The Paragon Group of Companies PLC

Pillar III Disclosures 30 September 2015

paragon

CONTENTS

1 BACKGROUND

THE GROUP

The Paragon Group of Companies PLC ('the Company') controls a group of companies which form three principal trading business operations:

- Paragon Mortgages, which includes most of its originated loan assets;
- Idem Capital, its loan portfolio investment and third party servicing business; and
- Paragon Bank, the Group's banking subsidiary, which operates through Paragon Bank PLC and accepts savings deposits from customers and invests them in buy-to-let mortgage and consumer loans.

Each division is responsible for the generation of new business with servicing and the majority of other support functions managed on a group-wide basis. These divisions form the segments used by the Group to describe its business in its public reporting.

On 18 February 2014 Paragon Bank PLC ('the Bank') was authorised by the Prudential Regulation Authority ('PRA') and is regulated by the PRA and the Financial Conduct Authority ('FCA'). The PRA sets requirements for the Bank relating to capital and liquidity adequacy.

The Group's other divisions are subject to various forms of conduct regulation, principally by the FCA, but are not subject to PRA regulation. The Group as a whole is the subject of consolidated supervision by the PRA by reason of the Company being the parent company of the Bank. The PRA sets requirements for the consolidated group in respect of capital adequacy, but not in respect of liquidity.

DISCLOSURE FRAMEWORK

A legislative capital adequacy framework, the Capital Requirements Directive (CRD - also known as Basel II) was introduced in the European Union ('EU') in 2007 which governs the amount of capital that banks and building societies are required to hold in order to protect their members, depositors and shareholders. The aim of Basel II is to make regulatory capital requirements more risk sensitive and representative of risk management controls and procedures in place within firms. The Group seeks to ensure that it protects stakeholders by holding sufficient capital at all times.

The Basel III regulatory framework was finalised in December 2010 by the Basel Committee on Banking Supervision ('BCBS') and is being implemented in Europe through the Capital Requirements Directive IV ('CRD IV').

The CRD IV text was formally published in the Official Journal of the EU in June 2013 and became effective from 1 January 2014. It is made up of the Capital Requirements Regulation ('CRR'), which is directly applicable to firms across the EU, together with the Capital Requirements Directive ('CRD'), which must be implemented through national law. CRD IV also makes changes to rules on corporate governance including remuneration and introduces standardised EU regulatory reporting, referred to as COREP and FINREP.

The PRA, as prudential regulator of the Company, is the body responsible for implementing the CRD in the UK. The Company has been operating under the Basel III regime since the authorisation of the Bank in February 2014. It has adopted the Standardised Approach ('SA') for credit risk and the Basic Indicator Approach ('BIA') for operational risk.

The CRD consists of three elements, or 'Pillars', which represent the key principles of the Basel III regime:

Pillar I

This covers the minimum capital requirements of Basel III. The calculation is based on a risk based approach. It focuses on credit, operational and market risk in determining the Group's Minimum Capital Requirement ('MCR').

Pillar II

This requires that the Group conducts an Internal Capital Adequacy Assessment Process ('ICAAP') which is subject to review by the PRA under the Supervisory Review and Evaluation Process ('SREP').

In the ICAAP the Company's Board undertakes an assessment of the key risks facing the Company's business against which capital has not been provided under Pillar I to determine whether additional regulatory capital should be held, based on the identified risks and the risk management processes in place. A firm's Individual Capital Guidance ('ICG') is set by the PRA based on the ICAAP.

Pillar III

Pillar III complements Pillars I and II and aims to encourage market discipline by setting out disclosure requirements which should allow market participants to assess key pieces of information on a firm's capital, risk exposures, risk management processes and remuneration.

PILLAR III DISCLOSURE POLICY

This Pillar III disclosure, the second to be made by the Group, covers the Group as a whole, comprising the Company and its subsidiary undertakings. It is therefore prepared on the same basis as the Group's consolidated accounts for the year ended 30 September 2015 ('the Group Accounts'). These bodies are regulated on a consolidated basis and this disclosure treats them as such. References to the Group in this document therefore include Paragon Bank PLC.

The Company's Disclosure Policy for its Pillar III disclosures is based on its Board of Directors' interpretation of the requirements of CRD IV. The Pillar III disclosures will be updated on an annual basis using the Group's year end date of 30 September, following publication of the Annual Report and Accounts. The annual reporting process will include consideration of regulatory changes and developing best practice, to ensure that disclosures remain appropriate. More frequent disclosures will be made if there is a material change in the nature of the Group's risk profile during any particular year.

Pillar III regulatory capital disclosures are published on the Group's corporate website www.paragon-group.co.uk.

The Group's Pillar III regulatory capital disclosure policies were approved by the Board of Directors in January 2015 and confirmed in February 2016 on the approval of this document.

The Group Accounts set out a summary of the Group's risks, together with the controls and procedures in place to mitigate these risks. The Group Accounts are also published on the Group's corporate website.

BASIS OF DISCLOSURE

The figures in this Pillar III disclosure are consistent with the Group Accounts, but do not form part of the Group Accounts. The disclosures presented have been reviewed internally but have not been externally audited.

The Pillar III disclosures have been prepared for the Group as a whole, in accordance with the rules laid out in Articles 431 to 451 of Part 8 of the CRR. The disclosures provide information on the capital adequacy and risk management processes of the Group. These disclosures have been compiled on the most appropriate basis for this purpose and, as such, may not agree directly to similar disclosures presented in the Group Accounts.

The results of all subsidiary undertakings have been included in the Pillar III disclosures. The Bank's requirement to maintain regulatory capital and liquid resources above a level determined by the PRA could restrict its ability to make dividend payments or make loan repayments to other Group entities. There are no other current or foreseen material practical or legal impediments to the prompt transfer of capital resources or repayments of liabilities between the Company and its subsidiary undertakings.

References to 2015 and 2014 in the tables in this document are to balances at 30 September in each year or activity in the year then ended, as appropriate.

The Bank is required to prepare Remuneration Code Pillar III disclosures. These disclosures are the subject of a separate, stand-alone document and are published on the Bank's website, www.paragonbank.co.uk, on an annual basis.

DEVELOPMENT IN DISCLOSURES

The Group's Pillar III Disclosures have been reviewed in the light of new regulations and market practice and a benchmarking exercise comparing the Group's disclosures to a number of similar sized firms has been undertaken.

This Pillar III report reflects, in section 6, new disclosures on asset encumbrance in accordance with guidance from the European Banking Authority ('EBA'), while risk governance disclosures have been updated to reflect developments in risk reporting in the Group's Accounts, including the introduction of the Viability Statement and other measures under the 2014 version of the UK Code on Corporate Governance. Leverage disclosures have also been revised to accord more closely with CRD IV requirements, as shown in the Group Accounts. Comparative amounts based on the first year Pillar III report, for the year ended 30 September 2014, have been provided and movements between the opening and closing capital and exposure positions have also been discussed. Further background information has been provided to users in a number of areas.

The Group will continue to review market practice for Pillar III disclosure. It is considering the revised Pillar III disclosure requirements which were published in January 2015 by the BCBS and will carefully examine the guidelines for adoption of these requirements in the UK as they emerge.

APPROVAL

The first ICAAP for the Group following the authorisation of the Bank was prepared as at 31 March 2015. It was prepared under the direction of the Group Finance Director and the executive management of the Group, with appropriate input and challenge from other areas of the business. The ICAAP was reviewed and challenged by the Group's executive and was formally approved by the Board in May 2015. Throughout the ICAAP's preparation, the Board were kept up-to-date with its progress and key findings, and have received regulatory training sessions to ensure that they are able to provide the appropriate level of challenge.

The Group will review the ICAAP on at least an annual basis. The update process will occur more frequently if there is a significant change in the business model (potentially following an acquisition) or the economic environment within which the Group operates.

The Group's regulator carried out a review of the ICAAP submitted in 2015, the conclusion of which was that the actual level of the Group's capital is significantly in excess of the minimum requirements. A SREP of an updated ICAAP is expected to be carried out shortly after its completion.

The Pillar III disclosures were approved for publication by The Paragon Group of Companies PLC in February 2016.

2 GOVERNANCE

THE GROUP

Good corporate governance is essential to the ethos of the Group. The Board is responsible for overall Group strategy and for the delivery of that strategy within a strong corporate governance and corporate responsibility framework.

In April 2014, a review was undertaken of the Group's Governance and Risk Management Framework (excluding the recently established Paragon Bank) for a number of reasons including to take account of changes in best practice; the need for enhanced management of regulatory and conduct risks to ensure positive outcomes for customers; the Group's increased exposure to regulatory authorities including, but not limited to, the need for a number of entities within the Group to apply for FCA authorisation during 2015 in relation to their consumer credit and regulated mortgage activities; and the evolving expectations of external stakeholders. The outcome of this review, in so far as it related to the Company's governance structure, is detailed in this section.

Paragon Bank's governance and risk management framework was established as part of its start-up processes and reflects a similar governance structure to that of the Company. This structure is discussed in more detail below.

The Board of Directors is committed to the principles of corporate governance contained in the UK Corporate Governance Code ('Code') issued by the Financial Reporting Council ('FRC') in September 2014 and which is publicly available at www.frc.org.uk. Throughout the year ended 30 September 2015 the Company complied with the provisions of the new Code.

Leadership

The Board of Directors is responsible for overall Group strategy, for approving major agreements, transactions and other financing matters and for monitoring the progress of the Group against budget. All directors receive sufficient relevant information on financial, business and corporate issues prior to meetings and there is a formal schedule of matters reserved for decision by the Board, which includes material asset acquisitions and disposals, granting and varying authority levels of the Chairman and the executive directors, determination and approval of the Group's objectives, strategy and annual budget, investment decisions, corporate governance policies and financial and dividend policies.

During the year the Board of Directors consisted of the Chairman, three executive directors and four non-executive directors, except that between November 2014 and July 2015 there was an additional non-executive director. All the directors bring to the Company a broad and valuable range of experience and further details of this together with additional biographical details are set out in section B2 of the Group accounts.

The division of responsibilities between the Chairman and Chief Executive is clearly established, set out in writing and agreed by the Board. There is a strong non-executive representation on the Board, including the Senior Independent Director, Edward Tilly until 1 July 2015 and Fiona Clutterbuck, since that date. This provides effective balance and challenge. The Board also operates through a number of committees covering certain specific matters, these being:

Board Committees

- The Audit Committee, which during the year consisted of Peter Hartill (who chairs the Committee), Fiona Clutterbuck, Alan Fletcher, Edward Tilly, until his resignation on 1 July 2015 and Hugo Tudor, from his appointment on 24 November 2014, all of whom were independent non-executive directors. The Board is satisfied that all members of the Committee have recent and relevant financial experience. The Committee meets at least three times a year.

