Paragon Bank PLC
Registered No: 05390593

Paragon Bank PLC

Annual Report & Accounts

For the year ended 30 September 2022

CAUTIONARY STATEMENT

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

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

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

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

STRATEGIC REPORT

BUSINESS MODEL

The Bank was one of the first UK banks to be authorised under the regulatory regime introduced in 2014. It is a subsidiary of Paragon Banking Group PLC ('PBG'), a listed FTSE-250 company. PBG is the parent company of a group specialising in consumer finance and SME lending (the 'Group') of which the Bank is a member. It operates on a centralised basis with the majority of its employees based in Solihull, West Midlands.

The Bank shares in the Group's purpose - to support the ambitions of the people and the businesses of the UK by delivering specialist financial services

The operating structure of the Group is such that the majority of its activities are undertaken through the Bank and its subsidiary entities. The Bank plays a key role in supporting the Group's diversified funding strategy through its retail deposit taking capabilities. Retail deposits are expected to represent the majority of Group and Bank funding going forward, augmented by tactical securitisation and other wholesale issuances.

PROFITABILITY OF THE BUSINESS

The profitability of the business in the long term builds on:

- vigilance in the underwriting process to mitigate losses, leaning on the Group's long history of strong credit performance
- appropriate pricing of new advances or purchased loans, with a disciplined approach to the relationship between growth, risk and returns
- careful management of loan accounts to increase retention and reduce levels of delinquency, which utilises the operating model employed by the Group over many years
- arranging appropriate funding sources to sustain the business, where retail deposits form the core of the funding programme supported by wholesale issuance
- maintaining control of operating costs and ensuring the efficient use of resources

GENERATION OF ASSETS

The Bank generates assets for its balance sheet through a combination of direct and intermediary distribution. No branch network exists, but direct sales are delivered through a series of local sales teams servicing specialist markets. It offers loans in a variety of niche and specialist fields in the consumer and SME finance markets including:

- Buy-to-let and specialist residential mortgages
- Structured lending
- Second charge mortgage loans
- Motor finance

The Bank also generates income through its asset finance subsidiaries which provide SME customers with leasing products and related services and its development finance subsidiary which funds the activities of smaller property developers.

STRATEGIC REPORT (Continued)

LENDING

New business advances in the year, together with the year end loan balances are summarised below:

	Advances in the year		Net loan balances at the year end	
	2022	2021	2022	2021
	£m	£m	£m	£m
Mortgages	1,900.9	1,620.2	8,884.1	7,773.4
Commercial Lending	226.1	124.2	439.5	347.1
	2,127.0	1,744.4	9,323.6	8,120.5

The Bank's total loan book increased by 14.8% in the year following a 39.2% increase in the preceding year. The Bank continued to pursue its strategy of focussed growth as its markets continued to recover from the impacts of the Covid pandemic. Total advances increased 21.9% year-on-year, although the pattern varied across the Group's specialist markets, as a result of the differing impacts of the complex movements in the UK economic situation as it developed through the year.

MORTGAGES

The Bank offers buy-to-let first charge and owner-occupied mortgages on residential property in the UK. In all its offerings, it targets niche markets where its focus on detailed case-by-case underwriting and its robust and informed approach to property risk differentiate it from mass market and other specialist lenders.

New lending in this sector during the year is set out below.

	2022	2021
	£m	£m
First charge buy-to-let	1,899.9	1,604.6
First charge owner-occupied	1.0	1.5
Second charge	-	14.1
	1,900.9	1,620.2

Total mortgage originations in the Bank increased by 17.3%, as the housing market continued to recover from the Covid pandemic. The Bank's focus within the mortgage sector remained tightly on the specialist buy-to-let product, lending to larger landlords, those operating through corporate structures and those with complex properties, with other products ancillary to this activity.

The Bank has continued its focus on specialist customers in the buy-to-let market (those operating through corporate structures and those with larger portfolios). These are the customers best suited to the Bank's operating model and this targeting, coupled with a disciplined approach to underwriting and valuation, enables margins and retention rates to be optimised while providing the customers with a high standard of support for their business needs.

The Bank's first charge mortgage lending has been carefully managed to ensure that only lending with appropriate risks and returns is undertaken.

STRATEGIC REPORT (Continued)

Lending in the Bank's second charge mortgage operation was scaled back in summer 2020 in response to Covid, with people transferred to provide support to other business areas, and lending remaining low in the first half of that year. The Group took this opportunity to review the long-term strategic potential of second charge lending in light of its capital requirements and the Group's overall risk appetite and announced its withdrawal from this market in May 2021. Therefore, there were no completions in the year (2021: £14.1 million).

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

The Bank's outstanding first and second mortgage loan balances are set out below, analysed by business line.

	30 September 2022 £m	30 September 2021 £m
Originated assets		
First charge buy-to-let	8,697.8	7,517.6
First charge owner-occupied	28.0	35.6
Second charge	104.4	148.1
	8,830.2	7,701.3
Acquired assets		
Second charge	53.9	72.1
	8,884.1	7,773.4

At 30 September 2022 the balance on the Bank's mortgage portfolio was 14.8% higher than a year earlier, with the buy-to-let book having grown by 15.7%.

The annualised redemption rate on all mortgage assets is at 8.4% (2021: 6.6%), has continued at a relatively low level, with the increase representing a reversion closer to pre Covid levels. This is despite increasing numbers of 5 year fixed rate loans reaching end of their fixed rate period.

Arrears on the buy-to-let book remained consistent at 0.09% (2021: 0.09%), with the payment performance of the Bank's customers remaining strong, despite the growing economic pressures in the UK. Arrears on post-2010 lending were at 0.09% (2021: 0.09%). These arrears remain very low compared to the national buy-to-let market, with UKF reporting arrears of 0.41% across the buy-to-let sector at 30 September 2022 (2021: 0.45%). However landlord's expectations for their businesses appear more pessimistic than this performance data would suggest.

Arrears on originated second charge mortgages increased to 1.88% from 1.18% in the year, as the book continued to season, with performance remaining strong, while the new residential lending has yet to see any arrears, although the loans are still comparatively unseasoned.

Arrears on the acquired secured lending business have stayed consistent at 10.7% (2021: 10.7%), there were no purchases in the year and redemption of up to date accounts will naturally tend to increase the arrears percentage.

STRATEGIC REPORT (Continued)

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

COMMERCIAL LENDING

The Banks's focus within commercial lending is on lending to SME and mid-sized corporate customers. Its loan assets include motor finance and structured lending balances, while asset finance and development finance lending is conducted through subsidiary entities, funded by the Bank.

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

The Bank's focus across all its Commercial Lending business lines in the year has been on growing the scope of its operations to address a wider range of funding propositions for SME customers, while enhancing service, maintaining credit discipline and improving yields.

The Bank's new commercial lending activity in the segment during the year is set out below.

	2022 £m	2021 £m
Motor finance	166.2	100.2
Structured lending	59.9	24.0
	226.1	124.2

The impact of this new business has been to increase the Bank's overall Commercial Lending exposure by 50.3% in the year to £178.7million (2021 : £118.9million).

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

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

Lending in the year grew 65.8% to £166.2 million (2021: £100.2 million), although the business was significantly affected by the Covid pandemic in the first part of the 2021 financial year and the current year's business represents a return to a more normal level.

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

STRATEGIC REPORT (Continued)

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

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

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

The Bank's outstanding commercial loan balances are set out below, analysed by business line.

	30 September 2022 £m	**30 September 2021 £m**
Motor finance	260.8	224.9
Development finance	-	3.3
Structured lending	178.7	118.9
	439.5	347.1

Margins on commercial lending have remained strong. Arrears on the commercial lending business remain low with arrears in the motor finance business at 1.58% (2021: 2.30%).

The Bank made no development finance advances in the period, operating this business through a subsidiary entity. Its directly owned development finance book therefore continued to run off in the year. At 30 September 2022 the Bank had no development finance loans.

GROUP ENTITIES

During the period the amounts loaned to other Group entities increased to £1,610.9 million (2021: £1,394.0 million). The increase principally resulted from the Bank's funding of the underlying subsidiaries to continue enhancing further lending within the Group's commercial lending activity.

FUNDING

The Bank is funded primarily through retail savings deposits accepted from the general public. It is regulated and authorised by the Prudential Regulation Authority ('PRA') and regulated by the Financial Conduct Authority ('FCA'). Other sources of funding include central bank facilities provided by the Bank of England and group funding.

STRATEGIC REPORT (Continued)

The Bank's funding at 30 September 2022 and 30 September 2021 is summarised as follows:

	2022 £m	2021 £m
Retail deposit balances	10,669.2	9,300.4
Central bank facilities	2,750.0	2,819.0
Total on balance sheet funding	13,419.2	12,119.4
Off balance sheet central bank facilities	-	-
	13,419.2	12,119.4

RETAIL FUNDING

The Bank's retail deposit balance grew by 14.7% in the year to £10,669.2 million (2021: £9,300.4 million), exceeding £10 billion for the first time. The Bank considers the retail deposit market to be a reliable, scalable and cost-effective source of funding, which has remained fully functional throughout stresses including the Covid crisis. The Bank's offering has been centred on sterling household deposits, although it began to access the SME sterling deposit market in the year.

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

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

Savings accounts at the year end are analysed below.

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

STRATEGIC REPORT (Continued)

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

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

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

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

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

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

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

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

CENTRAL BANK FACILITIES

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

STRATEGIC REPORT (Continued)

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

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

The Bank expects to continue to make use of these central bank facilities going forward, in accordance with the objectives of the schemes. Where using them is appropriate and cost-effective, mortgage loans pre-positioned with the Bank of England are available to act as collateral for future drawings, if and when required. This provides access to potential liquidity or funding at 30 September 2022 of up to £1,776.0 million (2021: £1,424.2 million).

GROUP FACILITIES

The Bank is also funded by its parent entity, using equity and various forms of debt, including £150.0m Tier 2 Bond issuance which ensures that the capital structure of the Bank is similar to that of the Group as a whole, rather than consisting entirely of equity. Indebtedness to Group entities decreased in the year from £453.8 million at 30 September 2021 to £356.0 million at 30 September 2022.

DIVIDENDS AND DISTRIBUTIONS

During the year the Bank paid an interim dividend of £150.3 million (2021: £94.8 million). With a growing balance sheet and with a view to future growth opportunities the Bank has proposed a final dividend in respect of its earnings for the year to 2022 of £139.8 million (2021: nil).

REGULATORY CAPITAL

The Bank is subject to supervision by the PRA. As part of this supervision, the regulator will issue a Total Capital Requirement ('TCR') setting an amount of regulatory capital, defined under the international Basel III rules, currently implemented through the EU Capital Requirements Regulation and Directive regime ('CRD IV'), which was transposed to the PRA Rulebook as part of the Brexit arrangements. For the Bank, these amounts are calculated by reference to the entity together with certain subsidiaries (together the 'Bank's regulatory group').

The TCR includes elements determined based on the Bank's total risk exposure together with fixed elements, and is held in order to safeguard depositors in the event of severe losses being incurred by the Bank.

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

STRATEGIC REPORT (Continued)

The PRA requires firms to disclose capital measures both on the regulatory basis and as if these reliefs had not been given, referred to as the 'fully loaded' basis. The Bank's principal capital measures, Core Equity Tier 1 ('CET1') and Total Regulatory Capital ('TRC') for the Bank's regulatory group are set out below on both bases.

		2022 £m	2021 £m
CET1 capital	Basic	1,086.3	1,068.8
	Fully loaded	1,060.9	1,039.6
TRC	Basic	1,236.3	1,218.8
	Fully loaded	1,210.9	1,189.1

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

The increase in capital over the year is a result of the positive trading performance, which outweighed the impact of dividend payments. The capital positions set out above include gains made on fair value accounting, which will reverse over time. The increase in TCR on both the regulatory and fully loaded bases shown above has arisen principally as a result of balance sheet growth in the year.

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

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

The capital ratios for the Bank's regulatory group are set out below.

		2022	2021
CET1 ratio	Basic	14.5%	15.8%
	Fully loaded	14.2%	15.4%
TCR	Basic	16.5%	18.0%
	Fully loaded	16.2%	17.6%
UK leverage ratio	Basic	7.1%	7.6%
	Fully loaded	6.9%	7.4%

All of the Bank's capital ratios remain strong in the period despite the level of dividends paid. This reflects the trading profits, including those relating to fair values. As the IFRS 9 reliefs are phased out the fully loaded and regulatory bases will automatically converge.

STRATEGIC REPORT (Continued)

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

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

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

LIQUIDITY

The Bank’s operational capital and funding requirements are also influenced by the need to retain sufficient liquidity in the business to meet its cash requirements in the short and long term, as well as to provide a buffer under stress. There is also a regulatory requirement to hold liquidity. The Board regularly reviews liquidity risk appetite and closely monitors a number of key internal and external measures. The most significant of these, which are calculated for the Bank’s regulatory group on a basis which is standardised across the banking industry are the Liquidity Coverage Ratio (‘LCR’) and Net Stable Funding Ratio (‘NSFR’).

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

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

STRATEGIC REPORT (Continued)

FINANCIAL REVIEW

The Bank receives interest income from the assets on its own balance sheet but, also receives significant levels of dividends and other returns from its operating subsidiaries, reflected as other operating income in its income statement. Operating profits before tax for the Bank increased to £480.2 million in 2022 (2021: £182.5 million).

	£m	£m
Interest receivable	368.0	288.4
Interest payable and similar charges	(147.0)	(145.8)
Net interest income	221.0	142.6
Other operating income	174.4	95.5
Total operating income	395.4	238.1
Operating expenses	(99.8)	(81.5)
Provisions for losses	(6.6)	10.9
	289.0	167.5
Fair value net gain	191.2	15.0
Operating profit being profit on ordinary activities before taxation	480.2	182.5
Tax charge on profit on ordinary activities	(85.8)	(38.8)
Profit on ordinary activities after taxation	394.4	143.7

The Bank's total operating income in the year increased by 66.1% to £395.4 million (2021: 238.1 million).

Net interest income increased by 55.0% to £221.0 million from the £142.6 million recorded in the year ended 30 September 2021. The increase principally reflects growth in the size of the loan book, which rose by 14.8% to £9,323.6 million over the year (2021: £8,120.5 million) and from an improvement in net interest margin ('NIM'). During the year ended 30 September 2021 the Bank purchased loans from other Group companies spread across the twelve months, as a consequence interest received during 2021 was increased month on month as loans were purchased.

Other operating income in 2022 included £156.0 million of dividends from subsidiary companies (2021: £31.5 million) and £14.9 million of deferred sale consideration (2021: £60.3 million). Aside from this, fee income decreased slightly to £3.5 million (2021: £3.7 million).

Operating expenses increased to £99.8 million from £81.5 million reported in the previous year. The increase arises from the general increase in the cost base of the Group and the Bank being required to bear a larger proportion of these costs because of the increased proportion of the Group's business undertaken through it. The Board remains focussed on controlling operating costs through the application of rigorous budgeting and monitoring.

STRATEGIC REPORT (Continued)

The Bank's Expected Credit Loss ('ECL') evaluation at the year end has resulted in a net charge for impairment of £6.6 million (2021: release of £10.9 million). This mostly results from a balancing of the reduced likelihood of Covid impacts on the Group's portfolios against emerging economic and political issues such as the cost of living and doing business in the UK, the potential impacts on the global economy of the conflict in Ukraine and uncertainties over the future direction of UK Government policy, both generally and on issues which may affect the Bank and its customers directly. None of these issues have direct precedents and therefore a significant exercise of judgment is required to evaluate how these should be reflected in ECL.

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

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

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

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

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

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

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

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

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

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

STRATEGIC REPORT (Continued)

The forecast economic assumptions within each scenario, and the weightings applied, are set out in more detail in note 17.

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

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

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

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

The particularly high levels of these movements in the 2022 financial year, where a gain of £191.2 million was recorded (2021: £15.0 million), result primarily from the levels of volatility in UK benchmark interest rate expectations in the year, the Bank's approach to pipeline hedging and the retention strategy applying to maturing five-year fixed loans, which meant that the pipeline was larger and of longer duration (and hence more exposed to movements in rates) them in earlier periods.

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

Corporation tax has been charged at the rate of 17.9%, decreasing from 21.3% for the previous year. This is a result of the inclusion of dividend income in the Bank's profit, which does not fall to be taxed in the company. Excluding the dividends, the effective rate increases to 26.5% (2021: 25.7%).

Profit after taxation of £394.4 million (2021: £143.7 million) have been transferred to equity, which totalled £1,063.4 million at the year end (2021: £819.3 million).

PRINCIPAL RISKS AND UNCERTAINTIES

An analysis of the Bank's exposure to risk, including financial risk, and the steps taken to mitigate these risks are set out on pages 103 to 114 and in notes 38 to 42. A discussion of critical accounting estimates is set out in note 46.

After considering the above, the Bank's liquidity and its access to funding facilities, the directors have a reasonable expectation that the Bank will have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the Financial Statements.

OPERATIONS

ENVIRONMENT

The Group recognises the importance of its environmental responsibilities, monitors its impact on the environment, and designs and implements policies to reduce any damage that might be caused by the Bank's activities. The Bank operates in accordance with group environment policies, which are described in the PBG's Annual Report, which does not form part of this Report.

EMPLOYEES

The Bank has no employees of its own, instead being operated by employees of other group companies. The Group operates group-wide employment policies, which address diversity, employee involvement and employment of disabled persons, and these are discussed in the Annual Report of PBG.

Approved by the Board of Directors

and signed on behalf of the Board

RICHARD WOODMAN

Director

15 December 2022

PRINCIPAL RISKS AND MITIGATIONS

The Bank's system of risk management and governance is integrated with that of the wider Group. It is supervised by the Bank's Board of Directors, supported by its Audit Committee, Remuneration Committee and Risk and Compliance Committee. The work of the Risk and Compliance Committee is supported by an executive risk management structure, reporting to the Chief Executive officer and headed by an Executive Risk Committee ('ERC'). Executive committees covering specific aspects of the Bank's risk management, including the Asset and Liability Committee ('ALCO'), Credit Committee, Customer and Conduct Committee ('CCC') and Operational Risk Committee ('ORC') report to the ERC. Additionally the Risk and Compliance Committee is supported by a Model Risk Committee ('MRC') with non-executive director representation. For each of these bodies. For each of these bodies, the membership is the same as for the equivalent bodies in PBG.

Further information on the risk framework of the Group is set out in the Annual Report and Accounts of PBG and its Pillar 3 report, which are available on its website at www.paragonbankinggroup.co.uk

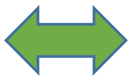
Principal risks

The Bank is exposed to a number of principal risks and uncertainties that arise from the operation of its business model and strategy. A summary of those risks and uncertainties which could prevent the achievement of the Bank's strategic objectives, how the Bank seeks to mitigate those risks and the change in the perceived level of each risk in the last financial year are described below.

This analysis represents the Bank's gross risk position as presented to, and discussed by, the Risk and Compliance Committee as part of its ongoing monitoring of the Bank's risk profile.

The risks are set out in accordance with the Bank's classification of its principal risks, approved by the Board in the year. The principal risks remain consistent from the previous financial year.

The changes in the perceived level of each risk during the last financial year are indicated using the symbols shown below:

	Risk increasing		Risk decreasing		Risk stable

PRINCIPAL RISKS AND MITIGATIONS

<table>
<tr><th colspan="3">Capital Risk</th></tr>
<tr><th colspan="2">Description</th><th>Mitigation</th></tr>
<tr><td colspan="2">The Bank faces the risk of insufficient capital to operate effectively including meeting minimum regulatory requirements, operating within Board approved risk appetite and supporting it's strategic goals.

Following the year end the Bank of England published their Consultation Paper regarding the process for the implementation of the Basel 3.1 standards in the UK, which will be effective from on 1 January 2025.</td><td>A robust process exists over Pillar 1 capital reporting, both internally and to the PRA, with a comprehensive annual Internal Capital Adequacy Assessment Process ('ICAAP') assessment including all material capital risks.

An internal capital buffer is maintained in excess of minimum regulatory requirements to protect against unexpected losses or risk-weighted asset growth.

The Bank submitted the second stage of its application for the accreditation of its IRB approach to buy-to-let credit risk for capital adequacy purposes to the PRA in March 2021. The project continues to progress to plan, and work will continue through the next financial year.

The Bank of England Basel 3.1 proposals largely follow the core Basel proposals and, as such, are materially in line with expectations. The Consultation Paper also highlighted enhancements to the IRB accreditation process and an increase in the Bank's threshold for Strong and Simple treatment to £20 billion of assets, each of which would have a favourable impact on the Group if retained in the ultimate rules.</td></tr>
<tr><td>Year on year change</td><td colspan="2">While there has been little impact on the overall capital risk framework in the financial year the global and UK economic outlook has deteriorated significantly since Russia's intervention in Ukraine, with global inflationary pressures intensifying sharply.

Although downside risks will present headwinds, the Group's strengthening profitability and the progress made in balance sheet management mean that capital ratios remain strong with considerable headroom over requirements. This, in turn, provides significant capacity to support lending to households and businesses.</td></tr>
</table>

PRINCIPAL RISKS AND MITIGATIONS

Liquidity and Funding Risk

Description	Mitigation
The Bank is exposed to the risk that it has insufficient funds to meet its obligations as they fall due. Retail deposit taking is central to the Bank's funding plans and therefore changes in market conditions could impact the ability of the business to maintain the level of funding required to sustain normal business activity.	The Bank maintains a diversified range of retail medium and long-term funding sources to cover future business requirements and liquidity to cover shorter term funding needs. Internally, comprehensive treasury policies are in place to ensure sufficient liquid assets are maintained and that all financial obligations can be met as they fall due, even under stressed conditions. The Bank utilises the Group's dedicated Treasury function which is responsible for the day-to-day management of its overall liquidity and wholesale funding arrangements. The Board, through the delegated authority provided to the ALCO, sets limits as to the level, composition and maturity of liquidity resources.
Year on year change	The Bank remains well placed to access funding from a wide range of sources to meet its future funding requirements. Access to the retail savings market has been effective during the year through both direct and intermediated deposit platform distribution channels.

Market Risk

Description	Mitigation
The Bank is exposed to the risk that changes in interest rates at which it lends and those at which it borrows may adversely affect its net interest income and profitability. In addition, its financial performance may be affected by fluctuations in the exchange rates between currencies.	This risk is managed within Board approved risk appetite limits with comprehensive treasury polices in place to ensure that the risk posed by changes and mismatches in interest or exchange rates are effectively managed. Day-to-day management of interest rate risk within Board approved limits is the responsibility of Treasury with control and oversight provided by ALCO. The Bank seeks to match the maturity profile of assets and liabilities and uses financial instruments, such as interest rate swaps, to hedge the exposure arising from repricing gaps.
Year on year change	The Bank's overall market risk profile, relative to its balance sheet, has remained broadly similar and therefore associated risk levels remain generally stable compared to previous periods. However, the rise in the Bank of England base rate to its highest level in over a decade have increased volatility in pricing levels on both the asset and liability sides of the balance sheet, requiring particular focus on risk management in this area.

PRINCIPAL RISKS AND MITIGATIONS

<table>
<tr><th colspan="3">Credit Risk</th></tr>
<tr><th colspan="2">Description</th><th>Mitigation</th></tr>
<tr><td colspan="2">Credit risk elements which could expose the Bank to the risk of unexpected material losses include:
Customer risks through failure to screen potential borrowers, and manage repayments
Concentration risk in credit portfolios through an uneven distribution of exposures of borrowers, asset classes, sectors or geographies
Reduction in value of collateral owned by the Bank, or secured against debt owed to it
Wholesale counterparty risk
Outsourcer default risk</td><td>The Bank has a robust limit framework supported by comprehensive policies in place that set out detailed criteria which must be met before loans are approved. Exceptions to credit policies require approval by the Credit Risk function, operating under a mandate from the Credit Committee.

The Bank uses a range of sources to inform expectations of key external factors such as interest rate movements and house price inflation which are in turn used to guide policy and underwriting.

The Bank also continues to exploit opportunities to diversify the range of its activities and income streams, consistent with its strategic objective of operating as a prudent, risk focussed specialist lender.

The majority of the Bank's loans by value continue to be secured against residential property in England and Wales at conservative loan-to-value levels. The primary collateral therefore benefits from the features of UK property which forms part of a highly mature, liquid, sustainable market demonstrated over many decades of operation.

Exposure to wholesale counterparty credit risk is limited to counterparties that meet specific credit rating criteria per the Bank's comprehensive treasury policies. Exposure to approved counterparties is monitored daily by senior management within the Group's Treasury function with all exposure managed within ALCO approved limits.

Ongoing monitoring of the credit rating and financial performance of all outsourced relationships and critical suppliers is undertaken.</td></tr>
<tr><td>Year on year change
</td><td colspan="2">Prudent credit policies combined with the Bank's consistently high lending standards have ensured that customer loan repayments have been maintained in line with expectations, and arrears and losses remain at historically low levels. Tracking of customer risk profiles across lending areas show little indication of stress, and asset equity coverage continues to provide significant credit risk mitigation.

Whilst current loan performance remains exemplary, the Bank continues to monitor the potential future impact of the increasing interest rate environment and higher costs of living and has reviewed and adjusted credit policy and affordability models accordingly. As a result of these broader economic movements, in particular the rapid increase in marker interest rates, the credit risk profile has marginally increased compared to 30 September 2021.</td></tr>
</table>

PRINCIPAL RISKS AND MITIGATIONS

Model Risk

Description	Mitigation
Models are used across the Bank to inform financial decision making and hence it is imperative that the environment in which the models are designed, implemented and operate is subject to appropriate rigour.	As the use of internally developed models has increased across the Bank, a robust framework and governance has been developed to manage the associated risks. This includes the MRC which oversees the development, implementation and ongoing monitoring of models across the Bank and the wider group. The Model Governance Framework provides a structured and disciplined approach to the management of model risk. This includes clear development, implementation and ongoing oversight principles together with the requirements for independent validation based on model materiality criteria.

Year on year change	
	It is recognised that the increasing use of internally developed models will drive a commensurate risk to the Bank. However, given the strength of the framework and oversight processes, model risk remains within appetite and the outlook remains stable. The Group is reviewing the contents of the recent PRA Consultation paper (CP 6/22) on model risk management principles for banks to ensure it will be compliant with the proposed Supervisory Statement when published.

