A.

Strategic Report

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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)

Commercial Lending

Business customers	40,750+
Loan assets	£1.97 billion (+4.8%)
New lending	£1.13 billion (2022: £1.30 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.

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

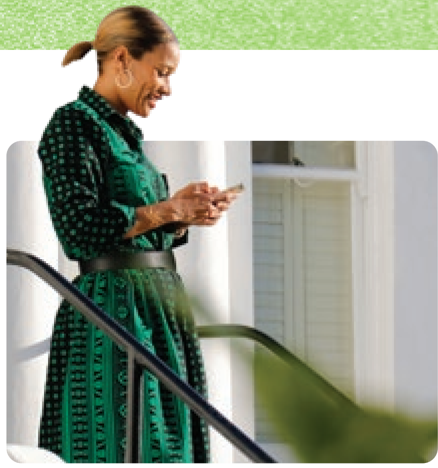
RESPECT

HUMOUR

CREATIVITY

Supporting our customers

Landlords



The Private Rented Sector ('PRS') is an important part of the UK's housing mix, providing a home to approximately one in five households[1]. Buy-to-let mortgage finance is estimated to fund 36.7% of PRS properties[2], 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 properties
average portfolio size[3]

17 years
average experience as a landlord[3]

53.7%
proportion of lending to limited company landlords

YourMortgage
AWARDS 1989-2023
10x WINNER

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

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

Project support from conception to completion

> **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**

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

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

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 allowance[4]

50:50
new customer application split between fixed and variable interest rate accounts

97%
of customers know the maximum limit on the FSCS guarantee[5]

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

Award WINNER 2023
Cash ISA Provider of The Year

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

[4] Paragon Savings Customers, Financial Outcome Survey 2023
[5] Paragon Savings Customers, New Application Survey 2023

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

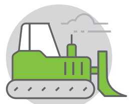
* Employer skills survey, UK average 3.3 days

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 score[1]

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 operate[1]

Strong financial foundations

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

CET1 ratio

15.5%

[1] 2023 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

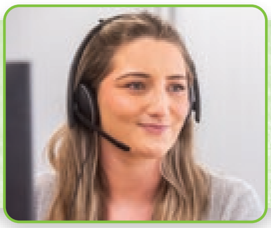
Our strategy

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

Our strategic pillars



A customer focused culture

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

A dedicated team

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

Principal risks

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 Paragon[1]

[1] 2023 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

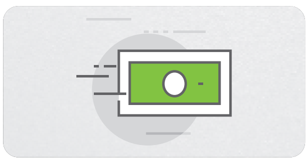
SME businesses need finance partners that can help them to adapt and grow. Our asset expertise means we are well-placed to help customers fund new assets or refinance existing ones.

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

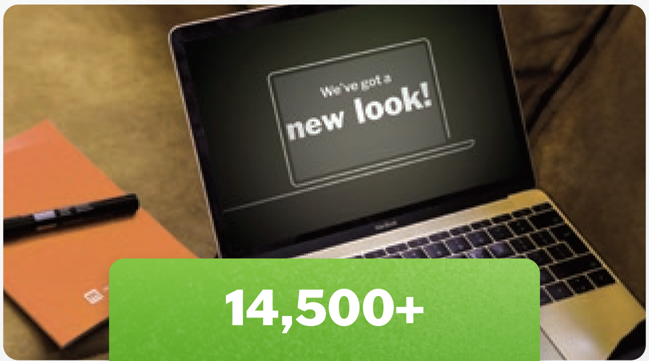
£24.4 million
2023 IT costs as we invest in digitalisation

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



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

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**

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%.