- The Nomination Committee, consisting of Robert Dench, who chairs the Committee, Nigel Terrington and all of the non-executive directors, ensuring that a majority of the Committee's members are independent non-executive directors.
- The Remuneration Committee, which during the year consisted of Alan Fletcher (who chairs the Committee), Fiona Clutterbuck, Peter Hartill, Edward Tilly, until his resignation on 1 July 2015 and Hugo Tudor, from his appointment on 24 November 2014, all of whom were independent non-executive directors, and the Chairman of the Company, Robert Dench.
- The Risk and Compliance Committee, which consisted of Fiona Clutterbuck (who chairs the Committee), Peter Hartill, Alan Fletcher, Edward Tilly, until his resignation on 1 July 2015 and Hugo Tudor, from his appointment on 24 November 2014, all of whom were independent non-executive directors and the Chairman of the Company, Robert Dench. The Committee meets at least four times a year.

All board committees operate within defined terms of reference and sufficient resources are made available to them to undertake their duties. The terms of reference of the board committees are available on request from the Company Secretary.

Executive Committees

Three executive committees, the Asset and Liability Committee, the Credit Committee and the Operational Risk and Compliance Committee, consisting of executive directors and appropriate senior members of staff report to the Risk and Compliance Committee. Details of their activities are given below.

Asset and Liability Committee ('ALCO')

ALCO comprises heads of relevant functions and is chaired by the Group Finance Director.

The principal purpose of the ALCO is to monitor and review the financial risk management of the Group's balance sheet. As such, it is responsible for overseeing all aspects of market risk, liquidity risk and capital management as well as the treasury control framework. ALCO operates within clear delegated authorities, monitoring exposures and providing recommendations on actions required.

Credit Committee

The Credit Committee comprises senior managers from the finance and risk functions and is chaired by the Group Finance Director.

The Credit Committee approves credit risk policies and defines risk grading and underwriting criteria for the Group. It also provides guidance and makes recommendations in order to implement the Group's strategic plans for credit. This committee oversees the management of the credit portfolio, the post origination risk management processes and the management of past due or impaired credit accounts. It also makes recommendations for credit risk appetite and monitors performance against appetite on an on-going basis.

Operational Risk and Compliance Committee

The Operational Risk and Compliance Committee comprises heads of relevant functions and was chaired by the Chief Operating Officer until 1 June 2015 and the Group Chief Risk Officer subsequently.

The Committee is responsible for overseeing the Group's operational risk management and compliance systems, ensuring that the business is operating within risk appetite. It considers key operational risk information such as loss events, emerging risks and control failures.

With respect to Compliance, the Committee is responsible for overseeing the maintenance of effective systems and controls to meet regulatory and conduct obligations and for countering the risk that we might be used to further financial crime. It is also responsible for reviewing the quality, adequacy, resources, scope and nature of the work of the Group Compliance function, including the annual Compliance Monitoring Plan.

PARAGON BANK

The Bank has its own internal governance structure, including a Board with independent non-executive directors. The governance structure is modelled on the provisions of the Code in so far as they can be adapted to apply to a subsidiary entity. The Bank operates within delegated authority from the Board of Directors of The Paragon Group of Companies PLC.

Leadership

The Bank's Board of Directors is responsible for overall strategy, for approving major agreements, transactions and other financing matters and for monitoring the progress of the Bank against budget. All directors receive sufficient relevant information on financial, business and corporate issues prior to meetings and there is a formal schedule of matters reserved for decision by the Bank, which includes material asset acquisitions and disposals, granting and varying authority levels of the Chairman and the executive directors, determination and approval of the Bank’s objectives, strategy and annual budget, investment decisions, corporate governance policies and financial and dividend policies.

During the year the Bank’s Board of Directors comprised the Chairman, two executive directors, one non-executive director appointed by the shareholder and two independent non-executive directors, one who only served from 4 February 2015. All of the directors bring to the Bank a broad and valuable range of experience.

The division of responsibilities between the Chairman and Managing Director is clearly established, set out in writing and agreed by the Bank Board. There is a strong non-executive representation on the Board. This provides effective balance and challenge.

The Bank Board has agreed a conflicts policy which includes a process to identify and authorise any conflicts which might arise. At each meeting of the Bank Board actual or potential conflicts of interest in respect of any director are reviewed.

The Bank Board also operates through a number of committees covering certain specific matters, these being:

Board Committees

- The Bank's Remuneration Committee, which consisted of Nigel Terrington (who chairs the Committee), Stephen Blaney, Patrick Newberry and Finlay Williamson from his appointment to the board on 4 February 2015.
- The Bank's Audit Committee, which consisted of Patrick Newberry (who chairs the Committee), Nigel Terrington, Stephen Blaney and Finlay Williamson from his appointment to the board on 4 February 2015 The Board is satisfied that all members of the Committee have recent and relevant financial experience. The Committee meets at least four times a year.
- The Bank's Risk and Compliance Committee, which consisted of Finlay Williamson, (who chaired the committee from his appointment to the board of 4 February 2015), Stephen Blaney, Patrick Newberry and Nigel Terrington. Fiona Clutterbuck, an independent non-executive director of the Company chaired the one meeting of the committee held in the year before the appointment of Finlay Williamson on a non-voting basis. The Committee meets at least four times a year.

Executive Committees

- The Bank's Asset and Liability Committee, which consisted of the heads of relevant functions and is chaired by Andrew Smithson, the Bank's Finance Director. The Committee meets regularly and monitors the Bank’s liquidity risks, interest rate risks, currency risks and treasury counterparty exposures.
- The Bank's Credit Committee, which consisted of the heads of relevant functions and is chaired by Richard Doe, the Managing Director. It meets regularly and is responsible for establishing credit policy and monitoring compliance therewith.
- The Bank's Operational Risk and Compliance Committee, which consisted of the heads of relevant functions and is chaired by the Chief Risk Officer. It meets regularly and is responsible for operational, conduct and business risks.

3 RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group regards the effective identification, monitoring and control of risk as an integral part of its management processes. To support this, the Group's risk management framework and supporting risk committee structures have been further developed during the last year.

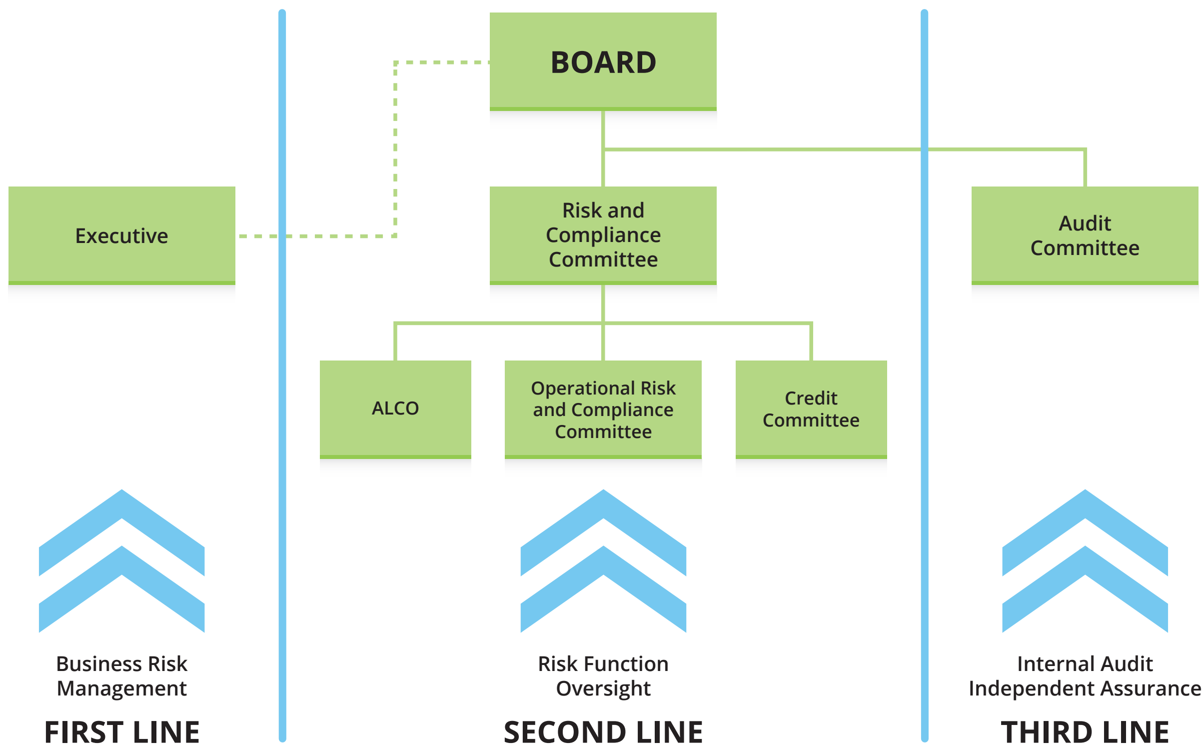
There are a number of potential risks and uncertainties which could have a material impact on the Group's performance and could cause actual results to differ materially from previous or expected results. To identify and control these risks the Group utilises a risk management framework which analyses its risks under the categories of Business Risk, Credit Risk, Liquidity Risk, Market Risk, Operational Risk, Conduct Risk and Pension Obligation Risk.

The Group's system of risk management includes the Credit Committee, Operational Risk Committee and ALCO, an enhanced Group Risk and Compliance function and an appropriately qualified Internal Audit function. This risk management framework is monitored by the board level Risk and Compliance Committee.

The Group's risk management framework operates within a 'Three Lines of Defence' model:

- The first line of defence, comprising the executive directors, their managers and people, holds primary responsibility for designing, operating and monitoring risk management and control processes.
- The second line of defence is provided by the Group Risk and Compliance Committee and supporting sub-committees together with oversight provided by the recently formed Group Risk and Compliance function including the Credit Risk, Compliance and Financial Crime areas.
- The third line of defence is provided by Group Internal Audit and the Group Audit Committee which are responsible for reviewing the effectiveness of the first and second lines of defence.

The way in which the three lines of defence model aligns with the wider governance framework and information on risk matters ultimately flows to the Group Board is illustrated below:



The remainder of this section sets out:

- The principal risks to which the Group is exposed and the main steps taken to mitigate against them
- A summary of the Group's risk appetite with regard to those risks
- Details of the Board's assessment of the Group's risk management processes

PRINCIPAL RISKS

The principal risks inherent in the Group's business model include the following:

Business risk

Business risk is defined as any risk to the Group arising from changes in its business, including the risk that the business may not be able to implement its business plan and desired strategy.