Reputational Risk

Description	Mitigation
Maintenance of a strong reputation across all lines of business and operational activities is core to the Group's philosophy. Detrimental reputational impacts may result from crystallisation of other principal risks, but also through failure to safeguard the integrity of the brand or failing to meet external expectations in conducting business practices.	The reputational impacts of any changes to strategy, pricing, processes are explicitly considered in the decision-making process and are reviewed by the Director of External Relations. The Group has an experienced External Relations function who manage all Group communications and ensure that the reputational profile of the Group remains protected at all times. All material risk events are reviewed for reputational impact and mitigating actions are initiated as appropriate.

Year on year change	
	The Group continues to manage its reputation effectively in all its dealings. Whilst it is mindful that threats to its reputation can emanate from many sources, the Group remains well-placed to respond quickly and efficiently to any potential reputational issue.

PRINCIPAL RISKS AND MITIGATIONS

<table>
<tr><th colspan="2">Strategic Risk</th></tr>
<tr><th>Description</th><th>Mitigation</th></tr>
<tr><td>The Bank's strategy as a specialist lender is key to its operating model and business planning. However, there is a risk that changes to the business model or macroeconomic, geopolitical, regulatory, competitive or other factors may impact delivery of strategic objectives.</td><td>The Bank closely monitors economic developments in the UK and overseas, with support from leading independent macro-economic and other advisors.

Stress testing is performed to assess its expected performance under a range of operating conditions. This provides the Board with an informed understanding and appreciation of the Bank's capacity to withstand shocks of varying severities.

The Bank continues to exploit opportunities to diversify the range of its activities and income streams, consistent with its strategic objective of operating as a prudent, risk focussed lender.</td></tr>
<tr><td>Year on year change</td><td>Prospects for the UK's economic performance remain uncertain. Short-term disruption from Covid has been replaced by a material increase in both the cost of living and input costs for businesses, putting pressure on household and corporate disposable income. Taken alongside a sharp reversal in monetary policy and political instability, the near-term economic outlook remains uncertain while the medium and longer-term impacts of Covid, together with the implications of the UK's new trading relationships post-Brexit, are still to be determined. Whilst the Bank has continued to remain resilient throughout the pandemic, and activity levels have been strong, the potential for future waves of the virus and associated lockdowns still present a risk.</td></tr>
</table>

<table>
<tr><th colspan="2">Climate Risk</th></tr>
<tr><th>Description</th><th>Mitigation</th></tr>
<tr><td>The Bank considers the impact of climate change either directly on the Bank or indirectly through its third-party relationships.

This includes the transitional risk to its strategy and profile through moving to a low carbon environment and any physical risks arising from changes to the natural environment that could impact the calculation and valuation of assets and liabilities.</td><td>The Bank proactively manages physical risk and has specific underwriting policies aimed at mitigation, for example, risks associated with flooding and coastal erosion and subsidence.

The potential for transition risk is monitored within the different business lines, with external events prompting consideration of amendments to credit policy and underwriting criteria.

Joining Bankers For Net Zero (B4NZ) and establishing targets for offsetting the Group's operational footprint emissions are key building blocks in embedding governance and oversight of the risks from climate change. Longer term strategic planning will be informed by ongoing and enhanced analysis, supported by scenario testing.

The Sustainability Committee provides comprehensive oversight of climate initiatives across each business line, whilst the Credit Committee monitors the performance of property collateral against EPC data.</td></tr>
<tr><td>Year on year change</td><td>The Group has continued to make progress on its climate change agenda, with activity focused on identifying implications across business lines and the signing up to B4NZ.

However, the levels of regulatory scrutiny and public interest in this area have continued to increase during the period and therefore the overall risk is considered to have increased over the year.</td></tr>
</table>

PRINCIPAL RISKS AND MITIGATIONS

Conduct Risk	
Description	**Mitigation**
The commitment to delivering fair customer outcomes is at the heart of the Bank's and the Group's culture. Conduct risk arises where the culture and behaviours fail to promote the customer's best interests resulting in unfair outcomes for the customer.	The Bank is covered by the Group's formal Conduct Risk Management framework, which includes detailed policies addressing the fair treatment of customers. At the centre of these is the Conduct Risk Policy. This sets out the overarching approach to the management of conduct risk. The management of conduct risk within the Bank is tailored to the specific product and customer type concerned including dedicated quality and control teams which validate process adherence and the delivery of fair treatment for customers and appropriate management of vulnerable customers. All employees are required to undertake conduct risk related training. The Group's approach to employee remuneration means that very few employees are included in financial incentive schemes. The incentive scheme framework is reviewed by the CCC annually and individual schemes require approval from the Chief People Officer, CFO and Conduct and Compliance Director before implementation.
Year on year change 	Whilst the Bank is well-placed to provide appropriate support, the current economic environment and cost of living crisis is likely to put a strain on some of the Group's customers, potentially increasing vulnerabilities. In addition, the introduction of the FCA's Consumer Duty raises the expectations of firms to proactively seek to prevent causes of foreseeable harm.

PRINCIPAL RISKS AND MITIGATIONS

Operational Risk	
Description	**Mitigation**
Operational Risk arises across the Bank through the possible inadequacy or failure of internal processes, people and systems or from external events. Operational risk is inherently diverse in nature. All the Bank's activities create various forms of operational risk which need to be managed through a strong control and oversight structure. Exposure to operational risk is exacerbated through any periods of transformation and / or stress.	The Group has an established operational risk framework which enables timely and accurate analysis of operational risk exposures and drives accountability and remedial actions where issues are identified. Management of operational risk is enabled through a comprehensive framework of policies which are designed to ensure that all key operational risks are managed consistently across the business. This includes risk areas such as Change Management, Procurement, Data Protection, Financial Crime and People. The Bank is committed to ensuring it remains resilient, particularly in respect of IT capability. Significant investment has been undertaken to ensure it is well-protected in the face of the evolution of cyber threats particularly as the Bank increasingly moves to cloud-based infrastructure and looks to harness digital capability as part of its IT roadmap. Whilst the Bank continues to drive through strategic transformation across all its lending lines, there remains a continuing focus on ensuring that these changes do not compromise overall resilience. A well-embedded change framework ensures that changes are managed in a controlled way. The Bank relies on third party providers for a number of key services including in the provision of its savings offering and in respect of material IT services. The robust oversight of third parties is also seen as critical to overall resilience. Despite industry-wide challenges in recruiting and retaining skilled employees, continued investment in people has been undertaken to ensure that risk exposures are minimised. This includes management of key dependency risk through effective succession planning, recruitment, development and retention strategies.
Year on year change	Whilst the Bank continues to maintain a robust control environment and successfully navigated the operational challenges posed by Covid, the new post-pandemic challenges have further impacted the operating environment. The Bank has made progress on its strategic transformation programme during the year, and it is expected that this will benefit operational risk management in the longer term. However these types of programme have an inherent execution risk, which the Bank is managing carefully. Changing working patterns and economic uncertainty have influenced the recruitment market driving increased competition between firms to attract the strongest candidates. Impacts of the war in Ukraine and the wider cost of living challenges have further increased risk exposures across key operational risk categories such as cyber risk and financial crime. Against this background, regulatory compliance expectations continue to rise, and the Bank is committed to ensuring that it remains compliant in its operational activities. There is potential that as expectations increase gaps may be identified which will need addressing to reduce inherent operational risk exposures.

DIRECTORS' REPORT

The directors present their Annual Report prepared in accordance with Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and the audited Financial Statements of Paragon Bank PLC, a company registered in England and Wales with registration no: 05390593, for the year ended 30 September 2022.

DIRECTORS

The directors who served during the year:

Fiona J Clutterbuck (resigned 1 September 2022)

Nigel S Terrington

Richard J Woodman

Barbara A Ridpath

Hugo R Tudor

Graeme H Yorston

Alison C M Morris

Peter A Hill

Robert D East (appointed 1 September 2022)

Tanvi P Davda (appointed 1 September 2022)

The directors have no interests in the shares of the Bank. Their interest in the shares and securities of the parent company are set out in that company's accounts.

Directors' indemnity and insurance

Under Article 159 of the Articles, the Company has qualifying third party indemnity provisions for the benefit of its directors, for the purposes of section 234 of the Companies Act 2006, which were in place throughout the year, and which remain in force at the date of this report, in the form of directors' and officers' liability insurance. The directors' and officers' liability insurance covers all directors of the Company's subsidiary entities.

CORPORATE GOVERNANCE STATEMENT

As part of the wider Group, the Board is committed to the principles of corporate governance contained in the UK Corporate Governance Code issued by the Financial Reporting Council ('FRC') in July 2018 ('the Code') and which is publicly available at www.frc.org.uk. Throughout the year ended 30 September 2022, the Bank complied with the principles and provisions of the Code, so far as these can be applied to the Bank as a subsidiary entity.

Although the Listing Rules only apply to PBG, which means that only PBG is (strictly speaking) required to comply (or explain its non-compliance) with the Code, PBG promotes high standards of governance, and there is therefore a clear need to ensure that robust corporate governance practices are applied throughout the Group to meet these high standards. Additionally, as a significantly-sized company, the Bank is also required to apply and disclose against a corporate governance code in its own right. With this in mind, insofar as the Code and the corporate governance framework for the Group is capable of being applied to the Bank, the Board has decided that it should be so applied.

DIRECTORS' REPORT (Continued)

Certain of the Code's provisions are applied at PBG and Group level but cannot be applied at the level of the Bank. For example, Code provisions relating to workforce engagement are not applied by the Bank because the Bank does not have any direct employees. Wherever possible, however, the Bank applied the Code in the year ended 30 September 2022 just as the Code was applied at PBG in the same year. The Boards and Committees of PBG and the Bank have identical membership and sit jointly on most occasions. Meetings of each board are held concurrently, with separate meetings when appropriate to consider matters specific to either PBG or the Bank, as relevant. This aligned structure of the Boards and Committees of PBG and the Bank enables the concurrent application of the Code at parent and subsidiary level wherever possible, while also reducing complexity and unnecessary duplication of governance practices.

Detailed information regarding PBG's corporate governance arrangements and compliance with the Code is provided in PBG's Annual Report and Accounts for the year ended 30 September 2022. Given the application of similar corporate governance practices to PBG and the Bank, PBG's corporate governance statement as contained in its 2022 Annual Report and Accounts also describes corporate governance practices and Code compliance at the Bank.

The table below: (i) signposts relevant sections of PBG's Annual Report and Accounts for the year ended 30 September 2022 which describe in further detail how the Code's Principles have been applied throughout the Group and to the Bank; and (ii) explains at a high level how the Bank has aligned its practices with the principles of the Code.

Section 1: Board Leadership and Company Purpose	**Section(s)**
A: The Bank is led by an effective and entrepreneurial board, who promote the long-term sustainable success of the Bank, generating shareholder value and contributing to wider society.	B3
B: The Bank's purpose, values and strategy, which align with its culture, have been established and are promoted by the Board.	B1
C. The Board ensures that necessary resources are in place for the Bank to meet its objectives and measure performance and has established a framework of effective controls which enables risk to be assessed and managed.	B8
D. The Board ensures effective engagement with stakeholders and encourages their participation.	B4.3
E. The Board of PBG ensures that, at Group-level, workforce policies and practices are consistent with the Group's values and support its long-term sustainable success. The workforce can raise any matters of concern via established whistleblowing procedures.	B4.3
Section 2: Division of Responsibilities	
F. The Chair is objective and leads the Board effectively, facilitating constructive relations and effective contribution from non-executive directors.	B4.1
G. The Board includes an appropriate combination of executive and non-executive directors, with a clear division of responsibilities.	B4.1

DIRECTORS' REPORT (Continued)

H. Non-executive directors have sufficient time to meet their board responsibilities. They provide constructive challenge, strategic guidance, offer specialist advice and hold management to account.	B4.1
I. The Board, supported by the Bank's Company Secretary, has the policies, processes, information, time and resources required to function effectively and efficiently.	B4.1
Section 3: Composition, Succession and Evaluation	
J. Appointments to the Board are subject to a formal, rigorous and transparent procedure, and an effective succession plan is in place for Board and senior management. Appointments and succession plans are based on merit and objective criteria and promote diversity.	B5
K. There is an appropriate mix of skills, experience and knowledge. Tenure and membership of the Board and its committees are regularly reviewed.	B4.4
L. The annual board evaluation provides an opportunity for the directors to consider their collective and individual effectiveness and decide where there are areas for improvement.	B4.4
Section 4: Audit, Risk and Internal Control	
M. The policies and procedures, established by the Board, ensure the independence and effectiveness of internal and external audit functions. The Board has satisfied itself of the integrity of financial and narrative statements.	B6
N. The Board presents a fair, balanced and understandable assessment of the Bank's position and prospects.	B6
O. The Board has established procedures to manage risk, oversee the internal control framework, and determine the principal risks the Bank is willing to take in order to achieve its long-term strategic objectives.	B8
Section 5: Remuneration	
P. Remuneration policies and practices support strategy and promote long-term sustainable success. Executive remuneration is aligned to the Group's purpose, values and clearly linked to successful delivery of long-term strategy.	B7
Q. A formal and transparent procedure has been established to develop policy and determine Group director and senior management remuneration. No director is involved in deciding their own remuneration outcome.	B7
R. Directors exercise independent judgement and discretion when authorising remuneration outcomes, taking account of Group and individual performance, and wider circumstances	B7

DIRECTORS' REPORT (Continued)

BOARD AND STAKEHOLDERS

While good corporate governance is important to the Board, so is maintaining a reputation for high standards of business conduct in all of the Bank operations, and management of conduct risk is a key part of the risk management framework. PBG's 2022 Annual Report sets out information on corporate responsibility, including the Group's people policies and engagement with employees, involvement in industry initiatives, support for the community and environmental, social and conduct impacts. All of these Group policies and engagement initiatives apply to the Bank, as a member of the Group.

The Board, in its deliberations and decision-making processes, takes into account views of the Bank's stakeholders and, where applicable, considers the impact of those decisions on the communities and environment within which the Group operates. The Board is mindful of its duty to act in good faith and to promote the success of the Bank for the benefit of its shareholder and with regard to the interests of all of its stakeholders.

The Board is kept updated on all material issues affecting stakeholders by the executive directors and receives regular updates from ExCo members, other senior managers and external advisers. Members of the Board also engage directly with employees, shareholders of PBG (as the Bank's ultimate shareholders) and regulators, as further detailed below.

The Board confirms that, for the year ended 30 September 2022, it has acted to promote the success of the Bank for the benefit of its member and continues to have due regard to the following matters laid out in section 172 (1) of the Companies Act 2006:

a. The likely consequences of any decision in the long-term
b. The interests of the Group's employees
c. The need to foster the Bank's business relationships with suppliers, customers and others
d. The impact of the Bank's operations on the community and the environment
e. The desirability of the Bank maintaining a reputation for high standards of business conduct
f. The need to act fairly as between members of the Bank

Companies are required to describe in the Annual Report how the directors have had regard to the matters set out above when performing their duties.

As part of the Group, the Bank's stakeholder engagement takes place at the Group level and the Bank looks to Group initiatives for guidance and takes this Group stakeholder engagement and these Group initiatives into account in the Bank's decision making as there is substantial common identity between the non-shareholder stakeholders of the Bank and those of the Group. The Bank follows Group policies and procedures as mentioned above, including those relating to standards of business conduct, employees, the environment, the community and other stakeholders. More detail may be found in the PBG 2022 Annual Report and Accounts.

The PBG and the Bank's boards have identical membership and sit jointly on most occasions. Meetings of each board are held concurrently, with separate meetings when appropriate to consider matters specific to either PBG or the Bank, as relevant. In considering items of business, the Bank makes autonomous decisions on each item's own merits after due consideration of: the long-term success of the Bank; those factors set out in section 172 of the Companies Act 2006, where relevant; and the stakeholders impacted.

DIRECTORS' REPORT (Continued)

The Bank has no employees of its own, using staff employed by other Group entities (s172 (1)(b)). It has a single shareholder, PBG (s172 (1)(f)).

The table below sets out: how the Board and Senior Management take the above factors into account when engaging with the Bank's key stakeholders; why the stakeholders listed are significant for the Bank; how stakeholder engagement and regard for the factors set out in section 172 (1) of the Companies Act 2006 have affected the Board's decision-making; and how decision-making and stakeholder engagement at the Bank align to the Bank's and the Group's strategic priorities and culture. Reference is made to Group-level stakeholder engagement where appropriate.

Shareholders

Creating long-term shareholder value through growing profits and dividends (s172 (1)(a))

Although the Bank has no external shareholders, as a direct subsidiary of PBG the Board actively considers the Group's shareholders' interests and views (s172 (1)(f)). Our strategy is to build a specialist bank for our customers, which delivers sustainable growth and shareholder returns through a low risk and robust model.

How we engage and / or monitor

- The Group has an Investor Relations Programme, where nearly fifty meetings were held with PBG's shareholders (being the shareholders of the Bank's ultimate holding company). In addition, our Chief Executive Officer ('CEO') and CFO held numerous meetings with analysts to discuss and understand shareholder feedback
- A comprehensive update on Investor Relations is included in the CEO's report to each Board meeting
- The Chair and SID / Chair of the Remuneration Committee held several meetings with shareholder advisory groups
- The Board receives an in-depth update on Investor Relations, which includes investor feedback, following the publication of PBG's financial results

Outcome

- The data on PBG's shareholder feedback provided helps the Board to understand the interests of the Group's shareholders and align the Group's strategy with these interests

Further information on the Group's investor relations activities is given in section B4.3 of PBG's 2022 Annual Report and Accounts. Discussions with investors on remuneration matters are discussed in the Remuneration Report (Section B7) of PBG's 2022 Annual Report and Accounts.

DIRECTORS' REPORT (Continued)

Customers

Supporting the ambitions of the people and businesses of the UK by delivering specialist financial services (s172 (1)(c))

Our customers are at the heart of our business and its long-term success and our eight core values (as set out in section A2 of PBG's 2022 Annual Report and Accounts) underpin the way we interact with them every day. Engagement with our customers enables us to maintain our deep understanding of them and the markets they operate in, designing products to meet their needs and continually striving to exceed their expectations in order that we can maintain long-lasting relationships with them in view of our strategic goal of becoming the UK's leading specialist bank.

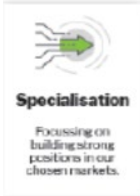
How we engage and / or monitor

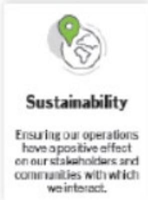
- Regular customer satisfaction surveys on key product lines are reported to the Board
- Focussed analysis on key customer groups is undertaken
- The Board receives Customer Insight updates bi-annually
- The Board was briefed on the new FCA Consumer Duty at one of its quarterly training sessions and has been updated on progress throughout the year
- Customer metrics are a key element of the Performance Share Plan ('PSP')

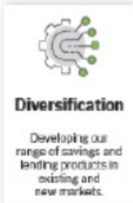
Outcome

- Customer feedback on key product lines, as measured by net promoter scores, has remained strong
- The Board approved the implementation plan for the new FCA Consumer Duty and a non-executive director was recently appointed as Consumer Duty Champion
- Greater understanding of customers and their priorities is used to refine product offerings, documentation and processes
- All employees received training on how to identify and support customers in vulnerable circumstances, with customer-facing employees receiving additional in-depth training
- Complaint levels remain low by industry standards

Further information on the Group's relationship with its customers is set out in section A6.2 of PBG's 2022 Annual Report and Accounts.







DIRECTORS' REPORT (Continued)

Employees

Helping all of our people to develop their career and reach their potential (s172 (1)(b))

By working together, we help our customers to achieve their ambitions and the Group to achieve its strategic priorities. A wide range of employee skills and expertise, as well as commitment and motivation of employees, are crucial to the Group's success. Our shared values and focus on employee engagement provide the foundation for this success by enabling us to understand what is important to our employees and create a supportive working culture through which we can attract, develop and retain talent.

How we engage and / or monitor

- All employees were invited to complete an anonymous survey as part of the Investor in People ('IIP') triennial assessment, which included specific questions on the Group's culture
- The Chief People Officer updates the Board and ExCo on employee feedback from surveys and from the People Forum, as well as other metrics
- The Chair and non-executive directors attend the Group's People Forum on a regular basis
- Designated ExCo members with responsibility for gender diversity and wider diversity regularly report progress on these matters
- The Group's EDI network is sponsored by a member of ExCo and, throughout the year, members of the Board and ExCo have attended employee listening circles
- The Nomination Committee receives six-monthly updates on succession planning and feedback from the EDI network from the Chief People Officer
- People metrics are a key element of the PSP

Outcome

- The Group was reaccredited as an Investor in People and achieved Platinum IIP status
- Adoption of a permanent hybrid working model following several successful pilots
- Feedback from the People Forum and regular updates from the Chief People Officer enable the Board to support and understand employees and their engagement
- Tailored career development programmes embedded across the Group for apprentices through to high potential senior leaders
- The Code of Conduct, which articulates the Group's culture, purpose and values, was rolled out to 100% of employees
- Enhanced annual leave provisions for all employees in the year

Sustainability

Ensuring our operations have a positive effect on our stakeholders and communities with which we interact.

DIRECTORS' REPORT (Continued)

Further information on the involvement of the Group's people and the impact of policies on them can be found in section A6.3 of PBG's 2022 Annual Report and Accounts.

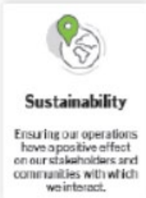
Regulators

Engaging transparently and openly with regulators to ensure we comply with current legislation and maintain the Bank's reputation for high standards of business conduct (s172 (1)(c) and s172 (1)(e))

One of our key values is to be honest and open in everything we do. Frequent and transparent communication with regulators enables us to plan for regulatory change and maintain our high ethical and reputational standards. Through frequent regulator communications we also strive to give regulators an understanding of our sector, which they can use to develop policies that address sectoral issues while minimising adverse sectoral impacts.

How we engage and / or monitor

- Regular engagement with the PRA throughout the year on key regulatory matters, including the IRB implementation
- Direct contact between the Chair and non-executive directors and regulators
- The ExCo and Board are kept regularly updated on all interaction with the FCA and PRA
- Senior Managers and Certification Regime ('SMCR') is embedded across the Group, with conduct measures monitored monthly, overseen by the Executive Risk Committee
- A revised framework to identify Material Risk Takers ('MRTs') and process their remuneration packages was embedded during the financial year following the Bank becoming a Level 2 firm for remuneration purposes on 1 October 2021
- Dialogue maintained with HMRC, with the CFO designated as Senior Accounting Officer, directly responsible for the Group's tax policies
- The risk element of the PSP includes an assessment of any material regulatory breaches



Outcome

- All changes to the Board and Senior Management Functions are approved by the regulator, where required
- A Risk Adjustment Review Group has been established to identify instances of potential risk adjustment for MRTs and others on a more structured and formal basis than had previously been the case

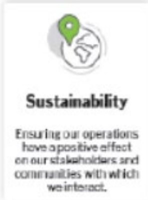
Further information on the Group's tax policies is set out in Section A6.5 of PBG's 2022 Annual Report and Accounts.

DIRECTORS' REPORT (Continued)

Society and community

Helping the UK economy grow and supporting the communities in which we operate (s172 (1)(d))

We aim to be an energetic and valuable contributor to the communities in which we operate, recognising that our long-term success is linked to the wellbeing and resilience of the communities we serve. Our commitment includes active involvement in a range of community volunteering and charity partnerships.



How we engage and / or monitor

- Members of the senior team are active in industry bodies, gaining insight into thinking about how the sector impacts communities and public policy
- ExCo members actively support community activities within the business
- Employees support a nominated charity each year via payroll donations and fund-raising efforts
- All employees are given one day per year to volunteer for specific initiatives

Outcome

- In the twelve months ended 31 December 2021 our employees had raised nearly £43,000 for the Alzheimer's Society and during the nine months ended 30 September 2022 our employees raised over £31,000 for Mind
- The Group's Charity Committee is sponsored by a member of ExCo
- Employees were supported to take part in a range of volunteering activities
- 286 employee volunteering days were used to support specific initiatives in our local communities

Further information on the Group's community involvement is set out in Section A6.5 of PBG's 2022 Annual Report and Accounts.

DIRECTORS' REPORT (Continued)

Environment and climate change

Continually reducing our environmental impact and designing products that support positive environmental change (s172 (1)(d))

We take care to identify, manage and minimise our impact on the environment, both in terms of the impact of our lending products and our own operational impact. We recognise that climate change poses financial and other risks to the Group and our strategy, which is why ensuring the sustainability of our operations is one of our five strategic priorities.

Sustainability

Ensuring our operations have a positive effect on our stakeholders and communities with which we interact.

How we engage and / or monitor

- The Group has an executive level Sustainability Committee which addresses all climate-related issues on a cross-group basis
- Climate change is designated a principal risk within the Group's risk management framework
- The Board receives updates on the potential risks and strategic impacts of climate change
- The Group has joined Bankers for Net Zero
- The CFO has been designated as the responsible director for climate change matters
- The Group's ICAAP includes a climate change scenario analysis module
- The Group complies with all applicable laws and regulations relating to the environment

Outcome

- The Group offers a range of green mortgages which encourage landlords to invest in energy efficient properties
- Loans to finance battery electric vehicles, including light commercial vehicles, are offered by the Group's motor finance business
- Southampton office moved to a more energy-efficient location
- The Board has objectives in place against current energy performance to further reduce consumption
- Operational emissions for the year have been offset with purchased carbon credits certified by Gold Standard or VCS
- Environmental / climate change targets are considered as part of the new Remuneration Policy
- The Group publishes an annual sustainability report and has a dedicated Sustainability section on its website

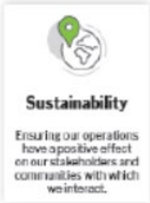
Further information on the Group's management of climate change risk and its environment policies is set out in Section A6.4 of PBG's 2022 Annual Report and Accounts.

DIRECTORS' REPORT (Continued)

Business partners and suppliers

Commitment to the fair treatment of all business partners. In return, we expect our partners to help us deliver a high standard of service to our customers and act responsibly (s172 (c))

Our suppliers play a vital role in supporting our business and allowing us to provide high standards of service to our customers in responsible and ethical ways. We seek to build good relationships with our suppliers as we believe that working well with them is central to our strategic goal of sustainability and key to our continued success.



How we engage and / or monitor

- Key business partner relationships, including intermediaries and suppliers are identified, actively monitored and reported to ExCo and the Board
- Regular feedback surveys conducted amongst intermediaries with the results fed back to ExCo and Board
- The Group has a Supplier Code of Conduct which sets out our overall approach to supplier engagement and corporate responsibility
- A supplier satisfaction survey was undertaken to seek the views of third party suppliers on their experience with the Group, which will be used to identify and action any areas for improvement

Outcome

- Intermediary feedback key to designing new broker portals and other operational systems
- Our suppliers understand the minimum standards we expect from them and our commitments and expectations around bribery and corruption, data protection and modern slavery
- Ongoing engagement with our key suppliers ensuring operational resilience and reduced risk
- The Group is a signatory to the UK's Prompt Payment Code, with ensuring prompt payment a priority in the year

The Group's management of business partner relationships is discussed further in Section A6.7 of PBG's 2022 Annual Report and Accounts.