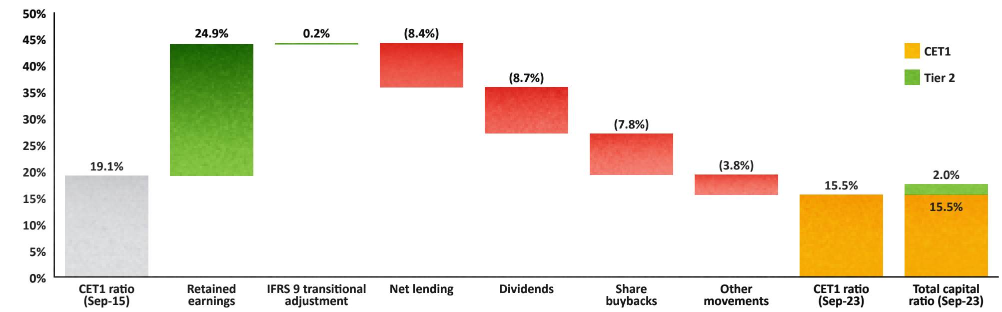
Our approach

- 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.

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

42%
reduction in market-based emissions[1]

92%
of total electricity from renewable sources

46%
of waste diverted from landfill

[1] compared to 2019 base line

Financing a greener world

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.

£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

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)

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

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.

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.

A3. Chief Executive’s review

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

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 turnround 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.

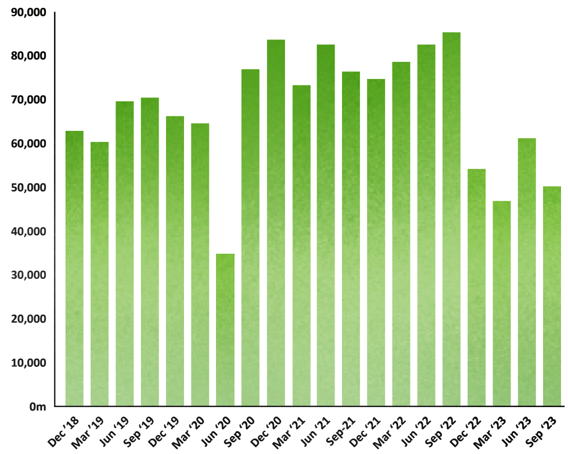
This weakening of demand put downward pressure on house prices, with the Nationwide House Price Index recording a year-on-year fall of 5.3% to September 2023 (2022: increase of 9.5%), although prices had broadly stabilised towards the end of the year. This was a smaller fall than some had predicted and 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.

UK mortgage approvals (£m)

Bank of England



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 £m	2022 £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 £m	2022 £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

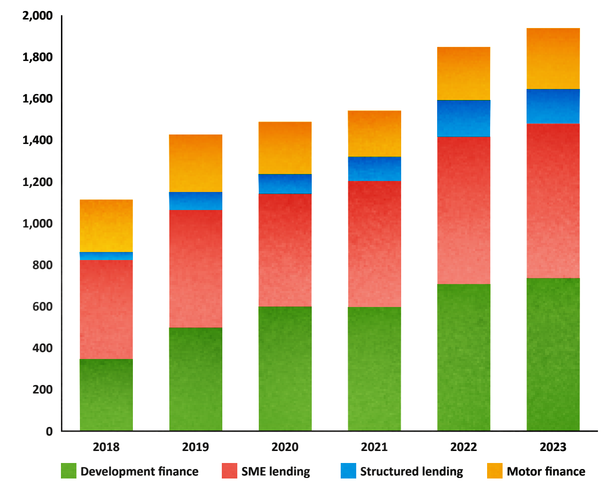
New lending in the Commercial Lending segment fell by 13.4% in the year as the UK economy slowed and customers felt the impact of the interest rate environment. Performance varied between business lines with development finance, where economic and political uncertainty increased caution amongst developers,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

Commercial Lending portfolio (£m)



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.

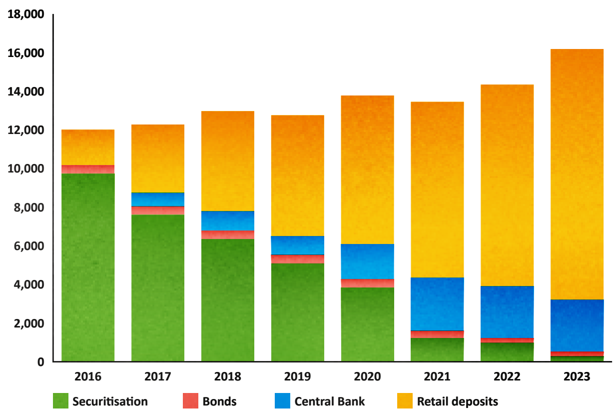
The Group has built cash reserves during the period, applying them to repay wholesale borrowings, including the repayment of the last remaining funding structure from the period before Paragon Bank received its banking licence.