The Group's operations are domiciled entirely in the United Kingdom ('UK') and therefore there is a risk that any deterioration in the general UK economy might adversely affect the Group's business.

In addition, the Group is heavily reliant on lending to customers investing in the UK private rented sector. Demand for the Group's buy-to-let products is therefore significantly influenced by the performance of this sector, which in turn is dependent upon underlying factors such as house prices, supply of rental property, demographic changes and government housing policy. Demand for all of the Group's loan products is dependent upon such factors as market interest rates, employment levels and other factors that determine disposable income.

Adverse economic conditions might increase the number of customers that default on their loans or adversely affect funding structures, which may in turn increase the Group's costs and could result in losses on some of the Group's assets, or restrict the ability of the Group to develop in the future.

As part of an established governance process, the Group's executive management undertakes a review of strategic objectives each year. This helps to inform the development of detailed business plans for each of the Group's principal trading operations within which account is taken of key risks and mitigants.

The Group closely monitors economic developments in the UK and overseas, with support from a leading independent macro-economic research company. This ensures it is able to consider various economic scenarios within its formal business planning cycle.

The Group employs robust underwriting and monitoring processes which reflect prudent credit risk policies designed to be maintained through economic cycles. To support the validation of asset values for its core buy-to-let lending products the Group maintains an in-house team of Chartered Surveyors with considerable experience and understanding of the sector.

The UK financial services market is highly competitive and the Group faces strong competition in all of the core markets in which it operates, including its lending markets and the debt purchase and asset servicing markets. There is a danger that the Group's profitability and / or market share may be impaired if its offerings do not remain competitive.

To mitigate this risk the Group maintains relationships with its customers, business introducers and other significant participants in the markets in which it is active, as well as being active in industry-wide organisations and initiatives. This enables market trends and their attendant risks to be identified and addressed within the relevant business strategy.

Credit risk

Credit risk is the risk that a loan customer or treasury counterparty will be unable to meet their obligations as they fall due. As a primary lender, the Group faces credit risk as an inherent component of its lending and asset purchase activities. Adverse changes in the credit quality of the Group's loan customers arising from their personal circumstances or from systemic risks in UK and global financial systems could reduce the recoverability and value of the Group's assets.

In order to mitigate credit risk, the Group has comprehensive policies in place that set out detailed criteria which must be met before loans are approved and funds released. These policies are approved by the Credit Committee under authority granted by the Board Risk and Compliance Committee. Credit policies incorporate limits for concentration risk arising from factors such as large exposures to particular counterparties, geographical areas or types of lending. Exceptions to these policies require approval by the Group's Credit Risk function, operating under a mandate from the Credit Committee. Group Credit Risk is an integral part of the Group Risk and Compliance function and provides regular reports to the Credit Committee and Risk and Compliance Committee on the performance of the Group's lending.

Originated assets are subject to individual underwriting approval with robust control and support provided by well-established decision tools, while purchased assets are subject to extensive pre-contract due diligence and rigorous ongoing analysis and monitoring.

The Group is exposed to the failure of counterparties with which it places deposits. In addition it is exposed to the risk of loss in the event of the failure of a counterparty with which it has negotiated hedging agreements to mitigate interest rate and foreign exchange risk. The Group therefore requires all counterparties with which it contracts to meet specific credit rating criteria. Exposure to these counterparties is monitored daily by senior management within the Group's Treasury function and is reported monthly to the ALCO, a subsidiary committee of the Board's Risk and Compliance Committee.

The Group's approach to the management of credit risk and the systems in place to mitigate that risk on both originated and purchased assets are further described in sections 5 and 7 below.

Liquidity risk

Liquidity risk is the risk that the Group, although solvent, has insufficient financial resources to enable it to meet its obligations as they fall due or finance its future plans, or can only secure such resources at excessive cost.

The Group relies on its access to sources of funding to finance the origination of new business, portfolio acquisitions and working capital. If access to funding became restricted, either through market movements or regulatory or governmental action, this might result in the scaling back or cessation of some business lines.

The Group's banking business relies on retail deposits; therefore changes in market liquidity could impact the ability of the business to maintain the level of liquidity required to sustain normal business activity. In addition, there is a risk that the Group could face sudden, unexpected and large cash outflows from customer withdrawals.

The Group, through ALCO, seeks to mitigate this risk by investigating alternative sources of finance which are, or might become, available to the Group and by keeping its funding and working capital position under review. Paragon Bank is required, under regulation, to hold prescribed levels of liquid funds in order that requests for retail withdrawals can be met.

The Group has a dedicated Treasury function which is responsible for the day to day management of the Group's overall funding arrangements and which operates in line with a comprehensive suite of Treasury policies.

The Group's capital position and its policies in respect of capital management are described more fully in section 4 below.

Market Risk

Market risk is the risk of either a loss of capital or a reduction in earnings arising from an adverse movement in market prices or rates.

Changes in interest rates may adversely affect the Group's net income and profitability. In particular, the Group's profitability is determined by the difference between the rates at which it lends and those at which it can borrow. Therefore any changes in market interest rates which result in a mismatch can impact the Group's profit.

The steps taken by the Group to mitigate against the long term effects of interest rate movements, through the structuring of its products and the use of hedging procedures, are described in section 8 below.

Conduct risk

Conduct risk is the risk that decisions, behaviours, culture and approach lead to poor outcomes for customers.

The Group provides a range of financial services products across several brands to consumers and small business customers. As a result, the Group is exposed to potential conduct risk should it fail to treat its customers fairly. This could arise, for example, if certain products fail to meet the needs of customers or customer complaints are handled ineffectively.

The manner in which financial services companies treat their customers is subject to considerable regulatory scrutiny. There is, therefore, a risk that regulatory bodies may determine that the Group is not ensuring that its customers receive fair treatment. Systemic poor customer treatment may lead to regulatory censure, reputational damage and resulting reductions in the Group's profitability.

In order to mitigate these risks, the Group has a suite of policies in place covering areas of particular importance to the fair treatment of customers.

It has also established an Operational Risk and Compliance Committee whose remit extends to overseeing compliance with the FCA's rules and guidance, including those relating to the fair treatment of customers. The Committee receives reports each month from selected business areas relating to customer treatment and complaint handling.

During the year, the Group has strengthened its Compliance function which now sits within a Group Risk and Compliance division reporting to a newly created role of Group Chief Risk Officer. The Compliance function has developed a formal monitoring plan which is heavily focussed on conduct risk. The plan is reviewed by both the Operational Risk and Compliance Committee and Risk and Compliance Committee.

Within the Group's consumer loan servicing area there is also a dedicated Quality and Control team which monitors the activities of customer facing staff to validate the delivery of fair treatment for customers. The team also undertakes thematic reviews and customer experience reviews to help inform management of changes required to processes or training.

The Group maintains a centralised complaint handling function to ensure complaints are dealt with in a consistent and efficient manner.

All employees are required to undertake conduct risk related training with those in consumer lending customer facing roles also receiving monthly focussed training which is subject to performance testing.

Further information regarding the Group's approach to treating its customers fairly is given in section A5.3 of the Group Accounts.

Operational risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It includes reputational risks associated with business practices or market conduct and the risk of failing to comply with applicable laws regulations or policies. It also includes failure to comply with relevant regulatory requirements and/or identify and assess the impact of future regulations.

The Group continues to develop its operational risk management framework. These developments include self assessments across the Group's business areas to identify significant risks and key controls, the completion of risk registers, the enhancement of risk event reporting and the refinement of risk appetite statements. The risk management process is overseen by the Operational Risk and Compliance Committee which reports to the Board Risk and Compliance Committee.

The activities of the Group subject it to operational risks relating to its ability to implement and maintain effective information technology ('IT') systems to process the high volume of transactions with customers. In addition there is a risk that the Group fails to ensure that these systems offer adequate protection against the threat of cyber-crime.

The Group therefore has a formally agreed IT Strategy which ensures that priority is given to those areas which are most critical to the delivery of the Group's strategy and business plan. It maintains an ongoing programme of investment in IT infrastructure and systems which includes investment in security solutions to counteract cyber security threats. There is continued focus on the information security management system to ensure that controls, testing and user awareness is maintained and improved. The Group is currently certified to the International Standard on Information Security Management ISO 27001.

Change programmes are closely managed with robust control and testing processes to ensure that system developments meet operational requirements and are effectively implemented.

In order to ensure it can deal effectively with unexpected operational disruptions, the Group has a well-established business continuity plan which is updated and tested regularly. The Group is currently certified to the International Standard on Business Continuity ISO 22301.

The customers and market sectors to which the Group supplies products and the capital markets from which it obtains much of its funding, have been subject to legislative and other intervention by UK Government, European Union and other regulatory bodies. Certain of the Group's own activities are also subject to direct regulation. These levels of intervention have increased over recent years and this trend is expected to continue in the future. The Group is therefore exposed to the risk that its financial performance and reputation could suffer significantly if it fails to identify, interpret and comply with relevant regulatory and legal obligations.

In order to mitigate this risk, the Group has Risk and Compliance and Legal teams who review key regulatory and legal developments to assess the impact on the Group's operations. These teams work with business areas to provide advice on the implementation of appropriate measures to meet identified requirements. Expert third party advice is also sought where necessary. Major regulatory or legal change initiatives are subject to formal change governance with progress reporting to the Risk and Compliance Committee.

The Group Risk and Compliance function has a formal regulatory compliance monitoring plan which is reviewed by the Operational Risk and Compliance Committee and the Risk and Compliance Committee. It also provides independent oversight of business areas' adherence to anti-money laundering and financial crime requirements. All employees are required to undertake regulatory training.

The Group recognises that its success is dependent upon recruiting and retaining skilled senior management and personnel at all levels of the organisation. The levels of regulation surrounding business conduct mean that a highly trained operational workforce is vital to the Group's ability to conduct business. Failure to maintain the necessary skill base would put at risk the Group's ability to successfully carry out its plans.

The Group's employment policies, which are designed to mitigate this exposure and ensure that an appropriately skilled workforce is, and remains, in place are described within section A5.1 of the Group Accounts.

Pension obligation risk

Pension obligation risk is the risk of contractual or other liabilities in respect of the Group's pension arrangements leading to costs which would reduce its scope to undertake other business activities.

The Group operates a defined benefit pension plan ('the Plan'), which is closed to new entrants. Its commitments under this plan expose it to the risk that the assets of the scheme may be insufficient to meet its liabilities, either due to the investment performance of the Plan or the present assumptions of future inflation and members' salaries or mortality rates being inaccurate.

In conjunction with the Trustee, the Group conducts asset-liability reviews of the Plan. These studies are used to assist the Trustee and the Group to determine the optimal long-term asset allocation with regard to the structure of liabilities within the Plan. The results of the studies are used to assist the Trustee in managing the volatility in the underlying investment performance and risk of a significant increase in the scheme deficit by providing information used to determine the investment strategy of the Plan.