AUDITOR

The directors have taken all reasonable steps to make themselves and the Bank's auditor, KPMG LLP, aware of any information needed in preparing the audit of the Annual Report and Financial Statements for the year, and, as far as each of the directors is aware, there is no relevant audit information of which the auditor is unaware.

A resolution for the re-appointment of KPMG LLP as the auditor of the Bank is to be proposed at the forthcoming Annual General Meeting.

DIRECTORS' REPORT (Continued)

POLITICAL CONTRIBUTIONS

The Bank has not made any political donations or incurred and political expenditure during the year.

DIVIDENDS

An interim dividend of 27.2 pence per share was paid in the year (2021: 17.2 pence per share), a final dividend of 25.3 pence is proposed (2021: nil).

INFORMATION PRESENTED IN OTHER SECTIONS

Certain information required to be included in a directors' report by the Companies Act 2006 and regulations made there under can be found in the other sections of the Annual Report, as described below. All of the information presented in these sections is incorporated by reference into this Directors' Report and is deemed to form part of this report.

- Commentary on the likely future developments in the business of the Bank is included in the Strategic Report
- A description of the Bank's financial risk management objectives and policies, and its exposure to risks arising from its use of financial instruments are set out in notes 38 - 42 to the accounts
- Information concerning the employment of disabled persons and the involvement of employees in the business is given in the strategic report

Approved by the Board of Directors and signed on behalf of the Board.

RICHARD WOODMAN

Director

15 December 2022

STATEMENT OF DIRECTORS' RESPONSIBILITIES

in relation to Financial Statements

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law, including the Companies Act 2006 (the 'Companies Act'), requires the directors to prepare consolidated financial statements for the Bank in respect of each financial year. In respect of the financial statements for the year ended 30 September 2022, that law requires the directors to prepare the financial statements in accordance with UK-adopted international accounting standards in conformity with the requirements of the Companies Act and they have also elected to prepare the separate financial statements of the Company on the same basis.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Bank and the Bank's profit or loss for the year. In preparing the financial statements the directors are also required to:

- select suitable accounting policies and apply them consistently
- make judgements and estimates that are reasonable, relevant and reliable
- state whether the financial statements have been prepared in accordance with UK-adopted international accounting standards.
- assess the ability of the Bank to continue as a going concern, disclosing, as applicable, matters related to going concern
- use the going concern basis of accounting unless they intend to liquidate the Bank or to cease operations or they have no realistic alternative to doing so
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information
- provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance

The directors are responsible for keeping adequate accounting records for the Bank that are sufficient to record and explain its transactions, disclose with reasonable accuracy at any time its financial position and enable them to ensure that its financial statements comply with the requirements of the Companies Act.

They are responsible for the implementation of such internal control processes as they deem necessary to enable the preparation of financial statements which are free from material misstatements, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for the preparation of a strategic report, directors' report, directors' remuneration report and corporate governance statement, which comply with that law and those regulations.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

in relation to Financial Statements (continued)

The Board of Directors currently comprises:

R D East (Chair of the Board)

N S Terrington (CEO)

R J Woodman (CFO)

H R Tudor (Senior Independent Director ('SID'))

B A Ridpath (Non-executive director)

G H Yorston (Non-executive director)

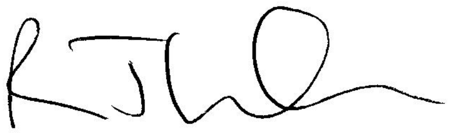
A C M Morris (Non-executive director)

P A Hill (Non-executive director)

T P Davda (Non-executive director)

Each of the current directors confirm that, to the best of their knowledge, the financial statements, prepared in accordance with International Financial Reporting Standards as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Bank.

Approved by the Board of Directors and signed on behalf of the Board.



RICHARD WOODMAN

Director

15 December 2022

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF PARAGON BANK PLC

1 Our opinion is unmodified

We have audited the financial statements of Paragon Bank PLC ("the Company") for the year ended 30 September 2022 which comprise the:

- Statement of Profit or Loss
- Balance Sheet
- Cash Flow Statement
- Statement of Movements in Equity
- Related notes, including the accounting policies in note 44, other than the disclosures labelled as unaudited in note 37.

In our opinion the financial statements:

- give a true and fair view of the state of Company's affairs as at 30 September 2022 and of its profit for the year then ended;
- have been properly prepared in accordance with UK – adopted international accounting standards; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ('ISAs (UK)') and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the Audit Committee.

We were first appointed as auditor by the shareholders on 9 February 2016. The period of total uninterrupted engagement is for the seven financial years ended 30 September 2022. We have fulfilled our ethical responsibilities under, and we remain independent of the Company in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to public interest entities. No non-audit services prohibited by that standard were provided.

2 Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters (unchanged from 2021), in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

Key audit matter	Our response
Impairment allowances on loans to customers Risk vs 2021: ▲ (£28.1 million; 2021: £24.0 million) *Refer to the accounting policy note and note 17 (financial disclosures).* ***Subjective estimate*** The measurement of expected credit losses ('ECL') involves significant judgements and estimates. The risk of material misstatement of ECL is heightened in the current year due to the increased judgement and estimation uncertainty as a result of the ongoing economic uncertainties. The key areas where we identified greater levels of management judgement and therefore increased	We performed the following audit procedures rather than seeking to rely on the Company's controls because the nature of the balance is such that we would expect to obtain audit evidence primarily through the detailed procedures described: • **Test of details:** Key aspects of our testing involved: - Testing the key inputs and assumptions impacting the Company's overall ECL calculation to assess their reasonableness. This included performing sensitivity analysis to understand the significance of certain assumptions; benchmarking procedures to compare the Company's key assumptions to comparable peer group organisations; and assessing the key assumptions against the Company's historical experience; and - Performing recalculations of the ECL measured on each of the Company's loan portfolios.

levels of audit focus in the Company's estimation of ECL are: **Economic scenarios** – IFRS 9 requires the Company to measure ECL on a forward-looking basis reflecting a range of future economic conditions. Significant management judgement is applied to determine the economic scenarios used, particularly in the current economic environment, and the probability weightings assigned to each economic scenario. **Qualitative adjustments** – Management makes adjustments to the model-driven ECL results to address issues relating to model responsiveness or emerging trends relating to the current economic environment as well as risks not captured by the models. Such adjustments are inherently subjective and significant management judgement is involved in estimating these amounts. **Significant Increase in Credit Risk ('SICR')** – The criteria selected to identify a significant increase in credit risk is a key area of judgement within the Company's ECL calculation as these criteria determine whether a 12 month or lifetime provision is recorded. **Model estimations** – Inherently judgmental modelling is used to estimate ECLs which involves determining Probabilities of Default ('PD'), Loss Given Default ('LGD'), and Exposures at Default ('EAD'). The LGD models used in the portfolios are the key drivers of the Company's ECL results and are therefore the most significant judgmental aspect of the Company's ECL modelling approach. The effect of these matters is that, as part of our risk assessment, we determined that the impairment of loans to customers has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. The financial statements disclose the sensitivities estimated by the Company (note 17). **Disclosure quality** The disclosures regarding the Company's application of IFRS 9 are important in explaining the key judgements and material inputs to the IFRS 9 ECL results, as well as the sensitivity of the ECL results to changes in these judgements or management's assumptions, in light of the estimation uncertainty arising.	• **Our economic scenario expertise:** We involved our own economic specialists to assist us in assessing the appropriateness of the Company's methodology for determining the economic scenarios used and the probability weightings applied to them. We assessed the overall reasonableness of the economic forecasts by comparing the Company's forecasts to our own modelled forecasts. As part of this work, we assessed the reasonableness of the Company's considerations of the economic uncertainty arising at the reporting date. • **Qualitative adjustments:** For the adjustment to the model-driven ECL, we assessed the reasonableness of the adjustments by challenging the basis of risks not addressed by the models in the current economic environment and the completeness of post-model adjustments ('PMAs') recognised, assessing the appropriateness of key assumptions and performing sensitivity analysis in respect of the PMAs. • **SICR**: We assessed the ongoing predictability of the SICR criteria and independently recalculated the loans' stage for 100% of the Company's loans and receivables. • **Our financial risk modelling expertise:** We involved our own financial risk modelling specialists in evaluating certain IFRS 9 models. We used our knowledge of the Company and our experience of the industry that the Company operates in to independently assess the appropriateness of the Company's IFRS 9 models and key components. • **Sensitivity analysis:** We performed sensitivity analysis over the key assumptions including the economic scenarios and weightings as well as certain PD and LGD assumptions, by applying alternative assumptions based upon the above procedures. • **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the Company's overall ECL. As a part of this, we assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the key judgements and assumptions made, was sufficiently clear. **Our results** The results of our testing were satisfactory, and we considered the ECL charge, provision recognised and the related disclosures to be acceptable (2021: acceptable).
Interest receivable on originated loan accounts Risk vs 2021: ▲ (£287.5 million; 2021: £226.8 million) *Refer to the accounting policy note and note 4 (financial disclosures).* ***Subjective estimate*** The recognition of interest receivable on originated loan accounts under the effective interest rate ('EIR') method requires management to apply judgement, with the most critical estimate being the loans' expected behavioural life. The expected behavioural life assumptions utilise repayment profiles which represent how customers are expected to pay. These profiles extend significantly into the future which creates a high degree of estimation uncertainty and subjects the judgement to future market changes. The Company makes its expected life assumptions based on its forecasting process which incorporates historical experience. Recent developments in the UK economy result in an elevated	We performed the following audit procedures rather than seeking to rely on the Company's controls because the nature of the balance is such that we would expect to obtain audit evidence primarily through the detailed procedures described: • **Historical comparison:** We critically assessed the Company's analysis and key assumptions over the repayment profiles by comparing them to the Company's historical trends and actual portfolio behaviour. This included considering the potential impact of uncertainties arising from the current economic environment on the behavioural life forecasts. • **Our sector experience:** We critically assessed key assumptions behind the Company's expected behavioural lives against our own knowledge of industry experience and trends and challenged the appropriateness of the level of segmentation applied to the loan portfolios by management. • **Sensitivity analysis:** We performed sensitivity analysis over the repayment profiles by applying alternative profiles based upon the above procedures.

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degree of subjectivity in this assessment.
The cohorts of loans and advances for which the expected behavioural life assumptions are most significant are buy-to-let products which were originated by the Company post-2010.
The effect of these matters is that, as part of our risk assessment, we determined that interest receivable on originated loan accounts has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole. The financial statements disclose the sensitivities estimated by the Company (note 46).
Disclosure quality
The disclosures regarding the Company's application of EIR accounting are important in explaining the key judgements and material inputs to the EIR adjustment, as well as the sensitivity of the EIR adjustment to changes in these judgements or management's assumptions, in light of the estimation uncertainty arising.
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Assessing transparency: We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the Company's EIR adjustments and interest receivable. As a part of this, we assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the critical estimates and assumptions made, was sufficiently clear.
Our results
The results of our testing were satisfactory, and we found the resulting estimate of interest receivable on originated loan accounts and the related disclosures to be acceptable (2021: acceptable).
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Recoverability of Company's investment in subsidiaries
Risk vs 2021: ◄►
(£667.1 million; 2021: £667.7 million)
Refer to the accounting policy note and note 22 (financial disclosures).
Forecast-based valuation
The carrying amount of the Company's investments in subsidiaries is significant and the investment in each of the Company's acquired businesses is at risk of irrecoverability due to changes in market factors since acquisition. Management assesses the recoverability of investments by comparison to the net asset value of the subsidiary and, where the carrying value exceeds the net asset value, by comparison to the recoverable amount of the investment assessed based on the subsidiary's value-in-use. The estimated recoverable amount of this balance is subjective due to the inherent uncertainty involved in forecasting future cash flows and deriving an appropriate discount rate to reflect the time value of money.
In calculating the recoverable amount, the directors made assumptions over the following key inputs: the forecast future cash flows, the discount rate and the long-term growth rate.
Disclosure quality
The disclosures regarding the Company's investments in subsidiaries are important in explaining the key judgements and material inputs to the impairment assessment, as well as the sensitivity of the recoverable amount (and therefore the impairment conclusion) to changes in these judgements or management's assumptions in light of the estimation uncertainty arising.
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We performed the following audit procedures rather than seeking to rely on the Company's controls because the nature of the balance is such that we would expect to obtain audit evidence primarily through the detailed procedures described:
Tests of detail: We compared the carrying amount of the investments with the relevant subsidiary's draft balance sheet to identify whether their net assets, being an approximation of their minimum recoverable amount, were in excess of their carrying amount.
Where the carrying value exceeds the net asset value and a value-in-use assessment was made, we performed the following:

Historical comparisons: We compared the Company's previous forecasting of cash flows with actual results to assess forecasting accuracy;
Benchmarking assumptions: We compared the Company's assumptions to externally derived data in relation to key inputs such as discount rates and challenged management on the forecast business performance. This included considering the impact of uncertainties arising from the current economic environment on the forecasts.
Our industry experience: We used our knowledge of the Company and our experience of the industry that the Company operates in to independently assess the appropriateness of the key assumptions, including the discount rate and cash flow forecasts.
Sensitivity analysis: We performed break-even analysis and applied alternative scenarios based on the assumptions noted above.
Assessing transparency: We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the estimated recoverable amount. In addition, we challenged whether the disclosure of the key judgments and assumptions made, was sufficiently clear

Our results
The results of our testing were satisfactory, and we found the resulting carrying amount of the investments in subsidiaries to be acceptable (2021: acceptable).
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3 Our application of materiality and an overview of the scope of our audit

Materiality for the Company financial statements as a whole was set at £8.8 million, determined with reference to a benchmark of Company profit before tax, normalised to exclude unusually significant fair value net gains in 2022, of £289.0m (2021: £8.1 million determined with reference to a benchmark of profit before tax). This materiality level represents 3.0% (2021: 4.5%) of the stated benchmark.

In line with our audit methodology, our procedures on individual account balances and disclosures were performed to a lower threshold, performance materiality, so as to reduce to an acceptable level the risk that individually immaterial misstatements in individual account balances add up to a material amount across the financial statements as a whole.

Performance materiality was set at 75% (2021: 75%) of materiality for the financial statements as a whole, which equates to £6.6 million (2021: £6.1 million). We applied this percentage in our determination of performance materiality because we did not identify any factors indicating an elevated level of risk.

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.44 million (2021: £0.40 million), in addition to other identified misstatements that warranted reporting on qualitative grounds.

We were able to rely upon the Company's internal control over financial reporting in several areas of our audit, where our controls testing supported this approach, which enabled us to reduce the scope of our substantive audit work; in the other areas the scope of the audit work performed was fully substantive.

4 Going concern

The directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or to cease its operations, and as they have concluded that the Company's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

We used our knowledge of the Company, its industry, and the general economic environment to identify the inherent risks to its business model and analysed how those risks might affect the Company's financial resources or ability to continue operations over the going concern period. The risks that we considered most likely to adversely affect the Company's available financial resources over this period were:

- the availability of funding and liquidity in the event of a market-wide stress scenario and
- the impact on regulatory capital requirements in the event of an economic slowdown or recession

We considered whether these risks could plausibly affect the liquidity and regulatory capital in the going concern period by comparing severe, but plausible downside scenarios that could arise from these risks individually and collectively against the level of available financial resources indicated by the Company's financial forecasts.

We considered whether the going concern disclosure in note 47 to the financial statements gives a full and accurate description of the directors' assessment of going concern.

Our conclusions based on this work:

- we consider that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate
- we have not identified, and concur with the directors' assessment that there is not, a material uncertainty related to events or conditions that, individually or collectively, may cast significant doubt on the Company's ability to continue as a going concern for the going concern period
- we found the going concern disclosure in note 47 to be acceptable

However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the above conclusions are not a guarantee that the Company will continue in operation.

5 Fraud and breaches of laws and regulations – ability to detect

Identifying and responding to risks of material misstatement due to fraud

To identify risks of material misstatement due to fraud ('fraud risks') we assessed events or conditions that could indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.

Our risk assessment procedures included:

- Enquiring of directors, Internal Audit and inspection of policy documentation as to the Company's high-level policies and procedures to prevent and detect fraud, including the Internal Audit function, and the Company's channel for 'whistleblowing', as well as whether they have knowledge of any actual, suspected or alleged fraud.
- Reading Board, Audit Committee and Risk Committee minutes.
- Considering remuneration incentive schemes and performance targets for management and directors including the Financial Performance metrics in the Annual Bonus and Performance Share Plan.
- Using analytical procedures to identify any unusual or unexpected relationships.

We communicated identified fraud risks throughout the audit team and remained alert to any indications of fraud throughout the audit.

As required by auditing standards, and taking into account possible pressures to meet profit targets and our overall knowledge of the control environment, we perform procedures to address the risk of management override of controls, and the risk of fraudulent revenue recognition, in particular the risk that the EIR adjustment on interest income may be misstated, the risk that Company management may be in a position to make inappropriate accounting entries, and the risk of bias in accounting estimates and judgements including the impairment allowances on loans to customers.

Further detail in respect of interest income on originated loans and impairment allowances on loans to customers is set out in the key audit matter disclosures in section 2 of this report.

We performed procedures including:

- Identifying journal entries to test based on risk criteria and comparing the identified entries to supporting documentation. These included those posted and approved by the same user and those including specific descriptors and
- Assessing whether the judgements made in making accounting estimates are indicative of a potential bias

Identifying and responding to risks of material misstatement due to non-compliance with laws and regulations

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience, through discussion with the directors and other management (as required by auditing standards), and from inspection of the Company's regulatory and legal correspondence and discussed with the directors and other management the policies and procedures regarding compliance with laws and regulations.

As the Company is regulated, our assessment of risks involved gaining an understanding of the control environment including the entity's procedures for complying with regulatory requirements.

We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the Company is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies legislation), distributable profits legislation and taxation legislation and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Company is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of the Company's licence to operate. We identified the following areas as those most likely to have such an effect: specific areas of regulatory capital and liquidity, conduct, money laundering and financial crime and certain aspects of company legislation recognising the financial and regulated nature of the Company's activities. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. Therefore, if a breach of operational regulations is not disclosed to us or evident from relevant correspondence, an audit will not detect that breach.

Context of the ability of the audit to detect fraud or breaches of law or regulation

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it.

In addition, as with any audit, there remained a higher risk of non-detection of fraud, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. Our audit procedures are designed to detect material misstatement. We are not responsible for preventing non-compliance or fraud and cannot be expected to detect non-compliance with all laws and regulations.

6 We have nothing to report on the other information in the Annual Report

The directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Strategic report and directors' report

Based solely on our work on the other information:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

7 We have nothing to report on the other matters on which we are required to report by exception

Under the Companies Act 2006, we are required to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

8 Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 36, the directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

9 The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Simon Ryder (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

66 Queen Square

Bristol

BS1 4BE

15 December 2022

The Accounts

Showing the financial position, results and cash flows of the Bank prepared in accordance with IFRS and UK law

STATEMENT OF PROFIT OR LOSS
For the year ended 30 September 2022

	Note	2022 £m	2021 (Restated*) £m
Interest receivable	4	368.0	256.2
Interest payable and similar charges	5	(147.0)	(113.6)
Net interest income		221.0	142.6
Other operating income	6	174.4	95.5
Total operating income		395.4	238.1
Operating expenses	7	(99.8)	(81.5)
Provisions for losses	9	(6.6)	10.9
Operating profit before fair value items		289.0	167.5
Fair value net gain	10	191.2	15.0
Operating profit being profit on ordinary activities before taxation		480.2	182.5
Tax charge on profit on ordinary activities	11	(85.8)	(38.8)
Profit on ordinary activities after taxation for the financial year		394.4	143.7

The results for the current and preceding years relate entirely to continuing operations.

There were no other items of comprehensive income in the current or preceding years.

* See Note 4

BALANCE SHEET
For the year ended 30 September 2022

	Note	2022 £m	2021 £m
Assets			
Cash – central banks	12	1,612.5	1,142.0
Cash – retail banks	12	33.6	52.1
Short term investments	13	-	-
Loans to customers	14	8,952.8	8,144.6
Investment in structured entities	18	1,791.2	1,944.1
Derivative financial assets	19	605.9	28.5
Sundry assets	20	115.0	127.5
Property, plant and equipment	21	-	5.1
Investment in subsidiary undertakings	22	2,278.0	2,061.7
Total assets		15,389.0	13,505.6
Liabilities			
Retail deposits	23	10,569.5	9,297.4
Derivative financial liabilities	19	118.1	42.0
Central bank facilities	24	2,750.0	2,819.0
Corporate bond	25	150.0	150.0
Sundry liabilities	26	648.5	339.2
Current tax liabilities	28	34.5	35.7
Deferred tax liability	29	55.0	3.0
Total liabilities		14,325.6	12,686.3
Called up share capital	30	552.6	552.6
Reserves	31	510.8	266.7
Total equity		1,063.4	819.3
Total liabilities and equity		15,389.0	13,505.6

Approved by the Board of Directors on 15 December 2022.
Signed on behalf of the Board of Directors

N S Terrington
Chief Executive

R J Woodman
Chief Financial Officer

CASH FLOW STATEMENT
For the year ended 30 September 2022

	Note	2022 £m	2021 £m
Net cash generated / (utilised) by operating activities	32	883.4	(934.8)
Net cash (utilised) by investing activities	33	(212.1)	(414.4)
Net cash (utilised) / generated by financing activities	34	(219.3)	869.7
Net increase / (decrease) in cash and cash equivalents		452.0	(479.5)
Opening cash and cash equivalents		1,194.1	1,673.6
Closing cash and cash equivalents		1,646.1	1,194.1
Represented by balances within:			
Cash	12	1,646.1	1,194.1
Short term bank borrowings		-	-
		1,646.1	1,194.1

STATEMENT OF MOVEMENTS IN EQUITY
For the year ended 30 September 2022

Year ended 30 September 2022	**Share capital £m**	**Profit and loss account £m**	**Total equity £m**
Transactions arising from			
Profit for the year	-	394.4	394.4
Other comprehensive income	-	-	-
Total comprehensive income	-	394.4	394.4
Transactions with owners			
Shares issued	-	-	-
Dividends paid	-	(150.3)	(150.3)
Net movement in equity in the year	-	244.1	244.1
Opening equity	552.6	266.7	819.3
Closing equity	552.6	510.8	1,063.4

Year ended 30 September 2021	**Share capital £m**	**Profit and loss account £m**	**Total equity £m**
Transactions arising from			
Profit for the year	-	143.7	143.7
Other comprehensive income	-	-	-
Total comprehensive income	-	143.7	143.7
Transactions with owners			
Shares issued	-	-	-
Dividends paid	-	(94.8)	(94.8)
Net movement in equity in the year	-	48.9	48.9
Opening equity	552.6	217.8	770.4
Closing equity	552.6	266.7	819.3

NOTES TO THE ACCOUNTS
For the year ended 30 September 2022

1. GENERAL INFORMATION

Paragon Bank PLC is a company domiciled in the United Kingdom and incorporated in England and Wales under the Companies Act 2006 with company number 5390593. The address of the registered office is 51 Homer Road, Solihull, West Midlands, B91 3QJ. The nature of the Bank's operations and its principal activities are set out in the Strategic Report.

These financial statements are presented in pounds sterling, which is the currency of the economic environment in which the Bank operates.

The remaining notes to the accounts are organised in to three sections:

- Analysis – providing further analysis and information on the amounts shown in the primary financial statements
- Capital and Financial Risk Management – providing information of the Bank's management of operational and regulatory capital and its principal financial risks
- Basis of preparation – providing details of the Bank's accounting policies and of how they have been applied in the preparation of the financial statements

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

The notes set out below give more detailed analysis of the balances shown in the primary financial statements and further information on how they relate to the operations, results and financial position of the Bank.

2. SEGMENTAL INFORMATION

The Bank is not currently obliged to provide information on operating segments in accordance with IFRS 8 as it has no listed debt or equity instruments.

All of the Bank's operations are conducted in the United Kingdom, all revenues arise from customers external to the Bank and the business is considered to represent a single segment. No customer contributes more than 10% of the revenue of the Bank, excluding dividends or deferred purchase consideration received from other Group companies.

Transactions with other Group entities are described in note 35.

3. REVENUE

	Note	2022	2021 Restated
		£m	£m
Interest receivable	4	368.0	256.2
Other operating income	6	174.4	95.5
Total revenue		542.4	351.7

4. INTEREST RECEIVABLE

The Bank has reconsidered the analysis it presents of net interest income in its accounts in light of the increasing magnitude of hedging impacts on these balances, with derivative income and expense attributed to the hedged transaction and shown separately. This will provide better information to users and is consistent with approaches currently used by comparable firms. Information in respect of the year ended 30 September 2021 has been restated on the same basis. While this change affects the total reported amounts of interest receivable and interest payable (note 5) by the amount reported as 'effect of fair value hedging of loan assets' below, total net interest is unaffected.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

4. INTEREST RECEIVABLE (CONTINUED)

Interest receivable is analysed as follows.

	2022 £m	2021 Restated £m
Interest receivable in respect of		
First mortgages	253.9	192.9
Secured consumer loans	8.8	12.0
Development finance	0.1	1.7
Finance leases	13.3	12.6
Other loans	11.4	7.6
Interest on loans to customers	287.5	226.8
Effect of fair value hedging of loan assets	(6.6)	(32.2)
Interest on loans to customers after hedging	280.9	194.6
Other interest receivable	26.3	12.5
Interest on group loan	23.4	23.2
Interest on investments	37.4	25.9
Total interest on financial assets	368.0	256.2

The above interest arises from:

	2022 £m	2021 Restated £m
Financial assets held at amortised cost	361.3	275.8
Finance leases	13.3	12.6
Derivative financial instruments held at fair value	(6.6)	(32.2)
	368.0	256.2

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

5. INTEREST PAYABLE AND SIMILAR CHARGES

The Bank's interest payable disclosure has been reanalysed, and comparative amounts restated and described in note 4

In the 2021 disclosures as originally presented, transactions relating to fair value hedging were included in 'interest payable on retail deposits' (£26.3m). These amounts have been reanalysed between 'effect of fair value hedging of deposits' below and 'effect of fair value hedging of loan assets' in note 4.

