18	11,829.6	1,573.1	13,402.7
Closing loans to customers	18	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	251.2	111.2	371.2
NIM		2.08%	6.44%	2.69%
Impairment provision charge	12	4.6	9.4	14.0
Cost of risk		0.04%	0.54%	0.10%

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

C. Cost:income ratio

Cost:income ratio is derived as follows:

	<i>Note</i>	2023	2022
		£m	£m
Cost – operating expenses	9	170.4	153.0
Total operating income		466.0	393.0
Cost / Income		36.6%	38.9%

Underlying cost: income ratio is derived as follows:

		2023	2022
		£m	£m
Cost – as above		170.4	153.0
Income – as above		466.0	393.0
Less: profit on disposal of loans		-	(4.6)
		466.0	388.4
Underlying cost: income ratio		36.6%	39.4%

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 and preceding years, the Board has determined that is appropriate to exclude the post-tax impact of fair value (losses) / gains from its calculation. The dividend cover for the year, subject to the approval of the 2023 final dividend at the AGM in March 2024 is therefore as set out below.

	<i>Note</i>	2023	2022
Earnings per share (p)	16	68.7	129.2
Attributable fair value (losses) / gains (p)		34.7	(79.1)
Attributable tax thereon (p)		(9.2)	21.4
Adjusted earnings (p)		94.2	71.5
Proposed dividend per share in respect of the year (p)	48	37.4	28.6
Dividend cover (times)		2.52	2.50

E. Net asset value

	<i>Note</i>	2023	2022
Total equity (£m)		1,410.6	1,417.3
Outstanding issued shares (m)	45	228.7	241.4
Treasury shares (m)	47	(10.1)	(3.6)
Shares held by ESOP schemes (m)	47	(4.0)	(3.9)
		214.6	233.9
Net asset value per £1 ordinary share		£6.57	£6.06
Tangible equity (£m)	61	1,242.4	1,247.1
Tangible net asset value per £1 ordinary share		£5.79	£5.33

F.

Glossary

P342 F1. Glossary

A summary of abbreviations used in the Annual Report and Accounts





Our values

RESPECT

To treat people as individuals and listen to their views

F1. Glossary

ACS	Annual Cyclical Scenario published by the Bank of England	CRR	Capital Requirements Regulation – EU Regulation 575/2013
Act	The Companies Act 2006	CSA	Credit Support Annex
AGM	Annual General Meeting	CSOP	Company Share Option Plan
AI	Artificial Intelligence	CVR	Commercial Variable Rate
ALCO	Asset and Liability Committee	DECL	Task Force on Disclosure about Expected Credit Loss
AQR	Audit Quality Review	DEFRA	Department for Environment, Food and Rural Affairs
Articles	The Articles of Association of the Company	DISP	FCA's Dispute Resolution: Complaints Sourcebook
ASHE	Annual Survey of Hours and Earnings	DSBP	Deferred Share Bonus Plan
AT1	Additional Tier 1	DTR	Disclosure and Transparency Rule
Paragon Bank or The Bank	Paragon Bank PLC	EAD	Exposure At Default
Bank Tax Code	The Code of Practice on Taxation for Banks	ECL	Expected Credit Loss
BBLS	Bounce Back Loan Scheme	EDI	Equality, Diversity and Inclusion
BBR	Bank Base Rate	EIR	Effective Interest Rate
BCBS	Basel Committee on Banking Supervision	EPC	Energy Performance Certificate
BEIS	Department for Business, Energy and Industrial Strategy	EPS	Earnings per Share
BEPS	Base Erosion and Profit Shifting	EQA	External Quality Assessment
BEVs	Battery-powered Electric Vehicles	ERC	Executive Risk Committee
BGS	Balance Guarantee Swaps	ERMF	Enterprise Risk Management Framework
BMS	Building Management System	ESG	Environmental, Social and Governance
B4NZ	Bankers For Net Zero	ESOP	Employee Share Ownership Plan
CAGR	Compound Annual Growth Rate	ESOS	Energy Savings and Opportunities Scheme
CBES	Climate Biennial Exploratory Scenario	EU	European Union
CBI	Confederation of British Industry	EUR	Euro
CBILS	Coronavirus Business Interruption Loan Scheme	EURIBOR	Euro Interbank Offered Rate
CCC	Customer and Conduct Committee	EV	Economic Value
CCCBNZ	Climate Change Committee Balanced Net Zero	EWI	Early Warning Indicators
CCoB	Capital Conservation Buffer	ExCo	Executive Performance Committee
CCP	Central Clearing Counterparty	FCA	Financial Conduct Authority
CCyB	Counter-Cyclical Capital Buffer	FLA	Finance and Leasing Association
CEO	Chief Executive Officer	FOS	Financial Ombudsman Service
CET1	Core Equity Tier 1	Framework	The Group Corporate Governance Policy Framework
CFO	Chief Financial Officer	FRC	Financial Reporting Council
CFRF	Climate Financial Risk Forum	FRF	Future Regulatory Framework
CGI	Chartered Governance Institute UK & Ireland	FRN	Floating Rate Note
CGU	Cash Generating Unit	FSCS	Financial Services Compensation Scheme
CIB	Chartered Institute of Bankers	FVTPL	Fair Value Through Profit and Loss
CIIA	Chartered Institute of Internal Auditors	GDP	Gross Domestic Product
CML	Council of Mortgage Lenders	GFI	Green Finance Institute
Code	UK Corporate Governance Code	GHG	Greenhouse Gas
CO₂e	CO ₂ Equivalent	GMP	Guaranteed Minimum Pension
COO	Chief Operating Officer	Group	The Company and all its subsidiary undertakings
Company	Paragon Banking Group PLC	HMRC	His Majesty's Revenue and Customs
CP	Consultation Paper	HPI	House Price Index
CPI	Consumer Price Index	HQLA	High Quality Liquid Assets
CPO	Chief People Officer	IAP	Internal Audit Plan
CRD IV	The EU Capital Requirements Regulation and Directive Regime	IAS	International Accounting Standard(s)
CRDs	Cash Ratio Deposits	IASB	International Accounting Standards Board
CRO	Chief Risk Officer	ICAAP	Internal Capital Adequacy Assessment Process
		IFRS	International Financial Reporting Standard(s)