The Group's exposure to risks relating to its pension arrangements is discussed in more detail in note 52 to the Group Accounts.

Other risks

The Group's exposure to other financial risks, including certain liquidity risks and market risks not described above, together with the procedures in place to mitigate those risks are described in detail in note 7 to the Group Accounts.

RISK APPETITE

Introduction

The Board accepts that a certain level of risk is inherent in the Group's business model, but it maintains a conservative stance in its approach to the acceptance of risk. The articulation of what constitutes an acceptable level of risk is achieved through risk appetite statements. Risk appetite is defined as the amount and type of risk which the Group is prepared to seek, accept or tolerate in pursuit of our long term business objectives.

By setting defined risk appetite, the Board communicates the level of acceptable risk and in turn mandates that risk to be proactively managed within that level. The degree of appetite for risk will vary across different business areas and also across different risk categories.

Format of risk appetite

The Group defines its risk appetite statement at two levels:

- Corporate risk appetite statement
- Principal risk appetite statements

CORPORATE RISK APPETITE STATEMENT

There are a number of core requirements that the Board expects all areas to comply with, which form the corporate risk appetite statement. These requirements are set out below:

CULTURE

The Group will promote a culture which has at its core the delivery of good outcomes for customers in the pursuit of commercial objectives and prudential risk management.

- The Group has no appetite for any risk arising from a systemic failure to deliver fair outcomes for customers

Systemic failure refers to the design of a product or service in such a way that it presents an inherent risk of poor outcomes.

PRUDENTIAL AND CONDUCT REGULATION

The Group will maintain appropriate financial and non-financial resources to support the implementation of its business strategy in a manner that delivers compliance with both prudential and conduct regulation.

- The Group has no appetite for regulatory non-compliance

CAPITAL

The Board expects that the senior management will maintain a business model which does not place the financial stability of the Group at risk.

The Board's risk appetite is to:

- Maintain capital quantity and quality to cover current and anticipated future risks
- Maintain sufficient capital to be able to survive a range of severe but plausible stressed scenarios

LIQUIDITY

The Board expects that the senior management will maintain a business model which does not place the financial stability of the Group at risk.

The Board's risk appetite is to:

- Maintain sufficient high-quality liquidity to cover both everyday business needs, and also any stressed conditions associated with either significant change to the business environment and/or significant changes to the Group's operating environment.

FINANCIAL CRIME

The Board expects that the senior management will maintain a business model that minimises the financial and reputational impact of financial crime.

- The Board has no appetite for exposure to financial crime

PRINCIPAL RISK APPETITE STATEMENTS

The principal risks are those which are inherent in the Group's operations and business plan and which are described above. Those risks are managed through the application of policies that are designed to reflect the Board's broad risk appetite.

The principal risk appetite statements set out below reflect anticipated operations based on the business plan for the year ended 30 September 2015.

Appetite statements are developed each year for the following year as part of establishing the Group's detailed business plans.

BUSINESS RISK

Business risk is defined as any risk arising from changes to the business, including the risk that the business may not be able to implement its business plan and desired strategy. A key business risk is that there is insufficient capital to meet the expectations in the business plan.

The Board's risk appetite is that:

- The Group maintains capital quantity and quality to cover current and anticipated future risks
- The Group maintains sufficient capital to be able to survive a range of severe but plausible stressed scenarios
- There will be no material change to the annual business plan in terms of volumes or activities without the Board's consent

CREDIT RISK

The Group is exposed to credit risk principally through its origination and acquisition of buy-to-let and consumer loans. The credit risk within each business line is managed by adherence to detailed product specific lending policies that outline the approach to lending, underwriting criteria, credit mandates and product terms. This risk management continues throughout the customer life-cycle from initial point of acquisition through to customer management and recovery activity. The Group mitigates credit risk by focusing on business streams where it has specific expertise and by maintaining responsible, conservative lending policies.

In addition, through the Group's Treasury activities, the Group is exposed to risk of loss through failure of an investment counterparty with which funds have been placed.

The Board's risk appetite is that:

- All credit exposures are underwritten and accepted strictly in line with the individual credit policies which have been approved for each product type
- The credit quality of investment counterparties is closely monitored by and all limits approved by ALCO with the primary objective being to minimise risk rather than maximise return
- Individual investment counterparty exposure is contained within approved limits for
    - Key systemically important relationship banks
    - Other banks and major UK building societies
    - Other UK building societies
    - Money market funds

LIQUIDITY RISK

The Group seeks to minimise liquidity risk to a level which in the event of funding restrictions would provide continuity of lending and committed investments for the immediacy, until lending and investments can be wound down in an orderly manner, and in the case of business operations for a period which allows the business to be adjusted if required.

The Board's risk appetite is that:

- The minimum level of corporate liquidity will comprise six month cash outflows based on anticipated corporate business costs including other cash commitments net of senior administration income. This liquidity is to be in the form of cash or committed undrawn funding facilities.
- A financing strategy will be put into place to cover maturing corporate debt prior to the scheduled maturity date and consistent with the debt amount and forecast cash flows.
- Sufficient funding for the next three months anticipated completions will be available in the Group's warehouse funding facilities.
- The Group has sufficient resources to meet capital investment requirements for warehouse special purpose vehicles ('SPVs') for the projected three month asset advances by reference to the annual business plan or current pipeline, whichever is the greater.

MARKET RISK

Market risk is the risk of a loss to either capital or earnings arising from an adverse movement in market prices or rates.

Day-to-day management of market risk is undertaken by the Group's Treasury function and monitored in the first instance by ALCO.

The Board's risk appetite is that:

- Risk against interest rate movements is controlled by limiting the permitted level of mismatching between the re-pricing rates of fixed lending assets and funding liabilities. This will be calculated as the profit impact of asset and liability mismatches based on a +1% movement in interest rates.
- There is to be no exposure to exchange rate risk given the high volatility of exchange rates and the lack of natural income offset that can be used in managing the exposure.

OPERATIONAL RISK

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It includes reputational risks associated with business practices or market conduct and the risk of failing to comply with applicable laws, regulations or policies.

The Board's risk appetite is that:

- The Group should incur fewer than a defined number of material risk events in any single financial year based on any event with an actual or potential capacity to cause:
    - A major adverse impact on over 5% of the customer base
    - Direct financial loss of £100,000 or more
    - A significant worsening of the Group's relationship with its regulators
    - Adverse mainstream or specialist media interest
    - The Group Business Plan being impacted by more than 5% in any of the next 3 years
    - A requirement for significant executive or business resource involvement to resolve the issue

- Total IT systems downtime must not exceed six hours in any twelve month period
- The business continuity plan must be fully rehearsed at least once per year

CONDUCT RISK

The Group and its subsidiaries take a cautious approach to conduct risk and endeavour to maintain an efficient operating environment adopting a culture, behaviours and approach to products and services that do not result in poor outcomes for customers.

The Board's risk appetite is that:

- Whilst acknowledging operational errors may lead to isolated instances of customer detriment (which must always be remediated) the Group has no appetite for any systemic failure to deliver fair outcomes for customers. In practice, this means we expect that:
    - Customers are provided with sufficient (clear, fair and not misleading) information in order to take an appropriate and informed decision on any product
    - Products only reach the customers they were designed for
    - Products are suitable for the target customer's personal circumstances and meet their needs
    - Products function as expected
    - Credit decisions provide outcomes to customers that are fair and appropriate to their personal circumstances and meet their needs
    - Customers receive a fair and reasoned response to their expressions of dissatisfaction
    - Customers are only charged fees in line with their expectations
    - Customers can be confident that their data is secure
    - Customers can be confident that when an unexpected incident occurs, the business will be recovered and they will not suffer any unfair outcomes

BOARD ASSESSMENT OF RISK MANAGEMENT ARRANGEMENTS

During the year the directors carried out a detailed risk evaluation facilitated by the Group Chief Risk Officer. As part of this exercise directors were individually required to:

- assess the strength of the Group's risk framework under each of the headings by which the Group categorises risk
- identify present key risk concerns for each part of the business
- identify future key risk concerns for each part of the business over a two to three year time horizon

The results of this exercise were subsequently reviewed by the directors and actions to address areas of concern were determined. Based upon this exercise and their observations throughout the year the directors were able to conclude that the Group's system of risk management was fit for purpose.

A similar exercise also took place with the Group's senior management with similar results.

At the year end the directors reconsidered the results of this exercise and the extent of progress on the identified action areas. They also considered whether there were any subsequent developments which would have impacted on their assessment and whether these had been addressed.

The directors concluded that this process constituted a robust assessment of all of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.

4 CAPITAL RESOURCES

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

The Group's regulatory capital is monitored by the Board of Directors and ALCO, who ensure that appropriate action is taken to ensure compliance with the regulator's requirements. The future regulatory capital requirement is also considered as part of the Group's forecasting and strategic planning process.

Both the Group and the Bank's capital risk appetite are linked to their wider risk appetite statement and ultimately their strategy.

The Group's overriding objectives in managing its capital is to generate a strong return for shareholders while operating within the risk appetite set by the board which requires it to:

- maintain capital quantity and quality to cover current and future risks within the Group;
- maintain sufficient capital to be able to survive a range of severe but plausible stressed scenarios; and
- utilise capital in order to generate a strong return for shareholders.

The Group's approach to defining capital risk appetite takes into account its prudent approach to operations and strong control environment. The risk appetite is described in both quantitative and qualitative terms:

- quantitatively, by describing the overall risk limits numerically. These limits cover the quantity and quality of capital to be held; and
- qualitatively, by outlining core principals in managing or mitigating risk and ensuring that the Group and the Bank have the necessary capabilities to prudently manage capital risks, and provide management with sufficient information to effectively oversee operations and risk levels.

At 30 September 2015 the Group's regulatory capital of £978.4m (2014: £981.1m), was comfortably in excess of that required by the regulator. Throughout the period from authorisation to that date the Group's regulatory capital also complied with these requirements.

The Group's regulatory capital differs from its equity as certain adjustments are required by the regulator. A reconciliation of the Group's equity to its regulatory capital determined in accordance with CRD IV at 30 September 2015 is set out below.

		2015	2014
		£m	£m
Total equity		969.5	947.1
Deductions			
Proposed final dividend		(21.8)	(18.3)
Intangible assets		(7.7)	(7.9)
Deferred tax adjustment	*	(0.3)	(0.5)
Common Equity Tier 1 ('CET1') capital		939.7	920.4
Other Tier 1 capital		-	-
Total Tier 1 capital		939.7	920.4
Corporate bond		110.0	110.0
Less: amortisation adjustment	†	(75.8)	(53.8)
		34.2	56.2
Collectively assessed credit impairment allowances		2.4	4.5
Total Tier 2 capital		36.6	60.7
Total regulatory capital		976.3	981.1

* Deferred tax assets in subsidiary companies are required to be deducted from regulatory capital. This balance is offset against the deferred tax liability in the consolidated accounts.