	2022 £m	2021 Restated £m
On retail deposits	108.8	94.2
Effect of fair value hedging of deposit	4.2	(6.0)
Interest on retail deposits after hedging	113.0	88.2
On bank loans and overdrafts	2.2	0.7
On corporate bonds	6.6	8.2
On central bank facilities	22.2	2.3
On intercompany loans	2.6	13.5
Total interest on financial liabilities	146.6	112.9
Discounting on lease liabilities	-	-
Other finance costs	0.4	0.7
Total interest payable and similar charges	147.0	113.6

The above amounts relate to:

	2022 £m	2021 Restated £m
Financial liabilities held at amortised cost	146.6	112.9
Other items	0.4	0.7
	147.0	113.6

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

6. OTHER OPERATING INCOME

	2022 £m	2021 £m
Loan account fee income	3.5	3.7
Deferred sale consideration	14.9	60.3
Dividend income	156.0	31.5
	174.4	95.5

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

7. OPERATING EXPENSES

	Note	2022 £m	2021 £m
Auditor remuneration	8	0.6	0.6
Financial Services Compensation Scheme levy		1.1	1.1
Depreciation of operational assets	21	0.3	0.3
Other administrative costs		97.8	79.5
		99.8	81.5

Other administrative costs relate to management and administrative services provided by fellow group companies as disclosed in note 35.

The Bank incurred no costs in respect of short-term operating leases in the year (2021: none).

8. AUDITOR REMUNERATION

The analysis of fees payable to the Bank's auditors (KPMG LLP) and their associates, excluding irrecoverable VAT, required by the Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2008 is set out below.

	2022 £m	2021 £m
Audit fee of the company	0.6	0.6
Total fees	0.6	0.6
Irrecoverable VAT	-	-
Total cost to the Bank	0.6	0.6

Fees paid to the auditors and their associates for non-audit services to the Company are not disclosed because the consolidated accounts of the Group are required to disclose such fees on a consolidated basis.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

9. PROVISION FOR LOSSES

	Note	2022 £m	2021 £m
Impairment / (release of provision) of financial assets:			
Loan accounts	17	5.1	(7.7)
Finance leases	17	1.8	(0.7)
Balances with group companies		(0.3)	(2.5)
		6.6	(10.9)

10. FAIR VALUE NET GAIN

	2022 £m	2021 £m
Ineffectiveness of fair value hedges (note 19)		
Portfolio hedges of interest rate risk		
Deposit hedge	11.6	(0.3)
Loan hedge	20.7	5.7
	32.3	5.4
Other hedging movements	5.4	6.4
Net gain on other derivatives	153.5	3.2
	191.2	15.0

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

11. TAX CHARGE ON PROFIT ON ORDINARY ACTIVITIES

(a) Analysis of charge in the year

	2022 £m	2021 £m
Current tax		
UK Corporation Tax on profits of the period	34.0	35.1
Adjustment in respect of prior periods	(0.2)	(0.6)
Total current tax	33.8	34.5
Deferred tax	52.0	4.3
Tax charge on profit on ordinary activities	85.8	38.8

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

11. TAX CHARGE ON PROFIT ON ORDINARY ACTIVITIES (CONTINUED)

The standard rate of corporation tax in the UK applicable to the Bank in the year was 19.0% (2021: 19.0%), based on legislation enacted at the year end. During the year ended 30 September 2021, the UK Government enacted legislation increasing the standard rate of corporation tax in the UK from 19.0% to 25.0% from April 2023. Therefore legislation currently in force will increase the standard rate of corporation tax applicable to the Bank to 22.0% in the year ending 30 September 2023 and to 25.0% in the year ending 30 September 2024 and thereafter. The effect of these changes on deferred tax balances was accounted for in the year ended 30 September 2021.

The Bank is subject to the Bank Corporation Tax Surcharge. This subjects any taxable profits arising in the Bank to an additional 8.0% of tax to the extent these profits exceed £25.0m. The effect of the surcharge is shown in note (c) below.

In the current financial year the UK Government enacted legislation which reduced the rate of the Banking Surcharge from 8.0% to 3.0%, also from April 2023, while increasing the profit threshold at which the surcharge applies to £100.0m from £25.0m. This will result in the surcharge applicable to Paragon Bank reducing to 5.5% with a threshold of £62.5m in the financial year ending 30 September 2023 and 3.0%, with a threshold of £100.0m, thereafter. The impact of this change on deferred tax balances has been accounted for in the current period.

(b) Deferred tax charge for the year

The deferred tax charge in the income statement comprises the following temporary differences:

	2022 £m	2021 £m
Impact of surcharge and changes in tax rate	15.8	1.6
Loans and derivatives	36.2	2.7
Deferred tax charge for the year	52.0	4.3
Prior period adjustment	-	-
Deferred tax charge (note 29)	52.0	4.3

The expected impact on deferred tax balances of the increase in the rate of UK Corporation Tax to 25.0% from April 2023 is included in the charge for the current year.

The expected impact on deferred tax balances of the withdrawal of the reduction in the rate of Corporation Tax to 17.0% described above was accounted for in the year ended 30 September 2021, the effect of the expected change having been accounted for when originally enacted.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

11. TAX CHARGE ON PROFIT ON ORDINARY ACTIVITIES (CONTINUED)

(c) Factors affecting tax charge for the year

Accounting standards require companies to explain the relationship between tax expense and accounting profit. This may be demonstrated by reconciling the tax charge to the product of the accounting profit and the 'applicable rate', generally the domestic rate of tax levied on corporate income in the jurisdiction in which the entity operates.

The Bank operates wholly in the UK. Consequently, it is appropriate to use the prevailing UK corporation tax rate as the comparator to the effective tax rate. As noted in (a) above, the UK corporation tax rate applicable to the Bank for the year was 19.0% (2021: 19.0%).

The impact of the Banking Surcharge is shown as a difference between tax at this rate and the actual tax charge in the table below:

	2022 £m	2021 £m
Profit on ordinary activities before taxation	480.2	182.5
Profit on ordinary activities multiplied by the UK standard rate of corporation tax	91.2	34.7
Effects of:		
Non taxable income	(29.7)	(6.6)
Bank Corporation Tax Surcharge – impact on current tax	8.7	9.7
Impact of surcharge and changes in tax rates – deferred tax	15.8	1.6
Prior year (credit) / charge	(0.2)	(0.6)
Tax charge for the year	85.8	38.8

Had the reduction in the Bank Surcharge referred to above been enacted at the same time as the other changes coming into force on 1 April 2023, the tax charge for the year would have been reduced by £0.5m, with a corresponding increase in the deferred tax asset.

(d) Factors affecting future tax charges

While the UK Government has made various announcements on the future direction of tax policy during the period and since the year end, none of these proposals have yet been legislated for and it is uncertain which of them might be. The future direction of UK tax policy will significantly effect the tax payable by the Bank, and this remains uncertain.

The Bank's overall future effective tax rate will also be impacted by the future level of the Surcharge, with the increase in the threshold at which it applies likely to narrow the differential between the Bank's effective tax rate and the standard rate of corporation tax.

At the balance sheet date there were no material tax uncertainties and no significant open matters with the UK tax authorities. The Bank has no material exposure to any other tax jurisdiction.

As a wholly based UK business the Bank does not expect to be significantly impacted by the Organisation for Economic Co-operation and Development ('OECD') project on Base Erosion and Profit Shifting ('BEPS').

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

12. CASH AND CASH EQUIVALENTS

	2022 £m	2021 £m
Deposits with the Bank of England	1,612.5	1,142.0
Balances with central banks	1,612.5	1,142.0
Deposits with other banks	33.6	52.1
Cash and cash equivalents	1,646.1	1,194.1

'Cash and Cash Equivalents' includes current bank balances, money market placements and fixed rate sterling term deposits with London banks, and balances with the Bank of England.

Cash and cash equivalents are allocated to Stage 1 under the IFRS 9 impairment regime. The probabilities of default have been assessed to be so low as to require no significant impairment provision.

13. SHORT TERM INVESTMENTS

This amount represents fixed rate securities issued by the UK Government for which a liquid market exists, and which are held from time to time, as part of the liquidity requirement of Paragon Bank PLC.

No such securities were held at either 30 September 2022 or 30 September 2021, but the Bank held this type of investment during the previous year.

14. LOANS TO CUSTOMERS

	Note	2022 £m	2021 £m
Loan accounts	15	9,062.8	7,895.6
Finance lease receivables	16	260.8	224.9
Loans to customers		9,323.6	8,120.5
Fair value adjustments from portfolio hedging		(370.8)	24.1
		8,952.8	8,144.6

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

15. LOAN ACCOUNTS

Loan accounts at 30 September 2022 and 30 September 2021, which are all denominated and payable in sterling, were:

	2022 £m	2021 £m
First mortgage loans	8,725.8	7,553.2
Second charge mortgage loans	158.3	220.2
Development finance loans	-	3.3
Other secured commercial lending	178.7	118.9
	9,062.8	7,895.6

The amounts of the loan assets above pledged as collateral under the central bank facilities described in note 24 are set out in the table below. The table also shows assets prepositioned with the Bank of England for use in future drawings.

	First Mortgages £m	Consumer Finance £m	Other £m	Total £m
30 September 2022				
In respect of:				
Central bank facilities	3,790.6	-	-	3,790.6
Total pledged as collateral	3,790.6	-	-	3,790.6
Prepositioned with Bank of England	2,675.5	-	-	2,675.5
Other assets not pledged as collateral	2,259.7	158.3	178.7	2,596.7
	8,725.8	158.3	178.7	9,062.8
30 September 2021				
In respect of:				
Central bank facilities	2,901.0	-	-	2,901.0
Total pledged as collateral	2,901.0	-	-	2,901.0
Prepositioned with Bank of England	3,190.1	-	-	3,190.1
Other assets not pledged as collateral	1,462.1	220.2	122.2	1,804.5
	7,553.2	220.2	122.2	7,895.6

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

16. FINANCE LEASE RECEIVABLES

The minimum lease payments due under these loan agreements are:

	2022 £m	2021 £m
Amounts receivable		
Within one year	74.8	74.4
Within one to two years	65.2	62.9
Within two to three years	57.5	47.6
Within three to four years	56.2	34.4
Within four to five years	24.2	16.1
After five years	36.2	29.0
	314.1	264.4
Less: future finance income	(49.4)	(36.1)
Present value	264.7	228.3

The present values of those payments, net of provisions for impairment, carried in the accounts are:

	2022 £m	2021 £m
Amounts receivable		
Within one year	63.0	64.2
Within two to five years	171.3	139.1
After five years	30.4	25.0
Present value	264.7	228.3
Allowance for uncollectible amounts	(3.9)	(3.4)
Carrying value	260.8	224.9

None of the Bank's finance lease receivables were pledged as collateral for liabilities at 30 September 2022 or 30 September 2021.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS

This note sets out information on the Bank's impairment provisioning under IFRS 9 for the loans to customers balances set out in note 14, including both finance leases, accounted for under IFRS 16, and loans held at amortised cost, accounted for under IFRS 9, as both groups of assets are subject to the IFRS 9 impairment requirements.

The disclosures are set out under the following headings:

- Basis of provision
- Impairments by stage
- Movements in impairment provision in the period
- Impairments charged to income
- Economic inputs to provision calculations
- Sensitivity analysis

Basis of provision

IFRS 9 requires that impairment is evaluated on an expected credit loss ('ECL') basis. ECLs are based on an assessment of the probability of default ('PD') and loss given default ('LGD'), discounted to give a net present value. The estimation of ECL should be unbiased and probability weighted, considering all reasonable and supportable information, including forward looking economic assumptions and a range of possible outcomes. Provision may be based on either twelve months or lifetime ECL, dependant on whether an account has experienced a significant increase in credit risk ('SICR').

The Company's process for determining its provisions for impairments is summarised below. This includes

- The methods used for the calculation of ECL
- How it defines SICR
- How it defines default
- How it identifies which loans are credit impaired, as defined by IFRS 9
- How the ECL estimation process is monitored and controlled
- How the Group develops and enhances the models it uses in the ECL estimation process
- How the Group uses judgemental adjustments to ensure all elements of credit risk are fully addressed

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Calculation of expected credit loss ('ECL')

For the majority of the Bank's loan assets, the ECL is generated using statistical models applied to account data to generate PD and LGD components.

PD on both a twelve months and lifetime basis is estimated based on statistical models for the Bank's most significant asset classes. The PD calculation is a function of current asset performance, customer information and future economic assumptions. The structure of the models was derived through analysis of correlation in historic data, which identified which current and historical customer attributes and external economic variables were predictive of future loss. PD measures are calculated for the full contractual lives of loans with the models deriving probabilities that, at a given future date, a loan will be in default, performing or closed. The Bank utilised all reasonably available information in its possession for this exercise.

LGD for each account is derived by calculating a value for exposure at the point of default (which will include consideration of future interest, account charges and receipts) and reducing this for security values and costs of recovery. These calculations allow for the Bank's potential case management activities. This evaluation includes the potential impact of economic conditions at the time of any future default or enforcement. The derivation of the significant assumptions used in these calculations is discussed below.

In certain asset classes a fully modelled approach is not possible. This is generally where there are few assets in the class, where there is insufficient historical data on which to base an analysis or where certain measures, such as days past due are not useful (e.g. where the loan agreement does not require regular payments of pre-determined amounts). In these cases, which represent a small proportion of the total portfolio, alternative approaches are adopted. These rely on internal credit monitoring practices and professional credit judgement.

Notwithstanding the mechanical procedures discussed above, the Bank will always consider whether the process generates sufficient provision for particular loans, especially large exposures, and will provide additional amounts as appropriate.

In extreme or unprecedented economic conditions, it is likely that mechanical models will be less predictive of outcomes as the historical data used for modelling will be insufficiently representative of present conditions. This may be the case where economic indicators at the reporting date and future expectations for those indicators lie outside the range of the observations used to construct the models. In such circumstances, management carefully review all outputs to ensure provision is adequate.

At 30 September 2022 the UK economy was subject to levels of inflation and interest rates not seen for some considerable time and not represented sufficiently in the data sets used to create the Group's models. There was also a level of uncertainty as to the direction of government policy which was unusual for the UK. The situation was evolving rapidly at the year end, meaning that there was a risk that credit metrics and external credit bureau data might not fully reflect increasing risks, which would lead to a potential understatement of PDs.

These factors led management to conclude that current and forecast economic conditions were not ones under which the Group's models would necessarily perform well, and that judgemental adjustments might be required to compensate for these weaknesses.

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Significant Increase in Credit Risk ('SICR')

Under IFRS 9, SICR is not defined solely by account performance, but on the basis of the customer's overall credit position, and this evaluation should include consideration of external data. The Bank's aim is to define SICR to correspond, as closely as possible, to that population of accounts which are subject to enhanced administrative and monitoring procedures operationally. The Bank assesses SICR in its modelled portfolios primarily on the basis of the relative difference in an account's lifetime PD between origination and the reporting date. The levels of difference required to qualify as an SICR may differ between portfolios and will depend, to some extent, on the level of risk originally perceived and are monitored on an ongoing basis to ensure that this calibrates with actual experience.

It should be noted that the use of the current PD, which includes external factors such as credit bureau data, means that all relevant information in the Bank's hands concerning the customers present credit position is included in the evaluation, as well as the impact of future economic expectations.

For non-modelled portfolios, the SICR assessment is based on the credit monitoring position of the account in question and for all portfolios a number of qualitative indicators which provide evidence of SICR have been considered.

As part of its determination of whether model outputs form a reliable basis for impairment provisioning, the Bank considered whether it had any evidence of groups of accounts demonstrating factors indicating a higher level of credit risk than other accounts in the same portfolios. No such evidence was noted at 30 September 2022, and hence no additional accounts were identified as having an SICR.

While no requirement to identify additional SICR cases has arisen in 2022, the approach is consistent with that adopted at 30 September 2021, and will be kept under review in future periods.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Definitions of default

As the IFRS 9 definition of ECL is based on PD, default must be defined for this purpose. The analysis of these default cases provides the foundation for the Bank's PD modelling. IFRS 9 provides a rebuttable presumption that an account is in default when it is 90 days overdue and this was used as the basis of the Bank's definition, combined with qualitative and quantitative factors specific to each portfolio.

The most influential quantitative factor in the majority of portfolios is the arrears level, while the principal qualitative factors relate to internal account management statuses. In particular the decision to commence a process of enforcement will be considered as a default in all portfolios. In the Bank's buy-to-let mortgage portfolio the appointment of a receiver of rent to manage the property on the customers behalf is considered a default, while for portfolios assessed on a case-by-case basis, such as the Bank's development finance loans, the movement of an account to the highest risk category is considered as a default.

This ensures that Bank's definitions of default for its various portfolios are materially aligned to the regulatory definitions of default used internally, and are broadly aligned to its internal operational procedures, allowing for the arbitrary nature of the 90-day cut-off, which is a regulatory rather than an operational requirement. In particular the Bank's receiver of rent cases are defined as defaulted for modelling purposes as the behaviour of the case after that point is significantly influenced by internal management decisions.

Credit Impaired loans

IFRS 9 defines a credit impaired account as one where an account has suffered one or more event which has had a detrimental effect on future cash flows. It is thus a backward-looking definition, rather than one based on future expectations.

Credit impaired assets are identified either through quantitative measures or by operational status. Designations of accounts for regulatory capital purposes are also taken into account. Assets may also be assigned to Stage 3 if they are identified as credit impaired as a result of management review processes.

All loans which are in the process of enforcement, from the point where this becomes the administration strategy, are classified as credit impaired.

Loans are retained in Stage 3 for three months after the point where they cease to exhibit the characteristics of default. After this point, they may move to Stage 2 or Stage 1 depending on whether an SICR trigger remains.

All default cases are considered to be credit impaired, including all receiver of rent cases and all cases with at least one payment more than 90 days overdue, even where such cases are being managed in the expectation of realising all of the carrying balance.

In order to provide better information for users, additional analysis of credit impaired accounts has been presented below distinguishing between probationary accounts, receiver of rent accounts, accounts subject to realisation / enforcement procedures and long term managed accounts, all of which are treated as credit impaired. While other indicators of default are in use, the categories shown account for the overwhelming majority of Stage 3 cases.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Monitoring of ECL estimation processes

The Group's ECL models are compiled on the basis of the analysis of relevant historical data. Before a model is adopted for use its operations and outputs are examined to ensure that it is expected to be appropriately predictive and, if it is an updated model, expected to be more predictive than any existing model. Before a new model is adopted the changes and impacts will be considered by the CFO, alongside any advice from the Group's independent model review functions.

The performance of all models is reviewed on an ongoing basis, by senior finance and risk management, including the CFO. Monitoring packs comparing actual and predicted loss levels are produced at regular intervals, set on the basis of the materiality of each model. The continuing appropriateness of model assumptions is also reviewed as part of this process.

Models are revisited on a regular basis to ensure that they continue to reflect the most recent data as the available information increases over time.

On a monthly basis all model outputs, model overlays and provisions calculated for non-modelled books are reviewed by senior finance management including the CFO in conjunction with the latest credit risk operational and economic metrics to ensure that the impairment provision by assets type remains appropriate. This exercise will be the subject of particular focus at year end and half year.

This information is summarised for the Audit Committee on a biannual basis, and they have regard to this data in forming their conclusions on the appropriateness of provisioning levels.

Model development

The models used by the Group are updated from time to time to allow for changes in the business, developments in best practice and the availability of additional data with the passing of time. During the year ended 30 September 2021 a major update to the buy-to-let PD model took place.

The adoption of this model has enabled the reporting process in the year to be more streamlined and supported increased use of scenario analysis.

The Group's programme of model development continued during the year with a particular focus on analysing how default and loss data recorded over the period of the Coved pandemic should be reflected in forward-looking models, given the unprecedented nature of the pandemic and the national and international response to it.

All revised models and model enhancements are carefully reviewed and tested before adoption, and are subject to a governance process for their approval.

The impacts of the adoption of the new PD model in the year ended 30 September 2021 on the calculated provision were not significant.

Judgemental Adjustments

In order to ensure that its loan portfolios are adequately provisioned, the Group considers whether there are factors not fully captured by the modelling process, including economic conditions more generally, which indicate a need for judgemental adjustments. Information considered includes credit data, customer and broker feedback received, the results of insight surveys, industry intelligence and expert knowledge within the business lines.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

During the year, the dominance of Covid in these considerations reduced as the short-term impact of the pandemic receded and other economic factors such as the UK cost of living, rising interest rates and the conflict in the Ukraine became more significant.

Towards the end of the year the consensus view of the likely severity of these impacts became markedly more pessimistic, and together with political instability in the UK Government and emerging negative economic indicators this generated a situation where very careful assessment of credit prospects was required.

Where management has identified a requirement to amend the calculated provision as a result of either model deficiencies or idiosyncratic behaviour in part of the portfolio, judgemental adjustments are applied to the modelled outputs so that the ECL recognised corresponds to expert judgement, taking into account the widest possible range of current information, which might not be factored into the modelling process.

In normal circumstances the Group's objective is to develop its modelling to the point where the level of judgemental adjustments required is minimal, but in economic conditions where previous relevant experience is limited or non-existent, some form of judgemental adjustment is always likely to be necessary. While high interest rate and inflation scenarios have occurred in the UK in the past, market conditions, products and regulatory expectations have moved on considerably in the meantime, and most such observations would pre-date the existence of buy-to-let mortgages as a distinct asset class. This means that the value of past history as a guide to future credit performance is reduced.

The current model behaviour and the potential for unobserved credit issues have meant that the requirement for such adjustments over recent periods has been significant. Evidence considered by management included internal performance data, customer feedback, evidence on the wider economy and quantitative and qualitative data and statements from industry, government and regulatory bodies. These are combined to form a broad estimate of the level of provision required across the Group.

The requirement for judgemental adjustments is considered on a portfolio-by-portfolio basis, and the potential for the existence of significant groups of assets being particularly exposed to credit risk in the expected economic scenarios is also considered.

At 30 September the amount of judgemental adjustments was £5.0m (2021: £6.6m). The movements in the period represent a transition from Covid related overlays to ones which relate more to the responsiveness of the Bank's provision models to current economic conditions.

It is considered that where Covid-related adjustments were made at 30 September 2021, this credit risk is now either reflected in credit metrics or has reduced. The adjustment at 30 September 2022 is principally a result of a disconnect between the credit metrics which drive the models and the economic expectations of management, brokers and customers at the year end date.

The Bank will continue to monitor the requirement for these adjustments as the economic situation develops and its impacts begin to be reflected in model outputs. It is anticipated that a more normal economic situation would require a lower value of adjustments, but the timescale in which such a scenario might be reached appears uncertain.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Impairments by stage and division

IFRS 9 calculations and related disclosures require loan assets to be divided into three stages, with accounts which were credit impaired on initial recognition representing a fourth class.

The three classes comprise: those where there has been no SICR since advance or acquisition (Stage 1); those where there has been a SICR (Stage 2); and loans which are impaired (Stage 3).

- On initial recognition, and for assets where there has not been an SICR, provisions will be made in respect of losses resulting from the level of credit default events expected in the twelve months following the balance sheet date
- Where a loan has experienced an SICR, whether or not the loan is considered to be credit impaired, provisions will be made based on the ECLs over the full life of the loan
- For credit impaired assets, provisions will also be made on the basis of ECLs

Impairments by stage

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

	Stage 1 £m	Stage 2 * £m	Stage 3 * £m	POCI £m	Total £m
30 September 2022					
Gross loan book	7,979.5	1,302.5	69.7	-	9,351.7
Impairment provision	(7.8)	(5.7)	(14.6)	-	(28.1)
Net loan book	7,971.7	1,296.8	55.1	-	9,323.6
Coverage ratio	0.10%	0.44%	20.95%	-	0.30%
30 September 2021					
Gross loan book	7,224.0	831.9	88.6	-	8,144.5
Impairment provision	(3.1)	(8.0)	(12.9)	-	(24.0)
Net loan book	7,220.9	823.9	75.7	-	8,120.5
Coverage ratio	0.04%	0.96%	14.56%	-	0.29%

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

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Finance leases included above, analysed by staging, were:

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
30 September 2022					
Gross loan book	229.9	32.9	1.9	-	264.7
Impairment provision	(1.3)	(1.4)	(1.2)	-	(3.9)
Net loan book	228.6	31.5	0.7	-	260.8
30 September 2021					
Gross loan book	215.7	9.1	3.5	-	228.3
Impairment provision	(1.4)	(0.5)	(1.5)	-	(3.4)
Net loan book	214.3	8.6	2.0	-	224.9

In terms of the Bank's credit management processes, Stage 1 cases will fall within the appropriate customer servicing functions and Stage 2 cases will be subject to account management arrangements. Stage 3 cases will include both those subject to recovery or similar processes and those which, though being managed on a long-term basis, are included with defaulted accounts for regulatory purposes. However, these broad categorisations may vary between different product types.

Legacy assets and acquired loans which were performing on acquisition are included in the staging analysis above.

Analysis of Stage 2 loans

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

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

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

The value of accounts in stage 2 has increased across all categories as a result of the generally worsening economic outlook. The largest increase is in those cases in the buy-to-let book identified with an SICR through PD movements, a result of the updated economic scenarios and weightings.

Provision levels and coverage in the Mortgage Lending division have both reduced, however, due to the impact of the strong growth in house prices on security values. Coverage levels in the Commercial Lending division have increased, largely as a result of the nature of the items included in this stage at 30 September 2022 compared to a year earlier, and a more pessimistic outlook for security values.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

	< 1 month arrears	Recent arrears	> 1 <= 3 months arrears	Total
	£m	£m	£m	£m
30 September 2022				
Gross loan book	8.9	1,275.5	18.1	1,302.5
Impairment provision	(0.1)	(4.9)	(0.7)	(5.7)
Net loan book	8.8	1,270.6	17.4	1,296.8
Coverage ratio	1.12%	0.38%	3.87%	0.44%
30 September 2021				
Gross loan book	5.4	815.6	10.9	831.9
Impairment provision	(0.1)	(7.6)	(0.3)	(8.0)
Net loan book	5.3	808.0	10.6	823.9
Coverage ratio	1.85%	0.93%	2.75%	0.96%

Analysis of Stage 3 loans

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

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

Where an account meets two of the criteria, it will be assigned to the category shown first in the list above.

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

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

The gross values of Stage 3 accounts at 30 September 2022 are significantly reduced from these at 30 September 2021 as the number of new defaults in the year remained low and historic cases were resolved.

Coverage levels remained broadly similar to the year end position. Ratios in Stage 3 will naturally be subject to a wider range of fluctuation than those elsewhere, given the low number of accounts involved, the consequent potential for mix effects and the idiosyncratic nature of some of the cases.