IIP	Investors In People	PIDA	Public Interest Disclosure Act 1998
ILAAP	Internal Liquidity Adequacy Assessment Process	PIEs	Public Interest Entities
ILG	Individual Liquidity Guidance	Plan	The Paragon Pension Plan
ILTR	Indexed Long Term Repo Scheme	PLC	Public Limited Company
IMLA	Intermediary Mortgage Lenders Association	PMA	Post-Model Adjustments
IRB	Internal Ratings Based	POCI	Purchased or Originated Credit Impaired (assets)
IRRBB	Interest Rate Risk in the Banking Book	PPC	Prompt Payment Code
ISAs	International Standards on Auditing	PRA	Prudential Regulation Authority (of the Bank of England)
ISDA	International Swaps and Derivatives Association	PRS	Private Rented Sector
ISO14001:2015	ISO14001:2015, 'Environmental Management Systems'	PRP	Profit Related Pay
ISO45001:2018	ISO45001:2018, 'Management Systems of Occupational Health and Safety'	PSP	Performance Share Plan
KPMG	KPMG LLP, the Group's auditor	PwC	PricewaterhouseCoopers LLP
LA	Late Action	RBA	Role Based Allowance
LCR	Liquidity Coverage Ratio	RCV	Refuse Collection Vehicles
LDI	Liability Driven Investments	RIBA	Royal Institute of British Architects
LGD	Loss Given Default	RICS	Royal Institution of Chartered Surveyors
LIBOR	London Interbank Offered Rate	RIDDOR	Reporting of Incidents, Disease and Dangerous Occurrences Regulation 2013
Lintstock	Lintstock Limited	RLS	Recovery Loan Scheme
LTGDV	Loan to Gross Development Value	RMBS	Residential Mortgage Backed Securities
LTV	Loan-to-Value	RNS	Regulatory News Service
M&A	Mergers and Acquisitions	RoR	Receiver of Rent
MEES	Domestic Minimum Energy Efficiency Standard as proposed by the UK Government	RoTE	Return on Tangible Equity
MES	Multiple Economic Scenarios	ROU	Right of Use
Minimum Standard	FRC Minimum Standard: Audit Committees and the External Auditor	RPI	Retail Price Index
MLRO	Money Laundering Reporting Officer	RSU	Restricted Stock Unit
MRC	Model Risk Committee	RWA	Risk Weighted Assets
MREL	Minimum Requirement for own funds and Eligible Liabilities	SA	Standardised Approach
MRT	Material Risk Taker	SAWG	Scenario Analysis industrial Working Group
MWh	Mega-Watt Hours	Schedule 7	Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008
NGFS	Network for Greening the Financial System	SFS	Specialist Fleet Services Limited
NI	National Insurance	SIC	Standard Industrial Classification
NII	Net Interest Income	SICR	Significant Increase in Credit Risk
NIM	Net Interest Margin	Sharesave	All Employee Share Option scheme
Notes	Asset backed loan notes	SME	Small and / or Medium-sized Enterprise(s)
NPS	Net Promoter Score	SMF	Senior Management Function
NSFR	Net Stable Funding Ratio	SMCR	Senior Managers and Certification Regime
OBR	Office of Budget Responsibility	SONIA	Sterling Overnight Interbank Average
OCI	Other Comprehensive Income	SPPI	Solely Payments of Principal and Interest
OFGEM	Office of Gas and Electricity Markets	SPV	Special Purpose Vehicle
OHSMS	Occupational Health and Safety Management System	TBMC	The Business Mortgage Company
OLAR	Overall Liquidity Adequacy Requirement	TCFD	Taskforce on Climate-related Financial Disclosures
ONS	Office for National Statistics	TCR	Total Capital Requirement
ORC	Operational Risk Committee	TFS	Term Funding Scheme
Order	The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014	TFSME	Term Funding Scheme with additional incentives for SMEs
PAYE	Pay As You Earn	TRC	Total Regulatory Capital
PD	Probability of Default	TRE	Total Risk Exposure
PCAF	Partnership for Carbon Accounting Financials	TSR	Total Shareholder Return
Performance Exco	Executive Performance Committee	TVR	Total Voting Rights
PPF	Pension Funding Partnership	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