† When Tier 2 capital instruments have less than five years to maturity the amount eligible as regulatory capital reduces by 20% per annum. As the Group's £110.0m Corporate Bond matures in 2017, this adjustment is required.

The movements in the Group's capital resources in the year can be analysed as follows:

	2015			2014		
	CET 1	**Tier 2**	**Total**	CET 1	Tier 2	Total
	£m	**£m**	**£m**	£m	£m	£m
Capital at 1 October 2014	**920.4**	**60.7**	**981.1**	849.6	84.4	934.0
Trading transactions						
Profit after tax	**107.1**	**-**	**107.1**	97.2	-	97.2
Other comprehensive income	**(5.9)**	**-**	**(5.9)**	(2.8)	-	(2.8)
Charge for share based payment	**4.5**	**-**	**4.5**	3.2	-	3.2
Tax on share based payment	**1.2**	**-**	**1.2**	1.3	-	1.3
Movement in collectively assessed impairment allowances	**-**	**(2.1)**	**(2.1)**	-	(1.7)	(1.7)
Purchase of intangible assets	**(1.2)**	**-**	**(1.2)**	(0.7)	-	(0.7)
Amortisation of intangible assets	**1.4**	**-**	**1.4**	1.3	-	1.3
Utilisation of tax losses	**0.2**	**-**	**0.2**	0.1	-	0.1
Capital transactions						
Proposed dividend at year end	**(21.8)**	**-**	**(21.8)**	(18.3)	-	(18.3)
Interim dividend paid in year	**(10.8)**	**-**	**(10.8)**	(9.1)	-	(9.1)
Share buy-backs	**(49.7)**	**-**	**(49.7)**	-	-	-
Shares issued	**2.5**	**-**	**2.5**	1.1	-	1.1
Shares purchased by ESOP	**(8.2)**	**-**	**(8.2)**	(2.5)	-	(2.5)
Amortisation of Tier 2 instruments	**-**	**(22.0)**	**(22.0)**	-	(22.0)	(22.0)
Capital at 30 September 2015	**939.7**	**36.6**	**976.3**	920.4	60.7	981.1

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

	2015	2014
	£m	£m
Credit risk		
Balance sheet assets	**4,426.8**	4,146.6
Off balance sheet	**88.7**	37.1
Total credit risk	**4,515.5**	4,183.7
Operational risk	**363.6**	337.1
Market risk	**-**	-
Other	**50.2**	108.7
Total risk weighted assets	**4,929.3**	4,629.5

Solvency ratios	**%**	%
CET1	**19.1**	19.9
Total regulatory capital	**19.8**	21.2

The CRD IV risk weightings for credit risk exposures are calculated using the SA.

The table below shows the causes of movements in RWA in the year at the Group level.

	2014 RWA	**Portfolio Quality**	**Portfolio Size**	**2015 RWA**
	£m	£m	£m	£m
First Mortgages	3,142.3	(23.4)	310.3	3,429.2
Second charge mortgages	110.5	(0.8)	(10.6)	99.1
Exposures secured on real estate	3,252.8	(24.2)	299.7	3,528.3
Retail exposures	418.4	0.2	59.8	478.4
Exposure on loans to customers	3,671.2	(24.0)	359.5	4,006.7
Institutions	459.0	12.2	(14.1)	457.1
Other assets	53.4	-	(1.8)	51.6
	4,183.6	(11.8)	343.6	4,515.4

Credit RWAs have increased by approximately 7.9 % since 30 September 2014. The principal cause of this increase has been the growth of the Groups buy-to-let loan book with total mortgage RWAs increasing by 9.1 % in the year. This is after allowing for an improvement in book quality due to increased house prices.

Exposure on retail assets has also increased due to asset purchases and new originations. The reduction in counterparty credit risk RWAs has arisen due to the effect of counterparty credit rating downgrades being offset by the reduction in balance size.

Changes in operational risk requirements reflect income growth within the regulatory prescribed income streams, as the Group calculates risk exposure from operating risk using the BIA.

The table below shows the calculation of the leverage ratio, based on the consolidated balance sheet assets, adjusted for amounts already provided in the Group Accounts and the post offer pipelines of loan assets at 30 September 2015.

	2015	2014
	£m	£m
Total balance sheet assets	11,878.9	10,895.1
Less: Derivative assets	(660.1)	(693.9)
On-balance sheet items	11,218.8	10,201.2
Less: Intangible assets	(7.7)	(7.9)
Total on balance sheet exposures	11,211.1	10,193.3
Derivative assets	660.1	693.9
Potential future exposure on derivatives	69.1	70.7
Total derivative exposures	729.2	764.6
Post offer pipeline at gross notional amount	482.3	209.8
Adjustment to convert to credit equivalent amounts	(241.1)	(104.9)
Off balance sheet items	241.2	104.9
Tier 1 capital	939.7	920.4
Total leverage exposure	12,181.5	11,062.8
Basel III leverage ratio	7.7%	8.3%

The Group has revised its calculation of the leverage ratio above to take account of the CRD IV rules for leverage disclosures, which the Financial Policy Committee of the Bank of England has indicated will be used for regulatory purposes in the UK.

The Group has also revised its calculation of the credit conversion factors in respect of pipeline assets used in both leverage and capital ratios to more closely correspond with CRD IV guidance. Corresponding figures have been adjusted for consistency, although the recalculated ratios differ from those already reported by insignificant amounts.

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

CAPITAL BUFFERS

CRD IV establishes a number of capital buffers to be met with CET1 capital, in addition to the Group's funds requirement set through Pillar I and Pillar II (together referred to as the 'CRD IV Buffers'):

Capital conservation buffer ('CCoB') - Designed to enable firms to absorb losses in stressed periods and is currently set at 2.5% of total risk exposure. The buffer will apply to the Group and will be phased in from 1 January 2016 to 1 January 2019.

Countercyclical capital buffer ('CCB') - CRD IV introduces a countercyclical capital buffer to ensure that banks build up capital in periods when credit is given that can be drawn down when losses are incurred in stressed periods and the buffer rate for the UK will be set by the Financial Policy Committee ('FPC') between 0% and 2.25%. At 1 December 2015, the FPC maintained a UK CCB rate of 0%.

Systemic risk buffer ('SRB') - In addition to the measures above, CRD IV provides for the setting of various SRB's with a view to mitigating structural macro prudential risk. The SRB is to be applied to systematically important institutions, ring-fenced banks and building societies over a certain threshold, which are together defined as 'SRB institutions'. Further systemic buffers may be required for globally important institutions. No SRBs apply to the Group as yet.

Under the Pillar II framework, banks are required to hold a Capital Planning Buffer ('CPB') in respect of the ICAAP and SREP process which leads to a final determination by the PRA of ICG.

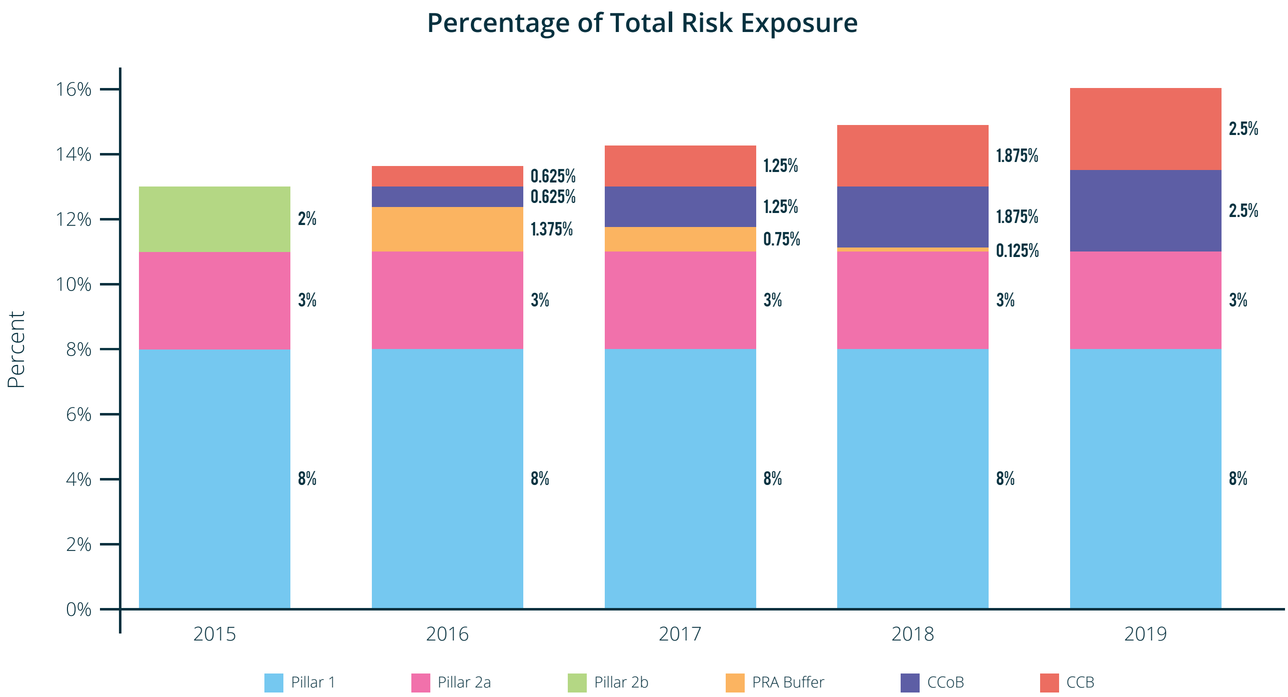
As part of the CRD IV implementation, the PRA is phasing in a PRA buffer from 1 January 2016, to replace the existing CPB. The PRA buffer will be calculated allowing for amounts already included in the CRD IV buffers and will be set on a firm to firm basis depending on each firm's vulnerability in a stress scenario, where the PRA has identified risk management and governance failings or where the PRA considers the existing CRD IV buffers inadequate. The PRA will set the PRA buffer as the excess capital required over and above the CRD IV buffers and may set a buffer of 0%. Implementation of the PRA buffer will be phased in between the 1 January 2016 and 1 January 2019 and in recognition of this the Group's CPB has been reduced by an amount of 0.625% of the total risk exposure amount.

CRD IV also sets minimum requirements for the quality of capital held.

There are a number of transitional provisions that apply to the buffers. The illustration below provides a summary of the timing and impact for each of the buffers on quantity and quality of capital to be held.