	Probation £m	> 3 month arrears £m	RoR managed £m	Realisations £m	Total £m
30 September 2022					
Gross loan book	3.9	18.4	31.2	16.2	69.7
Impairment provision	(0.4)	(0.6)	(9.4)	(4.2)	(14.6)
Net loan book	3.5	17.8	21.8	12.0	55.1
Coverage ratio	10.26%	3.26%	30.13%	25.93%	20.95%
30 September 2021					
Gross loan book	7.5	19.5	54.6	7.0	88.6
Impairment provision	(0.4)	(0.8)	(9.1)	(2.6)	(12.9)
Net loan book	7.1	18.7	45.5	4.4	75.7
Coverage ratio	5.33%	4.10%	16.67%	37.14%	14.56%

The security values available to reduce exposure at default in the calculation shown above for stage 3 accounts are set out below. The estimated value of the security represents, for each account, the lesser of the valuation estimate and the exposure at default in the Central scenario. Security values are based on the most recent valuation of the relevant asset held by the Bank, indexed or depreciated as appropriate.

	2022 £m	2021 £m
First mortgages	41.9	49.1
Second mortgages	6.2	6.3
Motor finance	0.7	2.0
	48.8	57.4

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

The RoR managed accounts are being managed to ensure the optimal resolution for landlords, tenants and lenders and this long-term, stable situation underpinned their treatment as not impaired under IAS 39, but the existence of the RoR arrangement causes the accounts to be treated as defaulted for regulatory purposes. The Bank's RoR arrangements are described in more detail below.

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

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

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

	30 September 2022		30 September 2021	
	No.	**£m**	**No.**	**£m**
Managed accounts				
Appointment date				
2010 and earlier	112	18.5	205	36.2
2011 to 2013	29	4.5	37	6.5
2014 to 2016	10	1.5	18	2.6
2016 and later	54	6.7	62	9.3
Total managed accounts	205	31.2	322	54.6
Accounts in the process of realisation	95	14.6	28	4.0
	300	45.8	350	58.6

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

Movements in impairment provision by stage

An analysis of movements by IFRS 9 stage for the years ended 30 September 2022 and 30 September 2021 is set out below.

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

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

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

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

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Loss allowance at 1 October 2021	3.1	8.0	12.9	-	24.0
New assets originated or purchased	2.5	-	-	-	2.5
Changes in loss allowance					
Transfer to stage 1	1.7	(1.7)	-	-	-
Transfer to stage 2	(1.2)	1.7	(0.5)	-	-
Transfer to stage 3	(0.2)	(0.2)	0.4	-	-
Changes on stage transfer	(1.6)	1.2	2.7	-	2.3
Changes due to credit risk	3.5	(3.3)	1.6	-	1.8
Write offs	-	-	(2.5)	-	(2.5)
Assets derecognised	-	-	-	-	-
Loss allowance at 30 September 2022	7.8	5.7	14.6	-	28.1

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Loss allowance at 1 October 2020	5.2	6.4	8.3	-	19.9
New assets originated or purchased	12.8	-	-	-	12.8
Changes in loss allowance					
Transfer to stage 1	1.1	(1.0)	(0.1)	-	-
Transfer to stage 2	(4.2)	4.3	(0.1)	-	-
Transfer to stage 3	(8.2)	(0.1)	8.3	-	-
Changes on stage transfer	(0.6)	0.6	0.9	-	0.9
Changes due to credit risk	(3.0)	(2.2)	(3.3)	-	(8.5)
Write offs	-	-	(1.1)	-	(1.1)
Assets derecognised	-	-	-	-	-
Loss allowance at 30 September 2021	3.1	8.0	12.9	-	24.0

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

During the year ended 30 September 2022 the impairment allowance remained relatively stable, due to the opposing effects of the easing of Covid-related pressures on the UK economy and mounting concerns about the nation's economic health more generally, with inflation and interest rates increasing and the potential for impacts from the conflict in Ukraine.

The increase in stage 1 provision came mostly from new lending, coupled with the need to make judgemental increases in the provision balance. Stage 2 provisions fell slightly as the impacts of additional Covid-related SICRs in 2021 fell away. Stage 3 provision reduced as bought forward cases were resolved.

The principal movements in the impairment provision in the year ended 30 September 2021 were downwards, with a more benign economic outlook reducing both the estimated likelihood of losses and the expected loss on defaulted cases as security values improved. However coverage levels still remained in excess of those pre-Covid, with PMAs in place to compensate for the potential impact of credit issues not apparent in the data.

While fewer accounts had been granted payment holiday extensions in that year than in the year ended 30 September 2020, this had driven further transfers from Stage 1 to Stage 2. Transfers to Stage 3 reflected principally a small number of realisation cases and other cases identified through credit review. Write offs largely related to the realisation of already provided losses on cases being worked out on a long-term basis.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

The movements in the Loans to Customers balances in respect of which these loss allowances have been made are set out below.

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Balances at 1 October 2021	7,224.0	831.9	88.6	-	8,144.5
New assets originated or purchased	2,180.2	-	-	-	2,180.2
Changes in staging					
Transfer to stage 1	359.3	(358.2)	(1.1)	-	-
Transfer to stage 2	(908.3)	917.7	(9.4)	-	-
Transfer to stage 3	(18.2)	(10.5)	28.7	-	-
Redemptions and repayments	(855.4)	(81.2)	(36.7)	-	(973.3)
Assets derecognised	-	-	-	-	-
Write offs	-	-	(2.5)	-	(2.5)
Other changes	(2.1)	2.8	2.1	-	2.8
Balance at 30 September 2022	7,979.5	1,302.5	69.7	-	9,351.7
Loss allowance	(7.8)	(5.7)	(14.6)	-	(28.1)
Carrying value	7,971.7	1,296.8	55.1	-	9,323.6
Balances at 1 October 2020	5,378.8	436.1	37.4	-	5,852.3
New assets originated or purchased	3,778.1	10.2	-	-	3,788.3
Changes in staging					
Transfer to stage 1	31.9	(30.0)	(1.9)	-	-
Transfer to stage 2	(506.4)	508.5	(2.1)	-	-
Transfer to stage 3	(58.3)	(10.2)	68.5	-	-
Redemptions and repayments	(485.9)	(87.9)	(13.5)	-	(587.3)
Assets derecognised	(933.7)	-	-	-	(933.7)
Write offs	-	-	(1.1)	-	(1.1)
Other changes	19.5	5.2	1.3	-	26.0
Balance at 30 September 2021	7,224.0	831.9	88.6	-	8,144.5
Loss allowance	(3.1)	(8.0)	(12.9)	-	(24.0)
Carrying value	7,220.9	823.9	75.7	-	8,120.5

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

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

At 30 September 2022 enforceable contractual balances of £5.9m (2021: £5.9m) were outstanding on non-POCI assets written off in the period. This will exclude those accounts where a full and final settlement was agreed and those where the contractual terms do not permit any further action. Enforceable balances will be kept under review for operational purposes but no amounts will be recognised in respect of such accounts unless further cash is received or there is a strong expectation that it will be.

Impairments charged / (released) to income

The amounts charged / (released) to the profit and loss account in the period are analysed as follows.

	2022	2021
	£m	£m
Provided / (Released) in period	3.3	(9.5)
Written off amounts	3.6	1.1
	6.9	(8.4)
Of which		
Loan accounts	5.1	(7.7)
Finance leases	1.8	(0.7)
	6.9	(8.4)

Economic impacts

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

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

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

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

The central scenario used for IFRS 9 impairment purposes is the same scenario which forms the basis of the Group's business planning and forecasting and will therefore generally carry the highest probability weighting. In its September 2022 forecasting cycle (the 'October reforecast'), the Group has adopted a central economic scenario derived using a broadly equivalent approach to that used in September 2021, with the starting point of the scenario updated to reflect the actual movements of economic variables in the year. The general trend of the Group's central forecast is broadly negative in the short term, with interest rates and inflation increasing sharply by historical terms in the early part of the five year forecast period before normalising. Short term falls in house prices are also anticipated.

Compared to the central scenario adopted at 30 September 2021, the new central forecast is based on a significantly higher interest rate environment throughout the period, reflecting increases already seen in the second half of the year and clear market expectations of higher rates to come. Inflation is much higher in the early years of the forecast than anticipated twelve months ago, with credit growth more constricted. GDP growth is slowed and house prices less positive in the short term, but recover later. These all reflect a worsening outlook for the UK than anticipated 12 months ago especially in the first two years of the period.

The upside and downside scenarios continue to be derived from the central scenario, as they have been in previous periods. The shapes of these three scenarios are broadly similar across the period, but the degree of divergence of the upside and downside scenarios from the central scenario has been reviewed to ensure that the asymmetrical nature of credit risk is properly accounted for and the full universe of possible outcomes adequately represented.

The severe scenario has been derived from stress testing scenarios published by the Bank of England, as in previous periods, with the 2022 Annual Cyclical Scenario being used at 30 September 2022. This scenario is based on a dep recession, higher interest rates and falling asset prices. To ensure that the scenario is appropriately severe in the Bank's circumstances a slightly higher unemployment level and a slightly worse outcome on house prices were assumed, otherwise the appreciation of security values in the later part of the forecast period would negate other impacts.

Following a review of the weightings of the different scenarios, set against the overall potential for variability in the future economic outlook, the Group decided to amend the scenario weightings used at 30 September 2021 for the current year.

The weightings attached to each scenario are set out below

	2022	**2021**
Central scenario	40%	40%
Upside scenario	10%	10%
Downside scenario	30%	35%
Severe scenario	20%	15%
	100%	100%

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

The economic variables comprising each scenario, and their minimum and maximum projected values for the first five years of the forecast period are set out below.

30 September 2022

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max %	Min %	Max %	Min %	Max %	Min %	Max %	Min %
Economic driver								
GDP	2.2	(0.3)	3.5	1.2	2.2	(2.7)	1.2	(5.0)
HPI	4.8	(4.5)	7.5	3.3	4.9	(13.1)	5.7	(17.8)
BBR	5.0	3.0	4.5	3.0	5.5	3.0	6.0	3.3
CPI	10.8	1.4	10.3	1.7	14.0	1.8	17.0	1.8
Unemployment	5.0	3.9	4.5	3.4	6.3	4.1	9.2	4.5
Secured lending	4.0	2.3	4.8	3.1	3.3	1.6	3.7	(1.2)
Consumer credit	5.0	2.5	5.8	3.3	4.3	1.8	4.8	(5.2)

30 September 2021

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max %	Min %	Max %	Min %	Max %	Min %	Max %	Min %
Economic driver								
GDP	11.5	1.1	13.3	1.6	7.3	0.9	14.3	(5.9)
HPI	6.1	(4.0)	7.7	0.6	2.9	(9.8)	2.4	(16.9)
BBR	0.8	0.1	1.0	0.1	0.5	0.1	0.2	(0.1)
CPI	4.0	1.8	3.8	1.8	4.5	1.8	2.0	0.2
Unemployment	5.5	4.1	4.7	3.8	5.9	4.5	11.9	4.8
Secured lending	4.8	3.0	5.5	3.5	4.0	2.5	3.1	(2.5)
Consumer credit	6.4	0.4	8.5	1.9	4.6	(0.1)	9.2	(8.9)

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

	2022 £m	2021 £m
Calculated provision	28.1	24.0
100% weighted central scenario	21.2	16.3
Effect of multiple economic scenarios	6.9	7.7

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Sensitivity

The calculation of impairment provision under IFRS 9 is subject to a variety of uncertainties arising from assumptions, forecasts and expectations about future events and conditions. To illustrate the impact of these uncertainties, sensitivity calculations have been performed for some of the most significant.

Economic conditions

To illustrate the potential impact of differing future economic scenarios on the total impairment, the provision which would be calculated if each of the economic scenarios were 100% weighted would be:

Scenario	2022 Provision £m	2022 Difference £m	2021 Provision £m	2021 Difference £m
Central	21.2	(6.9)	16.3	(7.7)
Upside	17.5	(10.6)	13.7	(10.3)
Downside	27.3	(0.8)	25.5	1.5
Severe	53.4	25.3	48.8	24.8

The weighted average of these 100% weighted provisions need not equal the weighted average ECL due to the impact of the differing PDs on staging. However due to the impact of post-model stage adjustments at 30 September 2021, the effect on the PD SICR test of 100% weighting has not been taken into account in the calculations at that date.

Significant increase in credit risk

The most important driver of SICR is relative PD. If all PDs were increased by 10%, loans with a gross value of £94.7m (2021: £60.8m) would transfer from stage 1 to stage 2, and the total provision would increase by £0.7m (2021: 0.8m) from the effects of higher expected losses and the impact of providing for expected lifetime losses, rather than 12-month losses on the additional stage 2 cases.

Value of security

The principal assumptions impacting on loss given default are the estimated security values. If the rate of growth in house prices assumed by the model were halved, ignoring any PD effects, then the provision for the Group’s first and second mortgages assets under the central scenario would increase by £1.8m (2021: £1.9m).

Receiver of rent

The majority of receiver of rent cases, which are included in Stage 3, are managed long-term and therefore their assumed realisation date has an important impact on the provision calculation. If the assumed rate of realisations was increased by 20%, the impairment provision in the central scenario would increase by £0.2m (2021: £0.3m).

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

18. INVESTMENT IN STRUCTURED ENTITIES

Investments in structured entities represent the Bank's investment in publicly traded, asset backed floating rate notes originally issued by Paragon Mortgages (No. 25) PLC ('PM25'), Paragon Mortgages (No. 26) PLC ('PM26') and Paragon Mortgages (No. 27) PLC ('PM27'), Paragon Mortgages (No. 28) PLC, special purpose vehicle ('SPV'). In addition, debt issued by Paragon Second Funding Limited ('PSF') was also held by the Bank during the year. These companies were established and controlled by entities in common control with the Bank to purchase pools of loan assets.

As PM25, PM26, PM27, PM28 and PSF are controlled by PBG, the Bank's ultimate parent, these entities are considered to be related parties of the Bank.

These investments are denominated in sterling and are considered to be debt investments as defined by IFRS. The underlying assets are mortgage loans made to United Kingdom borrowers. The Bank is under no obligation to make any contribution to the SPV and its maximum loss is limited to the carrying value of its investment.

The Investments consist of notes issued by SPV's which are rated by external agencies and a participation in a syndicated debt issued by a Group entity that is rated A2 by Moody's. Given the levels and stability of these ratings, they are included in stage 1 for IFRS 9 purposes and the PD is considered to be so low that any expected loss would be immaterial. Listed below are the notes listed per the rating.

	2022 £m	2021 £m
AAA	1,391.4	1,522.1
AA	251.9	272.7
A	44.5	44.5
BBB	40.8	40.8
Not rated	62.6	64.0
At 30 September 2022	1,791.2	1,944.1

The movements in the Bank's investment in structured entities in the year ended 30 September 2022 and the year ended 30 September 2021 were:

	2022 £m	2021 £m
Cost		
At 1 October 2021	1,944.1	1,220.3
Additions	15.8	804.4
Effective Interest Rate ('EIR') income	3.1	3.9
Payments received	(171.8)	(84.5)
At 30 September 2022	1,791.2	1,944.1

£7.2m (2021: £2.9m) is included in Sundry Assets (note 20) in respect of accrued interest on these Notes at the year end.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

19. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

Introduction

The Bank uses derivative financial instruments such as interest rate swaps for risk management purposes only. Each such derivative contract is entered into for economic hedging purposes to manage a particular identified risk (as described in notes 39 to 42) and any gains or losses arising are incidental to this objective. No trading in derivative financial instruments is undertaken.

Hedge accounting is applied where appropriate, though some derivatives, while forming part of an economic hedge relationship, do not qualify for this accounting treatment under the IAS 39 rules, particularly where the hedged risk relates to an off balance sheet item. In other cases, hedge accounting has not been adopted either because natural accounting offsets are expected or because complying with the IAS 39 hedge accounting rules would be particularly onerous.

The Bank's hedging arrangements are fair value hedges of portfolio interest rate risk, which are used to manage the interest rate basis risk inherent in fixed rate lending and deposit taking.

An economic hedge of interest rate basis risk in fixed rate lending will also address pipeline exposures, where future lending at a given fixed rate is anticipated. However, such arrangements do not qualify as hedges for accounting purposes.

In addition, the Bank utilises currency derivatives to hedge its exposure on the small amount of lending denominated in foreign currencies by one of its subsidiary undertakings.

The analysis below splits derivatives between those accounted for within portfolio fair value hedges and those which, despite representing an economic hedge, are not accounted for as hedges. There were no individual interest rate risk or cashflow hedging arrangements in place either in the year ended 30 September 2022 or the preceding year.

	2022 Assets £m	2022 Liabilities £m	2021 Assets £m	2021 Liabilities £m
Derivatives in accounting hedge relationships				
Fair value hedges				
Interest rate swaps				
Fixed to floating	466.3	-	18.7	(31.3)
Floating to fixed	0.3	(98.5)	2.8	(5.9)
	466.6	(98.5)	21.5	(37.2)
Total derivatives in accounting hedge relationships	466.6	(98.5)	21.5	(37.2)
Other derivatives				
Interest rate swaps	138.8	(19.6)	7.0	(4.6)
Currency futures	0.5	-	-	(0.2)
Total recognised derivative assets/(liabilities)	605.9	(118.1)	28.5	(42.0)

The credit risk inherent in the derivative financial assets shown above is discussed in note 39.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

19. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

a) Fair value hedges

Background and hedging objectives

The Bank's fair value hedges of portfolios of interest rate risk ('macro hedges') arise from its management of the interest basis risk inherent in its fixed rate lending and deposit taking activities. These activities would expose the Bank to movement in market interest rates if not hedged.

This position arises naturally where fixed rate loans are funded with floating or variable rate borrowings but may also arise where retail deposit funding is used. Where possible the Bank takes advantage of natural hedging between fixed rate assets and deposits, but it is unlikely that a precise match for value and tenor of the instruments could be achieved leaving unmatched items on both sides. This is referred to as repricing risk and controlled within limits under the Bank's interest rate risk management process, described in note 41. In order to manage these exposures, they are hedged with financial derivatives and form part of the Bank's portfolio hedging arrangements. Repricing risk is monitored regularly to ensure mismatches or gaps remain within limits set by policy.

Responsibility to direct and oversee structural risk management has been delegated by the Board to ALCO. A hedging strategy is developed for each fixed product considering behavioural characteristics, such as whether a customer is likely to prepay before contractual maturity. This is reviewed from time to time with any changes agreed with ALCO.

In order to manage potential exposure to increases in interest rates it may be necessary to undertake pre-hedging of fixed rate assets in the pipeline. Interest rate swaps used to hedge pipeline loan exposures, which are not yet recognised on the balance sheet, can cause unmatched fair value cost or credit to arise until both sides of the hedge can be recognised within the interest rate portfolio hedging arrangement, generally a few months after the inception of the derivative contract.

In managing interest rate exposure, the Treasury function may use interest rate swaps, forward rate agreements, swaptions or interest rate caps and floors. However, interest rate swaps are the most generally used instruments.

This policy creates two macro hedges:

- The 'loan hedge' matching fixed rate buy-to-let mortgage assets with interest rate swaps to convert the interest receivable to a floating rate
- The 'deposit hedge' matching fixed rate deposits with interest rate swaps which operates in the opposite direction, converting the fixed rate interest payable to floating rate amounts

During the year the Bank completed the process of changing the principal sterling reference rate used in its interest rate risk management framework from LIBOR to SONIA, with all hedges which referenced LIBOR transitioned to a SONIA basis. However, for administrative purposes, the macro hedges continued to be divided into two sections, one including the transitioned swaps and the other those swaps which referenced SONIA at inception.

Through the year, as assets and deposits matured and were replaced by new business, the formally LIBOR-linked element of the hedges reduced, and the originally SONIA-linked element increased.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

19. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

All new interest rate hedging arrangements for fixed rate assets or liabilities are executed with SONIA as a reference rate.

The remaining back book of swaps which referenced three-month LIBOR either ran off as the instruments reached maturity, or, where they had a maturity date after December 2021, transitioned to SONIA in accordance with the protocol issued by ISDA, the trade organisation for derivatives, at the point of LIBOR cessation.

The designation of the two macro hedges is updated, on a month by month basis, using software which compares the overall tenor, value and rate positions to match the expected fair value movement of the swaps with the expected interest rate risk related movement in the fair value of the relevant assets or liabilities over the designation period as closely as possible. The software applies regression analysis techniques to the potential impact of changes in expected interest rates over the designation period to maximise expected hedge effectiveness on a prospective basis. The value of the portfolio of loans or deposits selected is then designated, as a monetary amount of interest rate risk, as the hedged item, while the portfolio of swaps selected are designated as the hedging instruments.

Any swaps not selected in this process are disclosed as derivatives not in hedging relationships.

At the end of each designation period the Bank will assess the effectiveness of each hedge retrospectively, based on fair value movements (relating to interest rate risk components only) which have actually occurred in the period. Movements are compared to pre-determined test thresholds to determine whether the hedge was effective in the period.

Potential sources of ineffectiveness

The Bank has identified the following possible sources of hedge ineffectiveness in its portfolio hedges of interest rate risk:

- The maturity profile of the hedging instruments may not exactly match that of the hedged items, particularly where hedged items settle early
- The use of derivatives as a hedge of interest rate additionally exposes the Bank to the derivative counterparties' credit risk, which is not matched in the hedged item. This risk is minimised by transacting only with high quality counterparties and through collateralisation arrangements (as described in note 39)
- The use of different discounting curves in measuring fair value changes in the hedged items and hedging instruments
- Difference in the timing of interest payments on the hedged items and settlements on the hedging instruments

These sources of ineffectiveness are minimised by the portfolio matching process, which seeks to match the terms of the items as closely as possible.

In addition to the hedging ineffectiveness described above, group profit will also be affected by the fair value movements of interest rate swap agreements which were entered in to as part of the Bank's interest rate risk hedging strategy, but failed to find a match in the hedging portfolio.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

19. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

Hedging Instruments

The hedging portfolios at 30 September 2022 and 30 September 2021 consist of a large number of sterling denominated swaps In addition, at 30 September 2022 there were a small number of balance guarantee swaps ('BGS') in place. Settlement on all swaps is generally quarterly (monthly for BGS) where:

- One payment is calculated based on a fixed rate of interest and the nominal value of the swap
- An opposite payment is calculated based on the same nominal value but using a floating interest rate set at a fixed margin over a reference rate, LIBOR or SONIA

On the BGS the nominal value of the swap is linked to the principal value of a pool of assets and reduces in line with redemptions and repayments until maturity. Other interest rate swaps have a fixed nominal value throughout their lives.

The Bank pays fixed rate and receives floating when hedging exposures from fixed rate assets (in the loan hedge). Conversely, the Bank pays floating rate and receives fixed rate when hedging fixed rate deposits, in the deposit hedge.

The principal terms of the hedging instruments are set out below, analysed between the two directions of the swap.

	2022		2021	
	Deposit Hedge	**Loan hedge**	**Deposit Hedge**	**Loan hedge**
Average fixed notional interest rate	1.45%	1.10%	0.16%	0.87%
Average notional margin over LIBOR	-	-	-	-
Average notional margin over SONIA	-	-	-	-
	£m	**£m**	**£m**	**£m**
Notional principal value				
LIBOR swaps	-	-	471.5	2,605.7
SONIA BGS	-	47.0	-	62.6
SONIA swaps	4,286.0	4,847.5	2,415.0	1,087.0
	4,286.0	4,894.5	2,886.5	3,755.3
Maturing				
Within one year	3,097.0	1,092.0	2,224.5	351.1
Between one and two years	987.5	1,230.5	422.0	1,358.6
Between two and five years	201.5	2,569.5	240.0	2,041.1
More than 5 years	-	2.5	-	4.5
	4,286.0	4,894.5	2,886.5	3,755.3
Fair value	(98.2)	466.3	(3.1)	(12.6)

The value included above for BGS are analysed by their contractual maturity dates although, due to the terms of the instruments, it is likely that the balance outstanding will reduce more quickly.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

19. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

Accounting impacts

Movements affecting the portfolio fair value hedges during the year are set out below.

	2022		2021	
	Deposit Hedge £m	Loan Hedge £m	Deposit Hedge £m	Loan Hedge £m
Hedging items				
Interest rate swaps				
Included in derivative financial assets	0.3	466.3	2.8	18.7
Included in derivative financial liabilities	(98.5)	-	(5.9)	(31.3)
	(98.2)	466.3	(3.1)	(12.6)
Notional principal value	4,286.0	4,894.5	2,886.5	3,755.3
Change in fair value used in calculating hedge ineffectiveness	(94.8)	436.0	(15.4)	90.4

	2022		2021	
	Deposit Hedge £m	Loan Hedge £m	Deposit Hedge £m	Loan Hedge £m
Hedged items				
Fixed rate deposits				
Monetary amount of risk relating to Retail Deposits	3,986.4	-	2,730.4	-
Fixed rate loans				
Monetary amount of risk relating to Loans to Customers	-	4,973.5	-	3,819.9
Accumulated amount of fair value hedge adjustments included on balance sheet (notes 23 and 14) *	99.7	(370.7)	3.0	24.2
Of which: amounts related to discontinued hedging relationships being amortised	(7.9)	72.5	(1.7)	12.5
Change in fair value used in recognising hedge ineffectiveness	106.4	(415.3)	15.1	(84.7)
Hedge ineffectiveness recognised				
Included in fair value gains/losses in the profit and loss account	11.6	20.7	(0.3)	5.7

* Under the IAS 39 rules relating to fair value hedge accounting for portfolios of interest rate risk, the change in the fair value of the hedged items attributable to the hedged risk is shown as 'fair value adjustments from portfolio hedging' next to the carrying value of the hedged assets or liabilities in the appropriate note.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

19. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

b) Derivatives not in a hedging relationship

The Bank's other derivatives comprise:

- Interest rate swaps which are economically part of the Bank's portfolio hedging arrangements but failed to find a match in the hedge designation, including swaps hedging interest rate risk on the new lending pipeline
- Currency futures, economically hedging exposures on lending denominated in currency, where hedge accounting has not been adopted due to the size of the exposure

The principal terms of these derivatives are set out below.