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.

Funding by type (£m)

30 September 2016 – 2023



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

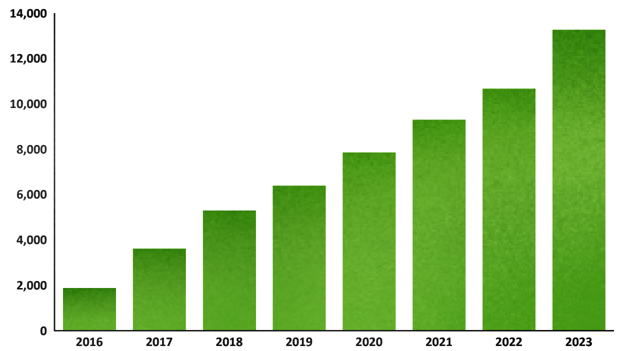
The UK savings market is a reliable, scalable and cost-effective source of funding, with the Group's strategy centred on offering sterling deposit products to UK households through a streamlined online presence, supported by an outsourced administration function, with additional routes to market provided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

Retail deposits (£m)

At 30 September 2016 – 2023



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).

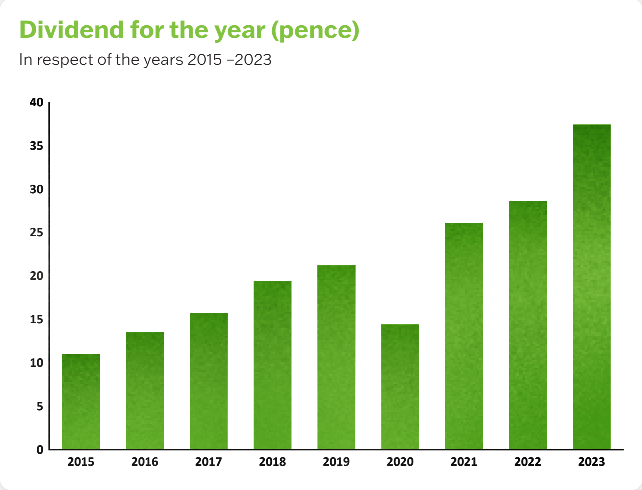
The NSFR is a longer-term measure of liquidity with a one-year horizon, supporting the management of balance sheet maturities. At 30 September 2023 the Bank's NSFR stood at 123.4% (30 September 2022: 122.3%), broadly comparable to its position twelve months earlier, and reflective of the strength of 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)	Cost of risk
	£m	%
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	**Cover ratio**	Unadjusted provision	Cover ratio
	£m		£m	
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 £m	2022 £m	2021 £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-focussed 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

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

A4.5.6 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

- **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 Females	2023 Males	2022 Females	2022 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 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	• Climate change designated as a principal risk
2021	• 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	• 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	• 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	• Net zero across the Green House Gas ('GHG') emissions associated with the Group's operational footprint
2050	• 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
a) Describe the Board's oversight of climate-related risks and opportunities	• 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	**(a) Governance** – Board oversight – Sustainability Committee and Climate change working groups
b) Describe management's role in assessing and managing climate-related risks and opportunities	• The Sustainability Committee is a dedicated sustainability governance forum and reports to ExCo and the Board • The terms of reference of key executive risk sub-committees incorporate the consideration of climate change	**(a) Governance** – Board oversight – Embedding climate change within the organisation's governance structure

Strategy

Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning where such information is material		Section
a) Describe the climate-related risks and opportunities the organisation has identified over the short, medium, and long term	As part of the 2023 ICAAP the following have been delivered: • A quantitative scenario analysis assessment on the most significant segment of the balance sheet, buy-to-let mortgages • A qualitative climate change risk assessment across both the Mortgage Lending and Commercial Lending divisions, considering the key climate-related risks and opportunities 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 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. 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.	**(b) Strategy** – Climate-related opportunities – Use of scenario analysis **(c) Risk management** – Potential risks identified over the short, medium and long term
b) Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning	• 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	**(b) Strategy** – Climate-related opportunities – Use of scenario analysis **(f) Operational impact** – 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	• 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	**(b) Strategy** – Use of scenario analysis **(g) Future developments**