For the purposes of this illustration only the Pillar 2a capital is assumed to be 3% of Total Risk Exposure and CPB 2% of Total Risk Exposure. CCoB and CCB are each assumed to be 2.5% (although the initial amount for CCB in the UK is actually 0%).

These are illustrated in the graph below:



The Group has reviewed the requirements set out within the CRR, including the impact of the transitional provisions. The capital position of the Group over the planning horizon demonstrates a significant surplus that can accommodate the requirements of the CCoB and CCB.

The Group has concluded that it will maintain a capital surplus over and above the CRR capital requirements, including relevant buffers, through the planning horizon.

5 CREDIT RISK

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

Primary responsibility for credit risk management across the Group lies with the Credit Committee. The Credit Committee is made up of six senior employees, headed by the Group Finance Director. Its key responsibilities include setting and reviewing credit policy, controlling applicant quality, tracking account performance against targets, agreeing product criteria and lending guidelines and monitoring performance and trends.

In order to control credit risk relating to counterparties to the Group's derivative financial instruments, short-term investments and cash deposits, ALCO determines which counterparties the Group will deal with, establishes limits for each counterparty and monitors compliance with those limits.

The carrying values of the assets of the Group which are subject to credit risk are set out below:

	2015	2014
	£m	£m
Loans to customers	**10,062.4**	9,255.9
Investments in structured entities	**18.1**	19.3
Derivative financial assets	**660.1**	693.9
Accrued interest	**0.4**	0.3
Short term investments	**41.1**	39.4
Cash	**1,056.0**	848.8
Maximum exposure to credit risk	**11,838.1**	10,857.6

While this maximum exposure represents the potential loss which might have to be accounted for by the Group, the terms on which the Group's loan assets are funded limit the amount of principal repayments on the Group's securitised and warehouse borrowings in cases of capital losses on assets, significantly reducing the effective shareholder value at risk.

The Group's RWAs, used in determining its Pillar I capital requirement can be analysed by category as shown below.

	Note	Exposure £m	Risk weighted exposure £m	Minimum capital required £m
30 September 2015				
Government and central banks	*a*	**327.1**	**-**	**-**
Credit institutions	*f*	**1,430.1**	**457.1**	**36.6**
Total liquidity exposures		**1,757.2**	**457.1**	**36.6**
Non-residential and business lending	*h*	**480.7**	**470.4**	**37.6**
Residential lending - performing	*i*	**9,531.2**	**3,392.5**	**271.4**
Residential lending - non-performing	*j*	**55.0**	**55.2**	**4.4**
Loans and advances to customers before impairment		**10,066.9**	**3,918.1**	**313.4**
Fixed and other assets	*q*	**51.6**	**51.6**	**4.1**
Total on balance sheet exposures		**11,875.7**	**4,426.8**	**354.1**
Off balance sheet exposures - pipeline		**241.2**	**88.7**	**8.8**
Total credit risk exposure		**12,116.9**	**4,515.5**	**362.9**
30 September 2014				
Government and central banks	*a*	39.4	-	-
Credit institutions	*f*	1,543.2	459.0	36.7
Total liquidity exposures		1,582.6	459.0	36.7
Non-residential and business lending	*h*	413.9	413.6	33.1
Residential lending - performing	*i*	8,788.9	3,225.4	258.0
Residential lending - non-performing	*j*	167.9	68.2	5.5
Loans and advances to customers before impairment		9,370.7	3,707.2	296.6
Fixed and other assets	*q*	56.6	56.6	4.5
Total on balance sheet exposures		11,009.9	4,222.8	337.8
Off balance sheet exposures - pipeline		104.8	37.1	2.9
Total credit risk exposure		11,114.7	4,259.9	340.7

The exposures shown above are assigned to the exposure classes set out in Article 112 of the CRR as shown below:

a) Exposures to central governments or central banks

f) Exposure to institutions

h) Retail exposures

i) Exposures secured by mortgages on immovable property

j) Exposures in default

q) Other items

These calculations use the SA for credit risk for all asset classes and the BIA for operational risk. A factor of 8% is applied to RWA values calculated in accordance with Article 92 of the CRR to determine the minimum Pillar I requirement for credit risk.

Pipeline exposure figures are now stated after credit conversion factors and comparative figures have been restated accordingly.

The Group has a very low operational risk appetite, highlighted by its lack of historic operational risk losses. In order to assess whether a Pillar IIa add-on is required for operational risk, the Group has reviewed historic operational losses, as well as performing scenario analysis on the Group's major operational risks.

Loans to customers and other investments in loan assets

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

Specific credit risk adjustments represent loan by loan impairment provisions determined in accordance with IAS 39. The Group identifies loan accounts potentially requiring impairment provisions through the number of missed payments and whether the account is in possession or a similar enforcement status (the 'impairment population' shown in the tables later in this section).

The amount of provision is determined based on the current balance reduced by the value of any security. Allowances are also made for current collection performance.

General credit risk adjustments represent emergence provisions derived in accordance with IAS 39, based on historic experience of the asset type and current economic conditions.

The Group's loan assets at 30 September 2015 are analysed as follows:

	Gross loan assets	Impairment provisions	Net loan assets	
	£m	£m	£m	%
30 September 2015				
Buy-to-let mortgages	**9,440.6**	**77.4**	**9,363.2**	**93.0%**
Owner occupied mortgages	**56.2**	**8.6**	**47.6**	**0.5%**
Total first mortgages	**9,496.8**	**86.0**	**9,410.8**	**93.5%**
Secured loans	**392.8**	**5.7**	**387.1**	**3.9%**
Loans secured on property	**9,889.6**	**91.7**	**9,797.9**	**97.4%**
Car loans	**44.0**	**0.6**	**43.4**	**0.4%**
Retail finance loans	**2.0**	**0.8**	**0.2**	**-**
Other loans	**237.8**	**17.9**	**220.9**	**2.2%**
Total loans to customers	**10,173.4**	**111.0**	**10,062.4**	**100.0%**
30 September 2014				
Buy-to-let mortgages	8,670.6	78.5	8,592.1	92.8%
Owner occupied mortgages	68.1	8.5	59.6	0.7%
Total first mortgages	8,738.7	87.0	8,651.7	93.5%
Secured loans	442.8	6.6	436.2	4.7%
Loans secured on property	9,181.5	93.6	9,087.9	98.2%
Car loans	6.5	0.8	5.7	0.1%
Retail finance loans	2.3	1.9	0.4	-
Other loans	180.4	18.5	161.9	1.7%
Total loans to customers	9,370.7	114.8	9,255.9	100.0%

First mortgages and secured loans are secured by charges over residential properties in England and Wales, or similar Scottish or Northern Irish securities. Car loans are effectively secured by the financed vehicle.

The Group does not utilise any form of credit risk mitigation in respect of loan assets beyond the security provided by its customers under their loan agreements.

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

All of the loans shown allow the customer to repay the balance early and this facility is often used, especially for mortgage loans. It is therefore considered that an analysis of these balances by contractual maturity would not provide useful information.

The Group's underwriting philosophy is based on a combination of sophisticated individual credit assessment and the automated efficiencies of a scored decision making process. Information on each applicant is combined with data taken from a credit reference bureau to provide a complete credit picture of the applicant and the borrowing requested. Key information is validated through a combination of documentation and statistical data which collectively provides evidence of the applicant's ability and willingness to pay the amount contracted under the loan agreement.

Despite the existence of the security described above, in assessing credit risk, an applicant's ability and propensity to repay the loan remain the principal factors in the decision to lend.

In considering whether to acquire pools of loan assets or invest in loan portfolios, the Group will undertake a due diligence exercise on the underlying loan accounts. Such assets are generally not fully performing and are offered at a discount to their current balance. The Group's procedures may include inspection of original loan documents, verification of security and the examination of the credit status of borrowers. Current and historic cash flow data will also be examined. The objective of the exercise is to establish, to a level of confidence similar to that provided by the underwriting process, that the assets will generate sufficient cash flows to recover the Group's investment and generate an appropriate return, without exposing the Group to material operational or conduct risks.

An analysis of the indexed loan to value ratio ('LTV') for those loan accounts secured on property by value at 30 September 2015 is set out below. For acquired accounts the effect of any discount on purchase is allowed for.

	2015 First mortgages %	**2015 Secured loans %**	2014 First mortgages %	2014 Secured loans %
Loan to value ratio				
Less than 70%	**51.9**	**33.7**	48.5	28.7
70% to 80%	**27.6**	**16.3**	25.9	14.5
80% to 90%	**12.8**	**16.7**	16.4	18.1
90% to 100%	**4.9**	**13.5**	5.7	15.8
Over 100%	**2.8**	**19.8**	3.5	22.9
	100.0	**100.0**	100.0	100.0
Average loan to value ratio	**69.5**	**80.9**	71.4	84.1
Buy-to-let	**69.7**		71.7	
Owner-occupied	**28.8**		32.4	

The regionally indexed LTVs shown above are affected by changes in house prices, with the Nationwide house price index, for the UK as a whole, registering an annual increase of 3.8% (2014: 9.4%) in the year ended 30 September 2015. The increase in average prices, however, is part of a more volatile picture, which has been particularly marked at the local and regional level. The Group maintains a specialist team of in-house surveyors to maximise its understanding of particular markets, both from a valuation and lettings standpoint.

The Group conducts valuations of properties given as security at the inception of loans and updates the valuations from time to time as part of its arrears management process, typically conducting drive-by or full valuations as accounts move through arrears states. LTV amounts shown above are based on the most recent valuation of each property on the Group's records.

In determining appropriate allowances for impairment the most recent valuation of the security will be used, with a discount reflecting the potential impact of a forced sale.

An analysis of those loan accounts secured on property, classified by property location, by value at 30 September 2015 is set out below. For acquired accounts the effect of any discount on purchase is allowed for.

	2015	2014
	£m	£m
Region		
Greater London	**1,683.2**	1,490.5
South East	**2,793.0**	2,466.9
South West	**980.6**	943.1
East Anglia	**335.8**	318.6
East Midlands	**537.2**	507.7
West Midlands	**472.9**	443.0
North	**381.1**	363.1
North West	**1,028.8**	1,005.7
Yorkshire and Humberside	**1,048.9**	1,028.1
Total England	**9,261.5**	8,566.7
Northern Ireland	**22.0**	24.6
Scotland	**172.3**	177.2
Wales	**363.2**	344.5
Total United Kingdom	**9,819.0**	9,113.0

The £9,819.0m (2014: £9,113.0m) of loans shown above are disclosed as £9,428.1m (2014: £8,672.0m) of first mortgage assets and £390.9m (2014: £441.0m) of secured loans in the aged analysis presented in the Group Accounts.