Interest rate swaps

	2022		2021	
	Pay fixed	**Pay floating**	**Pay Fixed**	**Pay floating**
Average fixed notional interest rate	1.71%	4.31%	0.48%	0.35%
Average notional margin over LIBOR	-	-	-	-
Average notional margin over SONIA	-	-	-	-
	£m	**£m**	**£m**	**£m**
Notional principal value				
LIBOR swaps	-	-	179.7	98.5
SONIA swaps	1,858.6	377.1	854.5	585.0
	1,858.6	377.1	1,034.2	683.5
Maturing				
Within one year	474.1	288.0	91.7	270.5
Between one and two years	61.5	86.0	258.5	331.0
Between two and five years	488.0	3.1	435.5	82.0
More than 5 years	835.0	-	248.5	-
	1,858.6	377.1	1,034.2	683.5
Fair value	122.1	(2.9)	3.1	(0.7)

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

19. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

Currency futures

	2022	2021
US Dollar futures		
Average future exchange rate	1.07	1.36
	£m	£m
Notional principal value	13.4	11.9
Maturing		
Within one year	13.4	11.9
Between one and two years	-	-
Between two and five years	-	-
	13.4	11.9
Fair value	0.5	(0.2)

20. SUNDRY ASSETS

	Note	2022 £m	2021 £m
Current assets			
Amounts owed by Group companies		58.0	55.6
Accrued interest income		7.2	2.9
CSA assets		19.5	45.2
CRDs		30.2	23.7
Other receivables		0.1	0.1
Sundry financial assets	48	115.0	127.5

Cash ratio deposits ('CRDs') are non-interest-bearing deposits lodged with the Bank of England, based on the value of the Bank's eligible liabilities. These are required to comply with regulatory rules.

Credit Support Annex ('CSA') assets are deposits placed with highly rated banks to act as security for the Bank's derivative financial liabilities.

Neither of these balances is accessible by the Bank at the balance sheet date. Therefore, they are included in sundry assets rather than cash balances.

CRD, CSA and accrued interest are considered to be stage 1 assets for IFRS 9 impairment purposes. The probabilities of default of the obligor institutions (the Bank of England and major banks) has been assessed and is considered to be so low as to require no significant impairment provision.

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21. PROPERTY, PLANT AND EQUIPMENT

The property, plant and equipment balance of the Company represents a right of use asset in respect of leases where the Company is the lessee. The carrying value of this asset is set out below.

	Land and buildings £m
Cost	
At 30 September 2020	-
Additions	5.4
Disposals	-
At 30 September 2021	5.4
Additions	-
Disposals	(5.4)
At 30 September 2022	-
Accumulated depreciation	
At 30 September 2020	-
Charge for the year	(0.3)
On disposals	-
At 30 September 2021	(0.3)
Charge for the year	(0.3)
On disposals	0.6
At 30 September 2022	-
Net book value	
At 30 September 2022	-
At 30 September 2021	5.1

NOTES TO THE ACCOUNTS - ANALYSIS
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22. INVESTMENT IN SUBSIDIARY UNDERTAKINGS

	Shares in Group companies £m	Loans to Group companies £m	Total £m
At 1 October 2020	422.7	1,224.6	1,647.3
Investments in subsidiaries	245.0	-	245.0
Loans advanced	-	2,075.0	2,075.0
Loans repaid	-	(1,905.6)	(1,905.6)
Provision movements	-	-	-
At 30 September 2021	667.7	1,394.0	2,061.7
Investments in subsidiaries	-	-	-
Loans advanced	-	5,429.8	5,429.8
Loans repaid	-	(5,212.9)	(5,212.9)
Provision movements	(0.6)	-	(0.6)
At 30 September 2022	667.1	1,610.9	2,278.0

Investments in subsidiaries represent transactions between the Company and various of its subsidiaries.

During the year ended 30 September 2022 the Company received £156.0m in dividend income from its subsidiaries (2021: £31.5m) and £23.4m of interest on loans to Group companies (2021: £34.2m).

The Company's subsidiaries, and the nature of its interest in them, are shown in note 50.

23. RETAIL DEPOSITS

The Bank's retail deposits, were received from customers in the UK and are denominated in sterling. The deposits comprise principally term deposits, notice accounts and easy access accounts. The method of interest calculation on these deposits is analysed as follows:

	2022 £m	2021 £m
Fixed rate	6,201.3	5,466.0
Variable rates	4,467.9	3,834.4
	10,669.2	9,300.4

The weighted average interest rate on retail deposits at 30 September 2022 and 30 September 2021, analysed by charging method, was:

	2022 %	2021 %
Fixed rate	1.74	1.25
Variable rates	1.55	0.42
All deposits	1.66	0.91

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

23. RETAIL DEPOSITS (CONTINUED)

The contractual maturity of these deposits is analysed below.

	2022 £m	2021 £m
Amounts repayable		
In less than three months	929.0	789.0
In more than three months, but not more than one year	3,732.1	3,105.4
In more than one year, but not more than two years	1,627.3	1,580.1
In more than two years, but not more than five years	421.4	507.4
Total term deposits	6,709.8	5,981.9
Repayable on demand	3,959.4	3,318.5
	10,669.2	9,300.4
Fair value adjustments for portfolio hedging	(99.7)	(3.0)
	10,569.5	9,297.4

24. CENTRAL BANK FACILITIES

During the year, the Bank has utilised facilities provided by the Bank of England including through its Sterling Monetary Framework. These facilities enable either funding or off-balance sheet liquidity to be provided to Paragon Bank on the security of designated pools of the Bank's first mortgage assets and/or the retained Notes described in note 15, with the amount available based on the value of the security given, subject, where appropriate, to a haircut.

Drawings under the TFSME have a maturity of four years and bear interest at bank base rate. The average remaining maturity of the Bank's drawings is 37 months (2021: 40 months). As these drawings were provided at rates below those available commercially, by a government agency, they were accounted for under IAS 20.

Drawings under the original TFS have a maturity of four years and bear interest at bank base rate. The average remaining maturity of the Bank's drawings at 30 September 2021 was 4 months and all outstanding drawings were repaid in the year. As these drawings were provided at rates below those available commercially, by a government agency, they were accounted for under IAS 20. The TFS is no longer available for new drawings.

Drawings under the Indexed Long-Term Repo Scheme ('ILTR') had a maturity of six months and a rate of interest set in an auction process. The Group accessed ILTR during the year, and it retains access to this programme for liquidity purposes.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

24. CENTRAL BANK FACILITIES (CONTINUED)

The amounts drawn under these facilities are set out below.

	2022 £m	2021 £m
TFSME	2,750.0	2,750.0
TFS	-	69.0
ILTR	-	-
Total central bank facilities	2,750.0	2,819.0

All TFSME borrowings fall due after more than one year. At 30 September 2021 £69.0 million of TFS borrowings were due within one year.

During the year all TFSME borrowings were repaid and redrawn, extending the maturity date to 21 October 2025 for the majority of drawings, with £5.2m falling due on 31 March 2027.

Further first mortgage assets of the Bank have been pre-positioned with the Bank of England for future use in such schemes. The assets pledged in support of these drawings are set out in note 15.

The balances arising from the TFSME and TFS carried in the Banks accounts are shown below.

	2022 £m	2022 £m	2021 £m	2021 £m
TFSME at IAS 20 carrying value	2,700.2		2,657.8	
Deferred government assistance	49.8		92.2	
		2,750.0		2,750.0
TFS at IAS 20 carrying value	-		68.7	
Deferred government assistance	-		0.3	
		-		69.0
		2,750.0		2,819.0

25. CORPORATE BOND

On 25 March 2021 the Bank issued £150.0m of Fixed Rate Callable Subordinated Tier-2 Notes due 2031 at par to its parent company, PBG, to provide it with long term capital. These bonds bear interest at a fixed rate of 4.375% per annum until 25 September 2026 after which interest will be payable at a reset rate which is 3.956% over that payable on UK Government bonds of similar duration at that time. At the same time the Tier-2 bond that was issued on 20 December 2017 was repurchased following a tender and cancelled The premium arising of £7.3m is included in interest payable.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

26. SUNDRY LIABILITIES

	2022 £m	2021 £m
Current liabilities		
Accrued interest	53.0	29.1
Amounts owed to group companies	206.0	303.8
CSA liabilities	388.3	-
Other accruals	1.2	1.1
Sundry financial liabilities	648.5	334.0
Lease payables (note 27)	-	0.2
	648.5	334.2
Non-current liabilities		
Lease payables (note 27)	-	5.0
Total sundry liabilities	648.5	339.2

CSA liabilities represent collateral received in respect of interest rate swap agreements.

All sundry financial liabilities above are carried at amortised cost.

27. LEASE PAYABLES

The Group's lease liabilities arise under the leasing arrangements described in note 36. Related right of use assets are shown in note 26.

	2022 £m	2021 £m
Leasing liabilities falling due:		
In more than five years	-	2.5
In more than two but less than five years	-	1.8
In more than one year but less than two years	-	0.7
In more than one year (note 26)	-	5.0
In less than one year (note 26)	-	0.2
	-	5.2

28. CURRENT TAX LIABILITIES

Current tax represents UK corporation tax owed.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

29. DEFERRED TAX LIABILITY

The movements in the net deferred tax liability / (asset) are as follows:

	2022 £m	2021 £m
Net liability / (asset) at 1 October 2021	3.0	(1.3)
Income statement charge	52.0	4.3
Net liability at 30 September 2022	55.0	3.0

The net deferred tax liability for which provision has been made is analysed as follows:

	2022 £m	2021 £m
Loans and derivatives	55.0	3.0
Net deferred tax liability	55.0	3.0

As stated in note 11, legislation in the year has increased the rate of corporation tax in the UK to 25.0% from April 2023. This change has been reflected in the deferred tax balance. The temporary differences have been provided at the rate prevailing when the Bank anticipates the temporary difference to reverse. In addition, it has been assumed that the surcharge will apply when the difference reverses. In the event that the temporary differences actually reverse in different periods a credit or charge will arise in a future period to reflect the difference. The timing of reversal of temporary differences will be affected by both matters within the Bank’s control and matters outside the Bank’s control.

30. CALLED-UP SHARE CAPITAL

The share capital of the Company consists of a single class of £1 ordinary shares.

Movements in the issued share capital in the year were:

	2022 Number	2021 Number
Ordinary shares		
At 1 October 2021 and 30 September 2022	552,625,034	552,625,034

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

31. RESERVES

Profit and loss account

	2022 £m	2021 £m
At 1 October 2021	266.7	217.8
Profit for the year	394.4	143.7
Dividends paid	(150.3)	(94.8)
At 30 September 2022	510.8	266.7

An interim dividend of £0.27 per share was paid during the year (2021: £0.17 per share). A final dividend of £0.25 per share is proposed (2021: nil).

32. NET CASH FLOW FROM OPERATING ACTIVITIES

	2022 £m	2021 £m
Profit before tax	480.2	182.5
Non-cash items included in profit and other adjustments:		
Depreciation on property, plant and equipment	0.3	0.3
Impairment losses on loans to customers	6.6	(10.9)
Net (increase) / decrease in operating assets:		
Loans to customers	(1,056.2)	(3,001.0)
Derivative financial instruments	(577.4)	(10.5)
Fair value of portfolio hedges	394.9	70.0
Other receivables	12.5	447.3
Net increase / (decrease) in operating liabilities:		
Retail deposits	1,368.9	1,443.8
Derivative financial instruments	76.1	(65.6)
Fair value of portfolio hedges	(96.8)	(13.0)
Other liabilities	309.3	36.0
Cash generated / (utilised) by operations	918.4	(921.1)
Income taxes (paid)	(35.0)	(13.7)
	883.4	(934.8)

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

33. NET CASH FLOW FROM INVESTING ACTIVITIES

	2022 £m	2021 £m
Proceeds from sale of operating property, plant and equipment	4.8	-
Advances of loans to subsidiary undertakings	(5,429.8)	(2,320.0)
Repayment of loans by subsidiary entities	5,212.9	1,905.6
Net cash (utilised) by investing activities	(212.1)	(414.4)

The presentation of cashflows related to loans to Group companies has been revised to correspond to that used in note 31 and the comparative amounts shown for 2021 reanalysed accordingly.

34. NET CASH FLOW FROM FINANCING ACTIVITIES

	2022 £m	2021 £m
Dividends paid (note 31)	(150.3)	(94.8)
Movement on central bank facilities	(69.0)	964.6
Capital element of lease payments	-	(0.1)
Net cash (utilised) / generated by financing activities	(219.3)	869.7

35. RELATED PARTY TRANSACTIONS

During the year the Bank has identified the following transactions with entities in common ownership, which are related parties.

Management and administrative services were provided to the Bank by Paragon Finance PLC. Details of the amounts charged to the Bank in respect of these services are disclosed in note 7. At the balance sheet date amounts owed by Paragon Finance PLC are disclosed in note 22.

During the year the Bank purchased £17.0m of debt issued by Paragon Second Funding Limited (2021: £77.5m) from a third party.

During the year the Bank transferred the office building to Paragon Finance Plc, amounts are disclosed in note 21.

Floating rate notes issued by PM25, PM26, PM27, PM28 and debt issued by PSF, companies in common control with the Bank, which are therefore related parties have been acquired by the Bank. At the balance sheet date, the outstanding investment is shown in note 18 and accrued interest on the investment is shown in note 20.

During the year the Bank provided an interest-bearing loan to each of Paragon Asset Finance Limited, Paragon Mortgages (2010) Limited, Paragon Finance Plc, Paragon Development Finance Limited and PBAF Acquisitions Limited which are related parties. Details of the interest charged

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

35. RELATED PARTY TRANSACTIONS (CONTINUED)

on the loans is provided in note 4. At the balance sheet date, the outstanding loan amounts are shown in note 22 with the accrued interest due shown in note 20. The Bank also provided various management and administrative services to these companies and its subsidiaries.

During the year the Bank had an interest bearing loan from the parent company, Paragon Banking Group, which is a related party. Details about the amount charged on the loan is provided in note 4. At the balance sheet date, the outstanding loan amount is shown in note 22 with £0.0m (2021: £0.1m) shown within 'accrued interest' in note 26. The Banks borrowing from its parent company under the T2 bond is shown in note 25.

Details of the Bank investments in other group entities and income derived from them are shown in note 22.

Outstanding current account balances with group entities are shown in notes 20 and 26. The Bank earned £2.2m (2021: £7.5m) from PM26, £10.0m (2021: £24.5m) from PM27 and £2.7m (2021: £28.3m) from PM28 in relation to deferred sale consideration, all these amounts are shown in note 6.

Intercompany dividends of £156.0m (2021: £31.5m) have been received during the year from direct subsidiaries of the Bank, which are related parties. Details of the income is shown in note 6.

During the year, certain non-executive directors of the Group were beneficially interested in savings deposits made with Paragon Bank, on the same terms as were available to members of the public. Deposits of £779,000 were outstanding at the year-end (2021: £16,000), and the maximum amounts outstanding during the year totalled £793,000 (2021: £301,000).

36. LEASING ARRANGEMENTS

As lessor

The Company, through its motor finance business, leases assets under finance leases.

Disclosures in respect of these balances are set out in these financial statements as follows:

Disclosure	Note
Investment in finance leases	16
Finance income on net investment in finance leases	4

As Lessee

The Bank's use of leases as a lessee relates to the rental of office buildings. Under IFRS 16 these have been accounted for as right of use assets and corresponding lease liabilities.

The average term of the current building leases from inception or acquisition was 10 years (2021: 10 years) with rents subject to review every five years. During the year the lease was transferred over to another group company.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2022

36. LEASING ARRANGEMENTS (CONTINUED)

Disclosures relating to these leases are set out in these financial statements as follows.

Disclosure	Note
Depreciation on right of use assets	7
Interest expense on lease liabilities	5
Additions to right of use assets	21
Carrying amount of right of use assets	21
Maturity analysis of lease liabilities	27

There was no subleasing of any right of use asset and the total cash flows relating to leasing as a lessee were £0.0m (2021: 0.1m).

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2022

The notes below describe the processes and measurements which the Bank uses to manage its capital position and their exposure to financial risks including credit, liquidity, interest rate and foreign exchange risk. It should be noted that certain capital measures, which are presented to illustrate the Bank's position, are not subject to audit. Where this is the case, the relevant disclosures are marked as such.

37. CAPITAL MANAGEMENT

The Bank's objectives in managing capital are:

- To ensure that the Bank has sufficient capital to meet its operational requirements and strategic objectives
- To safeguard the Bank's ability to continue as a going concern, so that it can continue to provide returns to shareholders and benefits for other stakeholders
- To provide an adequate return to shareholders by pricing products and services commensurately with the level of risk
- To ensure that sufficient regulatory capital is available to meet any externally imposed requirements

The protection of the Bank's capital base and its long-term viability are key strategic priorities.

The Bank sets its target amount of capital in proportion to risk, availability and cost. The Bank manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets, having particular regard to the relative costs and availability of debt and equity finance at any given time. In order to maintain or adjust the capital structure the Bank may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares, issue or redeem other capital instruments, such as retail or corporate bonds, or sell assets to reduce debt.

Regulatory capital

The Bank is subject to supervision by the PRA on a consolidated basis as part of its regulatory capital group. As part of this supervision the regulator will issue a Total Capital Requirement ('TCR') setting the amount of regulatory capital which the Group is required to hold at all times, in order to safeguard depositors from loss in the event of severe losses being incurred by the Group. This requirement is set in accordance with the international Basel III rules, issued by the Basel Committee on Banking Supervision ('BCBS'), which, following the implementation of the Financial Services Act 2021 on 1 January 2022, are implemented through the PRA Rulebook.

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

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2022

37. CAPITAL MANAGEMENT (CONTINUED)

Regulatory capital (continued)

The Bank has elected to take advantage of the IFRS 9 transitional arrangements set out in Article 473a of the CRR, which allow the capital impact of expected credit losses to be phased in over a five-year period. The phase-in factors applying to transition adjustments will allow for a 95% add back to CET1 capital and Risk Weighted Assets ('RWA') in the financial year ended 30 September 2019, reducing to 85%, 70%, 50% and 25% for the financial years ending in 2020 to 2023, with full recognition of the impact on CET1 capital in the 2024 financial year.

As part of the regulatory response to Covid, Article 473a was revised to extend the transitional arrangements for Stage 1 and Stage 2 impairment provisions created in the financial year ended 30 September 2020 and the financial year ended 30 September 2021, while maintaining the transitional arrangements for impairment provisions created before those years. In order to increase institutions lending capacity in the short term, the EU determined that these additional provisions should be phased into capital over the financial years ending 30 September 2022 to 30 September 2024, rather than recognising the reduction in capital immediately.

Where these reliefs are taken, firms are also required to disclose their capital positions calculated as if the relief were not available (the 'fully loaded' basis).

The tables below demonstrate that at 30 September 2022 the Bank's regulatory capital of £1,376.1m (2021: £1,218.8m) was comfortably in excess of the amounts required by the regulator, including £658.6m in respect of Total Capital Requirement (unaudited), which is comprised of fixed and variable elements. The CRR also requires firms to hold additional capital buffers, including a CCoB of 2.5% of risk weighted assets at 30 September 2022 (2021: 2.5%) and a CCyB, as at 30 September 2022 0.0% of risk weighted assets (2021: 0.0%). Firm specific buffers may also be required.

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2022

37. CAPITAL MANAGEMENT (CONTINUED)

Regulatory capital (continued)

The Bank's regulatory capital differs from its equity as certain adjustments are required by the regulator. A reconciliation of the Bank's equity to its regulatory capital determined in accordance with CRD IV at 30 September 2022 is set out below.

	Note	2022 £m	2021 £m
Total equity in the Bank		1,063.4	819.3
Other equity in regulatory consolidation	§	312.8	383.8
		1,376.2	1,203.1
Deductions			
Investments in shares	* §	(18.9)	(14.7)
Intangible assets in regulatory consolidation	† §	(150.4)	(150.2)
Proposed dividend		(139.8)	-
Pension surplus net of deferred tax		(5.3)	-
Prudent valuation adjustment	§ #	(0.9)	(0.1)
Add back IFRS9 transitional relief	§	25.4	29.2
Software relief	†	-	1.5
Insufficient coverage for non-performing exposures	ψ	(0.0)	-
Common Equity Tier 1 ('CET1') Capital		1,086.3	1,068.8
Other tier 1 capital		-	-
Total Tier 1 capital		1,086.3	1,068.8
Corporate bond	25	150.0	150.0
Total Tier 2 capital		150.0	150.0
Total regulatory capital		1,236.3	1,218.8

* Investments by entities within the regulatory consolidation in entities outside it.

§ Not audited.

† Under a relief enacted by the EU in December 2020 an amount in respect of software assets in intangibles is added back to capital. This was calculated in accordance with Article 36 (1) (b) of the CRR. This relief was rescinded for UK firms from 1 January 2022

\# For capital purposes, assets and liabilities held at fair value, such as the Group's derivatives, are required to be valued on a more conservative basis than the market value basis set out in IFRS 13. This difference is represented by the prudent valuation adjustment above, calculated using the 'Simplified Approach' set out in the CRR.

ψ Regulatory deduction where there is insufficient coverage for non-performing exposures required under Article 47(c) of the CRR which remains in force in the UK for the time being under the Brexit arrangements. The amount required at 30 September 2022 was less than £0.1m.

37. CAPITAL MANAGEMENT (CONTINUED)

Regulatory capital (continued)

The total risk exposure for the Bank and subsidiary entities included in its regulatory consolidation 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.

	2022	2021
	£m	£m
Credit risk		
Balance sheet assets	6,617.8	6,013.0
Off balance sheet	85.4	143.9
IFRS 9 transitional relief	25.4	29.2
Total credit risk	6,728.6	6,186.1
Operational risk	643.7	585.7
Other risk	118.6	13.7
Total risk exposure	7,490.9	6,785.5
	%	%
Solvency ratios		
CET1 capital	14.5	15.8
Total regulatory capital	16.5	18.0

This table is not subject to Audit

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

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2022

37. CAPITAL MANAGEMENT (CONTINUED)

Regulatory capital (continued)

On a fully loaded basis (excluding the effect of IFRS 9 transitional relief) the Bank's capital ratios would be:

	2022 £m	2021 £m
CET1 Capital	1,086.3	1,068.8
Less: IFRS 9 relief	(25.4)	(29.2)
Fully loaded CET1 Capital	1,060.9	1,039.6
TRC	1,376.1	1,218.8
Add back: IFRS 9 relief	(25.4)	(29.2)
Less: Excess Tier 2 capital	-	(0.5)
Fully loaded TRC	1,350.7	1,189.1
Total risk exposure	7,490.9	6,789.5
Add back: IFRS 9 relief	(25.4)	(29.2)
Fully loaded TRE	7,465.5	6,760.3
Fully loaded Solvency ratios	%	%
CET1	14.2	15.4
Total regulatory capital	16.2	17.6

This table is not subject to audit

The total regulatory capital at 30 September 2022 on the fully loaded basis of £1,350.7m was in excess of the Pillar 1 & 2a requirement of £656.5m on the same basis (amounts not subject to audit).

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2022

37. CAPITAL MANAGEMENT (CONTINUED)

Regulatory capital (continued)

The table below shows the calculation of the leverage ratio, based on the balance sheet assets of the Bank's regulatory group adjusted as shown below. The PRA has proposed a minimum UK leverage ratio of 3.25% for UK firms, with retail deposits of over £50.0 billion. In addition, in October 2021 the PRA stated its expectation that all other UK firms should manage their leverage risk so that this ratio does not ordinarily fall below 3.25%.

	2022 £m	2021 £m
Total balance sheet assets	17,242.4	15,041.9
Less: Derivative assets	(779.0)	(44.2)
Central bank deposits	(1,612.5)	(1,142.0)
CRDs	(30.2)	(23.7)
Accrued interest on sovereign exposure	(1.0)	-
On-balance sheet items	14,819.7	13,832.0
Less: Intangible assets	(150.2)	(150.2)
Investments	(18.9)	(14.7)
Add back: Software relief	-	1.5
Total on balance sheet exposures	14,650.6	13,668.6
Regulatory exposure for derivatives	434.7	-
Derivative assets	-	44.2
Potential future exposure on derivatives	-	36.3
Total derivative exposures	434.7	80.5
Post offer pipeline at gross notional amount	1,307.9	1,380.3
Adjustment to convert to credit equivalent amounts	(1,094.1)	(1,128.3)
Off balance sheet items	213.8	252.0
Tier 1 capital	1,086.3	1,068.8
Total leverage exposure before IFRS 9 relief	15,299.1	14,001.1
IFRS 9 relief	25.4	29.2
Total leverage exposure	15,324.5	14,030.3
UK leverage ratio	7.1%	7.6%

This table is not subject to audit

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2022

37. CAPITAL MANAGEMENT (CONTINUED)

The fully loaded leverage ratio is calculated as follows:

	2022 £m	2021 £m
Fully loaded Tier 1 capital	1,060.9	1,039.6
Total leverage exposure before IFRS 9 relief	15,299.1	14,001.1
	6.9%	7.4%

This table is not subject to audit

Following regulatory changes introduced from 1 January 2022, the Bank's regulatory group calculates regulatory exposure on derivatives using the Standardised Approach for Counterparty Credit Risk ('SA-CCR'), which includes elements based on the market value of derivative assets adjusted for collateral, amongst other things, and based on potential future exposure in respect of all derivatives held. In previous years the Mark-to-Market approach was used, however this is no longer available.

The UK leverage ratio is prescribed by the PRA and differs from the leverage ratio defined by Basel and the CRR due to the exclusion of central bank balances from exposures.

The Bank's return on assets for the year, as defined by Article 90 of CRD IV, is calculated as follows

	2022 £m	2021 £m
Net profit after tax	394.4	143.7
Divided by		
Total balance sheet	15,389.0	13,505.6
	2.56%	1.06%

This table is not subject to audit

38. FINANCIAL RISK MANAGEMENT

The principal financial risks arising from the Bank's exposure to financial instruments are credit risk, liquidity risk and market risk (particularly, interest rate risk and currency risk). The Board of Directors has a Risk and Compliance Committee, consisting of the Chair and the non-executive directors which is responsible for providing oversight and challenge to the Bank's risk management arrangements. Executive responsibility for the oversight and operation of the Group's risk management framework is delegated to the ERC. ERC discharges its duties through a number of sub-committees and escalates issues of concern to the Risk and Compliance Committee where appropriate.

The Credit Committee and ALCO are sub-committees of the ERC which monitor performance against the risk appetites set by the Board and make recommendations for changes in risk appetite where appropriate. They also review and, where authorised to do so, agree or amend policies for managing each of these risks, which are summarised in the relevant note.

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2022

38. FINANCIAL RISK MANAGEMENT (CONTINUED)

The financial risk management policies have remained unchanged throughout the year and since the year end. The position discussed in notes 39 to 42 is materially similar to that existing throughout the year.