P346 G1. Shareholder information
Information about dividends, meetings and managing shareholdings

P347 G2. Other public reporting
Current and future public reporting information for the Group





Our values

HUMOUR

To ensure we have fun while
achieving success!

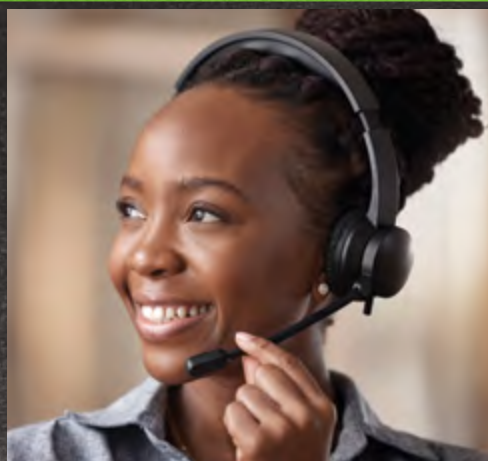
G1. Shareholder information

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 2024

Quarter 1 trading update

June 2024

Half-year results

July 2024

Quarter 3 trading update

December 2024

Full-year results

Dividend calendar

1 February 2024

Ex-dividend date for 2023 final dividend

2 February 2024

Record date for 2023 final dividend

8 March 2024

Payment date for 2023 final dividend

4 July 2024

Ex-dividend date for 2024 interim dividend

5 July 2024

Record date for 2024 interim dividend

26 July 2024

Payment date for 2024 interim dividend

Annual General Meeting

6 March 2024

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 2023, 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 2023, 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 seventh report against its Women in Finance charter commitments in September 2023.

All this reporting will be continued in the financial year ending 30 September 2024.

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 2023 Responsible Business Report will be published in December 2023 and will also be available on the Group's corporate website.

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

P350 H1. Contacts

Names and addresses of the Group's advisers





Our values

CREAT**VITY**

**To identify and create new
business opportunities and
apply creative and effective
solutions to problems**

H1. Contacts

Registered and head office

51 Homer Road, Solihull, West Midlands B91 3QJ
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

KPMG LLP
One Snowhill
Snow Hill Queensway
Birmingham B4 6GH

Solicitors

Slaughter and May
One Bunhill Row
London EC1Y 8YY

Registrars

Computershare Investor Services PLC
The Pavilions
Bridgwater Road
Bristol BS99 6ZZ
Telephone: 0370 707 1244

Brokers

Jefferies International Limited
100 Bishopsgate
London EC2N 4JL

Peel Hunt LLP
100 Liverpool Street
London EC2M 2AT

UBS Limited
5 Broadgate
London EC2M 2QS

Remuneration consultants

PricewaterhouseCoopers LLP
1 Embankment Place
London WC2N 6RH

Consulting actuaries

Mercer Limited
Four Brindleyplace
Birmingham B1 2JQ





PARAGON BANKING GROUP PLC
51 Homer Road, Solihull, West Midlands B91 3QJ
Telephone: 0121 712 2323
www.paragonbankinggroup.co.uk
Registered No. 2336032