The number of accounts in arrears by asset class, based on the most commonly quoted definition of arrears for the type of asset, at 30 September 2015, compared to the industry averages at those dates published by the Council of Mortgage Lenders ('CML') and the Finance and Leasing Association ('FLA'), was:

	2015	2014
	%	%
First mortgages		
Accounts more than three months in arrears		
Buy-to-Let accounts including receiver of rent cases	**0.19**	0.25
Buy-to-Let accounts excluding receiver of rent cases	**0.04**	0.04
Owner Occupied accounts	**3.55**	3.94
CML data for mortgage accounts more than three months in arrears		
Buy-to-Let accounts including receiver of rent cases	**0.67**	0.85
Buy-to-Let accounts excluding receiver of rent cases	**0.61**	0.74
Owner Occupied accounts	**1.27**	1.50
All mortgages	**1.17**	1.39
Secured loans		
Accounts more than 2 months in arrears	**19.56**	19.84
FLA data for secured loans	**15.80**	17.20
Car loans		
Accounts more than 2 months in arrears	**0.67**	7.85
FLA data for all personal loans	**3.00**	4.60
Other loans		
Accounts more than 2 months in arrears	**94.66**	87.50

No published industry data for asset classes comparable to the Group's other books has been identified.

The Group calculates its headline arrears measure for buy-to-let mortgages, shown above, based on the numbers of accounts three months or more in arrears, including purchased Idem Capital assets, but excluding those cases in possession and receiver of rent cases designated for sale. This is consistent with the methodology used by the CML in compiling its statistics for the buy-to-let mortgage market as a whole.

The number of accounts in arrears will be higher for closed books such as the owner occupied mortgage book and the retail finance and unsecured loan books than for comparable active ones, as performing accounts pay off their balances, leaving arrears accounts representing a greater proportion of the total.

The figures shown above for secured loans and other loans include purchased portfolios which generally include a high proportion of cases in arrears at the time of purchase and where this level of performance is allowed for in the discount to current balance represented by the purchase price.

An analysis of the Group's loan assets between assets held within securitisation structures, those within warehouse structures awaiting securitisation, those held within Paragon Bank and other loan assets is shown below.

	First Mortgages	Consumer Finance	Total
	£m	£m	£m
30 September 2015			
Loans funded by			
Securitisation structures	**7,464.7**	**448.4**	**7,913.1**
Warehouse facilities	**1,566.5**	**-**	**1,566.5**
	9,031.2	**448.4**	**9,479.6**
Paragon Bank assets	**349.6**	**15.0**	**364.6**
Other loans to customers	**30.0**	**144.8**	**174.8**
	9,410.8	**608.2**	**10,019.0**
30 September 2014			
Loans funded by			
Securitisation structures	7,094.7	528.1	7,622.8
Warehouse facilities	1,526.4	-	1,526.4
	8,621.1	528.1	9,149.2
Paragon Bank assets	0.5	-	0.5
Other loans to customers	30.1	70.4	100.5
	8,651.7	598.5	9,250.2

At 30 September 2015 94.6% (2014: 98.9%) of the carrying value of the Group's loans to customers was funded by securitisations and structures affecting the credit risk exposure of the Group in a similar way (see Section 9).

The payment status of the carrying balances of the Group's loan assets, before provision for impairment, at 30 September 2015 split between those accounts considered as performing and those included in the population for impairment testing, is shown below.

First Mortgages

	2015	2014
	£m	£m
Not past due	**9,274.0**	8,477.6
Arrears less than 3 months	**100.8**	125.0
Performing accounts	**9,374.8**	8,602.6
Arrears 3 to 6 months	**4.6**	5.9
Arrears 6 to 12 months	**4.1**	3.9
Arrears over 12 months	**15.8**	20.2
Possessions and similar cases	**28.8**	39.4
Impairment population	**53.3**	69.4
	9,428.1	8,672.0

Consumer Finance

	Secured loans	Car loans	Retail finance loans	Total
	£m	£m	£m	£m
30 September 2015				
Not past due	**265.2**	**43.3**	**0.1**	**308.6**
Arrears less than 2 months	**25.7**	**0.2**	**-**	**25.9**
Performing accounts	**290.9**	**43.5**	**0.1**	**334.5**
Arrears 2 to 6 months	**20.2**	**-**	**-**	**20.2**
Arrears 6 to 9 months	**8.9**	**-**	**-**	**8.9**
Arrears 9 to 12 months	**7.4**	**-**	**0.1**	**7.5**
Arrears over 12 months	**63.5**	**0.4**	**1.8**	**65.7**
Impairment population	**100.0**	**0.4**	**1.9**	**102.3**
	390.9	**43.9**	**2.0**	**436.8**
30 September 2014				
Not past due	291.2	3.8	0.1	295.1
Arrears less than 2 months	33.8	2.0	-	35.8
Performing accounts	325.0	5.8	0.1	330.9
Arrears 2 to 6 months	24.5	0.1	-	24.6
Arrears 6 to 9 months	12.4	-	-	12.4
Arrears 9 to 12 months	11.9	-	0.1	12.0
Arrears over 12 months	67.2	0.6	2.0	69.8
Impairment population	116.0	0.7	2.1	118.8
	441.0	6.5	2.2	449.7

Other loans

	2015	2014
	£m	£m
Not past due	**6.7**	14.5
Arrears less than 1 months	**0.5**	1.0
Performing accounts	**7.2**	15.5
Arrears 1 to 3 months	**0.5**	1.1
Arrears 3 to 6 months	**0.9**	1.5
Arrears 6 to 12 months	**2.7**	4.0
Arrears over 12 months	**226.5**	157.9
Impairment population	**230.6**	164.5
	237.8	180.0

Arrears in the tables above are based on the contractual payment status of the customers concerned. Where assets have been purchased by the Idem Capital loan investment business, customers may already have been in arrears at the time of acquisition and an appropriate adjustment made to the consideration paid.

Under the CRD, mortgages are past due if repayments are 90 days or more in arrears at the accounting date. The Group closely monitors arrears of loan repayments and impairment provisions are made where appropriate. The Group's accounting policy for impairments of loan assets is set out in note 3 to the Group Accounts and full details of movements in impairment provisions are set out in note 32 to the Group Accounts.

For capital adequacy purposes, collectively assessed credit impairment allowances are considered to be Tier 2 capital.

Investments in structured entities represent the Group's contribution made to special purpose vehicle ('SPV') companies established and controlled by third parties to purchase pools of loan assets. All such investments are denominated in sterling and the underlying loans are made to UK borrowers. Cash generated by the assets is distributed to investors in accordance with a specified priority of payments. The Group has no obligation to make further contributions to the SPV companies concerned.

Management has considered the position of the underlying assets and concluded that they will generate sufficient cash flows to repay the amount of the investment.

In the debt purchase industry, Estimated Remaining Collections ('ERC') is commonly used as a measure of the value of a portfolio. This is defined as the sum of the undiscounted cash flows expected to be received over a specified future period. In the Group's view, this measure may be suitable for heavily discounted, unsecured, distressed portfolios, but is less applicable for the types of portfolio in which the Group has invested, where cash flows are higher on acquisition, loans may be secured on property and customers may not be in default. In such cases, the IAS 39 amortised cost balance, at which these assets are carried in the Group balance sheet, provides a better indication of value.

However, to aid comparability the 84 and 120 month ERC values for the Group's purchased assets included in the Idem Capital division are set out below, analysed by the balance sheet line on which they appear. These are derived using the same models and assumptions used in the EIR calculations, but the differing bases of calculation lead to different outcomes.

	2015 Carrying value	**2015 84 month ERC**	**2015 120 month ERC**	2014 Carrying value	2014 84 month ERC	2014 120 month ERC
	£m	**£m**	**£m**	£m	£m	£m
Loans to customers	**432.9**	**555.1**	**647.3**	407.2	554.8	649.9
Investment in structured entities	**18.1**	**25.7**	**30.4**	19.3	26.6	32.3
	451.0	**580.8**	**677.7**	426.5	581.4	682.2

Amounts shown as loans to customers above include loans disclosed as first mortgages, secured loans and other loans.

6 ASSET ENCUMBRANCE

Asset encumbrance is the process by which assets are pledged in order to secure, collateralise or credit-enhance a financial transaction from which they cannot be freely withdrawn. The Group maintains a level of encumbrance commensurate with the scale and scope of its business operation, within the context of a robust and diversified funding capability. The majority of encumbrance arises from its securitisation transactions. Assets are encumbered in accordance with the contractual requirements of these transactions.

Unencumbered assets include cash-on-hand, unsecuritised loan assets, derivative assets, property, plant and other fixed assets, intangible assets including goodwill, and deferred tax assets.

The Group manages its level of encumbrance in accordance with the approved limits within its liquidity and funding risk strategies, and endeavours to ensure that a ratio covering depositor liabilities with unencumbered assets is maintained during normal business conditions. The Group continues to work closely with the regulators to ensure that its encumbrance profile remains transparent, proportionate and relevant to its business model.

In accordance with the threshold criteria under PRA supervisory statement SS11/14 (CRD IV: Compliance with the EBA's Guidelines on the disclosure of encumbered and unencumbered assets), the Group is not required to report on the fair value of encumbered and unencumbered collateral received. Furthermore, the statement requires that the data is presented as a median calculation rather than point in time.

The disclosures below are drawn up in accordance with templates A and C set out in the EBA guidelines (EBA/GL/2014/03).

Assets (Template A)

	Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
	£m	£m	£m	£m
Assets of the reporting institution	11,426.4	N/A	494.8	N/A
Loans on demand	834.9	N/A	220.2	N/A
Debt securities	-	-	85.5	85.5
Of which: asset backed securities	-	-	*44.4*	*44.4*
Of which: issued by general government	-	-	*41.1*	*41.1*
Loans and advances other than loans on demand	9,887.6	N/A	174.8	N/A
Of which: mortgage loans	*9,574.1*	*N/A*	*56.7*	*N/A*
Other assets	703.9	N/A	14.3	N/A

Encumbered Assets / Collateral Received and associated liabilities (Template C)

	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
	£m	£m
Carrying amount of selected financial liabilities	8,479.9	12,180.1
Debt Securities issued	8,479.9	12,180.1
Of which: covered bonds issued	-	-
Of which: asset-backed securities issued	*8,479.9*	*12,180.1*
Other sources of encumbrance	2,135.3	-
Other	2,135.3	-
Total sources of encumbrance	10,615.2	12,180.1

No comparative figures have been presented for either of the tables above as the data was not required to be compiled for regulatory purposes at 30 September 2014.

These asset encumbrance disclosures are prepared on a regulatory basis and as such will differ to the asset encumbrance disclosures presented in the Group Accounts, due to scope and definition differences.