39. CREDIT RISK

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

Primary responsibility for retail credit risk management across the Bank lies with the Credit Committee. The Credit Committee is made up of senior employees, drawn from financial and risk functions independent of the underwriting process. It is chaired by the Credit Risk Director. Its key responsibilities include setting and reviewing credit policy, under the delegated authority of the Risk and Compliance Committee 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 Bank's derivative financial instruments, short-term investments and cash deposits, ALCO determines which counterparties the Bank will deal with, establishes limits for each counterparty and monitors compliance with those limits.

The assets of the Bank which are subject to credit risk are set out below:

	Note	2022 £m	2021 £m
Financial assets at amortised cost			
Cash	12	1,646.1	1,194.1
Loans to customers	17	9,323.6	8,120.5
Investment in structured entities	18	1,791.2	1,944.1
CSA debtor	20	19.5	45.2
Accrued interest	20	7.2	2.9
Loans to group companies	22	1,610.9	1,394.0
Amounts owed by group companies	20	58.0	55.6
		14,456.5	12,756.4
Financial assets at fair value			
Derivative financial assets	19	605.9	28.5
Maximum exposure to credit risk		15,062.4	12,784.9

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2022

39. CREDIT RISK (CONTINUED)

Loans to customers

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

The Bank's loan assets at 30 September 2022 and 30 September 2021 are analysed as follows:

	2022 £m	2022 %	2021 £m	2021 %
Buy-to-let mortgages	8,697.8	93.3%	7,517.6	92.6%
Owner occupied mortgages	28.0	0.3%	35.6	0.4%
Total first mortgages	8,725.8	93.6%	7,553.2	93.0%
Second charge mortgages	158.3	1.7%	220.2	2.7%
Development finance	-	-	3.3	0.0%
Loans secured on property	8,884.1	95.3%	7,776.7	95.7%
Motor finance loans	260.8	2.8%	224.9	2.8%
Structured lending	178.7	1.9%	118.9	1.5%
Total loans to customers	9,323.6	100.0%	8,120.5	100.0%

The Bank'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.

In considering whether to acquire pools of loan assets or invest in loan portfolios, the Bank will undertake a due diligence exercise on the underlying loan accounts. The Bank'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 Bank's investment and generate an appropriate return without exposing the Bank to material operational or conduct risks.

First and second charge mortgages are secured by charges over residential properties in England and Wales, or similar Scottish securities. Motor finance loans are effectively secured by the financed vehicle.

Development finance loans are secured by the development property and various charges over the build.

Structured finance balances are effectively secured over the assets of the customer, with by security enhanced by maintaining at a level less than the amount of total amount of the security.

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

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2022

39. CREDIT RISK (CONTINUED)

Loans secured on residential property

An analysis of the indexed loan to value ratio ('LTV') for those loan accounts secured on property by value at 30 September 2022 and 30 September 2021 is set out below.

	2022 First Mortgages %	2022 Second charge Mortgages %	2021 First Mortgages %	2021 Second charge Mortgages %
Loan to value ratio				
Less than 70%	86.7	97.7	81.5	90.4
70% to 80%	11.9	1.1	16.6	7.8
80% to 90%	0.4	0.3	0.4	0.7
90% to 100%	0.3	0.0	0.4	0.2
Over 100%	0.7	0.9	1.1	0.9
	100.0	100.0	100.0	100.0
Average loan to value ratio	58.6	50.5	61.4	56.1

The regionally indexed LTVs shown above are affected by changes in house prices, with the Nationwide house price index, for the UK as a whole, registering an annual increase of 9.5% in the year ended 30 September 2022 (2021: 10.0%).

Development finance

Development finance loans do not require customers to make payments during the life of the loan, therefore arrears and past due measures cannot be used to monitor credit risk. Instead, cases are monitored on an individual basis by management and Credit Risk. The average loan to gross development value ('LTGDV') ratio for the portfolio at year end, a measure of security cover, is analysed below.

LTGDV	2022 By value %	2022 By number %	2021 By value %	2021 By number %
50% or less	-	-	-	-
50% to 60%	-	-	-	-
60% to 65%	-	-	100.0	100.0
65% to 70%	-	-	-	-
	-	-	100.0	100.0

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2022

39. CREDIT RISK (CONTINUED)

The average LTGDV cover at the year end was 0.00% (2021: 63.5%).

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

At 30 September 2022 the development finance portfolio comprised no accounts (2021: 2) with no carrying value (2021: £3.3m). The Bank's development finance portfolio has reduced to zero as this form of lending has now been concentrated in another group company.

Structured lending

The Bank's structured lending operation provides revolving loan facilities to support non-bank lending businesses. Loans are made to a Special Purpose Vehicle ('SPV') company controlled by the customer and effectively secured on the loans made by the SPV. Exposure is limited to a percentage of the underlying assets, providing a buffer against credit loss.

Summary details of the structured lending portfolio are set out below

	2022	2021
Number of transactions	8	8
Total facilities (£m)	220.5	185.5
Carrying value (£m)	178.7	118.9

The maximum advance under these facilities was generally 80% of the underlying assets, except where loans secured by residential property form the security for the facility, where 90% is admissible.

These accounts do not have a requirement to make regular payments, operating on revolving basis. The performance of each loan is monitored monthly on a case by case basis by the Group's Credit Risk function, assessing compliance with covenants relating to both the customer and the performance and composition of the asset pool. These assessments, which are reported to Credit Committee, are used to inform the assessment of expected credit loss under IFRS 9.

At 30 September 2022, all of these facilities were identified as Stage 1. At 30 September 2021 one of these facilities was identified as Stage 2 with the remainder in Stage 1.

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2022

39. CREDIT RISK (CONTINUED)

Arrears performance

The number of accounts in arrears by asset class, based on the most commonly quoted definition of arrears for the type of asset, at 30 September 2022 and 30 September 2021, compared to the industry averages at those dates published by the UK Finance ('UKF') and the Finance and Leasing Association ('FLA'), was:

	2022 %	2021 %
Buy-to-let mortgages		
Accounts more than three months in arrears		
Buy-to-Let accounts including receiver of rent cases	0.09	0.09
Buy-to-Let accounts excluding receiver of rent cases	0.08	0.08
Owner-occupied accounts	0.00	0.00
UKF data for mortgage accounts more than three months in arrears		
Buy-to-Let accounts including receiver of rent cases	0.41	0.47
Buy-to-Let accounts excluding receiver of rent cases	0.39	0.45
Owner-occupied accounts	0.80	0.94
All mortgages	0.72	0.85
Secured loans		
Accounts more than two months in arrears	8.90	7.80
FLA data for secured loans	7.50	8.60
Car loans		
Accounts more than two months in arrears	1.58	2.30

As a significant proportion of the loans in the Bank were advanced in the last four years, the arrears statistics will not be strictly comparable to the industry data at this stage. Where revised data at 30 September 2021 has been published by the FLA or UKF, the comparative industry figures above have been amended.

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

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

The figures shown above for secured loans include purchased portfolios which generally include a 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.

Investment in structured entities

Investments in structured entities represent publicly traded Mortgage Backed Floating Rate Notes issued by another Paragon Group company to a purchase pool of residential mortgage assets. The 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 Bank has no obligation to make further contributions to the company concerned.

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2022

39. CREDIT RISK (CONTINUED)

The 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.

Derivative financial assets

In order to control credit risk relating to counterparties to the Bank's derivative financial instruments and cash deposits, ALCO determines which counterparties the Bank will deal with, establishes limits for each counterparty and monitors compliance with those limits. Such counterparties are typically highly rated banks. 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.

Cash and cash equivalents

The Bank's cash balances are held in sterling at highly rated London banks, at the Bank of England and in current accounts. The Bank has a policy on large exposures 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 immaterial.

Loans to group companies

The Bank's loans to group companies support the ongoing finance operations of its subsidiaries and investment in loan assets acquired by the subsidiaries.

40. LIQUIDITY RISK

Liquidity risk is the risk that the Bank might be unable to satisfy any payment which is required to be made out of cash available to it at the time. The Bank's retail funding strategy is focussed on building a stable mix of deposit products. A high proportion of balances, around 95%, are protected by the FSCS which mitigates against the possibility of a retail run.

The cash outflows, including principal and estimated interest contractually required by the Group's retail deposit balances, analysed by the earliest date at which repayment can be demanded are set out below:

	2022 £m	2021 £m
Retail deposits		
Payable on demand	3,934.6	3,308.7
Payable in less than three months	955.1	808.1
Payable in less than one year but more than three months	3,813.7	3,189.5
Payable in less than one year or on demand	8,703.4	7,306.3
Payable in one to two years	1,697.8	1,626.9
Payable in two to five years	452.0	540.1
Payable in over five years	32.0	12.3
	10,885.2	9,485.6

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2022

40. LIQUIDITY RISK (CONTINUED)

The cash flows described above will include those for interest on retail deposits accrued at 30 September 2022 and 30 September 2021 disclosed in note 26. In order to reduce the liquidity risk inherent in the retail deposit balances, the PRA requires that the Bank, like other regulated banks, maintains a buffer of liquid assets to ensure it has sufficient available funds at all times to protect against unforeseen circumstances. The amount of this buffer is calculated using Individual Liquidity Guidance ('ILG') set by the PRA based on the Internal Liquidity Adequacy Assessment Process ('ILAAP') undertaken by the Bank. The ILAAP determines the liquid resources that must be maintained in the Bank to meet its Overall Liquidity Adequacy Requirement ('OLAR') and to ensure that it can meet its liabilities as they fall due. It is based on an analysis of its business as usual forecast cash requirements but also considers their predicted behaviour in stressed conditions.

At 30 September 2022 and 30 September 2021, the liquidity buffer comprised the following on and off balance sheet assets, all held within the Bank.

	Note	2022	2021
		£m	£m
Short term investments		-	-
Balances with central banks		1,505.5	1,142.0
Total on balance sheet liquidity		1,505.5	1,142.0
Long / short repo transaction		150.0	150.0
		1,655.5	1,292.0

Borrowings

The Bank issued £150.0m of green tier-2 debt in March 2021. This bond is optionally callable between 25 June 2026 and 25 September 2026 and has a final maturity date of 25 September 2031. Amounts expected to be payable, including interest are shown as corporate debt in the table below.

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2022

40. LIQUIDITY RISK (CONTINUED)

The total undiscounted amounts, inclusive of estimated interest, which would be payable in respect of the borrowings of the Bank, should those balances remain outstanding until the contracted repayment date, or the earliest date on which repayment can be required, are set out below.

	Central Bank Facilities £m	Corporate Debt £m	Total £m
30 September 2022			
Payable in less than one year	101.4	6.6	108.0
Payable in one to two years	123.8	6.6	130.4
Payable in two to five years	2,905.0	19.7	2,924.7
Payable in over five years	-	176.2	176.2
	3,130.2	209.1	3,339.3
30 September 2021			
Payable in less than one year	71.8	6.6	78.4
Payable in one to two years	6.7	6.6	13.3
Payable in two to five years	2,770.9	19.7	2,790.6
Payable in over five years	-	182.7	182.7
	2,849.4	215.6	3,065.0

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2022

40. LIQUIDITY RISK (CONTINUED)

The cash flows which are expected to arise from derivative contracts in place at the year end, estimating future floating rate payments and receipts on the basis of the yield curve at the balance sheet date are as follows:

	2022 Total cash outflow / (inflow) £m	2021 Total cash outflow / (inflow) £m
On derivative liabilities		
Payable in less than one year	88.8	23.2
Payable in one to two years	24.0	15.0
Payable in two to five years	3.6	7.6
Payable in over five years	0.1	0.3
	116.5	46.1
On derivative assets		
Payable in less than one year	(163.8)	(1.0)
Payable in one to two years	(157.0)	(5.5)
Payable in two to five years	(289.4)	(14.4)
Payable in over five years	(2.7)	(0.1)
	(612.9)	(21.0)
	(496.4)	25.1

41. INTEREST RATE RISK

Interest rate risk is the current or prospective risk to capital or earnings arising from adverse movements in interest rates. The Bank's exposure to this risk is a natural consequence of its lending, deposit-taking and other borrowing activities, as some of its financial assets and liabilities bear interest at rates which float with various market rates while others are fixed, either for a term or for their whole lives. Such risk is referred to as Interest Rate Risk in the Banking Book ('IRRBB'). The Bank does not seek to generate income from taking interest rate risk and aims to minimise exposures that occur as a natural consequence of carrying out its normal business activities.

The principal market-set interest rate used by the Group has historically been LIBOR, which has been used to set rates for certain loan assets and borrowings. However, the Group has continued to move towards the use of alternative reference rates, principally SONIA, during the year. All new wholesale debt and interest rate swaps recognised since that point have referenced SONIA, while existing LIBOR linked instruments have been transitioned.

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2022

41. INTEREST RATE RISK (CONTINUED)

The Bank has fixed and floating rate loan assets, together with fixed and floating rate savings deposit and manages mismatches using interest rate swap agreements to ensure any exposure remains appropriate to the Banks risk appetite. The Bank's ALCO monitors the interest rate risk exposure on the Bank's loan assets.

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

The Bank's loan assets are predominantly hedged fixed rate assets. The interest rates charged on the Bank's variable rate loan assets are determined by reference to, inter alia, the Bank'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 Bank's loan assets and borrowings and any exposure arising on the interest rate resets is relatively short term.

The Bank's use of derivatives and hedging to manage interest rate risk is described in more detail in note 19.

Interest rate sensitivity

To assess the Bank's exposure to interest rate movements the notional impact of a 1% change in UK interest rates on the equity of the Bank at 30 September 2022, and the notional annualised impact of such a change on the operating profit of the Bank, based on the year-end balance sheet have been calculated.

As a simplification this calculation assumes that all relevant UK interest rates move by the same amount in parallel and that all repricing takes place at the balance sheet date.

On this basis, a 1.0% increase in UK interest rates would decrease profit before tax by £30.2m (2021: £25.6m).

The principal direct point in time impact on the Group's equity would result from the revaluation of derivative assets and liabilities which are not part of fair value hedges at the balance sheet date. A 1% increase in rate expectations would increase equity by £32.7m (2021: increase by £13.4m). For this illustration no ineffectiveness in hedging relationships is assumed.

These calculations allow only for the direct effects of any change in UK interest rates. In practice, such a change might have wider economic consequences which would themselves potentially affect the Group's business and results.

IBOR transition

In July 2017 the FCA announced that by the end of 2021 it would no longer compel banks to make submissions to the LIBOR setting process. As a result of this, LIBOR will be discontinued in the early part of coming financial year. The UK Working Group on Sterling Risk-Free Interest Rates has recommended SONIA as its replacement and this recommendation has been adopted by the Group where appropriate.

LIBOR was historically used in setting interest rates on significant amounts of the Group's loan assets and borrowings and an internal working group was established to identify the impact on the business and ensure an orderly transition from LIBOR to other reference rates across all classes of financial instrument. This process was completed ahead of the required date.

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2022

42. CURRENCY RISK

The asset finance business has a limited amount of lending denominated in US dollars and may contract to purchase assets for leasing in currency. These balances are hedged through the Bank by the purchase of currency derivatives and/or appropriate currency balances.

As a result of these arrangements the Bank has no material exposure to foreign currency risk, and no sensitivity analysis is presented for currency risk.

The Bank’s use of financial derivatives to manage currency risk is described further in note 19.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2022

The notes set out below describe the accounting basis on which the Bank prepares its accounts, the particular accounting policies adopted by the Bank and the principal judgements and estimates which were required in the preparation of the financial statements.

They also include other information describing how the accounts have been prepared, required by legislation and accounting standards.

43. BASIS OF PREPARATION

The Bank is required, by the Companies Act 2006 and the Listing Rules of the FCA, to prepare its financial statements for the year ending 30 September 2022 in accordance with UK-adopted international accounting standards. In the financial years reported on this also means, in the Bank's circumstances, that the financial statements also accord with IFRS as approved by the International Accounting Standards Board.

In previous periods financial statements had been prepared under EU endorsed IFRS, however the change of framework does not change the substance of the requirements applying to the Bank and no prior-year restatement of the financial statements is required.

The particular accounting policies adopted have been set out in note 44 and the critical accounting judgements and estimates which have been regarded in preparing these financial statements are described in notes 45 and 46 respectively.

Adoption of new and revised reporting standards

In the preparation of these financial statements, no accounting standards are being applied for the first time.

Standards not yet adopted

There are no standards and interpretations in issue but not effective which address matters relevant to the Bank's accounting and reporting.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2022

44. ACCOUNTING POLICIES

The particular policies applied by the Bank in preparing these financial statements with the IFRS regime are described below.

(a) **Accounting convention**

The financial statements have been prepared under the historical cost convention, except as required in the valuation of certain financial instruments which are carried at fair value.

(b) **Basis of consolidation**

The Bank is exempt under Section 400 of the Companies Act 2006 from the obligation to prepare group financial statements, being a wholly-owned subsidiary undertaking of Paragon Banking Group PLC.

(c) **Going concern**

The directors have adopted this basis following a going concern assessment for the Group and the Company covering a period of at least twelve months following the date of approval of these financial statements. Details of this assessment are set out in note 47.

(d) **Cash and cash equivalents**

Balances shown as cash and cash equivalents in the balance sheet comprise demand deposits and short-term deposits with banks with initial maturities of not more than 90 days.

(e) **Short term investments**

Short term investments are held as part of the liquidity requirement of Paragon Bank PLC. As such they are measured at their fair value which corresponds to their market value at the balance sheet date.

(f) **Leases**

For leases where the group is the lessee a right of use asset is recognised in property, plant and equipment on the inception of the lease based on the discounted value of the minimum lease payments at inception. A lease liability of the same amount is recognised at inception, with the unwinding of the discount included in the interest payable.

Leases where the Group is lessor are accounted for as operating or finance leases in accordance with IFRS 16 – 'Leases'. A finance lease is one which transfers substantially all of the risks and rewards of the ownership of the asset concerned. Any other lease is an operating lease.

Finance lease receivables are accounted for as loans to customers, with impairment provisions determined in accordance with IFRS 9.

Rental income and costs on operating leases are charged or credited to the profit and loss account on a straight-line basis over the lease term. The associated assets are included within property, plant and equipment.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2022

44. ACCOUNTING POLICIES (CONTINUED)

(g) Loans to customers

Loans to customers includes assets accounted for as financial assets and finance leases. The Bank assesses the classification and measurement of a financial asset based on the contractual cash flow characteristics of the asset and its business model for managing the asset. The Bank has concluded that its business model for its customer loan assets is of the type defined as 'Hold to collect' by IFRS 9 and the contractual terms of the asset should give rise to cash flows that are solely payments of principal and interest ('SPPI'). Such loans are therefore accounted for on the amortised cost basis.

Loans advanced are valued at inception at the initial advance amount, which is the fair value at that time, inclusive of procuration fees paid to brokers or other business providers and less initial fees paid by the customer. Loans acquired from third parties are initially valued at the purchase consideration paid or payable. Thereafter, all loans to customers are valued at this initial amount less the cumulative amortisation calculated using the EIR method. The loan balances are then reduced where necessary by an impairment provision.

The EIR method spreads the expected net income arising from a loan over its expected life. The EIR is that rate of interest which, at inception, exactly discounts the future cash payments and receipts arising from the loan to the initial carrying amount.

Where financial assets are credit-impaired at initial recognition the EIR is calculated on the basis of expected future cash receipts allowing for the effect of credit risk. In other cases, the expected contractual cash flows are used.

(h) Finance lease receivables

Finance lease receivables are included within 'Loans to Customers' at the total amount receivable less interest not yet accrued, unamortised commissions and provision for impairment.

Income from finance lease contracts is governed by IFRS 16 – 'Leases' and accounted for on the actuarial basis.

(i) Impairment of loans to customers

The carrying values of all loans to customers, whether accounted for under IFRS 9 or IFRS 16, are reduced by an impairment provision based on their ECL, determined in accordance with IFRS 9. These estimates are reviewed throughout the year and at each balance sheet date.

With the exception of POCI financial assets (which are discussed separately below), all assets are assessed to determine whether there has been a significant increase in credit risk ('SICR') since the point of first recognition (origination or acquisition). Assets are also reviewed to identify any which are 'Credit Impaired'. SICR and credit impairment are identified on the basis of pre-determined metrics including qualitative and quantitative factors relevant to each portfolio, with a management review to ensure appropriate allocation.

Assets which have not experienced an SICR are referred to as 'Stage 1' accounts, assets which have experienced an SICR but are not credit impaired are referred to as 'Stage 2' accounts, while credit impaired assets are referred to as 'Stage 3' accounts.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2022

44. ACCOUNTING POLICIES (CONTINUED)

(i) Impairment of loans to customers (continued)

An impairment allowance is provided on an account by account basis:

- For Stage 1, at an amount equal to 12-month ECL, i.e. the total expected ECL that results from those default events that are possible within 12 months of the reporting date, weighted by the probability of those events occurring
- For Stage 2 and 3 accounts, at an amount equal to lifetime ECL, i.e. the total expected ECL that results from any future default events, weighted by the probability of those events occurring

In establishing an ECL allowance, the Bank assesses its probability of default, loss given default and exposure at default for each reporting period, discounted to give a net present value. The estimates used in these assessments must be unbiased and take into account reasonable and supportable information including forward-looking economic inputs.

While the Bank uses statistical models as the basis for its calculation of ECLs where appropriate, expert judgement will always be used to assess the adequacy of any calculated amount and additional provision made if required.

Within its buy-to-let portfolio the Bank utilises a receiver of rent process, whereby the receiver stands between the landlord and tenant and will determine an appropriate strategy for dealing with any delinquency. This strategy may involve the immediate sale of any underlying security or the short or long term letting of the property to cover arrears and principal shortfalls. Such cases are automatically considered to have an SICR, but where a letting strategy is adopted by the receiver, a tenant is in place and arrears are reduced or cleared, the account will not necessarily be considered to be credit impaired. Properties in receivership are eventually either returned to their landlord owners or sold.

For loan portfolios acquired at a discount, the discounts take account of future expected impairments and such assets are treated as POCI. For these assets, the Bank recognises all changes in future cash flows arising from changes in credit quality since initial recognition as a loss allowance with any changes recognised in profit or loss.

For financial accounting purposes, provisions for impairments of loans to customers are held in an impairment allowance account from the point at which they are first recognised. These balances are released to offset against the gross value of the loan when it is written off for accounting purposes. This occurs when standard enforcement processes have been completed, subject to any amount retained in respect of expected salvage receipts. Any further gains from post-write off salvage activity are reported as impairment gains.

(j) Investment in structured entities

Investments in structured entities are intended to be held to maturity and are therefore accounted for on the amortised cost basis. The return from such investments is calculated on the EIR basis.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2022

44. ACCOUNTING POLICIES (CONTINUED)

(k) Amounts owed by or to group companies

In the accounts of the Bank, balances owed by or to other group companies are carried at the current amount outstanding less any provision. Where balances owing between group companies fall within the definition of either financial assets or financial liabilities given in IAS 32 – 'Financial Instruments: Presentation' they are classified as assets or liabilities at amortised cost, as defined by IFRS 9.

(l) Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation.

Depreciation on right of use assets recognised in accordance with IFRS 16 is provided on a straight line basis over the term of the lease.

(m) Deferred sale consideration

Under the mortgage sale agreements profits of PM26, PM27 and PM28 are paid to the Company as originator of the loans by way of deferred sale consideration. Deferred sale consideration is recognised in the period in which it is received.

(n) Investments in subsidiaries

The Bank's investments in subsidiary undertakings are valued at cost less provision for impairment. An impairment is initially measured as the deficit between the carrying value of the investment and the net assets of the subsidiary, and, for acquired entities any shortfall is compared to the amount of goodwill carried at Group level.

(o) Retail deposits

Retail deposits are carried in the balance sheet on the amortised cost basis. The initial fair value recognised represents the cash amount received from the customer.

Interest payable to the customer is expensed to the income statement as interest payable over the deposit term on an EIR basis.

(p) Borrowings

Borrowings are carried in the balance sheet on the amortised cost basis. The initial value recognised includes the principal amount received less any discount on issue or costs of issuance.

Interest and all other costs of the funding are expensed to the income statement as interest payable over the term of the borrowing on an EIR basis.

(q) Central bank facilities

Where central bank facilities are provided at a below market rate of interest, and therefore fall within the definition of government assistance as defined by IAS 20 – 'Accounting for Government Grants and Disclosure of Government Assistance' the liability is initially recognised at the value of its expected cash flows discounted at a market rate of interest for a comparable commercial borrowing. Interest is recognised on this liability on an EIR basis, using the imputed market rate to determine the EIR.

The remaining amount of the advance is recognised as deferred government assistance and released to the profit and loss account through interest payable over the periods during which the arrangement affects profit.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2022

44. ACCOUNTING POLICIES (CONTINUED)

(r) Derivative financial instruments

All derivative financial instruments are carried in the balance sheet at fair value, as assets where the value is positive or as liabilities where the value is negative. Fair value is based on market prices, where a market exists. If there is no active market, fair value is calculated using present value models which incorporate assumptions based on market conditions and are consistent with accepted economic methodologies for pricing financial instruments. Changes in the fair value of derivatives are recognised in the income statement, except where such amounts are permitted to be taken to equity as part of the accounting for a cash flow hedge.

(s) Hedging

IFRS 9 paragraph 7.2.21 permits an entity to elect, as a matter of accounting policy, to continue to apply the hedge accounting requirements of IAS 39 in place of those set out in Chapter 6 of IFRS 9. The Bank has made this election and the accounting policy below has been determined in accordance with IAS 39.

For all hedges, the Bank documents the relationship between the hedging instruments and the hedged items at inception, as well as its risk management strategy and objectives for undertaking the transaction. The Bank also documents its assessment, both at hedge inception and on an ongoing basis, of whether the hedging arrangements put in place are considered to be 'highly effective' as defined by IAS 39.

For a fair value hedge, as long as the hedging relationship is deemed 'highly effective' and meets the hedging requirements of IAS 39, any gain or loss on the hedging instrument recognised in income can be offset against the fair value loss or gain arising from the hedged item for the hedged risk. For macro hedges (hedges of interest rate risk for a portfolio of loan assets or retail deposit liabilities) this fair value adjustment is disclosed in the balance sheet alongside the hedged item, for other hedges the adjustment is made to the carrying value of the hedged asset or liability. Only the net ineffectiveness of the hedge is charged or credited to income. Where a fair value hedge relationship is terminated, or deemed ineffective, the fair value adjustment is amortised over the remaining term of the underlying item.

Where a derivative is used to hedge the variability of cash flows of an asset or liability, it may be designated as a cash flow hedge so long as this relationship meets the hedging requirements of IAS 39. For such an instrument the effective portion of the change in the fair value of the derivative is taken initially to equity, with the ineffective part taken to profit or loss.