Risk Management

Disclose how the organisation identifies, assesses, and manages climate-related risks		Section
a) Describe the organisation's processes for identifying and assessing climate-related risks	• The Group's 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	• 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	**(c) Risk management** – Quantifying our climate exposure **(d) Metrics and targets** **(b) Strategy** – Use of scenario analysis
b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks	• Scope 3 financed emissions 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)	**(e) Financed emissions** – Scope 3 financed emissions balance sheet **(f) Operational impact** – Performance indicators – Emissions across the value chain
c) Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets	• The Group has become a member of B4NZ 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	**(b) Strategy** – Climate-related opportunities **(f) Operational impact** – Performance indicators **(g) Future developments**

(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

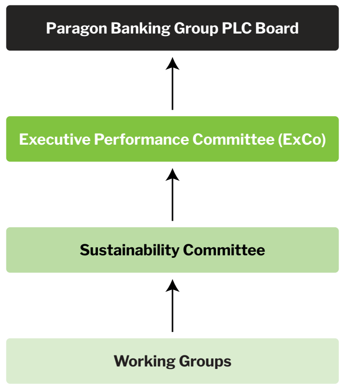
- Reviewed the Group's climate change maturity against supervisory expectations

- 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	
The NGFS divergent 1.5° net zero scenario was used to forecast key macroeconomic variables under the influence of climate change. In addition, the impact of achieving compliance with the originally proposed MEES in the PRS was considered across the mortgage portfolio. These two stress drivers were combined to assess the outcome on credit and capital across the mortgage portfolio.	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.
Physical risk	
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. 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.	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.
Net zero scenario analysis	
Analysis was performed considering the emissions across the entirety of the Group's value chain. 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. The analysis considered the implication of a 2030 interim decarbonisation target, and the key contributors to achieving the required emissions reductions.	The analysis identified retrofitting, electrification of heat, and low-emission electricity as key influences. The analysis indicated a key dependency of portfolio decarbonisation on appropriate government policy and strategy to drive consumer demand for decarbonisation and retrofit investment.

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	Moderately High	Low	**16.7%**	15.9%
	Transportation and storage		Low	**13.9%**	14.9%
	Mining and quarrying		Low	**1.5%**	1.8%
	Administrative and support service activities	Medium	Low	**21.2%**	20.5%
	Agriculture, forestry and fishing		Low	**2.3%**	2.3%
	Water supply, sewerage, waste management and remediation activities		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%**	68.3%

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_2e	tonnes CO_2e per £ million balance	$kgCO_2e$ 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 (restated[10])									
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_2e	Tonnes CO_2e	Baseline (restated) Tonnes CO_2e
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_2e per £m income *(Location-based)*	**3.2**	3.8	6.6
Normalised tonnes - Scope 1 and 2 CO_2e 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_2e per £m income *(Location-based)*	**4.3**	5.3	8.8
Normalised tonnes Scope 1,2 and 3 CO_2e 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.

CO_2 equivalent ('CO_2e') 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 10,002m^3 (2022: 10,202m^3), based on consumption recorded on purchase invoices, a normalised amount of 21.5m^3 per £m income (2022: 26.3m^3 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 targetted. 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
- CO_2 emissions for the Group's fleet have been restricted to 75g/km with annual reviews set each April to ensure continuing alignment with the objectives
- New orders will be restricted to electric-only vehicles from 1 October 2026, subject to the progress of the UK Government's decarbonisation plan
- All non-electric cars will be removed from the Group's fleet by 30 September 2031

In March 2022 the Group installed 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 Petrol and diesel used by company cars Air conditioning systems	Very Low	Included within '(f) Operational impact' above	Offset from 2022 Commitment to net zero by 2030
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 Waste generated in operations Water consumption	Very Low	Included within '(f) Operational impact'	Offset from 2022 Commitment to net zero by 2030
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				
UK Taxation				
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
Local taxation				
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