7 COUNTERPARTY CREDIT RISK

The Group's Treasury Policy statements include policies covering liquidity risk, interest risk and foreign exchange risk and counterparty risk, which are used to manage the credit risk that arises from exposures to treasury counterparties. The Counterparty Policy limits the Group's exposure to individual counterparties and compliance with the policy is reviewed monthly by ALCO.

Derivative financial assets

In order to control credit risk relating to counterparties to the Group's derivative financial instruments and cash deposits, ALCO determines which counterparties the Group will deal with, establishes limits for each counterparty and monitors compliance with those limits. Such counterparties are typically highly rated banks and, for all cash deposits and derivative positions held within the Group's securitisation structures, must comply with criteria set out in the financing arrangements, which are monitored externally. Where a derivative counterparty fails to meet the required criteria they are obliged under the terms of the instruments to set aside a cash collateral deposit. This is the only credit mitigation technique used by the Group. The amounts of these cash collateral deposits, which do not form part of the Group's cash position, are shown below.

The Group's exposure to credit risk in respect of the counterparties to its derivative financial assets, analysed by their long term credit rating as determined by Fitch is set out below.

	Carrying value		Exposure value	
	2015	2014	**2015**	2014
	£m	£m	**£m**	£m
Carrying value of derivative financial assets				
Counterparties rated				
AA-	**91.9**	193.5	**18.4**	38.7
A+	**6.2**	4.2	**3.1**	2.1
A	**515.1**	496.2	**257.6**	248.1
BBB+	**46.9**	-	**23.5**	-
Gross exposure	**660.1**	693.9	**302.5**	288.9
Collateral amounts posted	**(753.5)**	(87.3)	**(753.5)**	(87.3)
Net exposure	**(93.4)**	606.6	**(451.0)**	201.6

The values shown above are calculated as the fair value of the assets at the balance sheet date in accordance with the provisions of IFRS 13 – 'Fair Value Measurement'.

Cash collateral deposits placed by derivative counterparties are held with UK banks or other entities which satisfy a minimum rating of at least F1 and a long term default rating of A by Fitch, and similar ratings by other agencies.

None of the financial instruments to which the Group is a party have conditions requiring it to post collateral.

Short term investments

The Group's short term investments are held within the Bank and form part of the liquidity buffer it is required to hold by the PRA. These investments may only be placed in treasury bills and gilts issued by the UK government, or such similar instruments as are permitted by the regulator, and as such the credit risk is judged to be minimal. These assets are shown in the accounts of the Group at their current market value at the balance sheet date.

Cash and cash equivalents

The Group's cash balances are held in sterling at the Bank of England and highly rated banks in current accounts and as short fixed term deposits and money market placements. The Group has a large exposures policy to mitigate any concentration risk in respect of its cash deposits. Credit risk on these balances and the interest accrued thereon is considered to be minimal.

8 INTEREST RATE RISK

The Group is exposed to interest rate risk, the risk that margins will be adversely affected by movements in market interest rates, through its lending, deposit taking and borrowing activities.

As identified in section 3 of this disclosure document, this is the risk of loss of income from movements in interest rates. Such losses can occur because of the differing characteristics of the various elements within the balance sheet and mismatches between balances with the same characteristics on opposite sides of the balance sheet.

It has been established in the ICAAP that the interest rate risks to which the Group is most exposed if mitigating action is not taken, are re-pricing and basis risk.

These risks arise where balance sheet components are subject to different market forces. This includes exposures where interest is linked to different reference rates, the impact of fixed rate assets and liabilities and the effect of different classes of assets and liabilities re-pricing at different times.

The Group manages this position outside Paragon Bank by maintaining floating rate liabilities and matching these with floating rate assets, by hedging fixed rate assets and liabilities using interest rate swap or cap agreements and by maintaining a proportion of fixed rate liabilities.

Separately, within Paragon Bank, where there are fixed and floating rate loan assets, together with fixed and floating rate savings deposit liabilities mismatches are managed using interest rate swap agreements to ensure any exposure remains appropriate to the Banks's risk appetite.

The Group's ALCO monitors the interest rate risk exposure on the Group's loan assets and asset backed loan notes and ensures compliance with the requirements of the trustees in respect of the Group's securitisations and the terms of other borrowings. Paragon Bank has its own ALCO which focuses on the risks within the Bank, including the retail deposit position, although the Group's committee maintains oversight.

The rates of interest payable on the loan facilities and on asset backed loan notes issued in the securitisation process are reset either quarterly or monthly on the basis of LIBOR. Where asset backed loan notes are issued in foreign currencies, cross-currency basis swaps are put in place converting the reference interest rate to a sterling LIBOR basis.

The Group's retail deposits either bear variable interest rates or are fixed rate liabilities which are hedged in accordance with the Group's risk management strategy. The interest rates paid on the Group's variable rate deposits are determined by reference to, inter alia, returns achievable in the Group's lending markets and the rates being charged on similar products in the market.

The Group's loan assets predominantly bear LIBOR linked interest rates or are hedged fixed rate assets. The interest rates charged on the Group's variable rate loan assets are determined by reference to, inter alia, the Group's funding costs and the rates being charged on similar products in the market.

Generally these factors ensure the matching of changes in interest rates on the Group's loan assets and borrowings and any exposure arising on the interest rate resets is relatively short term. Forward rate agreements may be used to hedge against any perceived risk of temporary increases in LIBOR rates at month ends.

The Group has performed stress testing in order to assess whether a Pillar 2a add-on is required for interest rate risk and capital has been provided in accordance with the results.

Interest rate sensitivity

The sensitivity of the Groups assets and liabilities to a 1% increase in the UK interest rates is illustrated below, based on the balance sheet values at 30 September 2015 and 30 September 2014.

It should be noted that such a change in rates might have other impacts on the Group's performance and that the extent to which increases in rates can be passed on to certain customers may be limited by commercial and regulatory factors.

	2015	2014
	£m	£m
Variable rate mortgage loans	**78.3**	81.3
Variable rate consumer loans	**5.6**	6.3
Portfolio hedging on fixed rate loans	**12.9**	4.7
Interest bearing cash balances	**6.4**	7.8
Sterling equivalent principal of FRN and warehouse borrowings	**(90.5)**	(88.3)
Variable rate retail deposits	**(2.0)**	(0.2)
Portfolio hedging on fixed rate retail deposits	**(1.2)**	(0.2)
Total interest rate sensitivity	**9.4**	11.3

9 SECURITISATION

One of the Group's principal sources of funding is asset securitisation. The largest part of this funding relates to securitisations issued under the 'Paragon Mortgages' programme but other issues have been made from time to time to support other parts of the business.

The strategy underlying the Group's securitisation activities is to gain access to attractive funding rates for its lending activities and to mitigate liquidity risk by match funding the underlying loan assets. The structures are not intended to achieve significant transfer of credit risk away from the Group. The risk relating to the underlying assets therefore remains with the Group and is included in the credit risk analyses in this document.

A more detailed description of the Group's securitisation activities and how they affect the Group's risk profile and contribute to its risk management objectives is given in note 7 to the Group Accounts for the year ended 30 September 2015.

There are no specific capital requirements for the Group's securitisation vehicle companies. Further information on the Group's securitisations, on a transaction by transaction basis is provided in note 49 to the Group Accounts and detailed information on each of the Group's public securitisation transactions is published in the Bond Investor section of the Group's corporate website at www.paragon-group.co.uk.

The Group has no exposures to purchased securitisation positions.

10 COUNTRY-BY-COUNTRY REPORTING

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 came into effect on 1 January 2014 and place certain reporting obligations on financial institutions that are within the scope of CRD IV.

The objective of the country-by-country reporting requirements is to provide increased transparency regarding the source of the Financial Institution's income and the locations of its operations.

The Paragon Group of Companies PLC is a UK registered entity. Details of its principal subsidiaries are given in note 64 to the Group Accounts and the activities of the Group are described in section A2.1 of the Group Accounts.

The activities of the Group, described as required by the Regulations for the year ended 30 September 2015 were:

	United Kingdom £m
Year ended 30 September 2015	
Total operating income	**211.5**
Profit before tax	**134.7**
Tax on profit	**27.1**
Public subsidies received	**-**
Average number of full time equivalent employees	**935**
Year ended 30 September 2014	
Total operating income	197.9
Profit before tax	122.2
Tax on profit	25.6
Public subsidies received	-
Average number of full time equivalent employees	924

11 REMUNERATION POLICIES AND PRACTICES

Paragon Bank is required to prepare Remuneration Code Pillar III disclosures in addition to these regulatory capital disclosures. These disclosures are the subject of a separate, stand-alone document and are published on the Paragon Bank website, www.paragonbank.co.uk, on an annual basis.

Information on the remuneration of the directors of the Group is contained in the Directors' Remuneration Report presented as section B5 of the Group Accounts.

12 GLOSSARY

ABS	Asset Backed Securities
ALCO	Asset and Liability Committee
Bank	Paragon Bank PLC
BCBS	Basel Committee on Banking Supervision
BIA	Basic Indicator Approach
CCB	Countercyclical Capital Buffer
CCoB	Capital Conservation Buffer
CET1	Common Equity Tier 1
CML	Council of Mortgage Lenders
Code	UK Corporate Governance Code
Company	The Paragon Group of Companies PLC
COREP	Common Reporting Standards
CPB	Capital Planning Buffer
CRD	Capital Requirement Directive
CRR	Capital Requirements Regulation
EBA	European Banking Authority
ERC	Estimated Remaining Collections
ESOP	Employee Share Ownership Plan
EU	European Union
FCA	Financial Conduct Authority
FINREP	Financial Reporting Standards
FLA	Finance and Leasing Association
FPC	Financial Policy Committee
FRC	Financial Reporting Council
FRN	Floating Rate Note
Group	The Paragon Group of Companies PLC and all its subsidiary entities
Group Accounts	Annual Report and Accounts of The Paragon Group of Companies PLC for the year ended 30 September 2015
IAS	International Accounting Standard
ICAAP	Internal Capital Adequacy Assessment Process
ICG	Individual Capital Guidance
IFRS	International Financial Reporting Standard(s)
ILAA	Internal Liquidity Adequacy Assessment
LIBOR	London Interbank Offered Rate
LTV	Loan to value
MCR	Minimum Capital Requirement
Plan	The defined benefit pension plan operated by the Group.
PRA	Prudential Regulation Authority
RWA	Risk Weighted Assets
SA	Standardised Approach
SPV	Special Purpose Vehicle
SRB	Systemic Risk Buffer
SREP	Supervisory Review and Evaluation Process
UK	United Kingdom

paragon

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GRP11947 (03/2016)