The amount taken to equity is released to the income statement at the same time as the hedged item affects the income statement. Where a cash flow hedge relationship is terminated, or deemed ineffective, the amount taken to equity will remain there until the hedged transaction occurs, or is no longer expected to take place.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2022

44. ACCOUNTING POLICIES (CONTINUED)

(t) **Taxation**

The charge for taxation represents the expected UK corporation tax (including the Bank Corporation Tax surcharge where applicable) and other income taxes arising from the Bank's profit for the year. This consists of the current tax which will be shown in tax returns for the year and tax deferred because of temporary differences. This in general, represents the tax impact of items recorded in the current year but which will impact tax returns for periods other than the one in which they are included in the financial statements.

The Bank holds a provision for uncertain tax positions at the balance sheet date based on a global assessment of the expected amount that will ultimately be payable.

Tax relating to items taken directly to equity is also taken directly to equity.

(u) **Deferred taxation**

Deferred taxation is provided in full on temporary differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Deferred tax assets are recognised to the extent that it is regarded as probable that they will be recovered. As required by IAS 12 – 'Income Taxes', deferred tax assets and liabilities are not discounted to take account of the expected timing of realisation.

(v) **Revenue**

The revenue of the Bank comprises interest receivable and similar charges and other operating income. The accounting policy for the recognition of each element of revenue is described separately within these accounting policies.

(w) **Other operating income**

Other operating income, which is accounted for in accordance with IFRS 15, includes:

Event-based administration fees charged to borrowers (other than the initial fees included in amortised cost), which are credited when the related service is performed.

(x) **Dividends**

In accordance with IAS 10 – 'Events after the balance sheet date', dividends payable on ordinary shares are recognised in equity once they are appropriately authorised and are no longer at the discretion of the Bank. Dividends declared after the balance sheet date, but before the authorisation of the financial statements remain within shareholders' funds.

However, such dividends are deducted from regulatory capital from the point at which they are announced, and capital disclosures are prepared on this basis.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2022

44. ACCOUNTING POLICIES (CONTINUED)

(y) **Foreign currency**

Foreign currency transactions, assets and liabilities are accounted for in accordance with IAS 21 – 'The Effects of Changes in Foreign Exchange Rates'. The functional currency of the Company and all of the other entities in the Group is the pound sterling. Transactions which are not denominated in sterling are translated into sterling at the spot rate of exchange on the date of transaction. Monetary assets and liabilities which are not denominated in sterling are translated at the closing rate on the balance sheet date.

Gains and losses on retranslation are included in interest payable or interest receivable depending on whether the underlying instrument is an asset or a liability, except where deferred in equity in accordance with the cash flow hedging provisions of IAS 39.

45. CRITICAL ACCOUNTING JUDGEMENTS

The most significant judgements which the directors have made in the application of the accounting policies set out in note 44 relate to:

(a) Significant Increase in Credit Risk ('SICR')

Under IFRS 9, the directors are required to assess where a credit obligation has suffered a Significant Increase in Credit Risk ('SICR'). The directors' assessment is based primarily on changes in the calculated PD, but also includes consideration of other qualitative indicators and the adoption of the backstop assumption in the Standard that all cases which are more than 30 days overdue have an SICR, for account types where days overdue is an appropriate measure.

As part of its consideration of the adequacy of its impairment provisioning, management have considered whether there are any factors not reflected in its normal approach which indicate that a group, or groups of accounts should be considered as having an SICR. No such accounts were identified.

If additional accounts were determined to have an SICR, these balances would attract additional impairment provision, as such cases are provided on the basis of lifetime expected loss, rather the 12-month expected loss, and the overall provision charge would be higher. Conversely, if cases are incorrectly identified as SICR, impairment provisions will be overstated. Furthermore, adjustments to current PD estimates in the Group's models may also have the effect of identifying more or less accounts as having an SICR.

More information on the definition of SICR adopted is given in note 17.

(b) Definition of default

In applying the impairment provisions of IFRS 9 and the directors have used models to derive the probabilities of default. In order to derive and apply such models, it is required to define 'default' for this purpose. The Bank's definition of default is aligned to its internal operational procedures. IFRS 9 provides a rebuttable presumption of default when an account is 90 days overdue and this was used as the starting point for this exercise. Other factors include account management activities such as appointment of a receiver or enforcement procedures.

A combination of qualitative and quantitative measures was considered in developing the definition of default. If a different definition of default had been adopted the expected loss amounts derived might differ from those shown in the accounts.

More information on the Bank's definition of default adopted is given in note 17.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2022

45. CRITICAL ACCOUNTING JUDGEMENTS (CONTINUED)

(c) Classification of financial assets

The classification of financial assets under IFRS 9 is based on two factors:

- The company's 'business mode' – how it intends to generate cash and profit from the assets; and
- The nature of the contractual cash flows inherent in the assets

Financial assets are classified as held at amortised cost, at fair value through other comprehensive income, or at fair value through profit or loss.

For an asset to be held at amortised cost, the cash flows received from it must comprise solely payments of principal and interest ('SPPI'). In effect, this restricts this classification to 'normal' lending activities, excluding arrangements where the lender may have a contingent return or profit share from the activities funded. The Bank has considered its products and concluded that, as standard lending products, they fall within the SPPI criteria.

This is because all of the Bank's lending arrangements involve the advancing of amounts to customers, either as loans or finance lease products and the receipt of repayments of principal and charges, where those charges are calculated based on the amount loaned. There are no 'success fee' or other compensation arrangements not linked to the loan principal.

The use of amortised cost accounting is also restricted to assets which a company holds within a business model whose object is to collect cash flows arising from them, rather than seek to profit by disposing of them (a 'Held to Collect' model). The Bank's strategy is to hold loan assets until they are repaid or written off. Loan disposals are rare, and the Bank does not manage its assets in order to generate profits on sale. On this basis, it has categorised its business model as Held to Collect.

Therefore, the Bank has classified its customer loan assets as carried at amortised cost.

The Bank's policy is to hold the FRN's acquired and included in 'investment in structured entities', for liquidity purposes and has no intentions to sell them at any point, as such, has categorised the business model for these assets as Held to Collect. The FRNs provide cash returns in the form of Sonia linked interest and principal at nominal value. These cash flows are considered as SPPI and the Bank carries its investments in structured entities at amortised cost.

46. CRITICAL ACCOUNTING ESTIMATES

Certain balances reported in the financial statements are based wholly or in part on estimates or assumptions made by the directors. There is, therefore, a potential risk that they may be subject to change in future periods. The most important of these, those which could, if revised significantly in the next financial year, have a material impact on the carrying amounts of assets or liabilities are:

(a) **Impairment losses on loans to customers**

Impairment losses on loans are calculated based on statistical models, applied to the present status, performance and management strategy for the loans concerned which are used to determine each loan's PD and LGD.

Internal information used will include number of months arrears, qualitative information, such as possession by a first charge holder on a second charge mortgage or where a buy-to-let case is under the control of a receiver of rent, the receiver's present and likely future strategy for the property (e.g. keeping current tenants in place, refurbish and relet, immediate sale etc).

External information used includes customer specific data, such as credit bureau information as well as more general economic data.

Key internal assumptions in the models relate to estimates of future cash flows from customers' accounts, their timing and, for secured accounts, the expected proceeds from the realisation of the property or other charged assets. These cash flows will include payments received from the customer, and, for buy-to-let cases where a receiver of rent is appointed, rental receipts from tenants, after allowing for void periods and running costs. These key assumptions are based on observed data from historical patterns and are updated regularly based on new data as it becomes available.

In addition, the directors consider how appropriate past trends and patterns might be in the current economic situation and make any adjustments they believe are necessary to reflect current and expected conditions.

In evaluating the potential impact of the economic situation at 30 September 2022 this process is made more complex by both the elevated level of uncertainties and the lack of recent experience of similar situations against which to benchmark. At the same time, the level to which Covid-related 'scarring' has yet to manifest itself in credit metrics is still unclear.

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

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2022

46. CRITICAL ACCOUNTING ESTIMATES (CONTINUED)

(a) Impairment losses on loans to customers (continued)

In order to provide forward looking economic inputs to the modelling of the ECL, the Group must derive a set of scenarios which are internally coherent. The Group addresses these requirements using four distinct economic scenarios chosen to represent the range of possible outcomes. These scenarios at 30 September 2022 have been derived in light of the current economic situation, at that date, modelling a variety of possible outcomes as described in note 17. It should be noted, however, that there remains a significant range of different opinions amongst economists about the longer-term prospects for the UK, which have diverged again over the period since September 2021, with both UK economic and geopolitical uncertainties building.

The variables are used for two purposes in the IFRS 9 calculations:

- They are applied as inputs in the models which generate PD values, where those found by statistical analysis to have the most predictive value are used
- They are used as part of the calculation where the variable has a direct impact on the expected loss calculation, such as the house price index

The economic variables will also inform assumptions about the Bank's approach to account management given a particular scenario.

In addition to uncertainty created by the economic scenarios, the Group recognises that the present situation lies outside the range of situations considered when it originally derived its IFRS 9 approach to impairment. It is considered that the current forecast scenarios, which include higher rates of interest and inflation than in the historically observed data, represent situations where its models may not be able to fully allow for potential economic impacts on its loan portfolios. It therefore assessed, for each class of asset, whether any adjustment to the normal approach was required to ensure sufficient provision was created and also reviewed other available data, both from account performance and customer feedback to form a view of the underlying reasons for observed customer behaviours and of their future intentions and prospects.

As a result of this exercise additional requirements for provision were identified, to compensate for potential model weakness and to allow for economic pressures in the wider economy which cannot be identified by a modelled approach. By their nature such adjustments are less systematic and therefore subject to a wider range of outturns. The nature and amounts of these PMA's are set out in note 17.

The position after considering all these matters is set out in note 17, together with further information on the Group's approach. The economic scenarios described above and their impact on the overall provision are also set out in that note.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2022

46. CRITICAL ACCOUNTING ESTIMATES (CONTINUED)

(b) Effective interest rates

In order to determine the EIR applicable to loans and borrowings an estimate must be made of the expected life of each asset or liability and hence the cash flows relating thereto, including those relating to early redemption charges. For purchased loan accounts this will involve estimating the likely future credit performance of the accounts at the time of acquisition. These estimates are based on historical data and reviewed regularly. For purchased accounts historical data obtained from the vendor will be examined. The accuracy of the EIR applied would therefore be compromised by any differences between actual repayment profiles and that predicted, which in turn would depend directly or indirectly (in the case of borrowings) on customer behaviour.

To illustrate the potential variability of the estimate, the amortised cost values were recalculated by changing one factor in the EIR calculation and keeping all others at their current levels. This exercise indicated that:

- A reduction of the assumed average lives of loans secured on residential property by three months would reduce balance sheet assets by £9.7m (2021: £7.4m)
- An increase of the assumed average lives of loans secured on residential property by three months would increase balance sheet assets by £9.8m (2021: £7.5m)
- An increase of 50% in the number of five year fixed rate buy-to-let loan assets assumed to redeem before the end of the fixed rate period, generating additional early redemption charges would increase balance sheet assets by £6.6m (2021: £7.6m)

As any of these changes would, in reality, be accompanied by movements in other factors, actual outcomes may differ from these estimates.

(c) Investments in subsidiaries

The carrying value of the Bank's investments in shares in subsidiary entities is based on the original cost of investment less any provision for impairment. This impairment test is initially based on the net asset values of those entities and their subsidiaries, if any, adjusted, for acquired entities by the amount of the related goodwill, net of impairment, calculated at group level. This amount is verified based on the projected cash flows of the business, as derived from management forecasts and other assumptions including a discount factor.

The accuracy of this impairment calculation would therefore be compromised by any differences between these forecasts and the levels of business activity that the acquired business is able to achieve in practice. As the forecast levels of business are based on the Bank's central economic scenario, any variance from this will potentially impact on the valuation. This test will also be affected by the accuracy of the discount factor used.

Of the £667.1m of investments in shares in group entities £475.1m is directly supported by tangible net assets of subsidiaries with only £205.0m relying in part on the goodwill of the subsidiary.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2022

47. GOING CONCERN

Accounting standards require the directors to assess the Bank's ability to continue to adopt the going concern basis of accounting. In performing this assessment, the directors consider all available information about the future, the possible outcomes of events and changes in conditions and the realistically possible responses to such events and conditions that would be available to them, having regard to the 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' published by the Financial Reporting Council in September 2014.

Particular focus is given to financial forecasts to ensure the adequacy of resources available for the Bank to meet its business objectives on both a short term and strategic basis. The guidance requires that this assessment covers a period of at least twelve months from the date of approval of these financial statements.

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

The key stresses modelled in detail to evaluate the Bank's forecasting addressed: increased buy-to-let volumes; higher funding costs; higher buy to let redemptions; and a high impairment stress based on the severe scenario set out in note 17, but with no reduction in lending volumes. This impairment stress is derived from but more severe than the stress testing scenario published by the Bank of England in September 2022. These stresses did not take account of management actions which might mitigate the impact of the adverse assumptions used.

Under all these scenarios, the Bank had the ability to meet its obligations over the forecast horizon and maintain a surplus over its regulatory requirements for both capital and liquidity through normal balance sheet management activities.

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

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

The Bank's retail deposits of £10,669.2 million (note 23) are repayable within five years, with 80.8% of this balance (£8,620.59 million) payable within twelve months of the balance sheet date. The liquidity exposure represented by these deposits is closely monitored; a process supervised by the Asset and Liability Committee. The Bank is required to hold liquid assets to mitigate this liquidity risk. At 30 September 2022 the Bank held £1,505.5 million of balance sheet assets for liquidity purposes, in the form of central bank deposits (note 12). A further £150.0 million of liquidity was provided by an off balance sheet swap arrangement (note 25), bringing the total to £1,655.5 million.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2022

47. GOING CONCERN (CONTINUED)

The Bank manages its liquidity in line with the Board's risk appetite and the requirements of the PRA, which are formally documented in the Board's approved ILAAP. The Bank maintains a liquidity framework that includes a short to medium term cash flow requirement analysis, a longer-term funding plan and access to the Bank of England's liquidity insurance facilities, where pre-positioned assets would support drawings of £1,776.0 million. Holdings of the Group's own externally rated mortgage backed loan notes can also be used to access the Bank of England's liquidity facilities or other funding arrangements. At 30 September 2022 the Bank had £455.2 million of such notes available for use, of which £171.6 million were rated AAA.

The Bank's cash analysis, continues to show a strong cash position, even after allowing scope for significant discretionary payments.

As described in note 34 the Bank's capital base is subject to consolidated supervision by the PRA. Its capital at 30 September 2022 was in excess of regulatory requirements and its forecasts indicate this will continue to be the case.

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

After performing this assessment, the directors concluded that there was no material uncertainty as to whether the Bank would be able to maintain adequate capital and liquidity for at least twelve months following the date of approval of these financial statements and consequently that it was appropriate for them to continue to adopt the going concern basis in preparing the financial statements of the Bank.

48. FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The Bank's financial assets and financial liabilities are valued on one of two bases, defined by IFRS 9:

- Financial assets and liabilities carried at fair value through profit and loss ('FVTPL')
- Financial assets and liabilities carried at amortised cost

IFRS 7 – 'Financial Instruments: Disclosures' requires that where assets are measured at fair value these measurements should be classified using the fair value hierarchy set out in IFRS 13 – 'Fair Value Measurement'. This hierarchy reflects the inputs used, and defines three levels.

- Level 1 measurements are unadjusted market prices
- Level 2 measurements are derived from directly or indirectly observable data, such as market prices or rates
- Level 3 measurements rely on significant inputs which are not derived from observable data

As quoted prices are not available for level 2 and 3 measurements, the valuation is derived from cash flow models based, where possible, on independently sourced parameters. The accuracy of the calculation would therefore be affected by unexpected market movements or other variances in the operation of the models or the assumptions used.

The Bank had no financial assets or liabilities in the year ended 30 September 2022 or the year ended 30 September 2021 carried at fair value and valued using level 3 measurements.

48. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

The Bank has not reclassified any of its measurements during the year.

The methods by which fair value is established for each class of financial assets and liabilities are set out below.

a) Assets and liabilities carried at fair value

The following table summarised the Bank's financial assets and liabilities which are carried at fair value.

	Note	**2022**	**2021**
		£m	**£m**
Financial assets			
Derivative financial assets	19	605.9	28.5
Short term investments	13	-	-
		605.9	28.5
Financial liabilities			
Derivative financial liabilities	19	118.1	42.0
		118.1	42.0

All of these financial assets and financial liabilities are required to be carried at fair value by IFRS 9.

Derivative financial assets and liabilities

Derivative financial instruments are stated at their fair values in the accounts. The Bank uses a number of techniques to determine the fair values of its derivative assets and liabilities, for which observable prices in active markets are not available. These are principally present value calculations based on estimated future cash flows arising from the instruments, discounted using a risk adjusted interest rate.

The principal inputs to these valuation models are SONIA sterling benchmark interest rates.

In order to determine the fair values, the management applies valuation adjustments to observed data where that data would not fully reflect the attributes of the instrument being valued, such as particular contractual features or the identity of the counterparty. The management reviews the models used on an ongoing basis to ensure that the valuations produced are reasonable and reflect all relevant factors. These valuations are based on market information and they are therefore classified as level 2 measurements. Details of these assets are given in note 19.

Short term investments

The short-term investments described in note 13 are freely traded securities for which a market price quotation is available and are classified as level 1 measurements.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2022

48. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

b) Assets and liabilities carried at amortised cost

The fair values for financial assets and financial liabilities held at amortised cost, determined in accordance with the methodologies set out below are summarised below.

	Note	2022 Carrying amount £m	2022 Fair value £m	2021 Carrying amount £m	2021 Fair value £m
Financial assets					
Cash	12	1,646.1	1,646.1	1,194.1	1,194.1
Loans to customers	17	9,323.6	9,084.3	8,120.5	8,164.0
Investment in structured entities	18	1,791.2	1,791.2	1,944.1	1,944.1
Loans to group companies	20	58.0	58.0	55.6	55.6
Sundry financial assets	20	57.0	57.0	71.9	71.9
		12,875.9	12,636.6	11,386.2	11,429.7
Financial liabilities					
Retail deposits		10,669.2	10,745.6	9,300.4	9,308.5
Amounts owed to group companies		356.0	356.0	453.8	453.8
Other financial liabilities		442.5	442.5	35.4	35.4
		11,467.7	11,544.1	9,789.6	9,797.7

The fair values of retail deposits shown above will include amounts for the related accrued interest.

Cash and investment in structured entities

The fair values of cash and cash equivalents and investments in structured entities which are carried at amortised cost are considered to be not materially different from their book values. In arriving at that conclusion market inputs have been considered but because all the assets mature within three months of the year end and the interest rates charged on financial liabilities reset to market rates on a quarterly basis, little difference arises.

While the Group’s asset backed loan notes are listed, the quoted prices for an individual note may not be indicative of the fair value of the issue as a whole, due to the specialised nature of the market in such instruments and the limited number of investors participating in it.

As these valuation exercises are not wholly market based, they are considered to be level 2 measurements.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2022

48. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

Loans to customers

To assess the likely fair value of the Bank's loan assets in the absence of a liquid market, the directors have considered the estimated cash flows expected to arise from the Bank's investments in its loans to customers based on a mixture of market based inputs, such as rates and pricing and non-market based inputs such as redemption rates. Given the mixture of observable and non-observable inputs these are considered to be level 3 measurements.

Retail deposits

To assess the likely fair value of the Bank's retail deposit liabilities, the directors have considered the estimated cash flows expected to arise based on a mixture of market based inputs, such as rates and pricing and non-market based inputs such as withdrawal rates. Given the mixture of observable and non-observable inputs, these are considered to be level 3 measurements.

Sundry assets and liabilities

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

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

49. ULTIMATE PARENT COMPANY

The smallest and largest group into which the Bank is consolidated, and the Bank's immediate and ultimate parent company and ultimate controlling party is Paragon Banking Group PLC, a company registered in England and Wales.

Copies of the consolidated financial statements of Paragon Banking Group PLC are available from that company's registered office at 51 Homer Road, Solihull, West Midlands, B91 3QJ.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2022

50. DETAILS OF SUBSIDIARY UNDERTAKINGS

Subsidiary undertakings of the Bank at 30 September 2022, where the share capital is held directly by the Bank or by its subsidiaries are shown below:

Company	Holding	Principal Activity
Direct subsidiaries of Paragon Bank PLC		
Paragon Finance Plc	100%	Residential mortgage and asset administrator
Mortgage Trust Limited	100%	Residential mortgages
Paragon Mortgages (2010) Limited	100%	Residential mortgages
Paragon Mortgages Limited	100%	Residential mortgages
Paragon Asset Finance Limited	100%	Holding company and portfolio administration
Paragon Development Finance Limited	100%	Development Finance
PBAF Acquisitions Limited	100%	Residential mortgages and asset investment
Direct and indirect subsidiaries of Paragon Asset Finance Limited		
Paragon Commercial Finance Limited	100%	Asset finance
Paragon Business Finance PLC	100%	Asset finance
Paragon Technology Finance Limited	100%	Asset finance
PBAF (No. 1) Limited	100%	Holding company
Premier Asset Finance Limited	100%	Asset finance broker
Specialist Fleet Services Limited	100%	Asset finance and contract hire
City Business Finance Limited	100%	Non-trading
Collett Transport Services Limited	100%	Non-trading
Fineline Holdings Limited	100%	Non-trading
Fineline Media Finance Limited	100%	Non-trading
Homer Management Limited	100%	Non-trading
Lease Portfolio Management Limited	100%	Non-trading
State Securities Holdings Limited	100%	Non-trading
State Security Limited	100%	Non-trading
Direct subsidiaries of Paragon Mortgages Limited		
Paragon Second Funding Limited	100%	Residential mortgages and loan and vehicle finance
Paragon Options PLC	100%	Non-trading
Direct subsidiaries of Mortgage Trust Limited		
Mortgage Trust Services PLC	100%	Residential mortgages and asset administration
Direct subsidiaries of Paragon Development Finance Limited		
Paragon Development Finance Services Limited	100%	Portfolio administration

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50. DETAILS OF SUBSIDIARY UNDERTAKINGS (CONTINUED)

The financial year end of all of the Bank's subsidiary companies is 30 September. They are all registered in England and Wales and they all operate in the UK.

The registered office of each of the entities listed in this note is the same as that of the Bank (note 1).

The Bank has no interest in the shares of its indirect subsidiaries.

E. Useful Information

Information which may be helpful to shareholders and other users of the Annual Report and Accounts

This section includes

E1 Glossary	A summary of abbreviations used in the Annual Report and Accounts.
E2 Contacts	Names and addresses of the Bank's advisers.

E1 GLOSSARY

ALCO	Asset and Liability Committee
BBR	Bank Base Rate
BCBS	Basel Committee on Banking Supervision
BEPS	Base Erosion and Profit Shifting
BGS	Balance Guarantee Swaps
CCC	Customer and Conduct Committee
CCoB	Capital Conservation Buffers
CCyB	Counter-Cyclical Buffers
CEO	Chief Executive Officer
CET1	Core Equity Tier 1
CFO	Chief Financial Officer
CPI	Consumer Price Index
CRD IV	The current EU Capital Requirements Regulation and Directive Regime
CRDs	Cash Ratio Deposits
CRO	Chief Risk Officer
CRR	Capital Requirements Regulation – EU Regulation 575/2013
CSA	Credit Support Annex
CTRF	Contingent Term Repo Facility
ECL	Expected Credit Loss
EIR	Effective Interest Rate
EDI	Equality, diversity and inclusion
ERC	Estimated Remaining Collections
ERMF	Enterprise Risk Management Framework
ESG	environmental, social and governance
EU	European Union
ExCo	Executive Committee
FCA	Financial Conduct Authority
FLA	Finance and Leasing Association
FLS	Funding for Lending Scheme
FRC	Financial Reporting Council
FRN	Floating Rate Note
FSCS	Financial Services Compensation Scheme
FVTPL	Fair Value Through Profit and Loss
GDP	Gross Domestic Product
HPI	House Price Index

E1 GLOSSARY (Continued)

HQLA	High Quality Liquid Assets
IAS	International Accounting Standard(s)
IASB	International Accounting Standard(s) Board
IBOR	Interbank Offered Rates
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standard(s)
ILAAP	Internal Liquidity Adequacy Assessment Process
ILG	Individual Liquidity Guidance
ILTR	Indexed Long Term Repo Scheme
IPCD	IP Completion Day
IRB	Internal Ratings Based
IRRBB	Interest Rate Risk in the Banking Book
ISA	Individual Savings Account
ISDA	International Swaps and Derivatives Association
KPMG	KPMG LLP, the Bank's auditor
LCR	Liquidity Coverage Ratio
LGD	Loss Given Default
LIBOR	London Interbank Offered Rate
LTGDV	Loan to Gross Development Value
LTV	Loan to Value
MRC	Model Risk Committee
NPS	Net Promoter Score
NSFR	Net Stable Funding Ratio
OBR	Office of Budget Responsibility
OECD	Organisation for Economic Co-operation and Development
OLAR	Overall Liquidity Adequacy Requirement
ORC	Operational Risk Committee
P7F	Paragon Seventh Funding Limited
PBG	Paragon Banking Group PLC
PD	Probability of Default
PLC	Public Limited Company
PM14	Paragon Mortgages (No.14) PLC
PM25	Paragon Mortgages (No.25) PLC
PM26	Paragon Mortgages (No.26) PLC
PM27	Paragon Mortgages (No.27) PLC

E1 GLOSSARY (Continued)

PM28	Paragon Mortgages (No.28) PLC
PMA	Post Model Adjustment
POCI	Purchased or Originated Credit Impaired (assets)
PSF	Paragon Second Funding Limited
PRA	Prudential Regulatory Authority
PSP	Performance Share Plan
RoR	Receiver of Rent
RWA	Risk Weighted Assets
Schedule 7	Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008
SICR	Significant Increase in Credit Risk
SID	Senior Independent Director
SMCR	Senior Managers and Certification Regime
SME	Small and / or Medium-sized Enterprise(s)
SONIA	Sterling Overnight Interbank Average Rate
SPPI	Solely Payments of Principal and Interest
SPV	Special Purpose Vehicle company
TCR	Total Capital Requirement
TFS	Term Funding Scheme
TFSME	Term Funding Scheme for SMEs
The 2018 Code	UK Corporate Governance Code (2018 version)
The Act	The Companies Act 2008
The Bank	Paragon Bank PLC
The Group	PBG and all of its subsidiary and parent undertakings
TRC	Total Regulatory Capital
UK	United Kingdom
UKF	UK Finance

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